KARPAGAM ACADEMY OF HIGHER EDUCATION

(Established Under section 3 of the UGC Act, 1956)
Pollachi Main Road, Eachanari (Post),
Coimbatore – 641 021.

DEPARTMENT OF COMMERCE

B.COM

SUBJECT / CODE :FINANCIAL ACCOUTING /: 17CMU101

SEMSTER : I

LECTURE PLAN

UNIT-1

S.No	LECTURE DURATION (Hr)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Accounting information System – Definition of accounting, Users and their Needs,	T-1.2 R1-1.7 – 1.8
2	1	Characteristics of Accounting – Functions, Advantages and Limitations of Accounting	R1 -1.8 – 1.9
3	1	Branches and Bases of Accounting, Concept & Conventions Accounting Standards	R1 -1.8 – 1.14 T -2.2 – 2.11 W1
4	1	Journal – Meaning – General format- Rules- Sums	R1 - 4.1 – 4.3
5	1	Journal Entries – Sums	T - 2.35 – 2.53
6	1	Journal Entries – Sums	T - 2.35 – 2.53
7	1	Ledger – Meaning – General format- Rules- Sums	R7 - 4.35
8	1	Ledger – Problems	T -2.54 – 2.79
9	1	Ledger – Problems	T -2.54 – 2.79
10	1	Trial Balance – General Format - Sums	T -3.4 – 3.12
11	1	Subsidiary Books- Types- Purchase and Purchase Return Book & Sales and Sales Return Book	R1 -6.1 – 6.3
12	1	Preparation of Cash Book , Single, Double and Triple Column Cash Book – Problems to be worked	T -2.79 – 2.87
13	1	Preparation of Cash Book - Problems to be worked	T -2.79 – 2.87
14	1	Triple column cash book	T -2.79 – 2.87

15	1	Recapitulation and important questions discussion	
		Total no. of hours planned for unit - I	**15**

SUPPORT MATERIALS

Text book

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2015)

W1 www.iasplus.com/en/standards

W2 www.accountingtools.com>revenue_regonition.

UNIT-II

S.No.	LECTURE DURATION (Hr)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Business Income- Revenue Recognition, Meaning and aspect Regarding to Revenue Recognition	W2
2	1	Depreciation meaning, Definition and causes of depreciation , Need and significance of depreciation,	R1 -12.1 – 12.2 T -11.1 – 11.3
3	1	Straight Line Method - Problems to be Worked	T -11.9 – 11.16
	1	Straight Line Method - Problems to be Worked	T -11.9 – 11.16
4	1	Diminishing Balance Method - Problems to be Worked	T -11.7 – 11.8
5	1	Diminishing Balance Method - Problems to be Worked	T -11.7 – 11.8
6	1	Final Accounts - Meaning and Advantages, Trading Account and Profit And Loss Account And Balance sheet Format	R1 -10.1 – 10.9
7	1	Preparation of Trading Account - Problems to be Worked	T -5.17 – 5.48
8	1	Preparation of Trading and Profit And Loss Account and Meaning and Format – sums	T -5.17 – 5.48
9	1	Preparation of final accounts - sums	T -5.17 – 5.48
10	1	Preparation of final accounts - sums	T -5.17 – 5.48

11	1	Preparation of final accounts - sums	T -5.17 – 5.48
12	1	Preparation of final accounts with adjustments - sums	T -5.17 – 5.48
13	1	Preparation of final accounts with adjustments - sums	T -5.17 – 5.48
14	1	Preparation of final accounts - sums	T -5.17 – 5.48
15	1	Recapitulation and important questions discussion	
		Total no. of hours planned for unit – II	15

SUPPORT MATERIALS

<u>Text book</u>

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

<u>Reference Books</u>

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2015)

W1 www.iasplus.com/en/standards

W2 www.accountingtools.com>revenue_regonition.

UNIT – III

S.No.	LECTURE DURATION (Hr)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Hire Purchase system– Definition, features of hire purchase system	R2-18.1 – 18.2
2	1	Accounting treatment of high value goods – Entries in the books of hire purchaser	R2 -18.3
3	1	Journal Entries in the books of hire vendor - sums	R2: -18.3 – 18.7
4	1	Journal Entries in the books of hire vendor - sums	R2: -18.3 – 18.7

5	1	Default and repossession – sums	R2: 18.4-18.16
6	1	Partial and complete repossession – procedure , sums	R2: 18.4-18.16
7	1	Hire purchases trading account – procedure – sums	R2-18.14 – 18.16
8	1	Instalment Purchases system , Comparison with hire purchases system	R2-18.16 – 18.21
9	1	Calculation of interest – Problems to be worked	R2-18.8 – 18.14
10	1	Methods of computation of profit- Debtors method and debtors and stock method problems to be worked	R2-18.29 – 18.32 R2-18.33 – 18.35
11	1	Methods of computation of profit- Debtors method and debtors and stock method problems to be worked	R2-18.29 – 18.32 R2-18.33 – 18.35
12	1	Instalment purchase system – Sums	R2-18.35 – 18.39
13	1	Instalment purchase system – Sums	R2-18.35 – 18.39
14	1	Accounting under instalment purchase system – problems	R2-18.35 – 18.39
15	1	Recapitulation and important questions discussion	
		Total no. of hours planned unit – III	**15**

SUPPORT MATERIALS

Text book

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(20105)

W1 www.iasplus.com/en/standards

W2 www.accountingtools.com>revenue_regonition.

UNIT – IV

S.No.	LECTURE DURATION (periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Consignment, Meaning, Definition and Features, Difference between sale and Consignment	T -25.1 – 25.2
2	1	Valuation of stock at cost and invoice price	T -25.7 – 25.10
3	1	Journal Entries and Ledger in the books of Consignor – Sums	T -25.13 – 25.16
4	1	Preparation of Journal Entries and Ledger in the books of Consignee – Sums	T -25.16 – 25.18
5	1	Preparation of Journal Entries and Ledger in the books of Consignee – Sums	T -25.16 – 25.18
6	1	Consignment Account - Problems to be Worked	T -25.19 – 25.73
7	1	Consignment Account - Problems to be Worked	T -25.19 – 25.73
8	1	Preparation of Journal entries and ledger accounts – Consignment account – sums	T -25.19 – 25.73
9	1	Consignment account – sums	T -25.19 – 25.73
10	1	Joint Venture accounts - Definition and Features	T -26.1
11	1	Difference between Joint Venture, consignment and Partnership	T -26.2
12	1	Preparation of Joint Venture account when separate set of books are maintained – Sums	T -26.4
13	1	Preparation of Joint Venture account when separate set of books are maintained – Sums	T -26.4
14	1	Preparation of Joint Venture account when separate set of books are not maintained – Sums	T -26.8
15	1	Recapitulation and important questions discussion	
		Total no. of hours planned unit – IV	**15**

SUPPORT MATERIALS

Text book

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2015)

W1 www.iasplus.com/en/standards

W2 www.accountingtools.com>revenue_regonition.

UNIT – V

S.No.	LECTURE DURATION (periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Accounting for Partnership – Definition and features	T -21.1
2	1	Admission of Partner: Fixed Capital Method and Fluctuating Capital Method	T -21.5 – 21.15
3	1	Calculation of profit Sharing Ratio – Sums	T -22.1 – 22.3
4	1	Methods of Valuation Goodwill – Sums	T -22.3 – 22.10
5	1	Admission of a partner - sums	T -22.11 – 22.38
6	1	Retirement of Partner- Definition and features	T -23.1 – 23.3
7	1	Calculation of profit Sharing Ratio – Sums	T -23.3 – 23.4
8	1	Calculation of goodwill – Sums	T -23.3 – 23.4
9	1	Preparation of Realisation account - sums	T -23.3 – 23.4
10	1	Retirement of Partner – Sums	T -23.8 – 23.30
11	1	Retirement of Partner – Sums	T -23.8 – 23.30
12	1	Recapitulations and discussion of important questions	
13	1	Discussion of previous year ESE question papers	
14	1	Discussion of previous year ESE question papers	
15	1	Discussion of previous year ESE question papers	
		Total no. of hours planned unit – V	**15**

SUPPORT MATERIALS

Text book

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2015)

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(Deemed University Established Under Section 3 of UGC Act 1956)
Coimbatore - 641021.
(For the candidates admitted from 2017 onwards)

DEPARTMENT OF COMMERCE

SUBJECT : **FINANCIAL ACCOUNTING**
SEMESTER : **I**
SUBJECT CODE : **17CMU101** **CLASS** : **I B.Com. - B**

UNIT-I

Theoretical Framework : Accounting information system: Users and their needs. Characteristics of accounting - Functions, Advantages and limitations of accounting. Branches of accounting. Bases of accounting: - Concepts and Conventions – Bases of Accounting – Accounting standards – Journal- Ledger – Subsidiary Books – Trial Balance.

Suggested Readings:

Text Book

1. Reddy and Moorthy. (2016). *Financial Accounting* Chennai. Margham Publications.

Reference Book

1. M.C.Shukla, T.S. Grewal and S.C.Gupta. (2013).*Advanced Accounts*. [Vol.-I Revised Edition] New Delhi, S. Chand & Co.
2. S.N. Maheshwari, and. S. K. Maheshwari.(2013). *Financial Accounting*.[First Edition]. New Delhi, Vikas Publishing House.
3. Deepak Sehgal. (2014). *Financial Accounting*.[4th Ed]. New Delhi, Vikas Publishing House,
4. Tulsian, P.C. (2013). *Financial Accounting*, [4th Ed]. New Delhi, S.Chand Publishing
5. Compendium of Statements and Standards of Accounting. (2013). New Delhi, The Institute of Chartered Accountants of India.

UNIT – I

ACCOUNTING INFORMATION SYSTEM

ACCOUNTING

"Accounting is as old as money itself". Since in early ages commercial activities were based on barter system, record keeping was not a necessity. The Industrial Revolution of 19th century along with rapid rise in population, paved way for the development of commercial activities, mass production and credit terms. Thus recording of business transaction has become an important feature. In recent years with the change of technologies and marketing along with stiff competition, accounting system has undergone remarkable changes.

IMPORTANCE OF ACCOUNTING

When a person starts a business, whether large or small, his main aim is to earn profit. He receives money from certain sources like sale of goods, interest on bank deposits etc. He has to spend money on certain items like purchase of goods, salary, rent, etc. These activities take place during the normal course of his business. He would naturally be anxious at the year end, to know the progress of his business. Business transactions are numerous, that it is not possible to recall his memory as to how the money had been earned and spent. At the same time, if he had noted down his incomes and expenditures, he can readily get the required information. Hence, the details of the business transactions have to be recorded in a clear and systematic manner to get answers easily and accurately for the following questions at any time he likes.

i. What has happened to his investment?

ii. What is the result of the business transactions?

iii. What are the earnings and expenses?

iv. How much amount is receivable from customers to whom goods have been sold on credit?

v. How much amount is payable to suppliers on account of credit purchases?

vi. What are the nature and value of assets possessed by the business concern?

vii. What are the nature and value of liabilities of the business concern?

USES AND THEIR NEEDS OF ACCOUNTING

I. Internal users of accounting information

The internal users comprise of owners, management and employees.

i **Owners :** the sole traders or partners or shareholders who have provided the capital of a business unit are interested in its performance and progress. They are primarily interested in the revenue and expenses, profit or loss, net worth and external liabilities.

ii **Management**: sole traders and partners usually manage their own business. But companies are managed by paid professionals. Management of a business involves making day to day decisions on routine matters and also policy decisions, whenever needed. Accounting data is the basic for most of the decisions made by management.

iii **Employees:** the work force is interested in the profitability of the business which affects their bonus , incentives and working conditions. The success or failure of the business is linked to their livelihood. Labour unions use the accounting data in their bargaining strategies with the management.

II. External users of accounting information :

Various outside groups and individuals make use of accounting information for their own purpose:

i. Creditors and financiers : suppliers of goods and services , commercial banks, public deposit holders, debentures holders, etc., are included in this category. They are interested in the liquidity position and repaying capacity of the business.

ii. Potential investors: those who are interested in investing their surplus funds should know about the financial conditions of a business unit while making their investment decisions . They are more interested in future earning and risk.

iii. Consumers: Those who use the products and their services of a firm are interested in knowing the justification for the prices changed to them. They examine the expenses, sales, and profit to see if they are paying fair prices for the products and service

CHARACTERISTICS OF ACCOUNTING

1. The accounting principles are developed for practical purposes. They cannot be validated or proved like the principles of mathematics, physics and chemistry. They are the best possible suggestions based on practical experiences ,reasoning and observation of the professional accountants.
2. The principles are for common usage to ensure uniformity and understanding. They are not rigid. They can be adapted to the changing needs and circumstances of business units . They enhance the usefulness of the data relating to the activities of a firm.
3. They are not specifically made or legislated by any government or legal authority. They are not legally enforceable.

4. They are in the process of evolution and are likely to change as per the dictates of changing circumstances and technology.

FUNCTIONS OF ACCOUNTING

i. Identifying: Identifying the business transactions from the source documents.

ii. Recording: The next function of accounting is to keep a systematic record of all business transactions, which are identified in an orderly manner, soon after their occurrence in the journal or subsidiary books.

iii. Classifying: This is concerned with the classification of the recorded business transactions so as to group the transactions of similar type at one place. i.e., in ledger accounts. In order to verify the arithmetical accuracy of the accounts, trial balance is prepared.

iv. Summarising : The classified information available from the trial balance are used to prepare profit and loss account and balance sheet in a manner useful to the users of accounting information.

v. Analysing: It establishes the relationship between the items of the profit and loss account and the balance sheet. The purpose of analysing is to identify the financial strength and weakness of the business. It provides the basis for interpretation.

vi. Interpreting: It is concerned with explaining the meaning and significance of the relationship so established by the analysis. Interpretation should be useful to the users, so as to enable them to take correct decisions.

vii. Communicating: The results obtained from the summarised, analysed and interpreted information are communicated to the interested parties.

ADVANTAGE OF ACCOUNTING

The following are the main advantage of accounting:

Systematic records: all the business transactions are recorded in the books of accounting records. Any events or happening which has financial effect is included in the accounting records. They are always at disposal of the management for decision making.

Preparation of financial statements: Results of business operations and the financial position of the concern are provided by accounting periodically. This is essential for distributing of profits to the owners and for planning the future policies and programs by the management.

LIMITATION OF ACCOUNTING

- In spite of its indispensible position in modern business establishments, accounting has its own limitations.
- It cannot record all the events and transactions taking place in all enterprise .it ignores transaction which cannot be expressed in terms of money. It cannot measures the qualitative aspects of the product, policies, management and the workers. It cannot quantify the movable of employees in the organization.
- Accounting relies on estimate and forecasts in several important matters like useful life of machinery, market value of investment .similarly ,subjective opinions of the accountant can influences valuation of stocks, provision on debtors for doubtful debts and discount etc. Accounting results may not be accurate and reliable due to such estimate and subjective influences of individual accountants.
- Accountants rely on historical cost of recording the fixed asset. Depreciation is also provided on the recorded cost of the assets. When the time for replacement cost is usually for more than the accumulated funds through depreciation. Accounting also ignores the price level changes which drastically alter the value of asset and liabilities. Inflation which is an universal phenomenon makes the profit ascertained and financial position shown by accounting unrealistic and unreliable.

Every one of these limitation has been engaging the attention of the professional bodies. Recent developments like human resources accounting. Inflation accounting, International Accounting standards etc., have been aimed at improving the usefulness of accounting by overcoming

BOOK-KEEPING

Book-keeping is that branch of knowledge which tells us how to keep a record of business transactions. It is often routine and clerical in nature. It is important to note that only those transactions related to business which can be expressed in terms of money are recorded. The activities of book-keeping include recording in the journal, posting to the ledger and balancing of accounts.

OBJECTIVES

The objectives of book-keeping are

i. To have permanent record of all the business transactions.

ii. To keep records of income and expenses in such a way that the net profit or net loss may be calculated.

iii. To keep records of assets and liabilities in such a way that the financial position of the business may be ascertained.

iv. To keep control on expenses with a view to minimize the same in order to maximize profit.

iv. To know the names of the customers and the amount due from them.

v. To know the names of suppliers and the amount due to them.

vi. To have important information for legal and tax purposes.

ACCOUNTING

Book-keeping does not present a clear financial picture of the state of affairs of a business. When one has to make a judgment regarding the financial position of the firm, the information contained in these books of accounts has to be analysed and interpreted. It is with the purpose of giving such information that accounting came into being.

Accounting is considered as a system which collects and processes financial information of a business. These information are reported to the users to enable them to make appropriate decisions.

Definition

American Accounting Association defines accounting as “the process of identifying, measuring and communicating economic information to permit informed judgments and decision by users of the information”.

Objectives

The main objectives of accounting are

- To maintain accounting records.
- To calculate the result of operations
- To ascertain the financial position.
- To communicate the information to users.

Difference between Book-keeping and Accounting

Sl. No.	Basis of distinction	Book-keeping	Accounting
1.	Scope	Recording and maintenance of books of accounts.	It is not only recording and maintenance of books of accounts but also includes analysis, interpreting and communicating the information.
2.	Stage	Primary stage.	Secondary stage.
3.	Objective	To maintain systematic records of business transactions.	To ascertain the net result of the business operation.
4.	Nature	Often routine and clerical in nature.	Analytical and executive in nature.
5.	Responsibilities	A book-keeper is responsible for recording business transactions.	An accountant is also responsible for the work of a book-keeper.
6.	Supervision	The book-keeper does not supervise and check the work of an Accountant.	An accountant supervises and checks the work of the book-keeper.
7.	Staff involved	Work is done by the junior staff of the organization.	Senior staff performs the accounting work.

BRANCHES OF ACCOUNTING

Providing information according to the needs of internal and external users has been recognized as the primary objectives of accounting. Modern business world has become highly competitive and technology oriented. Management of business units has become highly complex, needing varied types of information to satisfy the additional demand of movement for information, several new branches of accounting have been developed. The following are the most important of the branches of accounting:-

1. **Financial Accounting:** the accounting for revenues, expenses, assets and liabilities that is commonly carried on in the general office of business is known as FINANCIAL

ACCOUNTING. The financial accounting information is expressed in two main type of financial statement, viz :

2. **Cost Accounting:** it is that brace of accounting which deals with classification recording allocation summarization of current and prospective cost. It determines cost of production and distribution by department, function, products etc. cost accounting is essential for pricing of product and services and for cost reduction and cost control

3. **Management Accounting:** it is that brace of accounting which is meant exclusively for managerial decision making. it provides necessary information to the management for discharging its function of planning organizing co-coordinating, direction and controlling its usually provides data on funds and cash flow, investment projects, preparation and implementation of budgets etc. almost all the policy decision of management are made on the basic of primary data provides by management accounting

BASES OF ACCOUNTING

ACCOUNTING ASSUMPTIONS

Accounting Entity Assumption

According to this assumption, business is treated as a unit or entity apart from its owners, creditors and others. In other words, the proprietor of a business concern is always considered to be separate and distinct from the business which he controls. All the business transactions are recorded in the books of accounts from the view point of the business. Even the proprietor is treated as a creditor to the extent of his capital.

Money Measurement Assumption

In accounting, only those business transactions and events which are of financial nature are recorded. For example, when Sales Manager is not on good terms with Production Manager, the business is bound to suffer. This fact will not be recorded, because it cannot be measured in terms of money.

Accounting Period Assumption

The users of financial statements need periodical reports to know the operational result and the financial position of the business concern. Hence it becomes necessary to close the accounts at regular intervals. Usually a period of 365 days or 52 weeks or 1 year is considered as the accounting period.

Going Concern Assumption

As per this assumption, the business will exist for a long period and transactions are recorded from this point of view. There is neither the intention nor the necessity to wind up the business in the foreseeable future.

CONCEPTS OF ACCOUNTING

These concepts guide how business transactions are reported. On the basis of the above four assumptions the following concepts (principles) of accounting have been developed.

Dual Aspect Concept

Dual aspect principle is the basis for Double Entry System of book-keeping. All business transactions recorded in accounts have two aspects - receiving benefit and giving benefit. For example, when a business acquires an asset (receiving of benefit) it must pay cash (giving of benefit).

Revenue Realisation Concept

According to this concept, revenue is considered as the income earned on the date when it is realised. Unearned or unrealised revenue should not be taken into account. The realisation concept is vital for determining income pertaining to an accounting period. It avoids the possibility of inflating incomes and profits.

Historical Cost Concept

Under this concept, assets are recorded at the price paid to acquire them and this cost is the basis for all subsequent accounting for the asset. For example, if a piece of land is purchased for Rs.5,00,000 and its market value is Rs.8,00,000 at the time of preparing final accounts the land value is recorded only for Rs.5,00,000. Thus, the balance sheet does not indicate the price at which the asset could be sold for.

Matching Concept

Matching the revenues earned during an accounting period with the cost associated with the period to ascertain the result of the business concern is called the matching concept. It is the basis for finding accurate profit for a period which can be safely distributed to the owners.

Full Disclosure Concept

Accounting statements should disclose fully and completely all the significant information. Based on this, decisions can be taken by various interested parties. It involves proper classification and explanations of accounting information which are published in the financial statements.

Verifiable and Objective Evidence Concept

This principle requires that each recorded business transactions in the books of accounts should have an adequate evidence to support it. For example, cash receipt for payments made. The documentary evidence of transactions should be free from any bias. As accounting records are based on documentary evidence which is capable of verification, it is universally acceptable.

ACCOUNTING CONVENTIONS OR PRINCIPLES

To make the accounting information useful to various interested parties, the basic assumptions and concepts discussed earlier have been modified. These modifying principles are as under.

Cost Benefit Principle

This modifying principle states that the cost of applying a principle should not be more than the benefit derived from it. If the cost is more than the benefit then that principle should be modified.

Materiality Principle

The materiality principle requires all relatively relevant information should be disclosed in the financial statements. Unimportant and immaterial information are either left out or merged with other items.

Consistency Principle

The aim of consistency principle is to preserve the comparability of financial statements. The rules, practices, concepts and principles used in accounting should be continuously observed and applied year after year. Comparisons of financial results of the business among different accounting period can be significant and meaningful only when consistent practices were followed in ascertaining them. For example, depreciation of assets can be provided under different methods, whichever method is followed, it should be followed regularly.

Prudence (Conservatism) Principle

Prudence principle takes into consideration all prospective losses but leaves all prospective profits. The essence of this principle is "anticipate no profit and provide for all possible losses". For example, while valuing stock in trade, market price or cost price whichever is less is considered.

ACCOUNTING STANDARDS

To promote world -wide uniformity in published accounts, the **International Accounting Standards Committee (IASC)** has been set up in June 1973 with nine nations as founder members. The purpose of this committee is to formulate and publish in public interest, standards to be observed in the presentation of audited financial statements and to promote their world-wide acceptance and observance. IASC exist to reduce the differences between different countries' accounting practices. This process of harmonisation will make it easier for the users and preparers of financial statement to operate across international boundaries. In our country, the **Institute of Chartered Accountants of India** has constituted **Accounting Standard Board** (ASB) in 1977. The ASB has been empowered to formulate and issue accounting standards, that should be followed by all business concerns in India.

ACCOUNT

Every transaction has two aspects and each aspect has an account. It is stated that '**an account is a summary of relevant transactions at one place relating to a particular head**'.

Classification of Accounts

Transactions can be divided into three categories.

i. Transactions relating to individuals and firms

ii. Transactions relating to properties, goods or cash

iii. Transactions relating to expenses or losses and incomes or gains.

Therefore, accounts can also be classified into Personal, Real and Nominal. The classification may be illustrated as follows

I. Personal Accounts: The accounts which relate to persons. Personal accounts include the following.

i. **Natural Persons:** Accounts which relate to individuals. For example, Mohan's A/c, Shyam's A/c etc.

ii. **Artificial persons:** Accounts which relate to a group of persons or firms or institutions. For example, HMT Ltd., Indian Overseas Bank, Life Insurance Corporation of India, Cosmopolitan club etc.

iii. **Representative Persons:** Accounts which represent a particular person or group of persons. For example, outstanding salary account, prepaid insurance account, etc. The business concern may keep business relations with all the above personal accounts, because of buying goods from them or selling goods to them or borrowing from them or lending to them. Thus they become either Debtors or Creditors.

The proprietor being an individual his capital account and his drawings account are also personal accounts.

II. Impersonal Accounts: All those accounts which are not personal accounts. This is further divided into two types viz. Real and Nominal accounts.

i. **Real Accounts:** Accounts relating to properties and assets which are owned by the business concern. Real accounts include tangible and intangible accounts. For example, Land, Building, Goodwill, Purchases, etc.

ii. **Nominal Accounts:** These accounts do not have any existence, form or shape. They relate to incomes and expenses and gains and losses of a business concern. For example, Salary Account, Dividend Account, etc.

Illustration: 1 Classify the following items into Personal, Real and Nominal Accounts.

1. Capital	2. Sales
3. Drawings	4. Outstanding salary
5. Cash	6. Rent
7. Interest paid	8. Indian Bank
9. Discount received	10. Building
11. Bank	12. Chandrasekar
13. Murugan Lending Library	14. Advertisement
15. Purchases	16. Mohan Kumar

Solution:

1. Personal account	2. Real account
3. Personal account	4. Personal (Representative) account
5. Real account	6. Nominal account
7. Nominal account	8. Personal (Legal Body) account
9. Nominal account	10. Real account
11. Personal account	12. Personal account
13. Personal account	14. Nominal account
15. Real account	16. Personal account

Golden Rules of Accounting

All the business transactions are recorded on the basis of the following rules.

S. No.	Name of Account	Debit	Credit
1.	Personal	The receiver	The giver

2.	Real	What comes in	What goes out
3.	Nominal	All expenses and losses	All incomes and gains.

Books of Original Entry

The books in which a transaction is recorded for the first time from a source document are called *Books of Original Entry* or *Prime Entry*. *Journal* is one of the books of original entry in which transactions are originally recorded in a chronological (day-to-day) order according to the principles of Double Entry System.

Journal

Journal is a date-wise record of all the transactions with details of the accounts debited and credited and the amount of each transaction.

Format

Journal

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)

Explanation:

1. ***Date:*** In the first column, the date of the transaction is entered. The year and the month are written only once, till they change. The sequence of the dates and months should be strictly maintained.

2. ***Particulars:*** Each transaction affects two accounts, out of which one account is debited and the other account is credited. The name of the account to be debited is written first, very near to the line of particulars column and the word **Dr.** is also written at the end of the particulars column. In the second line, the name of the account to be credited is written, starts with the word '**To**', a few space away from the margin in the particulars column to the make it distinct from the debit account.
3. ***Narration:*** After each entry, a brief explanation of the transaction together with necessary details is given in the particulars column with in brackets called **narration**. The words 'For' or 'Being' are used before starting to write down narration. Now, it is not necessary to use the word 'For' or 'Being'.
4. ***Ledger Folio (L.F):*** All entries from the journal are later posted into the ledger accounts. The page number or folio number of the Ledger, where the posting has been made from the Journal is recorded in the L.F column of the Journal. Till such time, this column remains blank.
5. ***Debit Amount:*** In this column, the amount of the account being debited is written.
6. ***Credit Amount:*** In this column, the amount of the account being credited is written.

Steps in Journalising

The process of analysing the business transactions under the heads of debit and credit and recording them in the Journal is called **Journalising**. An entry made in the journal is called a '**Journal Entry**'.

Step 1: A Determine the two accounts which are involved in the transaction.

Step 2: A Classify the above two accounts under Personal, Real or Nominal.

Step 3: A Find out the rules of debit and credit for the above two accounts.

Step 4: A Identify which account is to be debited and which account is to be credited.

Step 5: A Record the date of transaction in the date column. The year and month is written once, till they change. The sequence of the dates and months should be strictly maintained.

Step 6: A Enter the name of the account to be debited in the particulars column very close to the left hand side of the particulars column followed by the abbreviation Dr. in the same line. Against this, the amount to be debited is written in the debit amount column in the same line.

Step 7: A Write the name of the account to be credited in the second line starts with the word '**To**' a few space away from the margin in the particulars column. Against this, the amount to be credited is written in the credit amount column in the same line.

Step 8: A Write the narration within brackets in the next line in the particulars column.

Step 9: A Draw a line across the entire particulars column to separate one journal entry from the other.

Ledger

In the Journal, each transaction is dealt with separately. Therefore, it is not possible to know at a glance, the net result of many transactions. So, in order to ascertain the net effect of all the transactions relating to a particular account are collected at one place in the Ledger.

A Ledger is a book which contains all the accounts whether personal, real or nominal, which are first entered in journal or special purpose subsidiary books.

According to **L.C. Cropper**, 'the book which contains a classified and permanent record of all the transactions of a business is called the Ledger'.

The ledger that is normally used in a majority of business concern is a bound note book. This can be preserved for a long time. Its pages are consequently numbered. Each account in the ledger is opened preferably on a separate page. If one page is completed, the account will be continued in the next or some other page. But in bigger concerns, it is not practical to keep the ledger as a bound note book; Loose-leaf ledger now takes the place of a bound note book. In a loose-leaf ledger, appropriate ruled sheets of thick paper are introduced and fixed up with the help of a binder. Whenever necessary additional pages may be inserted, completed accounts can be removed and the accounts may be arranged and rearranged in the desired order. Therefore, this type of ledger is known as **Loose-leaf Ledger**.

Utility

Ledger is a principal or main book which contains all the accounts in which the transactions recorded in the books of original entry are transferred. Ledger is also called the **'Book of Final Entry'** or **'Book of Secondary Entry'**, because the transactions are finally incorporated in the Ledger. The following are the advantages of ledger.

i. Complete information at a glance:

All the transactions pertaining to an account are collected at one place in the ledger. By looking at the balance of that account, one can understand the collective effect of all such transactions at a glance.

ii. Arithmetical Accuracy

With the help of ledger balances, Trial balance can be prepared to know the arithmetical accuracy of accounts.

iii. Result of Business Operations

It facilitates the preparation of final accounts for ascertaining the operating result and the financial position of the business concern.

iv. Accounting information

The data supplied by various ledger accounts are summarized, analysed and interpreted for obtaining various accounting information.

FORMAT

Ledger Account

Dr. **Cr.**

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)

Year Month Date	To (Name of Credit Account in Journal)			Year Month Date	By (Name of Debit Account in Journal)		

Explanation:

i. Each ledger account is divided into two parts. The left hand side is known as the debit side and the right hand side is known as the credit side. The words 'Dr.' and 'Cr.' are used to denote Debit and Credit.

ii. The name of the account is mentioned in the top (middle) of the account.

iii. The date of the transaction is recorded in the date column.

iv. The word 'To' is used before the accounts which appear on the debit side of an account in the particulars column. Similarly, the word 'By' is used before the accounts which appear on the credit side of an account in the particulars column.

v. The name of the other account which is affected by the transaction is written either in the debit side or credit side in the particulars column.

vi. The page number of the Journal or Subsidiary Book from where that particular entry is transferred, is entered in the Journal Folio (J.F) column.

vii. The amount pertaining to this account is entered in the amount column.

Recording of Transactions in the ledger

Before recording transactions, we shall follow few steps that will help us know which account is debited and which account is credited. Please remember that in accounting we always look at things from the point of view of the business only.

1. State what are the accounts affected
2. Categorise each account under assets, liabilities, equity, revenue and expenses.
3. State whether each item is increasing or decreasing.
4. Translate the increase and decrease into debit and credit by using the table of balances below. (Same was given when we learnt the rules for assets, liabilities, equity, expenses and revenue)

CATEGORY	BALANCE	INCREASE	DECREASE

Assets	Dr	Dr	Cr
Liabilities	Cr	Cr	Dr
Equity	Cr	Cr	Dr
Revenue	Cr	Cr	Dr
Expenses	Dr	Dr	Cr

5. Verify that there are one debit entry and one credit entry of the same amount.
6. Record the transaction.

Problem 1. Pass journal entries for the following transactions in the books of Nikhil Bhusan:

1997 Jan. 1 Commenced business with a capital Rs. 20,000

3 Amount deposited in S.B.I Rs. 5,000

6 Goods purchased for cash Rs. 7,000

10 Furniture purchased from Chinmoy Rs. 5,000

11 Goods sold to Anil Majumdar for cash Rs. 8,000

13 Goods sold to Ashim Das Rs. 2,000

25 Cash drew for private uses Rs. 500

31 Salaries paid Rs. 800

Solution:

Journal

Date	Particulars	L. F.	Dr. Amount ₹	Cr. Amount ₹
1997 Jan. 1	Cash Account Dr. To Capital Account (Being capital invested)		20,000	20,000
3	Bank Account Dr. To Cash Account (Being cash deposited into bank)		5,000	5,000
6	Purchase Account Dr. To Cash Account (Being goods purchased for cash.)		7,000	7,000
10	Furniture Account Dr. To Chinmoy's Account (Being furniture purchased from Chinmoy.)		5,000	5,000
11	Cash Account Dr. To Sales Account (Being goods sold to Mazumdar on cash.)		8,000	8,000
13	Ashim Das' Account Dr. To Sales Account (Being goods sold to Ashim Das.)		2,000	2,000
25	Drawings Account Dr. To Cash Account (Being cash drew for personal use)		500	500
31	Salaries Account Dr. To Cash Account (Being salaries paid.)		800	800

Problem 2. Journalise the following transactions in the books of Amar and post them in the Ledger and Balance them:-

2004

March 1 Bought goods for cash Rs. 25,000 2
Sold goods for cash Rs. 50,000

3 Bought goods for credit from Gopi Rs.19,000

5 Sold goods on credit to Robert Rs.8,000

7 Received from Robert Rs. 6,000

9 Paid to Gopi Rs.5,000

20 Bought furniture for cash Rs. 7,000

Solution :

Journal of Amar

Date	Particulars	LF.	Debit Rs.	Debit P.	Credit Rs.	Credit P.
2004 Mar 1	Purchases A/c Dr. To Cash A/c (Cash purchases)		25,000	_	25,000	_
2	Cash A/c Dr. To Sales A/c (Cash Sales)		50,000	_	50,000	_
3	Purchases A/c Dr. To Gopi A/c (Credit purchases)		19,000	_	19,000	_
5	Robert A/c Dr. To Sales A/c (Credit Sales)		8,000	_	8,000	_
7	Cash A/c Dr.		6,000	_		_

	To Robert A/c (Cash received)				6,000	
9	Gopi A/c Dr. To Cash A/c (Cash paid)		5,000	_	5,000	–
20	Furniture A/c. Dr. To Cash A/c (furniture purchased)		7,000	_	7,000	–

Ledger Accounts
Cash Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 5	To Sales A/c		50,000	Mar 1	By Purchases A/c		25,000
7	To Robert A/c		6,000	9	By Gopi A/c		5,000
				20	By Furniture A/c		7,000
				31	By Balance c/d		19,000
			56,000				56,000
April 1	To Balance b/d		19,000				

Purchases Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 1	To Cash A/c		25,000	Mar 31	By Balance c/d		44,000
3	To Gopi A/c		19,000				
			44,000				44,000
April 1	To Balance b/d		44,000				

Sales Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 31	To Balance c/d		58,000	Mar 2	By Cash A/c		50,000
				5	By Robert A/c		8,000
			58,000				58,000
				April 1	By Balance b/d		58,000

Furniture Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			

Mar 20	To Cash A/c		7,000	Mar 31	By Balance c/d		7,000
			7,000				7,000
Apr 1	To Balance b/d		7,000				

Gopi Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 19	To Cash A/c		5,000	Mar 3	By Purchases A/c		19,000
31	To Balance c/d		14,000				
			19,000				19,000
				April 1	By Balance b/d		14,000

Robert Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 5	To Sales A/c		8,000	Mar 7	By Cash A/c		6,000
				31	By Balance c/d		2,000
			8,000				8,000
Apr 1	To Balance b/d		2,000				

SUBSIDIARY BOOKS

Periodical details of some important business transactions cannot be known, from the journal easily, e.g., monthly sales, monthly purchases.

Such a system does not facilitate the installation of an internal check system since the journal can be handled by only one person.

The journal becomes bulky and voluminous.

NEED FOR SUBSIDIARY BOOKS

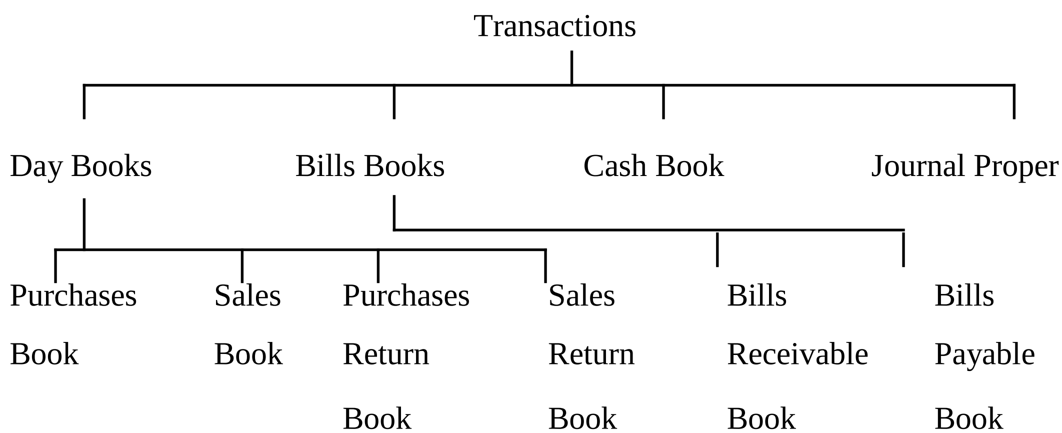
Moreover, transactions can be classified and grouped conveniently according to their nature, as some transactions are usually of repetitive in nature. Generally, transactions are of two types:

Cash and Credit. Cash transactions can be grouped in one category whereas credit transactions can be grouped in another category. Thus, in practice, the main journal is sub-divided in such a way that a separate book is used for each category or group of transactions which are repetitive and sufficiently large in number.

Each one of the subsidiary books is a special journal and a book of original or prime entry. Though the usual type of journal entries are not passed in these sub-divided journals, the double entry principles of accounting are strictly followed.

KINDS OF SUBSIDIARY BOOKS

The number of subsidiary books may vary according to the requirements of each business. The following are the special purpose subsidiary books.



PURPOSE OF SUBSIDIARY BOOK

Purchases Book records only credit purchases of goods by the trader.
Sales Book is meant for entering only credit sales of goods by the trader.
Purchases Return Book records the goods returned by the trader to suppliers.
Sales Return Book deals with goods returned (out of previous sales) by the customers.
Bills Receivable Book records the receipts of bills (Bills Receivable).
Bills Payable Book records the issue of bills (Bills Payable).
Cash Book is used for recording only cash transactions i.e., receipts and payments of cash.
Journal Proper is the journal which records the entries which cannot be entered in any of the above listed subsidiary books.

ADVANTAGES OF SUBSIDIARY BOOKS

The advantages of maintaining subsidiary books can be summarised as under :

Division of Labour : The division of journal, resulting in division of work, ensures more clerks working independently in recording original entries in the subsidiary books.

Efficiency : The division of labour also helps the reduction in work load, saving in time and stationery. It also gives advantages of specialisation leading to efficiency.

Prevents Errors and Frauds : The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrance of errors and frauds may be avoided.

Easy Reference : It facilitates easy references to any particular item. For instance total credit sales for a month can be easily obtained from the Sales Book.

Easy Postings : Posting from the subsidiary books are made at convenient intervals depending upon the nature of the business.

1. **Purchases Book**

Purchases book also known as Bought Day Book is used to record all credit purchases of goods which are meant for resale in the business. Cash purchases of goods, cash and credit purchases of assets are not entered in this book.

Before discussing the Purchase Day Book, in detail we are to explain the most significant terms, Trade Discount and Cash Discount.

Problem 3: From the following transactions of Ram for July, 2003 prepare the Purchases Book and ledger accounts connected with this book.

2003

July 5 Purchased on credit from Kannan & Co.

50 Iron boxes @ Rs. 500

10 Grinders @ Rs. 3,000

6 Purchased for cash from Siva & Bros.

25 Fans @ Rs. 1,250

10 Purchased from Balan & Sons on credit

20 Grinders @ Rs. 2,500

10 Mixie @ Rs. 3,000

20 Purchased, on credit, one Computer from Kumar for Rs. 35,000.

Solution :

In the books of Ram
Purchases Book

Date	Particulars	Inward Invoice No.	L.F.	Amount Details Rs.	Amount Total Rs.
2003	Kannan & Co.			25,000	
July 5	50 Iron boxes @ Rs. 500			30,000	
	10 Grinders @ Rs. 3,000				
	Goods purchased vide their bill No....... Dated......				55,000
10	Balan & Co.				
	20 Grinders @ Rs.2,500			50,000	
	10 Mixie @ Rs. 3,000			30,000	
	Goods purchased vide their bill No....... Dated......				80,000
	Total				1,35,000

Ledger Accounts

Dr. **Purchases Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 July	To Sundries as per Purchases Book		1,35,000				

Dr. Kannan & Co. Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 July 5	By Purchases A/c		55,000

Dr. Balan & Co. A/c Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 July 10	By Purchases A/c		80,000

Sales Book

The sales book is used to record all credit sales of goods dealt with by the trader in his business. Cash sales, **cash and credit sales of assets are not entered in this book.** The entries in the sales book are on the basis of the invoices issued to the customers with the net amount of sale.

Problem 4. From the transactions given below prepare the Sales Book of Ram for July 2003.

2003			
July 5	Sold on credit to S.S. Traders		
	10 Chairs	@ Rs. 250	Less 10%
	10 Tables	@ Rs. 850	Discount
8	Sold to Raja for cash		
	15 Chairs	@ Rs. 250	
20	Sold to Mohan & Co.		
	5 Almirah	@ Rs. 2,200	
	10 Tables	@ Rs. 850	
23	Sold on credit to Narayanan old computer for Rs. 5,000		
28	Sold to Kumaran for cash		
	15 Chairs	@ Rs. 250	

Solution:

In the books of Ram
Sales Book

Date	Particulars	Outward Invoice No.	L.F.	Amount Details Rs.	Amount Total Rs.
2003					
July 5	S.S. Traders & Co.				
	10 Chairs @ Rs. 250			2,500	
	10 Tables @ Rs. 850			8,500	
				11,000	
	Sold to S.S. Traders,			1,100	
	Invoice No....... dated				

					9,900
20	Mohan & Co 5 Almirah @ Rs. 2,200 10 Tables @ Rs. 850 Sales as per Invoice No...... dated			11,000 8,500	19,500
	Total				29,400

Ledger Accounts

Dr. **Sales Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 July 31	By Sundries as per sales book		29,400

Dr. **S.S. Trader's Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 July 5	To Sales A/c		9,900				

Dr. **Mohan & Co.'s Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003							

July 5	To Sales A/c		19,500				

Returns Books

Returns Books are those books in which the goods returned to the suppliers and goods returned by the customers are recorded.

The reasons for the return of goods are

- not according to the order placed.
- not upto the samples which were already shown.
- due to damage condition.
- due to difference in the prices charged.
- undue delay in the delivery of the goods.

Kinds of Returns Books

The following are the kinds of Returns Books;

- **Purchases Return** or **Returns outward book**
- **Sales Return** or **Returns inward book**

When the business concern returns a part of the goods purchased on credit, the returns fall under the category **Purchases Return** or **Returns Outward**.

When the business concern receives a part of the goods sold on credit, the returns fall under the category of **Sales Return** or **Returns Inward**.

Purchases Return Book

This book is used to record all returns of goods by the business to the suppliers. The entries in the Purchases Returns Book are usually made on the basis of debit note issued to the suppliers or credit note received from the suppliers. We call it a debit note because the party's (supplier) account is debited with the amount written in this note. The same note is termed as credit note from the receiving party's point of view because he will credit the account of the party from whom he has received the note together with goods.

Problem 5. Enter the following transactions in the purchases return book of Hari and post them into the ledger.

2003 Jan 5 Returned goods to Anand 5 chairs @ Rs.200 each, not in accordance with order.

Returned goods to Chandran 4 chairs @ Rs.200 each and
10 tables @ Rs.350 each, due to inferior quality.

Solution :

In the books of Hari
Purchases Return Book

Date	Particulars	Debit Note No.	L.F.	Amount Details Rs.	Amount Total Rs.	Remarks
2003 Jan 5	Anand 5 Chairs @ Rs.200				1,000	Not in accordance with order
14	Chandran 4 Chairs @ Rs.200 10 Tables @ Rs.350			800 3,500	4,300	Due to inferior quality
	Total				5,300	

Ledger Accounts

Dr. **Purchases Return Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.

				2003 Jan 31	By Sundries as per Purchases return book		5,300

Dr. **Anand Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Jan 5	To Purchases Return A/c		1,000				

Dr. **Chandran Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Jan 14	To Purchases Return A/c		4,300				

Sales Return Book

This book is used to record all returns of goods to the business by the customers. The entries in the sales return book are usually on the basis of credit notes issued to the customers or debit notes issued by the customers.

Problem 6. Enter the following transactions in Returns Inward Book:
2003
April 6 Returned by Shankar 30 shirts each costing Rs.150, due to inferior quality.

Amar Tailors returned 10 Baba suits, each costing Rs.100, on account of being not in accordance with their order.

T.N. Stores returned 12 Salwar sets each costing Rs.200, being not in accordance with order.

Solution:

Sales Return Book

Date	Particulars	Credit Note No.	L.F.	Details Rs.	Amount Rs.	Remarks
2003 April 6	Shankar 30 shirts @ Rs.150			4,500		Due to inferior quality
8	Amar Tailors 10 Baba suits @ Rs. 100			1,000		Not in accordance with the order
21	T.N Stores 12 Salwar sets @ Rs.200			2,400	7,900	Not in accordance with the order
	Total				7,900	

Ledger Accounts

Dr. **Sales Return Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 April 30	To Sundries as per Sales return book		7,900				

Dr. **Shankar Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 April 6	By Sales Return A/c		4,500

Dr. **Amar Tailors Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 April 8	By Sales Return A/c		1,000

Dr. **T.N. Stores Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.

				2003 April 21	By Sales Return A/c		2,400

CASH BOOKS

In every business house there are cash transactions as well as credit transactions. All credit transactions will become cash transactions when payments are made to creditors or cash received from debtors. Since, cash transactions will be numerous, it is better to keep a separate book to record only the cash transactions.

FEATURES OF CASH BOOKS

A cash book is a special journal which is used to record all cash receipts and cash payments. The cash book is a book of original entry or prime entry since transactions are recorded for the first time from the source documents. The cash book is a ledger in the sense that it is designed in the form of a cash account and records cash receipts on the debit side and cash payments on the credit side. **Thus, the cash book is both a journal and a ledger. Cash Book will always show debit balance,** as cash payments can never exceed cash available. In short, cash book is a special journal which is used for recording all cash receipts and cash payments.

ADVANTAGES OF CASH BOOKS

Saves time and labour: When cash transactions are recorded in the journal a lot of time and labour will be involved. To avoid this all cash transactions are straight away recorded in the cash book which is in the form of a ledger.

To know cash and bank balance: It helps the proprietor to know the cash and bank balance at any point of time.

Mistakes and frauds can be prevented: Regular balancing of cash book reveals the balance of cash in hand. In case the cash book is maintained by business concern, it can avoid frauds. Discrepancies if any, can be identified and rectified.

Effective cash management: Cash book provides all information regarding total receipts and payments of the business concern at a particular period. So that, effective policy of cash management can be formulated.

KINDS OF CASH BOOK

The various kinds of cash book from the point of view of uses may be as follow:

Kinds of cash book

I	II	III	IV
Single column cash book	Double column cash book a) With discount and cash columns b) With cash and bank columns	Triple column cash book with discount, cash and bank columns	Petty cash book

SINGLE COLUMN CASH BOOK

Single column cash book (simple cash book) has one amount column in each side. All cash receipts are recorded on the debit side and all cash payments on the credit side. In fact, this book is nothing but a Cash Account. Hence, there is no need to open cash account in the ledger.

Problem 6. Mr. M starts business with Rs. 20,000 on 1st April 2012. Of this he pays Rs. 15000 into his bank account. His cash transactions during the week were:
April 1 Purchased stationery for cash Rs. 100
April 2 Purchased goods for cash Rs. 2500
April 2 Cash Sales Rs.1500
April 3 Received from J Brown Cash on account Rs. 1000
April 4 Paid to J. R Cash Rs. 2200
April 5 Paid for Advertisement Rs. 400
April 6 Cash Sales Rs. 1800
April 6 Purchased old machinery Rs. 800
April 6 Purchase from sham on credit Rs. 6000

Solution: single column cash book .

Dr.	**Single Cash Book**								Cr.
Date	Receipts	V.No.	L.F.	Amount	Date	Payments	V.No.	L.F.	Amount
April 1, 2012	To Capital a/c			20000	April 1, 2012	By Bank a/c			15000
Apr-02	To Sale a./c			1500	Apr-01	By Stationery a/c			100

Apr-03	To J. Brown a/c			1000	Apr-01	By Purchase a/c			2500
Apr-06	To Sales a/c			1800	Apr-04	By J.R. a/c			2200
					Apr-05	By Advertisement a/c			400
					Apr-06	By Machinery a/c			800
					Apr-06	**By Bal. c/d**			**3300**
				24300					**24300**
Apr-07	**By Bal. b/d**			**3300**					

DOUBLE COLUMN CASH BOOK

On either side of the single column cash book, another column is added to record discount allowed and discount received.

Problem 7. From the following transactions prepare a two column cash book and post entries therefore to ledger accounts.

Year: 2016

Jan. 01: Opening balance of cash Rs.4,500.

Jan. 03: Received cash from R & Co. Rs.3,880 and allowed them a discount of Rs.20.

Jan. 05: Paid cash to H & Co. Rs.3,590 and received a discount of Rs.10.

Jan. 07: Merchandise purchased for cash Rs.940.

Jan. 09: Received interest on investment Rs.365.

Jan. 12: Purchased machinery for cash Rs.4,100.

Jan. 15: Cash sales for the first half of the month Rs.6,500.

Jan. 17: Paid cash for stationary Rs.635.

Jan. 20: Paid for office furniture Rs.710.

Jan. 21: Paid to H & Co. Rs.970 and received a cash discount of Rs.30.

Jan. 28: Cash received from R & Co. Rs.670 and allowed them a discount of Rs.30.

Jan. 31: Cash sales for the second half of the month Rs.7,600.

Jan. 31: Paid for salaries Rs.1,250.

Solution: Double Column Cash Book

Dr. (Receipts) CASH BOOK Cr. (Payments)

Date	Description	V.No.	PR	Disc.	Cash	Date	Description	V.No.	PR	Disc.	Cash
2016						2016					
Jan. 01	Balance b/d				4,500	Jan. 05	H & Co.		116	10	3,590
Jan. 03	R & Co.		120	20	3,880	Jan. 07	Purchases		108		940
Jan. 09	Interest income		104		365	Jan. 12	Machinery		110		4,100
Jan. 15	Sales		106		6,500	Jan. 17	Stationary exp.		112		635
Jan. 28	R & Co.		120	30	670	Jan. 20	Office furniture		114		710
Jan. 31	Sales		106		7,600	Jan. 23	H & Co.		116	30	970
						Jan. 31	Salaries exp.		118		1,250
						Jan. 31	Balance c/d				11,320
				50	23,515					40	23,515
Feb. 01	Balance b/d				11,320						

TRIPLE COLUMN

Large business concerns receive and make payments in cash and by cheques. Where cash discount is a regular feature, a Triple Column Cash Book is more advantageous. This cash book has three amount columns (cash, bank and discount) on each side. All cash receipts, deposits into bank and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on credit side.

Problem 8. The John trading company has undertaken the following transactions during the month of May 2016.

Year: 2016
May 01: Cash balance Rs.2,200, bank overdraft Rs.365.
May 03: Paid J & Co. by check Rs.1,200, discount received from him Rs.15.
May 05: Received from A & Co. a check for Rs.980, discount allowed to them Rs.20.
May 07: Deposited into bank the check received from A & Co. on May 05.
May 10: Purchased stationary for cash, Rs.150.
May 15: Purchased merchandise for cash, Rs.1,300.

May 15: Cash sales for the first half of the month, Rs.2,350.
May 16: Deposited into bank Rs.1,600.
May 18: Cash withdrawn from bank for personal expenses Rs.150.
May 19: Issued a check for merchandise purchased, Rs.1,650.
May 21: Drew from bank for office use, Rs.650.
May 24: Received a check from S & Sons and deposited the same into bank, Rs.1,560.
May 25: Paid a check to Ali Inc. for Rs.400 and received a discount of Rs.15.
May 27: Bought furniture for cash for office use, Rs.390.
May 29: Paid office rent by check, Rs.450.
May 30: Cash sales for the second half of the month Rs.4,300.
May 31: Paid salaries by check Rs.1,760.
May 31: Withdrew from bank for office use Rs.1,470.

Required: Record the above transactions in a three/triple column cash book.

Solution: Triple Column Cash Book

Dr. (Receipts) CASH BOOK Cr. (Payments)

Date	Description	V.No.	PR	Disc.	Cash	Bank	Date	Description	V.No.	PR	Disc.	Cash	Bank
2016							2016						
May 01	Balance b/d				2,200		May 01	Balance b/d					365
May 05	A & Co.		96	20	980		May 03	J & Co.		105	15		1,200
May 07	Cash		C			980	May 07	Bank		C		980	
May 15	Sales		94		2,350		May 10	Stationery		98		150	
May 16	Cash		C			1,600	May 15	Purchases		100		1,300	
May 21	Bank		C		650		May 16	Bank		C		1,600	
May 24	S & Sons		97			1,560	May 18	Drawings		101		150	
May 30	Sales		4		4,300		May 19	Purchases		100			1,650
May 31	Bank		C		1,470		May 21	Cash		C			650
May 31	Balance c/d					3,805	May 25	Ali Inc.		106	15		400
							May 27	Furniture		102		390	
							May 29	Rent exp.		103			450
							May 31	Salaries exp.		104			1,760
							May 31	Cash		C			1,470
							May 31	Balance c/d				7,380	
				20	11,950	7,945					30	11,950	7,945
Jun. 01	Balance b/d				7,380		Jun. 01	Balance b/d					3,805

PETTY CASH

In every business, of whatever size, there are many small cash payments such as conveyance, carriage, postage, telegram, etc. These expenses are generally repetitive in nature. If all these small payments are recorded in the cash book, it will be difficult for the cashier to maintain the records all by himself. In order to make the task of the cashier easy, these small and recurring expenses are recorded in a separate cash book called **"Petty Cash Book"** and the person who maintains the petty cash is called the **"Petty Cashier"**.

Petty means 'small'. The petty cash book is a book where small recurring payments like carriage, cartage, postage and telegram, printing and stationery etc., are recorded by the petty cashier, a person other than the main cashier.

IMPREST SYSTEM

Imprest means 'money advanced on loan'. Under this system the amount required to meet out various petty expenses is estimated and given to the petty cashier at the beginning of the specified period, usually a month. All the payments are supported by vouchers. At the end of the given period or earlier, when the petty cashier has spent the petty cash amount, he closes the petty cash book for the period and balances it. Then he submits the accounts to the cashier. He verifies the petty cash book with the vouchers. After satisfying himself as to the correctness and genuineness of the payments an amount equal to the cash spent is given to the petty cashier. This amount together with the unspent amount will bring up the cash in hand to the amount with which he originally started i.e., **the imprest amount**. Thus the system of reimbursing the amount spent by the petty cashier at fixed period, is known as the **imprest system of petty cash.**

For example, On June 1, 2002, Rs.1,000 was given to the petty cashier. He had spent Rs.940 during the month. He will be paid Rs.940 on 30th June by the cashier so that he may again have Rs.1,000 for the next month i.e., July.

Problem 9.From the following particulars prepare a Petty Cash Book under Imprest System. 2005

Jan. 1. Received from the Chief Cashier as imprest cash Rs.400.

Jan. 2. Paid Taxi hire Rs.20.

Jan. 3. Paid postage Rs.28 and stationery Rs.60.

Jan. 4. Purchased stationery Rs.48.

Jan. 5. Paid telegram charges Rs.28 and bus fare Rs.4.

Jan. 6. Bought postage stamps Rs.96.

Jan. 7. Paid Rs.72 for repairs of typewriter.

Solution:

Petty Cash Book

Amount Received	Date	Particulars	V. No.	Total	Traveling Expenses	Postages	Stationery	Office Expenses	Misc. Expenses
400	2005 Jan 1	Cash Received							

	Jun. 2	Taxi hire A/c		20	20				
	Jun. 3	Postage A/c		28		28			
	Jun. 3	Stationery A/c		60			60		
	Jun. 4	Stationery A/c		48			48		
	Jun. 5	Telegram A/c		28		28			
	Jun. 5	Bus fare A/c		4	4				
	Jun. 6	Postage A/c		96		96			
	Jun. 7	Repairs A/c		72				72	
				356	**24**	**152**	**108**	**72**	
		Balance c/d		44					
400				400					
44	Jun. 8	Balance b/d							
356		Cash received							

TRIAL BALANCE

In the previous chapters, you have learnt how to record and classify the transactions in the various accounts along with balancing thereof. The next step in the accounting process is to prepare a statement to check the arithmetical accuracy of the transactions recorded so for. This statement is called **'Trial Balance'**.

Trial balance is a statement which shows debit balances and credit balances of all accounts in the ledger. Since, every debit should have a corresponding credit as per the rules of double entry system, the total of the debit balances and credit balances should tally (agree). In case, there is a difference, one has to check the correctness of the balances brought forward from the respective accounts. Trial balance can be prepared in any date provided accounts are balanced.

Definition

"Trial balance is a statement, prepared with the debit and credit balances of ledger accounts to test the arithmetical accuracy of the books" – **J.R. Batliboi.**

Objectives of Trial Balance

The objectives of preparing a trial balance are:

- To check the arithmetical accuracy of the ledger accounts.
- To locate the errors.
- To facilitate the preparation of final accounts.

Advantages of Trial Balance

The advantages of the trial balance are

- It helps to ascertain the arithmetical accuracy of the book-keeping work done during the period.
- It supplies in one place ready reference of all the balances of the ledger accounts.
- If any error is found out by preparing a trial balance, the same can be rectified before preparing final accounts.
- It is the basis on which final accounts are prepared.

Methods of Trial Balance

A trial balance can be prepared in the following methods.

The Total Method : According to this method, the total amount of the debit side of the ledger accounts and the total amount of the credit side of the ledger accounts are recorded.

The Balance Method : In this method, only the balances of an account either debit or credit, as the case may be, are recorded against their respective accounts.

The balance method is more widely used, as it supplies ready figures for preparing the final accounts.

Problem 10. The following balances were extracted from the ledger of Rahul on 31st March, 2003. You are requested to prepare a trial balance as on that date in the proper form.

	Rs.		**rs.**
Salaries	36,320	Purchases	1,44,670
Sales	1,73,500	Sundry Debtors	1,430
Plant & Machinery	34,300	Travelling Expenses	2,630
Commission Paid	1,880	Carriage Inward	240
Stock on 1.4.2002	11,100	Sundry Creditors	14,260
Repairs	1670	Capital, 1.4.2002	62,500

Sundry Expenses	460	Drawings	3,500
Returns Inward	1,000	Cash at Bank	1,090
Discount Allowed	1,150	Returns Outward	400
Rent and Rates	3,220	Investments	6,000

Solution:

Trial Balance of Rahul as on 31/3/2003

S. No.	Name of the Account	L. F.	Dr. Rs.	Cr. Rs.	Nature of Balance (Why Dr. or Cr.)
1.	Salaries		36,320	–	Nominal A/c-expense
2.	Sales		–	1,73,500	Real A/c - goods
3.	Plant and Machinery		34,300	–	Real A/c - asset
4.	Commission Paid		1,880	–	Nominal A/c expense
5.	Stock on 1.4.2002		11,100	–	Real A/c - goods
6.	Repairs		1,670	–	Nominal A/c-expense
7.	Sundry Expenses		460	–	Nominal A/c-expense
8.	Returns Inward		1,000	–	Real A/c - goods
9.	Discount Allowed		1,150	–	Nominal A/c - loss
10.	Rent & Rates		3,220	–	Nominal A/c-expense
11.	Purchases		1,44,670	–	Real A/c - goods
12.	Sundry Debtors		1,430	–	Personal A/c – customers
13.	Travelling Expenses		2,630	–	Nominal A/c-expense
14.	Carriage Inward		240	–	Nominal A/c-expense
15.	Sundry Creditors		–	14,260	Personal A/c – suppliers
16.	Capital 1.4.2002		–	62,500	Personal A/c - owner
17.	Drawings		3,500	–	Personal A/c - owner
18.	Cash at Bank		1,090	–	Real A/c - asset
19.	Returns Outward		–	400	Real A/c - goods
20.	Investments		6,000	–	Real A/c. - asset
	TOTAL		2,50,660	2,50,660	

UNIT - I
POSSIBLE QUESTIONS
PART - B

1. What do you mean by accounting?
2. Define Accounting.
3. Briefly explain the users and their need for accounting information.
4. What are the branches of accounting?
5. What are the basic assumptions of accounting?
6. What do you mean by business entity assumption?
7. Write short notes on the following assumption.
   a) Money measurement b) Accounting period
8. What do you mean by going concern assumption?

9. What are the basic concepts of accounting?
10. What do you understand by revenue realisation concept?
11. What do you mean by historical cost concept?

PART - C

1. Enter the following transactions in the proper subsidiary books of Mr.Somu

2003 Nov.

1	Bought from Gopal 300 bags of wheat Rs.1,000 per bag less trade discount 10%
3	Purchased from Madhavan 150 bags of rice Rs.900 per bag less trade discount 10%
5	Returned to Gopal 10 bags of wheat which were purchased on 1.11.03.
7	Sold to Shiva 50 bags of rice Rs.1,200 per bag less Trade Discount 5%.
12	Sold to Sharma 25 bags of Wheat Rs.1,300 per bag less Trade Discount 10%.
14	Returned 15 bags of rice to Madhavan.
15	Shiva returned 5 bags of rice.
17	Bought from Rajan 200 bags of wheat Rs.950 per bag
24	50 bags of wheat returned to Rajan

2. Journalise the following transactions of Ms. Sneha for the Month of May 2016.

		Rs.
May 1	Started business with cash	1,00,000
5	Bought furniture	15,000
6	Cash purchase	90,000
7	Cash sales	40,000
12	Cash purchase	25,000
13	Credit sales to Moorthy	15,000
14	Credit purchase from Mr. Venkat	15,000
17	Cash sales	44,000
19	Allowed discount	500
21	Paid to Venkat	14,700
27	Advertisement	4,000
28	Sales	72,000
29	Rent	4,000
30	Telephone Charges	6,700

3. Journalise the following transactions and post them into ledger of Mr. Sekar for the Month of Sep 2015

Sep	4	Bought goods for Cash	Rs.29,500
	9	Sold goods to Rajesh on credit	Rs.50,000
	11	Received Commission	Rs.4,000
	17	Cash Sales	Rs.1,10,000
	19	Bought goods from Lashmi	Rs. 70,000
	21	Withdrew cash for office use	Rs.12,000
	27	Paid Salaries	Rs.30,000
	28	Paid wages	Rs.5,500
	29	Paid rent	Rs.7,000
	30	Bought stationery for cash	Rs. 2,000

4. Journalise the following transactions of Mr. Balan and post them to proper ledger accounts relating to the month of January 2012.

	Rs
Jan 1 Started business with	45,00,000
3 Goods purchased	7,00,000
5 Doods sold	150,000
10 Goods purchased from Sridhar	20,00,000
16 Goods returned to Ram kumar	50,000
23 Drew from bank	300,000
26 Furniture purchased	100,000
26 Settled Ram kumar's account	
30 Paid rent	25,000
31 Salaries paid.	120,000

5. Enter the following transaction in the sales book of M/s saran raj& sons and

Post them into the ledger.

1999

May 2 Sold to M/s Ragul Bros:

200 pieces long cloth at Rs. 90 per piece

300 pieces shirting @ Rs. 110 per piece

May 5 sold to M/s gupta & verma:

20 pieces coating @ Rs.250 per piece.

May 16 sold to M/s Mathur & jain:

250 blankets @ Rs. 50 each

120 blankets @ Rs. 75 each

May 20 sold 20 shirts to cheap stores @ Rs. 30 each for cash.

May 25 sold furniture to M/s santhosh & Co. on credit Rs. 800.

It is the practice followed by M/s saran raj & sons to allow 10% Trade discount on all sales.

6. From the following transaction, prepare Three- column cash book of Arjun for the month of Jul2009.

Jul 2009		Rs.
1	Cash balance	20,000
	Bank balance	23,000
3	Paid rent by cheque	5,000
4	Cash received on account of cash sales	6,000
6	Payment for cash purchase	2,000
8	Deposited into bank	8,000
9	Bought goods by cheque	3,000
10	Sold goods to Nathan on credit	7,120
12	Received cheque from madhan	2,900
	Discount allowed to him	100
13	Withdrew from bank for office use	4,350
14	Purchased furniture by cheque	1,260

15	Received a cheque for Rs.7000 from Nadhan in full settlement of his account, Which is deposited into bank	
17	Withdrew cash for personal use from the bank	1,200
18	Swamy, our customer has paid directly into our bank account	4000
19	parthi settled his account for Rs. 1,250 by Giving a cheque for	1,230
20	parthi's cheque sent to bank for collection	
21	Received from a ravi a currency note for Rs.1000 and gave him a change for it.	
22	Received cheque from kamal for Rs.6000 In full settlement for his account of Rs. 6,200 Deposited kamal's cheque into bank.	
25	paid into bank	9,000
29	parthi's cheque returned dishonoured	
31	paid salaries	10,000

7. Prepare trial balance from the following information

Particulars	Amount
Cash account	1,22,200
Capital	4,50,000
Bank	1,40,000
Purchases	2,20,000

Furniture	50,000
Sales	125,000
Returns outward	10,000
Discount	200
Drawing	10,000
Telephone rent	4,000
Stationery	2,000
Rent	10,000
Salaries	25,000
Returns inwards	2,000

KARPAGAM ACADEMY OF HIGHER EDUCATION

(Deemed University Established Under Section 3 of UGC Act 1956)
Coimbatore - 641021.
(For the candidates admitted from 2017 onwards)

DEPARTMENT OF COMMERCE WITH COMPUTER APPLICATIONS

SUBJECT : FINANCIAL ACCOUNTING
SEMESTER : I
SUBJECT CODE : 17CCU101 CLASS : I B.Com.CA

UNIT- II

Business Income – Revenue Recognition – Depreciation – Methods – Straight line method – Diminishing Balance Method – Change in Method of Depreciation – Final Accounts – preparation of final accounts for non- corporate business entities

Suggested Readings:

Text Book

1. Reddy and Moorthy. (2013). *Financial Accounting* Chennai. Margham Publications.

Reference Book

1. M.C.Shukla, T.S. Grewal and S.C.Gupta. (2013).*Advanced Accounts*. [Vol.-I Revised Edition] New Delhi, S. Chand & Co.
2. S.N. Maheshwari, and. S. K. Maheshwari.(2013). *Financial Accounting*.[First Edition]. New Delhi, Vikas Publishing House.
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4. Tulsian, P.C. (2013). *Financial Accounting*, [4th Ed]. New Delhi, S.Chand Publishing
5. Compendium of Statements and Standards of Accounting. (2013). New Delhi, The Institute of Chartered Accountants of India.

UNIT – II
BUSINESS INCOME

REVENUE RECOGNITION

Revenue recognition is an accounting principle under generally accepted accounting principles (GAAP) that determines the specific conditions under which revenue is recognized or accounted for. Generally, revenue is recognized only when a specific critical event has occurred and the amount of revenue is measurable. However, there are several situations in which exceptions may apply.

BREAKING DOWN REVENUE RECOGNITION

Revenue is at the heart of business performance. Everything hinges on the sale. As such, regulators know how tempting it is for companies to push the limits on what qualifies as revenue, especially when not all revenue is collected when the work is being done. Lawyers tend to bill clients in billable hours and present the bill after the case is completed. Construction managers often bill clients on a percentage-of-completion method. As a result, analysts like to know that revenue recognition policies for a company are relatively standard for the industry. This also helps to ensure an apples-to-apples comparison is being made between metrics using line items from the income statement.

Revenue Recognition Examples

If you pay for a candy bar with cash, it is considered a sale. If you pay for the candy bar with a piece of Monopoly money, it is not considered a sale. So, for example, assume Sue the store owner must report sales to her investors and knows that revenue is not the same as cash on paper. Sue is desperate to look good on paper, so she takes the Monopoly money and recognizes it as revenue. Investors think the company has positive earnings, but the revenues aren't real. Thankfully, investors are protected against such a scenario for many reasons, one of which is because there are certain rules about recognizing revenue to prevent managers like Sue from recording a fake sale.

Revenue recognition states that revenue should not be recorded until it is earned. However, not all sales are made in cash. The speed with which credit sales become cash is also a critical component of revenue recognition.

The classic case of misguided revenue recognition is a furniture company that is having a bad year. As a promotional gesture, the manager extends credit terms with no money down. The furniture company sells out of furniture and recognizes sales as revenue on the income statement, but the manager received no cash. The company is revenue-rich and cash-poor.

GAAP Changes to Revenue Recognition Policies

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) jointly issued Accounting Standards Codification (ASC) 606, regarding revenue from contracts with customers. ASC 606 provides a uniform framework for recognizing revenue with contracts. The old guidance was based on industry specific guidance, which created a system of fragmented policies. The new guidance is industry-neutral and therefore more transparent. Most companies have until 2018 to implement changes.

Revenue is the amount of money that a company actually receives during a specific period, including discounts and deductions for returned merchandise. It is the "top line" or "gross income" figure from which costs are subtracted to determine net income.

Revenue is calculated by multiplying the price at which goods or services are sold by the number of units or amount sold.

BREAKING DOWN REVENUE

Revenue is the amount of money that is brought into a company by its business activities. Revenue is also known as sales, as in the price-to-sales ratio, an alternative to the price-to-earnings ratio that uses revenue in the denominator.

There are different ways of calculating revenue, depending on the accounting method a business employs. Accrual accounting will include sales made on credit as revenue, as long as the goods or services have been delivered to the customer. It is therefore necessary to check the cash flow statement to assess how efficiently a company collects the money it is owed. Cash accounting, on the other hand, will only count sales as revenue if the payment has been received. When cash is paid to a company, this is known as a "receipt" to distinguish it from revenue. It is possible to have receipts without revenue, if the customer paid in advance for a service that has not been rendered or goods that have not been delivered.

Revenue is known as the "top line" because it is displayed first on a company's income statement. Expenses are then deducted from revenue in order to obtain net income, or profit – the "bottom line."

A company's revenue may be subdivided according to the divisions that generate it. For example, a recreational vehicles department might have a financing division, which could be as a separate source of revenue. Revenue can also be divided into "operating revenue," or sales from a company's core business, and "non-operating revenue," which derives from other, secondary sources. As these non-operating revenue sources are often not predictable or recurring, they can be referred to as one-time events or gains. For example, proceeds from the sale of an asset, a windfall from investments or money awarded through litigation would be considered non-operating revenue.

Investors will often consider a company's revenue and net income separately to determine the health of a business. It is possible for net income to grow while revenue remains stagnant, as a result of cost-cutting; such a situation does not bode well for a company's long-term growth. When public companies report quarterly earnings, the two figures that receive the most attention are typically revenue and earnings per share ("earnings" being equivalent to net income). Subsequent price movement in stocks generally correlates to whether a company beat or missed analysts' revenue and earnings per share expectations.

In the case of government, revenue is the money received from taxation, fees, fines, inter-governmental grants or transfers, securities sales, mineral rights and resource rights, as well as any sales that are made.

For non-profits, revenue is often referred to as "gross receipts." Its components include donations from individuals, foundations and companies; grants from government entities; investments; fundraising activities; and membership fees.

CASH COST

Cash cost is a cash basis accounting cost recognition process that classifies costs as they are paid for in cash, and is recognized in the general ledger at the point of sale. This method is contrary to the accrual cost recognition method, which directly influences the operating cash flow figure.

BREAKING DOWN CASH COST

Cash costs are costs that businesses pay for when using cash, or a check, but not credit. On a cash accounting basis, the costs paid for by using credit would not be recorded in the general ledger until the actual cash has been paid. This is the main reason why firms moved away from the cash accounting method to the accrual method, as the accrual method will recognize credit transactions as well as cash transactions.

DEPRECIATION

All assets whose benefit is derived for a long period of time, usually more than one year period are called as **Fixed Assets.** These assets decrease in value year after year due to wear and tear or lapse of time. This reduction in value of Fixed Assets is called Depreciation.

Generally, the term 'depreciation' is used to denote decrease in value, but in accounting, this term is used to denote decrease in the book value of a fixed asset. Depreciation is the permanent and continuous decrease in the book value of a fixed asset due to use, effluxion of time, obsolescence, expiration of legal rights or any other cause.

For instance, a factory owner, owns a machinery worth Rs.1,00,000, may estimate the life of the machinery as five years. This means that the value of the asset is reducing every year. Hence, it is necessary to spread the cost over five years during which the benefit of the asset is derived. Thus depreciation Rs.20,000 (Rs.1,00,000 / 5 years) is to be treated as an expense, which is debited to Profit and Loss account.

DEFINITION

In the words of Spicer and Pegler, "Depreciation is the measure of the exhaustion of the effective life of an asset from any cause during a given period".

Carter defines depreciation as "the gradual and permanent decrease in the value of an asset from any cause".

According to ICMA (Institute of Cost and Management Accountants - London) Terminology "Depreciation is the diminution in intrinsic value of asset due to use and lapse of time".

The above definitions reveal that when fixed assets are used in business to generate income, they lose their production capacity or earning capacity and at a particular point of time they render themselves useless. This reduction in the production capacity or earning capacity is termed as depreciation.

NEED FOR PROVIDING DEPRECIATION

The need for providing depreciation in accounting records arises due to any one or more of the following reasons.

1. To ascertain correct profit / loss

For proper matching of cost with revenues, it is necessary to charge depreciation against revenue in each accounting year, to calculate the correct net profit or net loss.

2. To present a true and fair view of the financial position

If the amount of depreciation is not provided on fixed assets in the books of account, the value of fixed assets will be shown at a higher value than it's real value in the balance sheet. As such it will not reflect the true and fair financial position of the business. Hence, to present a true and fair view of the financial position of the business, it is necessary that depreciation must be deducted from the book value of the assets in the balance sheet.

3. To ascertain the real cost of production

For ascertaining the real cost of production, it is necessary to provide depreciation.

4. To comply with legal requirements

As per Section 205(1) of the Companies Act 1956, it is compulsory for companies to provide depreciation on fixed assets before it declares dividend.

5. To replace assets

Depreciation is provided to replace the assets when it becomes useless.

CAUSES OF DEPRECIATION

The causes of depreciation may be internal or external. The internal causes arise from operation of any cause natural to or inherent in the asset itself. External causes arise from the operation of forces outside the business. These are being discussed below:

I. INTERNAL CAUSES

1. Wear and tear: Wear and tear is an important cause of depreciation in case of tangible fixed asset. It is due to use of the asset.

2. Disuse: When a machine is kept continuously idle, it becomes potentially less useful.

3. Maintenance: The value of machine deteriorates rapidly because of lack of proper maintenance.

4. Depletion: It refers to the physical deterioration by the exhaustion of natural resources eg., mines, quarries, oil wells etc.

II. EXTERNAL CAUSES

1. Obsolescence: The old asset will become obsolete (useless) due to new inventions, improved techniques and technological advancement.

2. Effluxion of time: When assets are exposed to forces of nature, like weather, wind, rain, etc., the value of such assets may decrease even if they are not put into any use.

3. Time Factor: Lease, copy-right, patents are acquired for a fixed period of time. On the expiry of the fixed period of time, the assets cease to exist.

TERMS USED FOR DEPRECIATION

1. Amortization: This refers to loss in the value of intangible assets such as goodwill, patents and preliminary expenses.

2. Depletion: Decrease in the value of mineral wealth such as coal, oil, iron ore, etc. is termed as depletion. The more we extract mineral wealth, the more they are depleted.

3. Obsolescence: When an asset becomes useless due to new inventions, improved techniques and technological advances, it is termed as obsolescence.

FACTORS DETERMINING THE AMOUNT OF DEPRECIATION

1. Original cost of the asset It implies the cost incurred on its acquisition, installation, commissioning and for additions or improvements thereof which are of capital nature

2. Estimated life: It implies the period over which an asset is expected to be used.

3. Residual value : It implies the value expected to be realised on its sale on the expiry of its useful life. This is otherwise known as **scrap value** or **turn-in value**.

METHODS OF CALCULATING DEPRECIATION

1. Straight line method or fixed instalment method.

2. Written down value method or diminishing balance method
3. Annuity method.
4. Depreciation Fund method.
5. Insurance Policy method.
6. Revaluation method

Straight Line Method or Fixed Instalment Method or Original Cost Method

Under this method, the same amount of depreciation is charged every year throughout the life of the asset. The amount and rate of depreciation is calculated as under.

1) Amount of depreciation

= Total cost - Scrap value / Estimated Life

2) Rate of depreciation

= Amount of Depreciation / Original Cost x100

Problem 1

A company purchased Machinery for Rs.1,00,000. Its installation costs amounted to Rs.10,000. It's estimated life is 5 years and the scrap value is Rs.5,000. Calculate the amount and rate of depreciation

Solution:

Total cost = Purchase Price + Installation Charges

= Rs.1,00,000 + Rs.10,000

= Rs. 1,10,000

Amount of depreciation = Total cost - Scrap value / Estimated life

= Rs.1,10,000-Rs.5,000 / 5

= Rs.1,05,000 / 5

= Rs.21,000

Merits:

1. Simplicity: It is very simple and easy to understand.

2. Easy to calculate: It is easy to calculate the amount and rate of depreciation.

3. Assets can be completely written off: Under this method, the book value of the asset becomes zero or equal to its scrap value at the expiry of its useful life.

Demerits:

The amount of depreciation is same in all the years, although the usefulness of the machine to the business is more in the initial years than in the later years.

Written Down Value Method or Diminishing Balance Method or Reducing Balance Method

Under this method, depreciation is charged at a fixed percentage each year on the reducing balance (i.e., cost less depreciation) of asset. The amount of depreciation goes on decreasing every year. For example, if the asset is purchased for Rs.1,00,000 and depreciation is to be charged at 10% p.a. on reducing balance method, then

Depreciation for the 1st year = 10% on Rs.1,00,000, ie., Rs.10,000

Depreciation for the 2nd year = 10% on Rs.90,000
(Rs.1,00,000 – Rs.10,000)
= Rs. 9,000

Depreciation for the 3rd year = 10% on Rs.81,000
(Rs.90,000 - Rs.9,000)
= Rs.8,100

Merits:

1. Uniform effect on the Profit and Loss account of different years: The total charge (i.e., depreciation plus repairs and renewals) remains almost uniform year after year, since in earlier years the amount of depreciation is more and the amount of repairs and renewals is less, whereas in later years the amount of depreciation is less and the amount of repairs and renewals is more.

2. Recognised by the Income Tax authorities: This method is recognised by the Income Tax authorities

3. Logical Method: It is a logical method as the depreciation is calculated on the diminished balance every year.

Demerits:

It is very difficult to determine the rate by which the value of asset could be written down to zero.

Distinction between Straight Line Method and Diminishing Balance Method:

Points of distinction	Straight line method	Diminishing balance method
1. Charge of depreciation	Depreciation is charged on the original cost of the asset.	Depreciation is charged on the written down value of the asset.
2. Change in Depreciation amount	Throughout the life of the asset, the amount of depreciation remains to be equal	Amount of depreciation is more during earlier years of the life of asset than later years and therefore amount is never equal.
3. Balance in Asset's account	Asset's account at the expiry of the expected life becomes nil.	Asset's account never becomes nil.
4.Overall charge	The overall charge, i.e., depreciation and repairs taken together go on increasing from year to year.	Overall charge remains same for every year throughout the life of the asset.
5. Profits	Profits under this method are more during the earlier years of the life of the asset because of less charge of repairs.	Profits are less during the earlier years than the later years because of higher charge for depreciation.
6. Suitability	It is suitable for assets having shorter life and lesser value.	It is suitable for assets having long life and requiring additions or extensions in its life and substantial repairs in later years.

Annuity Method:

The annuity method considers that the business besides loosing the original cost of the asset in terms of depreciation and also looses interest. On the amount used for buying the asset. This is based on the assumption that the amount invested in the asset would have earned in case the same amount would have been invested in some other form of investment. The annual amount of depreciation is determined with the help of annuity table. This method is used to calculate depreciation amount on lease.

Depreciation Fund Method or Sinking Fund Method :

Under this method, funds are made available for the replacement of asset at the end of its useful life. The depreciation remains the same year after year and is charged to Profit and

Loss account every year through the creation of depreciation fund. The amount of annual depreciation is invested in good securities bearing interest at a specified rate. The aggregate amount of interest and annual provision is invested every year. When the asset is completely written off or is to be replaced, the securities are sold and the amount so realised by selling securities is used to replace the old asset.

Insurance Policy Method:

According to this method, an Insurance policy is taken for the amount of the asset to be replaced. The amount of the policy is such that it is sufficient to replace the asset when it is worn out. A sum equal to the amount of depreciation is paid as premium every year. The amount goes on accumulating at a certain rate of interest and is received on maturity. The amount so received is used for the purchase of new asset, replacing the old one.

Revaluation Method:

Under this method, the assets like loose tools are revalued at the end of the accounting period and the same is compared with the value of the asset at the beginning of the year. The difference is considered as depreciation.

RECORDING DEPRECIATION

Depreciation is directly charged against the asset by debiting Depreciation account and crediting the Asset account. Depreciation account is closed by transferring to Profit and Loss account at the end of the year. The entries will be as under:

1) For the amount of depreciation to be provided at the end of the year:

Depreciation A/c Dr.

To Asset A/c

2) For transferring the amount of depreciation at the end of the year.

Profit and Loss A/c Dr.

To Depreciation A/c

Asset Account will be shown at cost less depreciation i.e., written down value at the end of the year in the Balance sheet.

1. On 1-1-99, A ltd., purchased machinery for Rs. 1,20,000 and on 30th June 2000, it acquired additional machinery at a cost of Rs.20,000. On 31st March 2001, one of the original machines, which had cost Rs.5,000 was found obsolete and sold as scrap for

Rs.500. It was replaced on that date by a new machine costing Rs.8,000. Depreciation is provided at the rate of 15% per annum on the written down value.

Show the ledger accounts for the first three years
(a) When depreciation is written off in the asset account; and
(b) When depreciation is accumulated in a separate account.

Solution:

Machinery Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1-1-99	To Bank a/c	1,20,000	31-12-99	By Depreciation a/c	18,000
				By Balance C/d	1,02,000
		1,20,000			1,20,000
1-1-00	To Balance B/d	1,02,000	31-12-00	By Depreciation a/c	16,800
30-6-00	To Bank a/c	20,000		By Balance C/d	1,05,200
		1,22,000			1,22,000
1-1-01	To Balance B/d	1,05,200	31-3-01	By Bank	500
31-3-01	To Bank a/c	8,000		By Depreciation a/c	135
				By P&L a/c	2,977
			31-12-01	By Depreciation a/c (15,238 + 900)	16,138
			31-12-01	By Balance C/d	93,450
		1,13,200			1,13,200
1-1-02	To Balance B/d	93,450			

Depreciation account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
31-12-99	To Machinery a/c	18,000	31-12-99	By P&L a/c	18,000
		18,000			18,000
31-12-00	To Machinery a/c	16,800	31-12-00	By P&L a/c	16,800
		16,800			16,800
31-3-01	To Machinery a/c	135	31-12-01	By P&L a/c	16,273
31-12-01	To Machinery a/c	16,138			
		16,273			16,273

(b) When depreciation is accumulated in a separate account:

Machinery Account:

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1-1-99	To Bank a/c	1,20,000	31-12-99	By Balance C/d	1,20,000
		1,20,000			1,20,000
1-1-00	To Balance B/d	1,20,000	31-12-00	By Balance C/d	1,40,000
30-6-00	To Bank a/c	20,000			
		1,40,000			1,40,000
1-1-01	To Balance B/d	1,40,000	31-3-01	By Bank	500
31-3-01	To Bank a/c	8,000		By Prov. For dep. A/c	1,523
				By P & L a/c	2,977
			31-12-01	By Balance C/d	1,43,000
		1,48,000			1,48,000

Provision for Depreciation Account

Machinery Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
31-12-99	To Balance C/d	18,000	31-12-99	By Depreciation a/c	18,000
		18,000			18,000
31-12-00	To Balance C/d	34,800	1-1-00	By Balance B/d	18,000
			31-12-00	By Depreciation a/c	16,800
		34,800			34,800
31-12-01	To Machinery a/c	1,523	1-1-01	By Balance B/d	34,800
31-12-01	To Balance C/d	49,550	31-3-01	By Depreciation a/c	135
			31-12-01	By Depreciation a/c	16,138
		51,073			51,073

Depreciation Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
31-12-99	To Prov. For Dep. A/c	18,000	31-12-99	By P & L a/c	18,000
		18,000			18,000
31-12-00	To Prov. For Dep. A/c	16,800	31-12-00	By P & L a/c	16,800
		16,800			16,800
31-3-01	To Prov. For Dep. A/c	135			
31-12-01	To Prov. For Dep. A/c	16,138	31-12-01	By P & L a/c	16,273
		16,273			16,273

Workings:

Original cost of asset sold as on 1-1-99 Rs. 5,000

Less. Depreciation @ 15% for 1999 on 5,000 Rs. 750
Balance as on 1-1-2000 Rs. 4,250
Less: Depreciation @ 15% for 2000 on 4,250 Rs. 638
Balance as on 1-1-2001 Rs. 3,612
Less: Depreciation @ 15% for 3 months Rs. 135
(on 3,612) Rs. 3,477
Less: Sold as Scrap Rs. 500
Loss transferred to P&L a/c Rs. 2,977

Illustration 2:
The cost of Machinery in use with a firm on 1-1-2000 was Rs.50, 000 against which the depreciation provision stood at Rs.19,190 on that date; the firm provided depreciation at 10% per annum on straight line method.

The firm started its business on 1-1-1996. On 30-9-2000 two machines costing Rs.3,000 and Rs.2,400 respectively, both purchased on 1-7-1997 had to be discarded because of damage and had to be replaced by new machines costing Rs.4,000 and Rs.3,000 respectively.

One of the discarded machines is sold for Rs. 1,600; against the other it was expected that Rs.600 would be realized. Show the Machinery Account, Provision for Depreciation Account and Machinery Disposal Account for the year 2000.

Solution:

Machinery Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1-1-00	To Balance B/d	50,000	30-9-00	By Machine Disposal a/c	5,400
30-9-00	To Bank a/c	7,000	31-12-00	By Balance C/d	51,600
		57,000			57,000
1-1-01	To Balance B/d	51,600			

Provision for Depreciation Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
30-9-00	To Machine Disposal a/c	1,350	1-1-00	By Balance B/d	19,190
31-12-00	To Balance C/d	22,475	31-12-00	By Depreciation a/c (On machinery in use)	4,635
		23,825			23,825
			1-1-01	By Balance B/d	22,475

Machinery Disposal Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
30-9-00	To Machinery a/c	5,400	30-9-00	By Prov. For Dep. A/c	1,350
				By Depreciation a/c (On two machines for 9 months)	405
				By Bank a/c	1,600
				By P & L a/c	1,445
			31-12-00	(Balancing figure) By Balance C/d	600
		5,400			5,400
1-1-01	To Balance B/d	600			

Working Notes:

1. Depreciation provided on two discarded machines
(Rs.3000 + 2400)
For 1997 (for 6 months) Rs. 270
For 1998 540
For 1999 540
Total depreciation till 1-1-2000 1350
Depreciation for 9 months to 30-9-2000 405

2. Depreciation on Machinery in use:

Cost of Machinery on 1-1-2000	Rs.50,000
Less: Cost of discarded machines	5,400
	44,600
Depreciation for one year on Rs.44,600	4,460
Depreciation for 3 months on Rs.7,000	175
Total depreciation on machinery in use	4,635

FINAL ACCOUNTS

Trial balance proves the arithmetical accuracy of the business transactions, but it is not the end. The businessman is interested in knowing whether the business has resulted in profit or loss and what the financial position of the business is at a given period. In short, he wants to know the profitability and the financial soundness of the business. The trader can ascertain these by preparing the final accounts. The final accounts are prepared at the end of the year from the trial balance. Hence the trial balance is said to be the connecting link between the ledger accounts and the final accounts.

Parts of Final Accounts

The final accounts of business concern generally include two parts. The first part is Trading and Profit and Loss Account. This is prepared to find out the net result of the business. The second part is Balance Sheet which is prepared to know the financial position of the business. However manufacturing concerns, will prepare a Manufacturing Account prior to the preparation of trading account, to find out cost of production.

Trading Account

Trading means buying and selling. The trading account shows the result of buying and selling of goods.

Need

At the end of each year, it is necessary to ascertain the net profit or net loss. For this purpose, it is first necessary to know the gross profit or gross loss. The trading account is prepared to ascertain this. The difference between the selling price and the cost price of the goods is the gross earning of the business concern. Such gross earning is called as gross profit. However, when the selling price is less than the cost of goods purchased, the result is gross loss.

Adjustments

1. **Closing Stock**

The unsold goods in stock at the end of the accounting period are called as closing stock. This is to be valued at cost or market price whichever is lower.

Value of closing stock will appear

i) On the credit side of trading account and

ii) On the assets side of balance sheet.

2. **Outstanding Expenses**

Expenses which have been incurred but not yet paid during the accounting period for which the final accounts are being prepared are called as **outstanding expenses**.

Outstanding expenses will be shown

i) On the debit side of Profit and Loss account by way of additions to the particular expenses and

ii) On the liabilities side of the Balance Sheet.

3. **Prepaid Expenses**

Expenses which have been paid in advance are called as **prepaid (unexpired) expenses**.

Prepaid expenses will be shown

i) On the debit side of the Profit and Loss account by way of deduction from the particular expenses and

ii) On the assets side of the Balance Sheet.

4. **Accrued Incomes or Outstanding Incomes**

Income which has been earned but not received during the accounting period is called as **accrued income**.

Accrued income will be shown

i) On the credit side of Profit and Loss account by way of addition to particular income and

ii) On the assets side of the Balance Sheet

5. **Incomes Received in Advance**

Income received during a particular accounting period for the work to be done in future period is called as **income received in advance**.

Incomes received in advance will be shown

i) On the credit side of the Profit and Loss account by way of deducting from the particular income and

ii) On the liabilities side of the Balance sheet.

6. **Interest on Capital**

In order to see whether the business is really earning profit or not, it is desirable to charge interest on capital at a certain rate.

Interest on capital will be shown

i) On the debit side of Profit and Loss account and

ii) On the liabilities side of the Balance Sheet by way of addition to the capital.

7. **Interest on Drawings**

Amount withdrawn by the owner for his personal use is called as **drawings**. When interest on capital is allowed, then interest on drawings is charged from the owner. Interest on drawings is an income for the business and will reduce the capital of the owner.

Interest on drawings will be shown

i) On the credit side of Profit and Loss account and

ii) On the liabilities side of the Balance Sheet by way of addition to the drawings which are ultimately deducted from the capital.

8. **Interest on Loan (Outstanding)**

Borrowings from banks, financial institutions and outsiders for business are called loans. Amount payable towards interest on loan is an expense for the business.

Interest on loan outstanding will be shown

i) On the debit side of the Profit and Loss account by way of addition to the appropriate interest account and

ii) On the liability side of the Balance sheet by way of addition to the particular loan account.

9. Interest on Investment:

Interest receivable on investments is an income for the business.

Accrued interest on investments (outstanding interest receivable) will be shown

i) On the credit side of the Profit and Loss account by way of addition to the appropriate interest account and

ii) On the assets side of the balance sheet by way of addition to the investments account.

10. Depreciation

Depreciation is the reduction in the value of fixed assets due to its use or obsolescence. Generally depreciation is charged at some percentage on the value of fixed asset.

Depreciation will be shown

i) On the debit side of Profit and Loss account and

ii) On the assets side of the Balance Sheet by way of deduction from the value of concerned asset.

11. Bad Debts

Debts which cannot be recovered are called **bad debts**. It is a loss for the business.

Bad debts will be shown

i) On the debit side of Profit and Loss account and

ii) On the assets side of the Balance Sheet by way of deduction from sundry debtors.

12. Provision for Bad and Doubtful Debts

Every business suffers a percentage of bad debts over and above the debts definitely known as irrecoverable and written off as Bad (Bad debts written off). If Sundry debtors figure is to be shown correctly in the Balance sheet provision for bad and doubtful debts must be adjusted. This Provision for bad and doubtful debts is generally provided at a certain percentage on Debtors, based on past experience.

While preparing final accounts, the bad debts written off given in adjustment is first deducted from the Sundry debtors then on the balance amount (Sundry debtors – Bad debt written off) provision for bad and doubtful debts calculated.

Provision for bad and doubtful debts will be shown

i) On the debit side of Profit and Loss Account and

ii) On the assets side of the Balance sheet by way of deduction from Sundry debtors (after Bad debts written off if any).

13. Provision for Discount on Debtors

To motivate the debtors to make prompt payments, cash discount may be allowed to them. After providing provision for bad and doubtful debts, the remaining debtors are called as **good debtors**. They may pay their dues in time and avail themselves of the cash discount permissable. So a provision for discount on good debtors at a certain percentage may have to be created.

Provision for discount on debtors will be shown

i) On the debit side of Profit and Loss account and

ii) On the asset side of the Balance sheet by way of deduction from Sundry debtors (after deducting bad debts written off and provision for bad and doubtful debts).

14. Provision for Discount on Creditors

Similar to cash discount allowed to debtors, the firm may have a chance to receive the cash discount from the creditors for prompt payment. Provision for discount on Creditors is calculated at a certain percentage on Sundry Creditors.

Provision for discount on creditors will be shown

i) On the credit side of Profit and Loss account and

ii) On the liabilities side of the Balance sheet by way of deduction from Sundry creditors.

SPECIMEN OF FINAL ACCOUNTS

Trading and Profit and Loss Account of Thiru ………… for the year ending 31st March, ……….

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		xxx	By Sales	xxx	
To Purchases	xxx		Less: Sales Return (or)	xxx	
Less: Purchase Return	xxx		Returns inward		

(or)		xxx			xxx
Returns Outward	xxx				
	xxx		By Closing Stock		xxx
To Wages		xxx			
Add: Outstanding	xxx				
Wages	xxx				
		xxx			
To Factory Rent					
Less: Prepaid Factory		xxx			
Rent		xxx			
		xxx			
To Freight		xxx			
To Carriage Inward		xxx			
To Clearing charges		xxx			
To Packing charges		xxx			
To Dock dues					
To Power (Factory)		xxx			
To Octroi Duty		xxx			xxx
To Gross Profit c/d					
(Transferred to Profit					
and Loss A/c)	xxx		By Gross Profit b/d		xxx
	xxx	xxx	(Transferred to Trading		
To Salaries			A/c)		
Add: Outstanding				xxx	
Salaries			By Commission received	xxx	xxx
			Add: Commission	xxx	
	xxx	xxx	accrued but not yet	xxx	
	xxx		received		xxx
			By Rent received		
To Insurance Premium			Less: Rent received in		xxx
Less: Prepaid Insurance			advance		xxx

Premium		xxx		xxx	
			By Interest on drawings		
	xxx		By Discount received	xxx	
			By (New) Provision for		
Interest on Capital	xxx	xxx	discount creditors (given		xxx
			in adjustments)		
Interest on Loan		xxx	Less: (Old) Provision for		
Add: Interest on Loan			discount on creditors		
Outstanding					
To Depreciation on:	xxx				
Fixed Assets, Building,	xxx				
Machinery, Furniture,	xxx				
etc.,					
	xxx				
To Bad Debts	xxx				
Add: (New) Bad Debts					
(given in adjustment)					
	xxx				
Add: (New) Provision					
for bad and doubtful					
debts (given in		xxx			
adjustment)					
Less: (Old) Provision					
for bad and doubtful	xxx				
debts					
To Discount Allowed	xxx	xxx			

		xxx			
To (New) Provision for discount on debtors (given in adjustment) Less: (Old) Provision for discount on debtors		xxx			
To Net profit (Transferred to Capital A/c)					

Balance Sheet of Thiru………… as on 31st March, …………

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
Capital	xxx		Cash in Hand		xxx
Add: Net Profit (or) Less: Net loss	xxx		Cash at Bank		xxx
			Sundry Debtors	xxx	
	xxx		Less: (New) Bad Debts written off	xxx	
Less: Drawings xxx				xxx	
Interest on Drawings xxx	xxx		Less: (New) Provision for Bad & Doubtful debts	xxx	
	xxx			xxx	
Less: income tax	xxx	xxx	Less: Provision for Discount on Debtors	xxx	xxx
Sundry Creditors	xxx				
Less: Provision for discount on creditors	xxx	xxx	Land and Building	xxx	
Loan	xxx		Less: Depreciation	xxx	xxx
Add: Interest on loan outstanding	xxx	xxx			
Outstanding Expenses		xxx	Plant and Machinery	xxx	
Income received in advance		xxx	Less: Depreciation	xxx	xxx

Bank overdraft			Furniture Less: Depreciation	xxx xxx	 xxx
			Goodwill Less: Written off	xxx xxx	 xxx
			Closing Stock Prepaid Expenses Accrued Commission		xxx xxx xxx
		xxx			**xxx**

Classification of Assets and Liabilities

Classification of Assets:

The properties and possessions of a business are called assets and they are classified into the following classes:

Fixed assets:

Fixed assets are assets which are acquired not for sale but for permanent use in the business e.g., land and buildings, plant and machinery, furniture etc. These assets help the business to be carried on.

Current Assets or Circulating Assets or Floating Assets:

Current assets denote those assets which are held for sale or to be converted into cash after some time e.g., sundry debtors. bills receivables, stock of goods etc.

Liquid Assets:

Liquid assets are those assets which are with us in cash or easily converted into cash e.g., cash in hand, cash at bank, investments etc.

Wasting Assets:

The assets that depreciate through "wear and tear", whose values expire with lapse of time or that become exhausted through working are known as **wasting assets**. This is a sub-class of fixed assets e.g., plant machinery, mines etc.

Intangible or Fictitious Assets:

There are assets which have no physical existence. Which can neither be seen with eyes not touched with hands. These are called **intangible assets** or **fictitious assets**. They do not represent anything valuable. They include debit balance of profit and loss account, goodwill etc.

Contingent Assets:

A **contingent asset** is one which comes into existence upon the happening of a certain event. If that event happens the asset becomes available, otherwise not. For example uncalled capital of a limited company.

Outstanding Assets:

Expenses paid in advance i.e., prepaid expenses, and income earned but not received are known as **outstanding assets**.

Classification of Liabilities:

The liabilities of a business are classified as follows:

Fixed Liabilities:

These are the liabilities which are payable immediately or in the near future. These liabilities are payable after a long period. Long term loans, capital of the proprietor are the examples of such kind of liabilities.

Current Liabilities:

These are the liabilities which are payable immediately or in the near future, such as creditors, bank loans etc.

Contingent Liabilities:

Contingent liabilities are those liabilities which arise only on the happening of some event. The event may or may not happen. Thus a contingent liability may or may not involve the payment of money. Examples of contingent liabilities are:

1. **Liabilities on bills discounted:** In case the bill is dishonored by the acceptor, the holder may be called upon to pay the amount to the discounter.
2. **Liability under guarantee:** In case the debtor fails to fulfill his obligation, the man who has given a guarantee or surety have to make good the loss to the creditor.
3. **Liability in respect of a pending suit:** A suit pending against a person in a court is a contingent liability because if the decision of the court goes against him, he may thereby become liable to pay compensation.

Contingent liabilities are not recorded in the books not they are included in the balance sheet. They are simply referred to by way of foot notes on the balance sheet.

Outstanding Liabilities:

Outstanding expenses and unearned income are examples of outstanding liabilities.

Classification of Capital:

The surplus or excess of assets over liabilities is called the capital or the proprietor. Capital may be classified as follows on the basis of the capital fund invested:

Trading Capital:

The portion of the funds of a concern which is represented by the fixed and floating assets is called the trading capital

Fixed Capital:

The portion of the funds of a concern which is represented by the fixed assets is called fixed capital.

Circulating Capital:

The portion of the funds of a concern which is represented by the floating or circulating assets is called the circulating or floating capital.

Working capital:

It is the amount which remains for the working of the business after the liabilities for acquiring the fixed assets have been discharged. The excess of the floating assets over the floating liabilities is also called the working capital.

Loan Capital:

The debentures and other fixed loans are sometimes called loan capital.

Watered Capital:

It is represented by fictitious assets.

PROBLEMS:

1. Prepare Trading, Profit & Loss A/c and Balance sheet from the following Trial Balance of Mr. V. Mohan Kumar.

Debit Balances	Amount Rs.	Credit Balances	Amount Rs.
Sundry Debtors	92,000	Mohan Kumar's Capital	70,000
Plant and Machinery	20,000	Purchase return	2,600
Interest	430	Sales	2,50,000
Rent, Rates, Taxes, & Insurance	5,600	Sundry Creditors	60,000
Conveyance charges	1,320	Bank overdraft	20,000
Wages	7,000		
Sales Returns	5,400		
Purchases	1,50,000		
Opening Stock	60,000		
Mohan Kumar's Drawing	22,000		
Trade expenses	1,350		
Salaries	11,200		
Advertising	840		
Discount	600		
Bad Debts	800		
Business premises	12,000		
Furniture and Fixtures	10,000		
Cash in hand	2,060		
	4,02,600		**4,02,600**

Adjustments:

(i) Stock on hand on 31-12-1996 Rs. 90,000

(ii) Provide depreciation on premises at 2.5%; Plant and Machinery at 7.5% and Furniture and Fixtures at 10%.

(iii) Write off Rs. 800 as further bad debts.

(iv) Provide for doubtful debts at 5% on sundry debtors.

(v) Outstanding rent was Rs. 500 and outstanding wages Rs. 400.

(vi) Prepaid insurance Rs. 300 and prepaid salaries Rs. 700.

Solution:

Trading and Profit and Loss A/c of V. Mohan Kumar for the year ending 31-12-96

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
To Opening stock		60000	By Sales	250000	
To Purchases	150000		Less: Sales return	5400	244600
Less: Purchase returns	2600	147400	By Closing stock		90000
To Wages	7000				
Add: Outstanding	400	7400			
To Gross Profit c/d (transferred to Profit and Loss A/c)		**119800**			
		334600			**334600**
To Trade Expenses		1350	By Gross Profit c/d (transferred from Trading A/c)		119800
To Salaries	11200				
Less: Prepaid salaries	700	10500			
To Conveyance Charges		1320			
To Advertising		840			
To Rent, Rates, Taxes and Insurance	5600				
Add: Outstanding rent	500				
	6100				
Less: Prepaid Insurance	300	5800			
To Discount		600			
To Interest		430			
To Bad Debts	800				
Add: Additional Bad Debts	800				
Add: (New) Provision for Bad Debts	4560	6160			

To Depreciation:					
Premises	300				
Plant and Machinery	1500				
Furniture and Fixtures	1000	2800			
To Net Profit transferred to Capital A/c		**90000**			
		119800			**119800**

Balance sheet of V. Mohan Kumar as on 31-3-1996

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	70000		Cash in Hand		2060
Less: Drawings	22000		Sundry Debtors	92000	
	48000		Less: Bad Debts	800	
Add: Net profit	90000	138000		91200	
Sundry Creditors		60000	Less: Provision for Bad and Doubtful Debts	4560	86640
Bank Overdraft		20000			
Outstanding:			Prepaid:		
Rent	500		Insurance	300	
Wages	400	900	Salaries	700	1000
			Plant & Machinery	20000	
			Less: Depreciation	1500	18500
			Business premises	12000	
			Less: Depreciation	300	11700
			Furniture & Fixtures	10000	
			Less: Depreciation	1000	9000
			Closing Stock		90000
		218900			**218900**

2. From the following balances as at31st December 1994 of trader, prepare a Trading and Profit & loss A/c for the year 1994 and a Balance Sheet as on that date:

Debit Balances	Amount Rs.	Credit Balances	Amount Rs.
Salaries	5,500	Creditors	9,500
Rent	1,300	Sales	32,000
Cash	1,000	Capital	30,000
Debtors	40,000	Loans	10,000
Trade expenses	600		
Purchases	25,000		
Advances	2,500		
Bank balance	5,600		
	81500		**81500**

Adjustments:

(i) The closing stock amounted to Rs. 9,000.

(ii) One month's Salary is outstanding.

(iii) One month's rent has been paid in advance.

(iv) Provide 5% for doubtful debts.

Solution:

Trading and Profit and Loss Ac of a Trader for the year ended as on 31-12-1994

Particulars	**Amount Rs.**	**Amount Rs.**	**Particulars**	**Amount Rs.**	**Amount Rs.**
To Purchases		25000	By Sales		32000
			By Closing Stock		9000
To Gross Profit C/d		**16000**			
		41000			**41000**
To Trade expenses		600	By Gross Profit B/d		16000
To Salaries	5500				
Add: Outstanding Salaries	500	6000			

To Rent	1300				
Less: Rent paid in Advance	118	1182			
To Provision for Bad and Doubtful debts		2000			
To Net Profit C/d		**6218**			
		16000			**16000**

Balance Sheet a Trader as on 31-12-1994

Liabilities	**Amount Rs.**	**Amount Rs.**	**Assets**	**Amount Rs.**	**Amount Rs.**
Capital	30000		Bank Balances		5600
Add: Net Profit	6218	36218	Cash		1000
Creditors		9500	Debtors	40000	
Loans		10000	Less: Provision for Bad and Doubtful debts	2000	38000
			Advances		2500
Outstanding Salaries		500	Rent paid in Advance		118
			Closing Stock		9000
		56218			**56218**

3. From the following Trial Balance of Thiru. Rehman as on 31st March 1995, prepare Trading and Profit & Loss A/c and Balance Sheet taking into account the adjustment:

Debit Balances	Amount Rs.	Credit Balances	Amount Rs.
Land and Buildings	42,000	Capital	62,000
Machinery	20,000	Sales	98,780
Patents	7,500	Return Outwards	500
Stock 1-4-1994	5,760	Sundry Creditors	6,300
Sundry debtors	14,500	Bills payable	9,000
Purchases	40,675		
Cash in hand	540		
Cash at Bank	2,630		
Return Inwards	680		

Wages	8,480		
Fuel & power	4,730		
Carriage on Sales	3,200		
Carriage on Purchases	2,040		
Salaries	15,000		
General expenses	3,000		
Insurance	600		
Drawings	5,245		
	1,76,580		**1,76,580**

Adjustments:

(i) Stock on 31-3-1995 was Rs. 6,800.

(ii) Salary outstanding Rs. 1,500.

(iii) Insurance Prepaid Rs. 150.

(iv) Depreciate Machinery @ 10% and Patents @ 20%.

(v) Create a provision of 2% on debts for bad debts.

Solution:

1. Trading and Profit and Loss A/c Thiru Rehman for the year ending as on 31st March 1995

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
To Opening Stock		5760	By Sales	98780	
To Purchases	40675		Less: Returns Inwards	680	98100
Less: Return Outward	500	40175	By Closing Stock		6800
To Wages		8480			
To Fuel and Power		4730			
To Carriage on Purchases		2040			
To Gross Profit C/d		**43715**			
		104900			**104900**
To Salaries	15000		To Gross Profit B/d		43715
Add: Outstanding Salaries	1500	16500			
To Insurance	600				
Add: Prepaid Insurance	150	450			
To Carriage on Sales		3200			

To General Expenses		3000			
To Depreciation:					
Machinery	2000				
Patent	1500	3500			
To Provision for Bad Debts		290			
To Net Profit C/d		**16775**			
		43715			**43715**

Balance Sheet of Thiru Rehman as on 31st March 1995

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	62000		Cash in Hand		540
Add: Net Profit	16775		Cash at Bank		2630
	78775		Sundry Debtors	14500	
Less: Drawings	5245	73530	Less: Provision for Bad Debts	290	14210
Sundry Creditors		6300	Land and Building		42000
Bills Payable		9000	Machinery	20000	
Outstanding Salary		1500	Less: Depreciation	2000	18000
			Patents	7500	
			Less: Depreciation	1500	6000
			Prepaid Insurance		150
			Closing Stock		6800
		90330			**90330**

4. From the following trial Balance prepare Trading, profit and loss A/c for the year ended 31-12-1981 and Balance Sheet as on that date:

Dr. Balance	Rs.	Cr. Balance	Rs.
Purchases	11,870	Capital	8,000
Debtors	7,580	Bad debts recovered	250

Return inwards	450	Creditors	1,250
Bank Deposits	2,750	Return outwards	350
Rent	360	Bank overdraft	1,570
Salaries	850	Sales	14,690
Travelling expenses	300	Bills Payable	1,350
Cash	210		
Stock	2,450		
Discount allowed	40		
Drawings	600		
	27,460		27,460

Adjustments:

(i) The Closing Stock on 31-12-81 was Rs. 4,200

(ii) Write off Rs. 80 as Bad Debts and create a reserve for bad debts at 5% 0n sundry debtors.

(iii) Three month rent is outstanding

Solution:

Trading and profit and Loss A/c for the year ended as on 31-12-1981

Particulars	**Amount Rs.**	**Amount Rs.**	**Particulars**	**Amount Rs.**	**Amount Rs.**
To Opening Stock		2450	To Sales	14690	
To Purchase	11870		Less: Return Inwards	450	14240
Less: Return Outwards	350	11520	To Closing Stock		4200
To Gross Profit C/d		**4470**			
		18440			**18440**
To Rent	360		By Gross Profit B/d		4470
Add: Outstanding Rent	120	480	By Bad Debts Recovered		250
To Bad Debts		80			
To Reserve for Bad Debts		375			
To Salaries		850			
To Travelling Expenses		300			

To Discount Allowed		40			
To Net Profit		**2595**			
		4720			**4720**

Balance Sheet as on 31-12-1981

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	8000		Cash		210
Add: Net Profit	2595		Bank Deposit		2750
	10595		Debtors	7580	
Less: Drawings	600	9995	Less: Bad Debts	80	
Creditors		1250		7500	
Bank Overdraft		1570	Less: Reserve for Bad Debts	375	7125
Bills Payable		1350	Closing Stock		4200
Outstanding Rent		120			
		14285			**14285**

5. From the following Trial Balance of Senthur Traders, prepare Trading and Profit & Loss Account for the year ending December 31, 2006 and Balance sheet as on that date:

Dr. Balance	Rs.	Cr. Balance	Rs.
Land & Building	60,000	Capital	96,000
Plant and Machinery	33,000	Sundry Creditors	15,000
Stock	12,000	Sales	60,000
Investment	15,000	Provision for Bad & Doubtful Debts	1,100
Purchases	45000	Loan	20,000
Wages	2000	Rent Received in advance	1,000
Carriage	2000	Commission Received	3,000
Salary	5000	Bills payable	15,000
Rent	2,000		
Cash at Bank	3000		

Sundry Debtors	30,000		
Discount	300		
Bad Debt	500		
Sales Returns	1300		
	2,11,100		**2,11,100**

Additional Information:

1. Closing stock valued at Rs. 12,000.
2. Bad Debt 500 and Provision for Bad & Doubtful Debts at 5%.
3. Salary outstanding Rs. 1000.
4. Commission Received in advance 1,000.
5. Depreciate Machinery @ 3% & land and Builders @ 2%.

2. Trading and profit and Loss A/c of Senthur Traders for the year ending as on 31-12-2006

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
To Opening Stock		12000	By Sales	60000	
To Purchases		45000	Less: Sales Returns	1300	58700
To Wages		2000	By Closing Stock		12000
To Carriage		2000			
To Gross Profit C/d		**9700**			
		70700			**70700**
To Salary	5000		By Gross Profit B/d		9700
Add: Salary	1000	6000	By Commission Received	3000	
To Rent		2000	Less: Commission Received in Advance	1000	2000
To Discount		300	By Rent Received in Advance		1000
To Bad Debts	500				
Add: Bad Debts	500				
	1000				

Add: Provision for Bad and Doutful Debts	1475				
	2475				
Less: Provision for Bad and Doutful Debts	1100	1375			
To Depreciation:					
Plant and Machinery	990				
Land abd Building	1200	2190			
To Net Profit C/d		**835**			
		12700			**12700**

Balance Sheet of Senthur Trader as on 31-12-2006

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	96000		Cash at Bank		3000
Net Profit	835		Investment		15000
		96835	Sundry Debtors	30000	
Outstanding Salary		1000	Less: Bad Debts	500	
Loan		20000		29500	
Commission Received in Advance		1000	Less: Provision for Bad and Doubtful Debts	1475	28025
Bills Payable		15000			
Sundry Creditors		15000	Land and Building	60000	
			Less: Depreciation	1200	58800
			Plant and Machinery	33000	
			Less: Depreciation	990	32010
			Closing Stock		12000
		148835			**148835**

FINAL ACCOUNTS OF NON-TRADING CONCERNS

1. Receipts and Payments Account
2. Income and Expenditure Account, and
3. Balance Sheet.

1. Receipts and Payments Account:

It is a Real Account. It is a consolidated summary of Cash Book. It is prepared at the end of the accounting period. All cash receipts are recorded on the debit side and all cash payments are recorded on the credit side.

Cash Book consisting of entries of receipts and payments in a chronological order while the Receipts and payments is a summary of total cash receipts and cash payments.

It starts with opening balance of Cash and Bank and ends with closing balance of Cash and Bank. It does not take into account outstanding amounts of receipts and payments. Receipts and Payments may be of Capital or Revenue nature; they may relate to the current or previous year or subsequent year; so long as they are actually received or paid, they must appear in this account.

Features of Receipts and Payment Account, In Brief:

ADVERTISEMENTS:

1. It starts with opening balance and ends with closing balance
2. It is the summary of cash and bank transactions.
3. Actual cash transactions are entered.
4. It includes capital as well as revenue items.
5. It follows cash system of accounting
6. It shows cash position and excludes all non-cash items.
7. It is a real account.
8. It does not take any income/expense outstanding at the beginning or at the end.

2. Income and Expenditure Account:

It is a Nominal Account. It is in the form of Profit and Loss Account. It is concerned with only revenue items—expenses and incomes. It records all losses and expenses on its debit side and all incomes and gains on its credit side of the incomes and expenses of revenue nature, only the portion pertaining to the current year is shown in the Income and Expenditure Account i.e. amount relating to the previous year or future year are excluded. Again, the incomes and expenses of current year, whether received or not, must be shown.

In other words, incomes and expenses have to be adjusted for both out-standing and pre-payments. All non-cash items, Depreciation, Bad Debts, Provision for Doubtful Debts etc. are taken into account.

The difference between the debit side and the credit side is either surplus or deficit for the year concerned and the difference will be transferred to the Capital Fund (also called General Fund or Accumulated Fund) appearing in Balance Sheet.

Features of Income and Expenditure Account, In Brief:

1. It is prepared in lieu of Profit and Loss Account.
2. It is a nominal account.
3. It is based on mercantile system of accounting.
4. There is no opening balance.
5. It ends with Surplus or Deficit.
6. It excludes all capital income and capital expenses.
7. It includes only revenue items.
8. It records all expenses whether paid or not, and all incomes whether received or not.

Distinction between Receipts and Payments Account and Income and Expenditure Account

Receipts and Payment Account	*Income and Expenditure Account*
1. It is a Real Account	1. It is a Nominal Account
2. It starts with opening balance.	2. It does not start with opening balance.
3. It ends with closing balance either cash in hand or at bank.	3. It ends with a surplus (excess of income over expenditure) or deficit (excess of expenditure over incomes)
4. It is similar to Cash Book.	4. It is similar to Profit and Loss Account.
5. Receipts are shown on the debit side and payments are shown on the credit side.	5. Expenses or losses are shown on the debit side and incomes and gains are shown on the credit side.
6. It contains both Capital and Revenue items.	6. It contains only Revenue items.
7. It includes receipts and payments whether they relate to any period past, previous and subsequent.	7. It includes only revenue items of the current year only.
8. No adjustments are made for outstanding or prepaid incomes and expenses	8. It takes into account the outstanding expenses and incomes.
9. Generally, it is not followed by Balance Sheet.	9. It is followed by Balance Sheet.
10. This is based on Cash system of accounting.	10. This is based on mercantile system.

3. Balance Sheet:

Balance Sheet in case of non-trading concern is prepared in the usual manner and consists of all liabilities and assets on the date on which it is prepared. The excess of assets over liabilities is termed Capital Fund or General Fund.

Again, The Capital Fund are accumulated with Capital Receipts, Receipts that are capitalized and further increased by surplus or decreased by deficit, during the year. At the inception of a non-trading concern, there will be no formal Capital Fund and in such case, the Surplus, if any, earned during the year constitute the Capital Fund at the end of the year.

Treatment of Special Items:

Subscriptions from members are collected periodically. These are regular revenue incomes and credited to Income and Expenditure Account. These are the major source of income for the non-trading concern. However, special subscriptions, if collected are kept separately from the General Fund for the specific purpose.

There are certain items which are peculiar to non-trading concerns and they need special treatment and are:

1. Donations:

Charitable institution may receive donations from time to time. If the amount is small and if such collections are frequent, then they may be treated as an income. Donations may also be of two types— General Donations and Specific Donations. Any donations received, not for a specific purpose, are treated as General Donations.

The General Donations of comparatively small amount may be taken to Income and Expenditure Account. General Donations of comparatively huge amount, which are of non-recurring nature, may be added to the Capital Fund. The nature and size of the organisation decide about the amount of donation being small or big.

In case of donations received for any specific purpose then it is termed Specific Donations. Such amount cannot be used for any other purpose, except the purpose of donor. Therefore, such amount may be shown in Balance Sheet (liability side).

All the Donations debited to Receipts and Payments Account and these amounts may be credited to Income and Expenditure Account or Liability side of the Balance Sheet, if it is for a specific purpose.

2. Legacy:

It is like donation. It is the amount given to a non-trading concern as per the will of deceased person. It is taken to the Receipts and Payments Account as Capital Receipts. These are not income but may appear in Balance Sheet. These types of receipts are of non-recurring nature.

3. Life Members Fee:

Non-trading concerns usually collect subscriptions every month from their ordinary members. There are another category of members called “Life Members”, from whom the subscriptions are collected as a lump sum.

Such subscriptions are called life subscription and are capital receipts. This can also be kept in a separate account and an amount equal to annual subscription can be transferred to subscription account. The balance in such account, on the death of the member must be transferred to Capital Fund.

4. Entrance Fee (Admission Fee):

These are the fees collected from every member at the time of his admission into membership. It is paid only once by the new entrants on becoming a member of a society or a club. Generally, there may be bye-laws as regards the accounting treatment of such amount. In the absence of any bye-laws, it is taken as an item for income.

Against treating it as an income, there are arguments favouring it as a capital receipt as the members pay such fees only once and therefore treat it as a capital receipt. In the absence of any instruction, it may be treated as an income and is credited to Income and Expenditure Account.

5. Sale of Old Sports Materials and Old Newspapers:

The amount received on account of sale of old sports materials and old newspapers are recurring incomes to a concern and therefore, treated them as revenue incomes. The purchases of balls, nets, etc. are revenue expenditure.

6. Purchase of Equipment:

The price paid for acquiring any equipment is a Capital Expenditure.

7. Honorarium Paid:

It is a payment of remuneration to a person who is not an employee of the organisation. Such as any special performance is done, by an outsider, at the organisation, then the payment is honorarium and is taken to Income and Expenditure Account as it is a revenue expenditure.

8. Subscription:

It is a primary source of income of a non-profit organisation. It is usually collected every month from all the ordinary members. Subscription is the amount paid by the members to keep their membership alive.

The subscription amounts are treated as revenue receipts. Subscription received from members is credited to Income and Expenditure Account on accrual basis i.e. total amount receivable from all the members as subscription should be considered as income for the year.

9. Special Fund:

If there is any specific fund, such as Prize Distribution Fund, the expenses or incomes relating to the fund may be adjusted to the fund itself (on the liability side of the Balance Sheet). Such expenses or incomes may not be taken to Income and Expenditure Account.

10. Sale of Old Assets:

If any asset is sold, the amount is debited to Receipts and Payments Accounts. It is not taken to Income and Expenditure Account. The profit or loss made on sale of old asset is recorded in Income and Expenditure Account.

Some Important Adjustments:

(A) Subscription:

Subscription received from members is treated as revenue income. In income and Expenditure Account, subscription for current year will be shown. If total subscription received as per Receipts and Payments Account during the year is given, adjustments will be made for outstanding subscription in the beginning and at the end of the year; and advance subscription in the beginning and at the end of the year.

(B) Expenses:

Total expenses paid during the year are shown in Receipts and Payments Account. These expenses may include outstanding of previous year and advance for next year. Similarly, some account may still be outstanding. Therefore, to calculate correct figure of expenses to be shown in Income and Expenditure Account, adjustments will have to be made.

(C) Consumable Items:

If institution consumes certain items such as medicines by hospital or sports items by clubs, relevant figures for Receipts and Payments Account and Income and Expenditure Account will be calculated. The value of goods consumed is shown in Income and Expenditure Account and the amount paid to creditors is shown in Receipts and Payments Account.

Problem

1. **Calculate the amount to be posted to Income and Expenditure Account for the year ended 2004:**

Receipts and Payments Account show that subscriptions received Rs 9,000. This account of subscriptions includes Rs 800 outstanding in the previous year and Rs 1,000 for the next year. Rs 2,000 is still outstanding for current year.

Solution:

Income and Expenditure Account
for the year ended Dec. 2004

Dr. Cr.

			Rs	*Rs*
	By Subscription received		9,000	
	Add: Outstanding for the current year:		2,000	
			11,000	
	Less: Outstanding for previous year:	800		
	Less: Received for next year:	1,000	1,800	9,200

2. In 2004, the subscriptions received were Rs 17,500 which includes Rs 400 for 2003 and Rs 600 for 2005. At the end of 2004 subscriptions outstanding were Rs 500. The subscriptions due but not received at the end of the previous year i.e., 2003 were Rs 600. What amount should be credited to Income and Expenditure Account as subscriptions?

Solution:

Income and Expenditure Account
for the year ended 31st Dec. 2004

		Rs	*Rs*
	By Subscription (2004)	17,500	
	Less: Subscriptions received for 2003	400	
		17,100	
	Less: Subscriptions received for 2005	600	
		16,500	
	Add: Subscriptions outstanding for 2004	500	
			17,000

3.During the year 2004, the expenses actually paid were Rs 3,250.

Find out the actual expenses chargeable to Income and Expenditure Account for the year ended 2004, if prepaid and outstanding are as follows:

Prepaid Expenses on 31.12.2003 Rs 300

Prepaid Expenses on 31.12.2004 Rs 400

Outstanding Expenses on 31.12.2003 Rs 450

Outstanding Expense on 31.12.2004 Rs 500

SOLUTION

Income and Expenditure Account
for the year ended 31st Dec., 2004

	Rs	*Rs*	
To Expenses Paid	3,250		
Add: Prepaid expeses in 2003	300		
Add: Outstanding expenses in 2004	500		
	4,050		
Less: Prepaid Expenses in 2004	400		
	3,650		
Less: Expenses Outstanding in 2003	450		
		3,200	

Problem 4

1. Subscriptions received as per Receipts and Payment Accounts during the year 2004 — Rs 15,960
2. Subscriptions received in advance for 2005, during 2004 — Rs. 1,500
3. Subscriptions outstanding on Dec. 2003 — Rs 750
4. Subscriptions received in advance *i.e.* for 2004, during 2003 — Rs 710
5. Subscriptions outstanding on 31st Dec. 2004 — Rs 500

SOLUTION

		Rs
Subscriptions as per Receipts and Payment Account		15,960
Add: Subscriptions received in 2003 for 2004		710
Add: Subscriptions outstanding on 31st Dec. 2004		500
	Rs	17,170
Less: Subscription received during 2004 for the year 2005	1,500	
Less: Subscriptions outstanding for 2003	750	2,250
Subscriptions to be credited to Income and Expenditure Account during 2004		14,920

Problem 5:

Calculate the amount of stationery to be debited to Income and Expenditure Account during 2004:

1.	Amount paid for stationery during the year 2004, as per Receipts and Payments Account	Rs 1,750
2.	Stock of stationery on 1.1.2004	Rs 150
3.	Paid advance for stationery on 31.12.2004	Rs 200
4.	Paid advance for stationery during Dec. 2003 but received stationery during the year 2004	Rs 250
5.	Creditors for stationery on 1.1.2004	Rs 370
6.	Stock of stationery on 31.12.2004	Rs 415
7.	Creditors for stationery on 31.12.2004	Rs 300

SOLUTIONS

	Rs	Rs
Amount paid for stationery as per Receipts and Payment Account		1,750
Add: Stock of stationery on 1.1.2004		150
Add: Paid advance during Dec. 2003 and ~~received~~ during 2004		250
Add: Creditors for stationery on 31.12.2004 (Stationery has been received but the payment is outstanding)		300
		2,450
Less: Paid advance for stationery 31.12.2004 (payment has been made but stationery not received)	200	
Less: Creditors for stationery 1.1.2004 (Stationery has been received during 2003 but the payment is made in 2004)	370	
Less: Stock of stationery on 31.12.2004 (Not consumed)	415	985
Amount of stationery to be debited to Income and Expenditure Account		1,465

6. Calculate the amount to be shown in Receipts and Payments Account for the year ended 31st Dec. 2004

1. Income and Expenditure Account shows a sum of Rs 7,500 against subscription during 2004.

2. Subscriptions outstanding at Dec. 2003—Rs 600.

3. Subscriptions received in advance in Dec. 2003—Rs 450

4. Subscriptions received in advance in Dec. 2004—Rs 270

5. Subscriptions outstanding at Dec. 2004—Rs 750

Solution:

Receipts and Payment Account
for the year ended 31st December 2004

Dr.	Rs	Rs	Cr.
To subscriptions as per Income and Expenditure Account	7,500		
Add: Subscriptions outstanding for 2003	600		
Add: Subscriptions received for 2005	270		
	8,370		
Less: Subscriptions received in 2003	450		
	7,920		
Less: Subscriptions outstanding in 2004	750		
		7,170	

Illustration 7:

From the following, find out the amount of subscriptions to be credited to Income and Expenditure Account for the year 2006.

Subscriptions received in 2006 – Rs. 48,000 which include Rs. 4,000 for 2005 and Rs. 8,000 for 2007.

Subscriptions due but not received at the end of the year 2006 were Rs. 20,000.

Subscriptions received in 2005 in advance for 2006 were Rs. 12,000

Solution:

Computations of subscriptions for 2006

	Rs
Subscriptions received during the year	48,000
Less: Received for previous year (2005)	4,000
	44,000
Less: Received for the next year (2007)	8,000
	36,000
Add: Outstanding subscriptions for 2006	20,000
	56,000
Add: Received in advance in 2005 for 2006	12,000
Subscriptions to be credited to Income and Expenditure Account for 2006	68,000

Types of Accounting Problems:

1. Preparation of Income and Expenditure Account and Balance Sheet from a given Receipts and Payment Account with additional information.

2. Preparation of Opening Balance Sheet and Closing Balance Sheet from a given Receipt and Payment Account and Income and Expenditure Account.

3. Preparation of Receipt and Payment account from a given income and Expenditure Account and other information given.

4. Income and Expenditure Account and Balance Sheet from a given Trial Balance with additional information.

1. Preparation of Income and Expenditure Account and Balance Sheet from a given Receipts and Payment Account with additional information:

The Income and Expenditure Account is simply another name for the Profit and Loss Account drawn up for a non-profit organisation. In this account, all losses and expenses relating to the period are debited and all gains and incomes relating to the same period are credited. It must be remembered that only the revenue items relating to the period are dealt within this Account.

In examinations, sometimes, Receipts and Payments Account is given and the students are required to prepare Income and Expenditure Account and in such situation, the following steps are to be followed:

1. Do not take the opening balance and closing balance of Cash in hand and at Bank.
2. Do not take Capital Receipts and Capital Expenditure.
3. Pick up only the revenue receipts and revenue payments and exclude the portions relating to previous and subsequent years.
4. Add the portions of incomes and expenses prepaid in the previous year on account of current year.
5. Add also the portions of incomes and expenses of the current year due but remaining unpaid.
6. Provide for depreciation, Reserve for doubtful debts etc. as needed in the problems.
7. Surplus or Deficit will be transferred to Capital Fund.

Problem 8. The Calcutta Cricket Club gives you the following information:

Dr. **Income and Expenditure Account for 2004** Cr.

	Rs			Rs
To Remuneration to Coach	4,500	By Donation and Subscriptions		25,500
To Wages	5,000	By Bar Room: Receipts:	3,000	
To Rent	2,500	Payments:	2,500	500
To Printing and Stationery	2,600	By Interest on Saving A/c		500
To Repairs	4,500	By Proceeds of Club:		
To Honorarium to Secretary	6,000	Night:	8,800	
To Depreciation on Equipment	4,700	Expenses:	4,000	4,800
To Surplus	1,500			
	31,300			31,300

Balance Sheet as on 31st Dec. 2004

31.12.2003	*Liabilities*		*31.12.2004*	*31.12.2003*	*Assets*	*31.12.2004*
Rs			*Rs*	*Rs*		*Rs*
	Expenses Unpaid:			1,000	Cas in hand	500
1,000	Printing and Stationery		800	3,000	Cash at Bank	1,000
	Wages		2,000	20,300	Savings Bank	21,100
4,000	Honorarium to Secretary		6,000	1,500	Subscriptions Outstanding	1,000
800	Subscriptions received in Advance		300	8,000	Equipment	17,500
28,000	Capital Fund	28,000				
	Entrance Fees	2,500				
	Surplus	1,500	32,000			
33,800			41,100	33,800		41,100

Prepare the Receipts and Payments Account of the Club for 2004. (*M.Com., Kolkata*)

Solution:

In the Books of Kolkata Cricket Club
Receipts and Payments Accounts
For the year ended 31st Dec. 2004

Dr.	Rs		Rs Cr.
To Balance b/d:		By Remuneration to Coach	4,500
Cash in hand	1,000	By Wages[4]	3,000
Cash at Bank:		By Rent	2,500
Current Account	3,000	By Printing and Stationery[2]	2,800
Savings Account	20,300	By Repairs	4,500
To Donations and Subscriptions[1]	25,500	By Honorarium to Secretary[3]	4,000
To Bar Room Receipts	3,000	By Bar Room Expenses	2,500
To Interest on Savings A/c	500	By Night Club Expenses	4,000
To Proceeds of Night Club	8,800	By Equipment[5]	14,200
To Entrance Fees	2,500	By Balance c/d:	
		Cash	500
		Cash at Bank:	
		Current Account	1,000
		Savings Account	21,100
	64,600		64,600

Workings:

		Rs.
I.	*Donations and Subscriptions received in 2004*	
	As per Income and Expenditure Account:	*25,500*
	Add: Outstanding on 31st Dec. 2003	*1,500*
		27,000
	Add: Received in advance for 2005	*300*
		27,300
	Less: Outstanding on 31st Dec. 2004	*1,000*
		26,300
	Less: Received in advance during 2003	*800*
		25,500

2.	*Printing and Stationery paid in 2004*	
	As per Income and Expenditure	*Rs 2,600*
	Less: Outstanding on 31st Dec. 2004	*800*
		1,800
	Add: Outstanding on 31st Dec. 2003	*1,000*
		2,800
3.	*Honorarium to Secretary paid in 2004*	
	As per Income and Expenditure	*Rs 6,000*
	Add: Outstanding on 31st Dec. 2003	*4,000*
		10,000
	Less: Outstanding on 31st Dec. 2004	*6,000*
		4,000
4.	*Wages paid in 2004*	
	As per Income and Expenditure	*Rs 5,000*
	Less: Outstanding on 31st Dec. 2004	*2,000*
		3,000
5.	*Purchase of Equipment in 2004*	
	Equipment on 31st Dec. 2004	*17,500*
	Add: Depreciation charged	*4,700*
		22,200
	Less: Opening Balance	*8,000*
		14,200

9. Calicut Sports Association extracts the following Receipts and Payments Account for the year ended 31st December 2004. From the particulars given, prepare Income and Expenditure Account for the year ended 31st December 2004.

Receipts and Payments Account
for the year ended 31st Dec. 2004

Dr.	Rs		Rs Cr.
To Balance b/d	1,125	By Newspapers	750
To Subscriptions	2,900	By Rent	250
To Tournament Fund	750	By Salaries	1,800
To Life Membership	1,000	By Office Expenses	1,200
To Enterance Fees	100	By Sports Equipments	1,150
To Donations for Building	1,500	By Tournament Expenses	450
To Sales of Newspapers	50	By Balance c/d	1,825
	7,425		7,425

Subscriptions outstanding on 31st December 2003 Rs 450 and on 31st December 2004 Rs 400. A subscription received includes Rs 100 on account of the year 2005.

Sports equipment was valued on 31st December 2003 at Rs 550 and on 31st December 2004 at Rs 1,090.

Office expenses include Rs 150 for 2003 whereas Rs 200 is still payable on this account for 2004.

Tournament Fund is treated as Capital Receipt. (B.Com., Calicut)

Solution:

Income and Expenditure Account
for the year ended 31st December 2004

Dr. Cr.

Expenditure		*Rs*	*Income*		*Rs*
To Newspaper		750	By Subscriptions:	2,900	
To Rent		250	Less: for 2003	450	
To Salaries		1,800		2,450	
To Office Expenses	1,200		Add: Outstanding (2004)	400	
Less: Paid for 2003	150			2,850	
	1,050		Less: Received for 2005	100	2,750
Add: Outstanding for 2004	200	1,250	By Entrance Fees		100
			By Sale of Newspaper		50
To Depreciation on Equipment:		610	By Excess Expenditure over Income		1,760
		4,660			4,660

Note: Life members' fee is capitalised. Tournament Expenses are shown separately.

POSSIBLE QUESTIONS
UNIT – II

PART - B

1. A company purchased Furniture for Rs.28,000. Depreciation is to be provided annually according to the Straight Line Method. The useful life of the furniture is 5 years and the residual value is Rs.2,000.
You are required to find out the amount of depreciation.

2. From the following particulars, find out the rate of depreciation, under Straight Line Method.
Cost of Fixed Asset Rs. 50,000
Residual Value Rs. 5,000
Estimated Life 10 years

4. Define Depreciation.
5. What is Fixed Asset?
6. What is residual value?
7. What is obsolescence?
8. What is outstanding expense?
9. What is prepaid expense?
10. What is accrued income?
11. What is income received in advance?
12. What is bad debt?
13. Write notes on Provision for bad and Doubtful debts.
14. Write notes on Provision for discount on Debtors.
15. Write notes on Provision for discount on Creditors.

PART - C

1. On 1 April, 2001, Excel Company Limited purchased a machine for Rs.56,000. On the date of purchase it was estimated that the effective life of the machine will be 10 years and after 10 years it's scrap value will be Rs.6,000. Prepare Machine Account and Depreciation Account for three years, Depreciation is charged on Straight Line Method. Accounts are closed on 31st March of every year.

2. A garment company purchased a Plant on 1 April 2001 for Rs.1,00,000. After having used it for three years it was sold for Rs.80,000. Depreciation is to be provided at the rate of 10% per annum on Fixed Instalment Method. Accounts are closed on 31st March every year. Find out the Profit or Loss on sale of Plant.

3. On 1st October 2000, a company purchased a plant for Rs.6,00,000. They spent Rs.40,000 on its erection. The firm writes off depreciation at the rate of 20% on Reducing Balance Method. The books are closed on 31st March every year. Prepare Plant account and Depreciation account for three years.

4. From the following balances as at 31st December 1994 of trader, prepare a Trading and Profit & loss A/c for the year 1994 and a Balance Sheet as on that date:

Debit Balances	Amount Rs.	Credit Balances	Amount Rs.
Salaries	5,500	Creditors	9,500
Rent	1,300	Sales	32,000
Cash	1,000	Capital	30,000
Debtors	40,000	Loans	10,000
Trade expenses	600		
Purchases	25,000		
Advances	2,500		
Bank balance	5,600		
	81500		**81500**

Adjustments:

(v) The closing stock amounted to Rs. 9,000.
(vi) One month's Salary is outstanding.
(vii) One month's rent has been paid in advance.
(viii) Provide 5% for doubtful debts.

5. From the following Trial Balance of Senthur Traders, prepare Trading and Profit & Loss Account for the year ending December 31, 2006 and Balance sheet as on that date:

Dr. Balance	**Rs.**	**Cr. Balance**	**Rs.**
Land & Building	60,000	Capital	96,000
Plant and Machinery	33,000	Sundry Creditors	15,000
Stock	12,000	Sales	60,000
Investment	15,000	Provision for Bad & Doubtful Debts	1,100
Purchases	45000	Loan	20,000
Wages	2000	Rent Received in advance	1,000
Carriage	2000	Commission Received	3,000
Salary	5000	Bills payable	15,000
Rent	2,000		
Cash at Bank	3000		
Sundry Debtors	30,000		
Discount	300		
Bad Debt	500		
Sales Returns	1300		

	2,11,100		**2,11,100**

Additional Information:

1. Closing stock valued at Rs. 12,000.
2. Bad Debt 500 and Provision for Bad & Doubtful Debts at 5%.
3. Salary outstanding Rs. 1000.
4. Commission Received in advance 1,000.
5. Depreciate Machinery @ 3% & land and Builders @ 2%.

6. **From the following, find out the amount of subscriptions to be credited to Income and Expenditure Account for the year 2006.**

Subscriptions received in 2006 – Rs. 48,000 which include Rs. 4,000 for 2005 and Rs. 8,000 for 2007.

Subscriptions due but not received at the end of the year 2006 were Rs. 20,000.

Subscriptions received in 2005 in advance for 2006 were Rs. 12,000

7. **Calculate the amount to be posted to Income and Expenditure Account for the year ended 2004:**

Receipts and Payments Account show that subscriptions received Rs 9,000. This account of subscriptions includes Rs 800 outstanding in the previous year and Rs 1,000 for the next year. Rs 2,000 is still outstanding for current year.

Reg. No……………………………

[16CMU101/16CCU101/16BPU101/16COU101]

KARPAGAM UNIVERSITY

Karpagam Academy of Higher Education
(Established Under Section 3 of UGC Act 1956)
COIMBATORE – 641 021
(For the candidates admitted from 2016 onwards)

B.Com., DEGREE EXAMINATION, NOVEMBER 2016

First Semester

COMMERCE/COMMERCE (COMPUTER APPLICATIONS)/ COMMERCE (BUSINESS PROCESS SERVICES)/ COMMERCE (CORPORATE SECRETARYSHIP)

FINANCIAL ACCOUNTING

Time: 3 hours Maximum : 60 marks

PART – A (20 x 1 = 20 Marks) (30 Minutes)
(Question Nos. 1 to 20 Online Examinations)

PART B (5 x 2 = 10 Marks) (2 ½ Hours)
Answer ALL the Questions

21. Define the term or "Accounting".
22. A company purchased a plant for Rs. 50,000. The useful life of the plant is 10 years and the residual value is Rs. 10,000. Find out the rate of depreciation under the straight line method.
23. What is hire purchase price?
24. Who is consignor and consignee?
25. Write the formula for calculating sacrificing ratio?

PART C (5 x 6 = 30 Marks)
Answer ALL the Questions

26. a. Journalise the following:
i) Ram started Business with cash Rs. 10000
ii) Paid salary to staff Rs. 500
iii) Sold goods to Sam for cash Rs. 5000
iv) Purchase from Ganesh Rs. 2500

(Or)

b. Prepare purchase and sales book

	Rs.		Rs.
Purchase goods from Balu	30,000	Sold goods to Jai	750
Sold goods to Sam	15,000	Bought goods from Raj	9,000
Bought goods from Gowri	13,500	Sold goods to Sathi	900
Sold goods to Tom	10,500		

27. a. A machine purchased on 1st July 1983 at a cost of Rs. 14,000 and Rs. 1,000 was spent for installation. The depreciation is 10% on original cost. The books are closed on 31st December each year. The machine was sold for Rs. 9,500 on 31st March 1986. Show the machinery Account.

(Or)

b. A company acquired a machine on 1.1.88 at a cost of Rs. 40,000 and spent Rs. 1,000 for its installation. The depreciation is charged at 10% under diminishing balance method. The books are closed on 31st December of each year. Show machinery a/c for 3 years.

28. a. On 1.1.2010 , Ravi purchased machinery on hire purchase system. The payment to be made Rs. 4,000 as down and Rs. 4,000 annually for 3 years. The cash price of machinery is Rs.14,900 and the rate of interest is 5%. Calculate the interest in each year's installment.

(Or)

b. What is Repossession? What are its types?

29. a. What are the features of consignment?

(Or)

b. Prepare joint venture a/c and joint venturer chand's a/c in the books of Ramu.

	Ramu	Chand
Goods supplied	60,000	30,000
Expenses paid	8,000	2,000
Sales proceeds	80,000	56,000

Sharing of P/L in the ratio of 2:1 between Ramu and Chand.

30. a. Calculate the amount of goodwill at 3 year's purchase of last 5 years average profits. The profits were:
1st year - Rs. 9600 2nd year – Rs. 14400 3rd year – Rs. 20000
4th year –Rs. 6000 5th year –Rs.10000.

(Or)

b. P and Q are partners in a firm sharing P/L in the ratio of 4:3. On 1st January 2011 R is admitted as partner and R brought Rs. 60,000 as capital and Rs. 14,000 for 1/3 share of goodwill. Calculate new sharing ratio and sacrificing ratio.

Reg. No................................

[14CMU201]

KARPAGAM UNIVERSITY

(Under Section 3 of UGC Act 1956)
COIMBATORE – 641 021
(For the candidates admitted from 2014 onwards)

B.Com. DEGREE EXAMINATION, JULY 2015

Second Semester

COMMERCE

FINANCIAL ACCOUNTING

Time: 3 hours Maximum : 60 marks

PART – A (10 x 2 = 20 Marks)
Answer any TEN Questions

1. What is depreciation?
2. State any two features of Straight line method of providing depreciation?
3. A company purchased a plant for Rs. 50, 000. The useful life of the plant is 10 years and the residual value is Rs.10, 000. Find out the rate of depreciation under the straight line method.
4. Write short note on Shortworkings.
5. What is Cum- Interest?
6. 1, 000 8% government bonds are purchased at Rs. 97 each. The brokerage and stamp duty amount to Rs.2 and Re.1 for each bond respectively. Show the journal entry.
7. Define single entry system?
8. What is a statement of affairs?
9. Find out profit from the following data

Capital at the beginning of the year	Rs. 8,00,000
Drawings during the year	Rs. 1,80,000
Capital at the end of the year	Rs. 9,00,000
Capital introduced during the year	Rs. 50,000

10. Give brief note on departmental accounts?
11. What are 'direct expenses' in the context of departmental accounts?
12. Give short note on branch accounts.
13. What is Hire purchase?
14. Explain installment?
15. Explain briefly the down payment.

PART B (5 X 8= 40 Marks)
Answer ALL the Questions

16. a. A company leased a colliery on 1-1-92 at a minimum rent of Rs. 20,000 merging into a royalty of Rs.1.50 per tonne with power recoup shortworkings

over first years of the lease. The output of the colliery for the first four years was 9,000 tonnes, 12,000 tonnes, 16,000 tonnes, 20,000 tonnes respectively. Give ledger accounts in the books of lessee.

Or

b. Mr. Ilayaraja furnishes the following details relating to his holding in 6% Government bonds:

Opening balance (face value Rs.1, 20,000) cost Rs. 1, 18,000

1-3-1996	200 unites purchased ex-interest Rs. 98.
1-7-1996	sold 400 units ex-interest out of the original holding at Rs.100.
1-10-1996	purchased 100 units at Rs.98.
1-11-1996	sold 400 units ex-interest at Rs.99 out of original holding.

Interest dates are 30th September and 31st March. Mr. Ilayaraja closes his books every 31st December. Show the investment account as it would appear in his books.

17. a. Mr. Mohan Kumar keeps his books of accounts under single entry system. His financial position on 31-12-1990 and 31-12-1991 was as follows:

	1990 Rs.	1991 Rs.
Cash	9,860	800
Stock in trade	38,520	57,020
Plant & Machinery	54,420	61,000
Bills Receivable	------	16,480
Sundry Debtors	24,840	43,940
Sundry Creditors	72,040	80,000
Furniture	4,960	5,220
Drawings	------	5,000

During the year he introduced additional capital of Rs. 20,000. From the above particulars prepare a statement of Profit and Loss of Mr. Mohan kumar for the year ended 31-12-1991.

Or

b. From the following details, findout the net credit sales for the year.

Opening balance of sundry debtors (Dr)	20,000
Cheque collection during the year	1,80,000
Cash collection during the year	25,000
B/R received during the year	5,000
Closing balance of sundry debtors (Dr)	24,000
Bad debts written off	2,500
Discount allowed	1,000
Goods returned by customers	2,500
Cheques dishonoured	500

18. a. Manian Ltd of Calcutta has a branch of Patna. Goods are invoiced to the Patna Branch the selling price being cost plus 25%.

The Patna branch keeps its own sales ledger and transmits all cash received to

Calcutta. All expenses are paid from Calcutta. From the following details prepare the Patna Branch a/c for the year 1989

Stock (01.01.89) (invoice price)	1,250
Stock (31.12.89) (invoice Price)	1,500
Debtors (01.01.89)	700
Debtors (31.12.89)	900
Cash sales for the year	5,400
Credit sales for the year	3,500
Goods invoiced to Calcutta	9,100
Rent	400
Wages	340
Sundry expenses	80

Or

b. The following purchases were made by a business house having three departments:

DEPT A	1,000 units	
DEPT B	2,000 units	at a total cost of Rs. 1,00,000
DEPT C	2,400 units	

Stocks on 1st January were

DEPT A	120 units
DEPT B	80 units
DEPT C	152 units

Sales were

DEPT A	1,020 units at Rs. 20 each
DEPT B	1,920 units at Rs. 22.50 each
DEPT C	2,496 units at Rs. 25 each.

The rate of gross profit is the same in each case. Prepare the Departmental trading account.

19. a. On 1-1-86, X purchased Machinery on hire purchase system. The payment is to be made Rs.4,000 down (on signing of the contract) and Rs.4,000 annually for three years. The cash price of the machinery is Rs.14,900 and the rate of interest is 5%. Calculate the interest in each year's instalment.

Or

b. What is instalment purchase system? Describe the characteristics instalment purchase system.

20. **Compulsory : -**

A machine purchased on 1st July 1983 at a cost of Rs.14, 000 and Rs.1, 000 was spent on its installation. The depreciation is written off at 10% on the original cost every year. The books are closed on 31st December every year. The machine was sold for Rs.9, 500 on 31st March 1986. Show the machinery account for all the years.

Time: 3

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[11CMU201]

KARPAGAM UNIVERSITY

(Under Section 3 of UGC Act 1956)
COIMBATORE – 641 021
(For the candidates admitted from 2011 onwards)

B.Com. DEGREE EXAMINATION, APRIL 2015

Second Semester

COMMERCE

FINANCIAL ACCOUNTING

Time: 3 hours Maximum : 100 marks

PART – A (15 x 2 = 30 Marks)
Answer ALL the Questions

1. What are the factors to be considered for determining the amount of depreciation?
2. What is the formula for calculating the rate of depreciation?
3. What are the features of written down value method of providing depreciation?
4. Given the cost of the asset Rs.25,000 and scrap value Rs.5,000 and estimated life of the asset is 5 years, what is the rate of depreciation?
5. What do you mean by annuity method of depreciation?
6. What is royalty?
7. Explain the meaning of shortworkings?
8. What do you mean by recoupment?
9. Who is Landlord?
10. What is a statement of affairs?
11. What do you mean by minimum rent?
12. What is Hire purchase?
13. What is 'cash price?'
14. What is meant by 'Hire purchase price'?
15. What is 'down payment'?

PART B (5 X 14= 70 Marks)
Answer ALL the Questions

16. a. On 1st January 2003 machinery was purchased by X for Rs. 50,000. On 1st July 2004, additions were made to the extent of Rs. 30,000. On 1st April 2005, further additions were made to the extent of Rs. 6,400. On 30th June 2004 machinery, original value of which was Rs. 8,000 on 1st January 2003, was sold for Rs. 6,000. Depreciation is charged at 10% p.a on written down value method. Show the machinery account for the three years in the books of Mr. X. He closes his books on 31st December.

Or

b. On 01.01.01 a company brought machinery costing Rs. 70,000. It is estimated that its working life is 10 years at the end of which it will fetch Rs. 10,000. Additions are made on 1.1.02 to the value of Rs. 40,000 (Residual value Rs. 4,000). More additions are made on 01.07.03 to the value of Rs. 20,000 (breakup value Rs.2,000) The working life of both the additional machinery is 20 years. Show the machinery account for the first four years, if depreciation is written off according to the straight line method. The accounts are closed on 31st Dec every year.

17. a. A Company leased a colliery on 01.01.92 at a minimum rent of Rs. 20,000 merging into a royalty of Rs. 1.50 per tone with power to recoup shortworkings over the first four years of the lease. The output of the colliery for the first four years was 9,000 tonnes, 12,000 tonnes, 16,000 tonnes and 20,000 tonnes. Give the journal entries for the four years in the books of the lessee.

Or

b. On 01.01.1982 Geetha granites Ltd leased a piece of land agreeing to pay a minimum rent of Rs.2,000 in the first year, Rs. 4,000 in the second year and thereafter Rs. 6,000 per annum merging into a royalty of 40 paise per tonne with power to recoup shortworkings over the first three years only. The figures of the annual output for the four years to 31st December 1985 were 1,000, 10,000, 18,000, and 20,000 tonnes respectively. Record these transactions in the ledger of the company.

18. a. Calculate the missing figures :

Profit made during the year	2,400
Capital at the end of the year	8,000
Capital introduced during the year	2,000
Drawings	1,200
Capital in the beginning	?

Or

b. Sharma commenced business on 1st January 1990 with a capital of Rs. 20,000. He immediately bought furniture & fixtures for Rs. 4,000. On 30th June 1990, he borrowed Rs. 10,000 form his wife @ 9% p.a(interest not yet paid) and introduced a further capital of his own amounting to Rs. 3,000. Sharma withdrew at the rate of Rs. 600 p.m at the end of each month for household expenses. On 31st December 1990 his position was as follows:
Cash in hand Rs. 5,600; Sundry debtors Rs. 9,600; Stock Rs. 13,600; Bills Receivables Rs. 3,200; Sundry creditors Rs. 1,000 and owing for Rent Rs. 300; Furniture and fixtures to be depreciated by 10% . Ascertain the profit or loss made by Mr. Sharma during the year 1990.

19. a. Lata shoe company opened a branch at Madras on 01.01.89. From the following particulars prepare the Madras Branch account for the year 1989 and 1990

	1989	1990
Goods sent to Madras branch	15,000	45,000
Cash sent to branch for		
Rent	1,800	1,800
Salaries	3,000	5,000
Other expenses	1,200	1,600
Cash received from the branch	24,000	60,000
Stock on 31st December	2,300	5,800
Petty cash in hand on 31st Dec	40	30

Or

b. Manian Ltd of Calcutta has a branch of Patna. Goods are invoiced to the Patna Branch the selling price being cost plus 25%.
The Patna branch keeps its own sales ledger and transmits all cash received to Calcutta. All expenses are paid from Calcutta. From the following details prepare the Patna Branch a/c for the year 1989

Stock (01.01.89) (invoice price)	1,250
Stock (31.12.89) (invoice Price)	1,500
Debtors (01.01.89)	700
Debtors(31.12.89)	900
Cash sales for the year	5,400
Credit sales for the year	3,500
Goods invoiced to Calcutta	9,100
Rent	400
Wages	340
Sundry expenses	80

20. a. The following purchases were made by a business house having three departments :

DEPT A	- 1,000 units	
DEPT B	2,000 units	at a total cost of Rs. 1,00,000
DEPT C	2,400 units	

Stocks on 1st January were

DEPT A	120 units
DEPT B	80 units
DEPT C	152 units

Sales were

DEPT A	2020 units at Rs. 20 each
DEPT B	3920 units at Rs. 22.50 each
DEPT C	1496 units at Rs. 25 each.

The rate of gross profit is the same in each case. Prepare the Departmental trading account.

Or

b. The following information is given by Balan, a merchant for the year ended 31.12.96

Sales Dept I	70,000
Dept II	30,000
Stock(01.01.96)	
Dept I	3,400
Dept II	1,100
Debtors	23,000
Office furniture	1,080
Rent	1,800
Insurance	2,400
Purchases	
DEPT I	43,000
DEPT II	25,000
Salary	5,400
Commission	2,200
Advertisement	5,800
Bank Charges	120
Stationery	2,700
Wages	10,000

Provide depreciation at 10% on furniture. Bad debts Rs. 300 . Prepare the Departmental Profit and Loss account.

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[12CMU201]

KARPAGAM UNIVERSITY

(Under Section 3 of UGC Act 1956)

COIMBATORE – 641 021

(For the candidates admitted from 2012 onwards)

B.Com. DEGREE EXAMINATION, APRIL 2015

Second Semester

COMMERCE

FINANCIAL ACCOUNTING

Time: 3 hours Maximum: 100 marks

PART A (15 X 2 = 30 Marks)
Answer ALL the Questions

1. What is the formula for calculating the rate of depreciation under straight line method?
2. A company purchased Furniture for Rs.28,000. Depreciation is to be provided annually according to the Written down value method. The useful life of the furniture is 3 years and the residual value is Rs.2,000. Rate of depreciation is 10%. You are required to find out the amount of depreciation.
3. What is scrap value or residual value?
4. Give a short note on 'Cum interest price'.
5. What is the meaning of 'shortworkings'?
6. From the following information compute the amount payable to landlord.
   Royalty: 50 paise per tonne of coal
   Minimum Rent: Rs.30,000 p.a
   Output: 1st year : 10,000 tonnes
   2nd year : 48,000 tonnes
   3rd year : 80,000 tonnes
   Shortworkings are recoverable during the first three years of lease.
7. From the following information, you are required to calculate total purchases:

	Rs.
Cash purchases	17,000
Creditors as on April 1, 2002	8,000
Cash paid to creditors	31,000
Purchases return	1,000
Creditors as on March 31, 2003	13,400

8. Calculate the profit of the concern under the statement of affairs method from the details given below:

Opening capital	Rs. 1,60,000
Closing capital	Rs. 1,80,000
Drawings	Rs. 36,000
Additional Capital	Rs. 10,000

9. What is conversion method?
10. Mixed goods were purchased for Rs.1,00,000 and later they were assorted into three categories X,Y,Z as follows:
    X 1,000 - Selling price Rs.20 each
    Y 2,000 - Selling price Rs.22.50 each
    Z 2,400 - Selling price Rs.25 each
    All categories yield the same rate of profit. Calculate the purchase price of each category.
11. State any two objectives of Branch Accounts?
12. Give any two differences between departments and branches.
13. What is the meaning of deferred instalment system?
14. Distinguish between cash price and hire purchase price.
15. Write a short note on repossession.

PART B (5 x 14=70 Marks)
Answer ALL the Questions

16. a. Deepak Manufacturing Company purchased on 1st April 2002, Machinery for Rs.2,90,000 and spent Rs.10,000 on it's installation. After having used it for three years it was sold for Rs.2,00,000. Depreciation is to be provided every year at the rate of 15% per annum on the Fixed Instalment method. Pass the necessary journal entries, prepare machinery account and depreciation account for three years ends on 31st March every year.

    Or

    b. Limited company purchased a Machinery on 1.6.2001 for Rs.2,10,000. On 1st October 2003, it purchased another machinery for Rs.1,00,000. On 1st October 2003, it sold off the first machinery purchased on 1.6.2001 for Rs.1,80,000. Accounts are closed every year on 31st March. Depreciation is written off at 10% per annum on Diminishing Balance Method. Prepare Machinery account and Depreciation account for the first three years.

17. a. A Company leased a colliery on 01.01.92 at a minimum rent of Rs. 20,000 merging into a royalty of Rs. 1.50 per tone with power to recoup shortworkings over the first four years of the lease. The output of the colliery for the first four years was 9,000 tonnes, 12,000 tonnes, 16,000 tonnes and 20,000 tonnes. Give the journal entries for the four years in the books of the lessee.

    Or

    b. Ramu took a lease of a mine for a period of 20 years. Royalty payable is Rs. 1 per tonne subject to a minimum rent of Rs. 12,000 per annum. The shortworkings are recoupable during the first three years of the lease. The output was
    1990 - Nil
    1991 – 4,000 tonnes.
    1992 – 20,000 tonnes
    1993 – 40,000 tonnes.
    Give the journal entries. Shortworkings account and Landlord's account in the books of Ramu.

18. a. Find out the purchases and sales from the following details by making the necessary accounts.

	Rs.
Opening balance of debtors	30,000
Opening balance of creditors	10,000
Collection from Debtors	1,60,000
Discount Received	2,500
Bad Debts	1,000
Payment to Creditors	14,000
Discount allowed	1,500
Returns inwards	2,000
Returns Outwards	3,000
Cash Purchases	6,000
Cash Sales	10,000
Closing balance of debtors	35,000
Closing balance of creditors	15,000

Or

b. Mr. James commenced business on 1.4.2004 with a Capital of Rs. 75,000. He immediately bought furniture for Rs. 12,000. During the year, he borrowed Rs. 15,000 from his wife as loan. He had withdrawn Rs. 21,600 for his family expenses. From the following particulars you are required to prepare Trading and Profit & Loss A/c and Balance Sheet as on 31.03.2005.

	Rs.
Cash received from Sundry debtors	1,21,000
Cash paid to Sundry creditors	1,75,000
Cash Sales	1,00,000
Cash Purchases	40,000
Carriage inwards	4,500
Discount allowed to Sundry debtors	4,000
Salaries	5,000
Office Expenses	4,000
Advertisement	5,000
Closing balance of Sundry debtors	75,000
Closing balance of Sundry creditors	50,000
Closing Stock	35,000
Closing cash balance	43,900

Provide 10% depreciation on furnitures.

19. a. The following purchases were made by a business house having three departments :

Dept A - 1,000 units
Dept B - 2,000 units
Dept C - 2,400 units

Dept A,B and C at a total cost of Rs.1,00,000

Stocks on 1st January were

Dept A - 120 units
Dept B - 80 units
Dept C - 152 units

Sales were

Dept A - 1020 units at Rs.20 each
Dept B - 1920 units at Rs.22.50 each
Dept C - 2496 units at Rs.25 each.

The rate of gross profit is the same in each case. Prepare the Departmental trading account.

Or

b. Kannan Ltd of Chennai has a branch at Patna. Goods are invoiced to the Patna Branch the selling price being cost plus 25%.
The Patna branch keeps its own sales ledger and transmits all cash received to Calcutta. All expenses are paid from Calcutta. From the following details prepare the Patna Branch a/c for the year 1989

	Rs.
Stock (01.01.89) (invoice price)	2,500
Stock (31.12.89) (invoice Price)	3,000
Debtors (01.01.89)	900
Debtors(31.12.89)	600
Cash sales for the year	15,400
Credit sales for the year	13,500
Goods invoiced to Calcutta	9,100
Rent	1,400
Wages	340
Sundry expenses	80

20. a. From the following details of a businessman who sells goods of small value at cost plus 50%. Prepare Hire Purchase Trading A/c.

01-01-90	Stock out with the customers at H.P Price	9,000
	Stock at shop at cost price	18,000
31-12-90	Goods worth Rs.500 repossessed (Inst. Not due Rs.2,000)	
	Cash received from customers	60,000
	Purchases made during the year	60,000
	Stock at cost at shop (excluding the goods repossessed)	20,000
	Instalments due but not received	9,000
	Stock out at Hire-Purchase price with the customers	30,000

Or

b. M Ltd sold a lorry to Arun on Hire purchase system. The cash price was Rs.7,45,000. Rs.2,00,000 was to be paid on delivery and the balance in three instalments of Rs.2,00,000 each at the end of each year. M Ltd charged interest @ 5% p.a. Arun depreciates the lorry at 10% per annum on reducing balance method. Calculate the interest and prepare journal entries in the books of Arun.

Reg. No..................................

[11CMU201]

KARPAGAM UNIVERSITY

(Under Section 3 of UGC Act 1956)
COIMBATORE – 641 021
(For the candidates admitted from 2011 onwards)

B.Com. DEGREE EXAMINATION, APRIL 2012

Second Semester

COMMERCE

FINANCIAL ACCOUNTING

Time: 3 hours | Maximum : 100 marks

PART – A (15 x 2 = 30 Marks)
Answer ALL the Questions

1. What is depreciation?
2. What is general reserve?
3. Define the term Provision.
4. What is Current Investment?
5. What is Short working?
6. What is cum-interest price?
7. What is single entry?
8. How do you ascertain profit under net worth method of single entry?
9. Write any two differences between single entry and double entry?
10. What is branch accounting?
11. What do you mean by installment purchase system?
12. Who is Hire Vendor?
13. What is WDV method of depreciation?
14. What is P&L account?
15. What are departmental accounts?

PART B (5 X 14= 70 Marks)
Answer ALL the Questions

16. a. A machine purchased on 1st July 1983 at a cost of Rs. 14,000 and Rs. 1,000 was spent on its installation. The Depreciation is written off at 10% on the original cost every year. The books are closed on 31st December each year. The machine was sold for Rs. 9,500 on 31st March 1986. Show the machinery account for all the three years.

Or

b. A firm purchases a leasehold property for a period of 5 years for Rs.10,000 on 1.1.95. It decides to write off the lease by the annuity method presuming the rate of interest at 5% p.a. The annuity table shows that the annual amount necessary to write off Re.1 at 5% p.a. is Re.0.230976. You are required to prepare the leasehold property account for five years

17. a. Mr. Investor furnishes the following details relating to his holding in 6% Government bonds:

Opening balance nominal Rs. 60,000 cost Rs. 59,000

1.3.96	100 units purchased ex-interest Rs. 98
1.7.96	Sold 200 ex-interests out of the original holding at Rs. 100
1.10.96	Purchased 50 units at Rs. 98 cum-interest.
1.11.96	Sold 200 units ex-interest at Rs. 99 out of the original holdings

Interest dates are 30th September and 31st March. Mr. Investor closes his books every 31st December. Show the investment account.

Or

b. Maniram Singh who had patented a circular TV antenna, granted Sky Enterprise a license for ten years to manufacture and sell the product on the following terms.

i. Sky enterprise was to pay Mainramsing a royalty of Rs. 10 for each antenna sole.

ii. The minimum royalty for each of the first three years covered by the license was to be Rs. 50,000. After these years royalties were to be payable on the actual numbers of antennas sold.

iii. If royalties on antenna sold amounted to less than Rs. 50,000, Sky enterprise was entitle to deduct the deficiencies from royalties in excess of the sum payable in respect of each of the first three years of the agreement.

The number of antennas sold in the first four years was as follows:

Year ended 31st March 1994	4300
1995	4900
1996	5450
1997	5250

You are required to prepare the following ledger accounts recording the above transactions in respect of royalties in the books of sky enterprise:

a. Royalites account b. Short workings account c. The account of Maniram Singh

18. a. Kannan kept his books on single entry system. His position on 31.12.1992 was as follows:

Cash in hand Rs. 250
Bank Rs. 2,750
Stock Rs. 21,000
Debtors Rs. 7,500
Furniture Rs. 1,750
Machinery Rs. 15,000
Creditors Rs. 18,000

He introduced new capital of Rs. 5,000 during the year and also withdrew @ Rs. 600 every month.

His Position on 31.12.1993 was as follows:

Cash Rs. 300
Bank Rs. 2,200
Stock Rs. 18,000
Debtors Rs. 12,000
Machinery Rs. 25,000
Creditors Rs. 23,000

From the above particulars prepare a statement of profit.

Or

b. Mr. George started a business as cloth merchant on 1st January 2004 with a capital of Rs. 10,000. On the same day he purchased furniture for cash Rs. 3,000. From the following information obtained from the books kept by single entry prepare a trading and profit and loss account for the year ending 31st December 2004 and Balance sheet as on that date.

Particulars	Rs.
Sales (inclusive of cash sales Rs. 7,000)	17,000
Purchases (inclusive of cash purchase Rs. 4,000)	15,000
Mr. George's Drawings	1,200
Salaries to Staff	2,000
Bad debts written off	500
Business expenses	700

Mr. George took cloth worth Rs. 500 from the shop for private use, and paid Rs. 200 to his son but omitted to record these transactions in his books. On the 31st December 2004, his sundry debtors were Rs. 5,200 and sundry creditors Rs. 3,600. Stock in hand valued on 31st December 2004 was Rs. 6,500.

19. a. M/s. Rohit brothers are having their Head Office at Delhi and branch at Meerut The following are the transactions of the Head Office with the Branch for the year ended 31st August 2002.

Stock at branch as on 1.9.2001		30,700
Debtors at the branch as on 1.9.2001		16,500
Petty Cash as on 1.9.2001		500
Goods supplied to the branch		1,51,200
Remittances from branch:		
Cash sales	10,500	
Realization of debts	1,67,740	1,78,240
Amount sent to branch:		
Salary	7,400	
Rent	2,400	
Petty Cash	3,000	12,800
Stock at branch as on 31.8.2002		23,150
Sundry debtors as on 31.8.2002		50,460
Petty cash as on 31.8.2002		750

Show the Meerut Branch Account in the books of the Head Office.

Or

b. Mohan sells goods on H.P System at cost plus 60% from the following particular prepare Hire Purchase Trading Account.

Jan. 1	Goods out on H.P System at H.P. Price	Rs. 32,000
Dec.31	Installments not due and unpaid	Rs. 72,000
Dec.31	Installments due and unpaid	Rs. 4,000

The following transactions took place during the year:

a. Goods sold on H.P price — Rs. 1,60,000
b. Cash received from customers — Rs. 1,12,000
c. Goods received back on default valued at (installment due Rs. 4,000) — Rs. 800

20. a. A company whose accounting year is the calendar year, purchased on 1.1.93 a machine for Rs. 40,000. It purchased further machinery on 1st Oct.1993 for Rs. 20,000 and on 1st July, 1994 for Rs. 10,000 on 1.7.1995, one fourth of the machinery installed on 1.1.1993 became obsolete and was sold for Rs. 6,800. Show the machinery account in the books of the company for all the three years under Diminishing Balance Method. Depreciation is to be provided at 10% p.a.

Or

Semester I

17CMU101	FINANCIAL ACCOUNTING	L	T	P	C
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Scope

Financial Accounting has wide scope and area of application. It is not only for the business world, but spread over in all the spheres of the society in all professions. As accounting is a dynamic subject, its scope and area of operation have been always increasing, keeping pace with the changes in socio-economic changes.

Objective

The objective of this paper is to help students to learn the basic concepts and conventions of accounting and basic accounting framework, to know about the final accounts of the company, and promoting students to know the various accounting systems

Unit I

Theoretical Framework - Accounting information system: Users and their Needs. Characteristics of Accounting - Functions, Advantages and Limitations of Accounting. Branches of Accounting- Bases of Accounting: - Concepts and Conventions –Accounting Standards – Journal- Ledger – Subsidiary Books – Trial Balance

Unit II

Business Income – Revenue Recognition – Depreciation – methods – straight line method – Diminishing Balance Method – Change in method of depreciation – Final Accounts – preparation of final accounts for non- corporate business entities

Unit III

Accounting for Hire-Purchase and Installment System- Transactions - Journal Entries and ledger accounts including Default and Repossession.

Unit IV

Consignment - Features, Accounting treatment - Consignor and Consignee. **Joint Venture -** Accounting procedures: Joint Bank Account, Records Maintained by Co-venturer of (a) all transactions (b) only his own transactions. (Memorandum joint venture account).

Unit V

Accounting for Partnership - Valuation of Goodwill – Calculation of Profit Sharing Ratio – Admission – Retirement of a Partner.

Note:

Distribution of marks - 20% theory and 80% problems

Suggested Readings

Text Book

1. Reddy T.S.& Moorthy.A. (2012), *Financial Accounting*, Chennai, Margham Publications.

Reference Books:

1. Shukla, M.C. Grewal T.S. & Gupta. S.C. (2013) Revised Edition, *Advanced Accounts.* New Delhi.Vol.-I. S. Chand & Co.,
2. Maheshwari, S.N. & Maheshwari S. K. (2013) *Financial Accounting*. New Delhi Vikas Publishing House.
3. Deepak Sehgal. (2014) *Financial Accounting*. New Delhi, Vikas Publishing House,
4. Tulsian, P.C. (2004) *Financial Accounting*, Pearson Education.
5. *Compendium of Statements and Standards of Accounting*.(2012) New Delhi, The Institute of Chartered Accountants of India,

Unit III : Accounting for Hire-Purchase and Installment System

Accounting for Hire-Purchase and Installment System- Transactions - Journal Entries and ledger accounts including Default and Repossession.

Introduction

By now you must have been familiar to various aspects of Book-keeping and Accountancy. You must have understood the concept of double entry system. Now-a-days the books of accounts are maintained under double entry system by all big business houses and multinationals. You know that the sales is the Key factor of success of business. The profit of a business always depends on the volume of its sales. A big business house can effect sales on cash basis as well as on credit basis. The credit sales are very important and essential for the growth of business. The sale proceeds under such sales are not immediately collected but are collected under certain arrangements such as Hire-purchase system or Instalment payment system or collection after a certain period together with interest on outstanding balances. Hire-purchase system is the most secured and effective tool of collecting the proceeds of a credit sale.

Meaning and Concept of Hire-purchase system

Hire-puchase system is a special system of purchase and sale of goods. Under this system purchaser pays the price of the goods in instalments. The instalments may be annual, six monthly, quarterly, monthly fortnightly etc. Under this system the goods are delivered to the purchaser at the time of agreement before the payment of instalments but the title on the goods is transferred after the payment of all instalments as per the hire-purchase agreement. The special feature of a hire-purchase transaction is that the payment of every instalment is treated as the payment of hire charges by the purchaser to the hire vendor till the payment of the last instalment.. After the payment of the last instalment, the amount of various instalments paid is appropriated towards the payment of the price of the goods sold and the ownership or the goods is transferred to the purchaser. Thus hire-purchase means a transaction where the goods are sold by vendor to the purchaser under the following conditions :

- the goods will be delivered to the purchaser at the time of agreement.
- the purchaser has a right to use the goods delivered.
- the price of the goods will be paid in installments.
- every installment will be treated to be the hire charges of the goods which is being used by the purchaser.
- if all installments are paid as per the terms of agreement , the title of the goods is transferred by vendor to the purchaser.

- if there is a default in the payment of any of the instalments, the vendor will take away the goods from the possession of the purchaser without refunding him any amount received earlier in the form of various installments.

Characteristics of Hire-purchase system

Before discussing the characteristics of hire-purchase system, we must know what is a hire purchase agreement and what are the contents of a hire-purchase agreement. Hire-purchase agreement means a contract between the hire vendor and the hire purchaser regarding the sale of goods under certain conditions. Usually every hire-purchase agreement shall contain the following terms:

- the cash price of the goods, cash price means the price at which goods may be purchased against cash payment.
- the hire-purchase price, hire purchase price means the total amount which is payable by the hire-purchaser under the agreement.
- the date on which the hire-purchase agreement will commence.
- the description of the goods that will be delivered to the hire-purchaser at the commencement of the agreement.
- the number of instalments to be paid by the hire-purchaser along with the amount of each instalment and the date of payment of each instalment.
- the down payment if any, the down payment means the amount which is required to be paid by hire-purchaser to the hire vendor at the time of commencement of hire-purchase agreement.
- the rate interest charged by the hire vendor (optional).

Characteristics of Hire-Purchase System

The characteristics of hire-purchase system are as under

- Hire-purchase is a credit purchase.
- The price under hire-purchase system is paid in instalments.
- The goods are delivered in the possession of the purchaser at the time of commencement of the agreement.
- Hire vendor continues to be the owner of the goods till the payment of last instalment.
- The hire-purchaser has a right to use the goods as a bailer.
- The hire-purchaser has a right to terminate the agreement at any time in the capacity of a hirer.

- The hire-purchaser becomes the owner of the goods after the payment of all instalments as per the agreement.
- If there is a default in the payment of any instalment, the hire vendor will take away the goods from the possession of the purchaser without refunding him any amount.

Difference between Hire-purchase system and Instalment payment system

Instalment Payment System is system of purchase and sale of goods in which title of goods is immediately transferred to the purchaser at the time of sale of goods and the sale price of the goods is paid in instalments. In the event of default in payment of any instalment, the seller has no right to take back goods from the possession of the purchaser. He can file a suit for the recovery of the outstanding balance of the price of goods sold. The followings are the differences between Hire-purchase system and Instalment payment system:

- In Hire-purchase system, the transfer of ownership takes place after the payment of all instalments while in case of Instalment payment system, the ownership is transferred immediately at the time of agreement.
- In Hire-purchase system, the hire-purchase agreement is like a contract of hire though later on it may become a purchase after the payment of last instalment while in Instalment payment system, the agreement is like a contract of credit purchase.
- In case of default in payment , in Hire-purchase system the vendor has a right to back goods from the possession of the hire-purchaser while in case of Instalment payment system, the vendor has no right to take back the goods from the possession of the purchaser; he can simply sue for the balance due.
- In Hire-purchase system, if the purchaser sells the goods to a third party before the payment of last instalment, the third party does not get a better title on the goods purchased. But in case of Instalment payment system, the third party gets a better title on the goods purchased.
- In Hire-purchase system the provisions of the Hire-purchase Act apply to the transaction while in case of Instalment payment system, the provisions of Sale of Goods Act apply to the transaction.

Accounting In the books of Hire-purchaser

- There are two methods of accounting in the books of Hire-purchaser. Their detailed description is as under:-
- **Asset Accrual Method:** Under this method it is considered that the hire-purchaser is the owner of the asset up to

the value of the cash price paid by him in the from of down payment or the cash price paid included in various instalments. The following journal entries are recorded under this method.

- (i)**On taking the delivery of asset:**
- No entry is recorded.
- (ii)**On making the down payment (if any)**
- Asset A/c Dr. (Amount of down payment)
- To Cash/Bank A/c.
- (iii)**On becoming the instalment due**
- Asset a/c. Dr (Balancing figure)
- Intt. A/c. Dr. (Amt. of Intt.)
- To Hire-Vendor A/c. (Amt. of Instalment)
- (iv)**On payment of instalment:**
- Hire-Vendor A/c Dr. (Amt. of Instalment)
- To Cash/Bank A/c.
- (v)**On charging the Depreciation:**
- Depreciation A/c Dr. (Amt. of Depreciation)
- To Asset A/c.
- (vi)**On Transfer of interest and depreciation to P/L A/c:**
- P/L A/c. (Total amt.)
- To Interest A/c (Bal. of Intt. A/c.)
- To Depreciation A/c. (Bal. of Dep. A/c.)

- **Under Total Assets Value Method:** Under this method of accounting in the books of hire-purchaser, is done on the assumption that the ownership of the asset is also transferred to the purchaser with the delivery of goods. The following journal entries are recorded under this method.
- (i)**On taking the delivery of assets at the time of agreement:**

- Asset A/c Dr. (Cash price of Asset)
- To Hire vendor A/c.

- (ii)**On making the down-payment (if any):**

- Hire-Vendor....... A/c. Dr. (Amount of down payment)
- To Cash/Bank A/c

- (iii)**On becoming the instalment due:**

- Interest A/c. Dr. (Amount of interest)
- To Hire-Vendor A/c

- (iv)**On payment of instalment:**

- Hire-Vendor a/c Dr. (Amount of instalment)
- To Cash/Bank A/c

- (v)**On charging the depreciations:**

- Depreciation A/c. Dr. (Amount of depreciation)
- To Asset A/c.

- (vi)**On Transfer of interest and depreciation to P/L A/c:**

- P/L A/c. Dr. (Total)

- To Interest A/c. (Bal. of Intt. A/c.)
- To Depreciation A/c. (Bal. of Dep. A/c.)

- **Posting in Ledger Accounts:** After passing journal entries under any of the methods discussed above, the following ledger accounts are opened in the ledger and the postings are made accordingly.
- (i) Asset A/c. (e.g. Trucks A/c, Machinery A/c. etc.)
  (ii) Vendor's A/c.
  (iii) Interest A/c.
  (iv) Depreciation A/c.
- Note: Before recording the entries the amounts of interest and depreciation will be calculated in two separate tables showing the calculations of interest and depreciation.
- **Calculation of Interest**
- The total payment made under hire-purchase system is more than cash price. In fact, this excess of payment over the cash price is interest. It is very essential to calculate interest because the amount paid for interest is charged to revenue and the asset is capitalized at cash price. Thus normally all instalments will include a part of cash price and a part of interest on the outstanding balance. However the amount paid at the time of agreement (down payment) will not include any interest. The calculation of interest is made under two conditions:
- **(a) When interest is included in amount of instalment:** Where the hire-purchase price i.e. payment made in the form of down payment and all instalments is more than the cash price, it is regarded that the interest is included in instalments. It is explained in the following example.
- **Worked out Example-1 (Calculation of Interest)**
  On Ist April,2005 Mr. X purchased from M/s Y & Co. one 'Motor Truck' under hire-purchase system, Rs. 5,000 being paid on delivery and the balance in five annual instalments of Rs. 7,500 each payable on 31st March each year. The cash price of the motor truck is Rs. 37,500 and vendors charge interest at the rate of 5 per cent per annum on yearly balances. Find out the amounts of principal and interest included in each instalment.

Calculation of Interest

Calculation of Intt.		Cash Price Rs.	Instalments Principal Rs.	Intt. Rs.	Total Rs.
Cash Price		37,500			
Less paid on delivery		- 5,000	5,000	-	5,000
		32,500			
First Instalment	7,500				
Less Intt. on Rs. 32,500 @ 5%	1,625				
Principal	5,875	-5,875	5,875	1,625	7,500
		26,625			
Second Instalment	7,500				
Less Intt. on Rs. 26,625 @ 5%	1,331				
Principal	6,169	- 6,169	6,169	1,331	7,500
		20,456			
Third Instalment	7,500				
Less Intt. on Rs. 20,456 @ 5%	1,023				
Principal	6,477	-6,477	6,477	1,023	7,500
		13,979			
Fourth Instalment	7,500				
Less Intt. on Rs. 13,979 @ 5%	699				
Principal	6,801	- 6801	6,801	699	7,500
		7,178			
Fifth Instalment	7,500				
Less Amount unpaid	7,178				
Interest	322	- 7,178	7,178	322	7,500
Total:		x	37,500	5,000	42,500

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(b) When interest is not included in instalments: Where the total amount paid in the form of down payment and all instalments is exactly equal to the cash price, it is regarded that the interest is not included in instalments. It means that interest is payable in addition to the agreed amount of instalment. It is explained in the following example.

Workedout Example-2 (Calculation of Interest): On April 1,2005, A Transport Company purchased a Motor Lorry from Motor Supply Co. Ltd. on hire-purchase basis, the cash price being Rs. 60,000. Rs. 15,000 on signing of the contract and balance in three annual instalments of Rs. 15,000 each on 31st March every year. In addition to it, interest at 5 per cent per annum was also payable to vendors on outstanding balances.

Calculation of Interest

Calculation of Intt.		Cash Price	Instalments		
			Principal	Intt.	Total
		Rs	Rs	Rs.	Rs.
Cash Price		60,000			
Less: Down payment		15,000	15,000	-	15,000
		45,000			
Ist Instalment	15,000				
Int. @ 5% on 45,000	2,250				
Total:	17,250	15,000	15,000	2,250	17,250
		30,000			
2nd Instalment	15,000				
Int. @ 5% on 30,000	1,500				
Total:	16,500	15,000	15,000	1,500	16,500
		15,000			
3rd Instalment	15,000				
Int. @ 5% on 15,000	750				
Total:	15,750	-	15,000	750	15,750
		15,000			
Total:		Nil	60,000	4,500	64,500

Accounting in the books of Hire-vendor

Hire Vendor: There is only one method of recording the entries in the books of hire-vendor. Irrespective of the fact whether the entries in the books of hire-purchaser are passed under the Asset Accrual Method or under the Total asset value Method.But the accounting entries in the books of hire-vendor are always passed under the total Asset Method. These entries are as under:-

(i)**On delivery of goods to the hire-purchaser at the time of agreement:**

Hire – purchaser A/c Dr.	Cash Price
To Hire – Sales A/c.	

(ii)**On receipt of cash at the time of agreement (down payment), if any:**

Cash/Bank A/c. Dr.	(Amt. of down payment)
To Hire-Purchaser	

(iii)**On interest being due:**

Hire – Purchaser A/c Dr.	Amt. of Interest
To Interest A/c.	

(iv)**On receipt of instalment:**

Cash/bank A/c.	(Amt. of Instalment)
To Hire – Purchaser	

(v)**On Transfer of Balance of Hire-Sales A/c. to Trading A/c. (at the end of first year only):**

Hire – Sales A/c Dr.	Cash Price
To Trading A/c.	

(vi)**On Transfer of amount of interest to P/L A/c:**

Interest A/c. Dr.	(Balance of Intt. A/c.)
To P/L A/c.	

Note: In solving a numerical problem, before recording the entries, the amount of interest included in various instalments will be separately calculated as already explained.

Posting in Ledger Accounts:

After passing entries in the journall of hire – vendor the following accounts will be opened in the ledger of hire – vendor and the postings will be made accordingly.

- (i) Hire – Purchaser A/c.
- (ii) Hire – Sales A/c. (only in first year)
- (iii) Interest A/c.

Calculate the amount of annual instalment, and show the Journal entries and necessary ledger accounts in the books of Moti Ltd. for three years. The present value of Annuity of Rupees one for three years at 5% is 2.72325.

Worked out examples-3:

On 1st April,2005 X Company Ltd. purchased a machine from Y Machines Ltd. on hire-purchase basis, the cash price being Rs. 55,850 Rs. 15,000 was paid on the signing of the contract and the balance in three annual instalments of Rs. 15,000 each on 31st March each year. Interest is charged at 5% per annum. Depreciation was written off at rate of 10% per annum on the diminishing balance system.

Give journal entries in the books of X Company Ltd. whose accounting year ends on 31st March each year, under Asset Accrual Method.

Solution:

(a) under Asset Accrual Method

Journal Entries in the Books of X Co. Ltd.

Date	**Particulars**	**LF**	**Dr.(Rs.)**	**Cr.(Rs.)**
2005 April 1	Machinery A/c ……………..Dr. To Bank A/c		15,000	15,000

	(Being down payment made at the time of delivery)			
2006 March 31	Machinery A/c ……………………………………...Dr. Interest A/c ....Dr. To Y Machine Ltd. (Being the first instalment due).		12,957 2,043	15,000
"	Y MachinesLtd. …………………Dr. To Bank (Being the amount paid in first instalment)		15,000	15,000
"	Depreciation A/c …………………Dr. To Machinery A/c (Being the depreciation charged)		5,585	5,585
"	Profit & Loss A/c …………………Dr. To Interest A/c ToDepreciation A/c (Being the amount transferred)		7,628	2,043 5,585
2007 March 31	Machinery A/c ……………………………………...Dr.		13,605	15,000

	Interest A/c ....Dr. To Y Machine Ltd. (Being the second instalment due).		1,395	
"	Y Machines Ltd. …………………Dr. To Bank (Being the amount paid in second instalment)		15,000	15,000
"	Depreciation A/c …………………Dr. To Machinery A/c (Being the depreciation charged)		5,027	5,027
"	Profit & Loss A/c …………………Dr. To Interest A/c ToDepreciation A/c (Being the amount transferred)		6,422	1,395 5,027
2008 March 31	Machinery A/c ……………………………………..Dr. Interest A/c ....Dr. To Y Machine Ltd. (Being the third instalment due).		14,288 712	15,000

"	Y Machines Ltd. …………………Dr. To Bank (Being the amount paid in third instalment)		15,000	15,000
"	Depreciation A/c …………………Dr. To Machinery A/c (Being the depreciation charged)		4,524	4,524
"	Profit & Loss A/c …………………Dr. To Interest A/c To Depreciation A/c (Being the amount transferred)		5,236	712 4,524

Note1: Interest has been calculated in the manner already explained in workedout example-1.

Calculation of Cash Price, if Cash Price is not given

Some times in a problem of hire-purchase, cash price of goods sold is not given. Only hire-purchase price is given under such situation first of all, cash price is to be calculated in order to find out the amount of interest included in each instalment. the cash price can be calculated under following two situations.

(a)By Annuity Method, if the annity value of Re. 1 is given:

Cash Price = (Annuity, Value of Re.1 x Amt. of one instalment) + down payment if, any.

Calculation of Cash Price by Annuity Method

Worked out Example-4

On 1st April,2005 a manufacturing company buys on Hire-purchase system a machinery for Rs. 60,000, payable by three equal annual instalments combining principal and interest, the rate of interest was 5% per annum. Calculate the amount of cash price and interest. The present value of an annuity of one rupee for three years at 5% interest is Rs. 2,72325.

Solution:

Calculation of Cash Price – The present value of an annuity of Re. 1 paid for 3 year @ 5% = Rs. 2,72325 Then the present value of Rs. 20,000 for 3 years = 2,72325 x 20,000 = Rs. 54,465 Cash Price Rs. 54,465

(b) **By Arithmetic Method, if the annuity value of Re. 1 is not given:**

? First take the last instalment and calculate interest included in that instalment. Interest: = (Amount of instalment x Rate of Int) / 100+Rate of Int.

Thereafter interest included in last but one instalment should be calculated. Interest = [(Amt. of last but one instalment + principal price included in the last instalment) x Rate of Interest] / 100+ Rate of Int.

- ? Interest included in all proceeding instalment should be calculated in the same manner.
- ? In the end, interest included in each instalment should be added. It should be remembered that down payment does not include any interest.
- ? Finally cash price = Hire purchse price – Total interest included in various instalments.

Calculation of Cash Price by Arithmetic Method

Worked out Example-5

Mr. X purchased a machine on Hire-Purchase system on 1st April,2005. He paid Rs. 5,000 at spot and then three annual instalments of Rs. 5,000 each. The rate of interest was 5% per annum. Find out the amount of interest included in instalments and cash price of the machine.

Solution:

(1)First of all Interest included in the 3rd instalment is to be calculated.

Interest=(5000x5)/105=Rs. 238,Principal= 5000-238=4762

(2)Interest included in second instalment = [(5000+4762)x5]/105 = 465, Principal=4535

(3)Interest included in 1st instalment = [(5000+4762+4535)x5]/105 = 681,Principal=4319

Cash Price = 4762+4535+4319+down payment Rs.5000 = Rs.=18616

Total Interest=Rs20000-18616=1384. I Yr. rs.681, IIYr. Rs465, III Yr.Rs238

Note: Now you can make the interest table in the usual manner as explained in worked out example-1 and check your calculation of amount of interest.

Calculation of Amount of Interest, if Rate of Interest is not given

Wherever, rate of interest is not given in the problem, again there can be two situations.

(a) When cash price and the amounts of instalments are given and the amount of each instalment is same. the following worked out example will make the calculation clear.

Worked out Example-6

(Calculation of Interest When Rate of Interest is not given) A machine was sold on hire-purchase system on 1st April,2005 Rs. 10,000 was paid at spot and rest was paid by four equal quarterly installments of 22,000 each. The cash price of machine was Rs. 90,000. Find out the amount of interest included in each installment.

Soluton:

Hire-purchase Price = 10,000 + (22,000 x 4) = Rs.98,000 Less: Cash Price Rs.90,000 Total Interest= Rs.8,000

The total Interest of Rs 8,000 is to be apportioned among the various installments i.e. 4th, 3rd, 2nd and 1st instalment in the ratio of 1:2:3:4 (i.e. among 1st, 2nd, 3rd and 4th installment in the ratio of 4:3:2:1)

(1)Share of 1st instalment in the Interest= 8,000x4/10 = Rs.3,200

(2)Share of 2nd instalment in the Interest= 8,000x3/10 = Rs.2,400

(3)Share of 3rd instalment in the interest= 8,000x2/10 = Rs.1,600

(4)Share of 2nd instalment in the interest= 8,000x1/10 = Rs. 800

(b) When cash price and amounts of instalments are given but the amount of each instalment is not equal: The following worked out example will clear the doubts.

Rate of Interest not known and Instalments of different amounts

Worked out Example-7

Cash price of a machine is Rs. 37,400 on 1st January,2003. Its hire-purchase price is Rs. 50,000. This hire-purchase price is paid in five annual instalments in the following manner: Rs. 15,000 at the end of the first year Rs. 12,000 at the end of second year; Rs. 10,000 at the end of third year, Rs. 8,000 at the end of fourth year, Rs. 5,000 at the end of fifth year. Calculate interest and cash price included in each instalment.

Solution:

Calculation of Interest Included in each Instalment

Total Interest= Hire-purchase price-Cash Price

Total Interest=Rs.50,000-37,400=12600

Total Interest of Rs12,600 is to be apportioned among the five instalments in the following manner:

Instalment No	Unpaid Amount(Rs.)	Calculation of Int.(Rs.)
First	50000	(12600x50000)/126000=5000
Second	50000-15000=35000	(12600x35000)/126000=3500
Third	35000-12000=23000	(12600x23000)/126000=2300
Fourth	23000-10000=13000	(12600x13000)/126000=1300
Fifth	13000-8000=5000	(12600x5000)/126000=500
Total	126000	

Calculation of Cash Price included in each instalment

Instalment No.	Instalment(Rs.)	Interest(Rs.)	Cash Price(Rs.)
First	15000	5000	10000
Second	12000	3500	8500
Third	10000	2300	7700
Fourth	8000	1300	6700
Fifth	5000	500	4500
Total	50000	12600	37400

POSSIBLE QUESTIONS

PART – B (2 MARKS)

1. What is meant by Installment System?
2. What is meant by Default?
3. What do meant by repossession?
4. Define down payment.
5. Define Hire purchase.
6. Define Hire Vendor.

POSSIBLE QUESTIONS
PART – C (8 MARKS)

7. The Madras Trading Co. purchased a motor car from Bombay motor Co. on hire purchase agreement on 1.1.80, paying cash Rs.10,000 and agreeing to pay further three instalments of Rs.10,000 each on 31st December each year. The cash price of the car is Rs.37,250 and the Bombay motor co charges interest at 5% p.a.

   The Madras Trading Co. writes off 10% p.a as depreciation on the reducing balance method. Journalise the above in the books of both the parties.

8. Sundar sells goods on H.P system at cost plus 60%. From the following prepare Hire purchase Trading a/c.

Jan 1 Goods out on H.P system at H.P Price	Rs.32,000
Dec 31 Instalments not due and unpaid	Rs.72,000
Instalments due and unpaid	Rs. 4,000

   The following transactions took place during the year:-

a) Goods sold on H.P price	Rs.1,60,000
b) Cash received from customers at H.P price	Rs.1,12,000
c) Goods received back on default valued at	Rs. 800

   (Instalment due Rs.4,000)

9. Mr. P Purchased 4 Cars for Rs.14,000 each 1.1.13 under the hire purchase system. The hire purchase price for all the 4 cares Rs.60,000 to be paid as Rs. 15,000 down payment and 3 equal instalments of Rs.15,000 each at the end of each year. Interest is charged at 5% p.a. The buyer depreciates the car at 10% p.a on straight line method.
   From the above particulars give journal entries in both the parties.

10. i. On 1-1-2008 Mr. Joel purchased machinery on hire purchase system. The payment is to be made Rs.40, 000 down(on signing of the contract) and Rs.40,000 annually for three years. The cash price of the machinery is Rs.1,49,000 and rate of interest is 6%. Calculate the interest in each year's installment.
    ii.Mr. Nakul purchased a machine on hire purchase system. As per terms, he is required to pay Rs.4000 down, Rs.2000 at the end of the first year, Rs.1500 at the end of the second year and Rs.2800 at the end of third year. Interest is charged at 5% p.a. Calculate the total cash price of the machine and the amount of interest payable on each instilment.

11. Marimuthu Brought 10 Cars for Rs.4,50,000 each 1.1.15 under the hire purchase system. The hire purchase price for all the 10 Cars Rs.5,00,000 to be paid as Rs. 1,00,000 down payment and 4 equal installments of Rs.1,00,000 each at the end of each year. Interest is charged at 5% p.a. The buyer depreciates the car at 10% p.a on straight line method. From the above particulars give journal entries in both the parties.
12. On 1-1-98 Z purchased machinery on hire purchase system. The payment is to be made Rs.4,000 down(on signing of the contract) and Rs.4,000 annually for three years. The cash price of the machinery is Rs.14,900 and rate of interest is 5%. Calculate the interest in each year's installment.
13. Mr. P purchased 4 cars for Rs 14,000 each on 1.1.92 under the hire purchase system. The hire purchase price for all 4 cars was Rs. 60,000 to be paid as Rs. 15,00 down payment and 3 equal installments of Rs. 15,000 each at the end of each year. Interest is charged at 5% p.a. the buyer depreciates the car at 10% p.a. on straight line method. From the above particulars give journal entries and relevant accounts in the books of Mr. P and in the books of Hire Vendor.

14. Revathi & co sells goods on H.P system at cost plus 60. From the following information prepare Hire Purchase Trading account to ascertain the profit and loss Account.

    1.1.2016 Goods with H.P customer(at H.P Price) Rs. 16,000

    31.12.2016 Goods sold on H.P during the year at H.P price Rs. 80,000

    Cash received during the year from customer Rs. 56,000

    Goods repossessed from customer (installments due Rs. 2,000) valued at Rs 300

    Goods with the H.P customer at H.P Price 36,000

15. VSS sells goods on Hire purchase system at cost plus 50%. From the following prepare Hire purchase Trading a/c.

Jan 1 Goods out on hire purchase system at hire purchase Price	Rs.64,000
Dec 31 Installments not due and unpaid	Rs.1,44,000
Installments due and unpaid	Rs. 8,000
The following transactions took place during the year:-	
a)Goods sold on H.P price	Rs.3,20,000
b) Cash received from customers at H.P price	Rs.2,24,000
c) Goods received back on default valued at	Rs. 1600
(Installment due Rs.4,000)	

(Or)

16. The Chennai Super King Trading Co. purchased a motor van from Mumbai Indians Motor Co. on hire purchase agreement on 1.1.2000, paying cash Rs.10,000 and agreeing to pay further three installments of Rs.10,000 each on 31st December each year. The cash price of the car is Rs.37,250 and the Mumbai Indian Motor co charges interest at 5% p.a. The Chennai Super King Trading Co. writes off 10% p.a as depreciation on the reducing balance method. Journalize the above in the books of both the parties.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed University Established Under Section 3 of UGC Act 1956)
Coimbatore - 641021.
(For the candidates admitted from 2017 onwards)
DEPARTMENT OF COMMERCE

SUBJECT : FINANCIAL ACCOUNTING
SEMESTER : I
SUBJECT CODE : 17CMU101 CLASS : I B.Com. - B

UNIT- IV

Consignment: Features, Accounting treatment - Consignor and Consignee. **Joint Venture:** Accounting procedures: Joint Bank Account, Records Maintained by Co-venturer of (a) all transactions (b) only his own transactions. (Memorandum joint venture account).

Suggested Readings:

Text Book

1. Reddy and Moorthy. (2016). *Financial Accounting* Chennai. Margham Publications.

Reference Book

1. M.C.Shukla, T.S. Grewal and S.C.Gupta. (2013).*Advanced Accounts*. [Vol.-I Revised Edition] New Delhi, S. Chand & Co.
2. S.N. Maheshwari, and. S. K. Maheshwari.(2013). *Financial Accounting*.[First Edition]. New Delhi, Vikas Publishing House.
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4. Tulsian, P.C. (2013). *Financial Accounting*, [4th Ed]. New Delhi, S.Chand Publishing
5. Compendium of Statements and Standards of Accounting. (2013). New Delhi, The Institute of Chartered Accountants of India.

Unit: IV
CONSIGNMENT ACCOUNTS

INTRODUCTION

Now-a-days it is quite common that manufacturers or wholesale dealers despatch goods to their agents at home and abroad to increase their sales. The knowledge of the agent of the local conditions where he resides proves useful in increasing the sales. Moreover it is very expensive for the manufactures to sell the goods directly either in home market or in foreign market. Therefore, different agents are appointed for different places.

MEANING OF CONSIGNMENT

It is common practice with practically all manufacturers or wholesalers to sell goods through agents both within the country and abroad. The goods are sent to be kept and sold on behalf of and at the risk of sender by the recipient. The person who forwards the goods for sale is consignor, the person to whom goods are forwarded for sale is 'consignee' and goods so sent are called 'Goods sent on Consignment'. Consignment is a means of facilitating sale but is not actually a sale. Consignment is different from sales. A consignment is returnable if goods are not sold but in case of sale, the goods are not returnable except for special reasons, such as on account of damage or if below standard goods are supplied. When goods are sold to a person the property in them passes to that person, but when goods are consigned to a person the legal ownership of the goods remains with the consignor. Hence when goods are sold the relationship between two parties is that of a creditor and debtor but when the goods are consigned relationship between the consignors and consignee is that of 'principal' and 'an agent'.

DISTINCTION BETWEEN CONSIGNMENT AND SALE

The following points summarize clearly, the difference between a consignment and a sale.

Sr. Basis	Consignment	Sale
1. Property in goods i.e. Ownership	Ownership remains with the consignor	Ownership passed to the buyer
2. Relation	Consignee is the agent of the consignor	Buyer is debtor of seller until the account is settled.
3. Risk and damage	Consignee holds the goods at the risk of the consignor therefore subsequent damage to the goods is the loss of the consignor	Any subsequent damage to the goods is the loss of the buyer
4. Return of goods	Goods may be returned if not sold	Goods are not returnable except for special reasons e.g. wrong kind or defective goods etc.
5. Expenses after delivery	Recoverable from the consignor	To be borne by the buyer
6. Forwarding letter	Proforma invoice	Invoice

PROCEDURE TO BE FOLLOWED IN CASE OF CONSIGNMENT

When the goods are despatched by the consignor to the consignee, the consignor makes out a statement known as 'proforma invoice' like a regular invoice giving details about the consignment and price which is normally at cost, but occasionally it may be at invoice price which is above the cost.

The consignee does not become liable for the payment of amount named in the invoice, but as matter of advance for goods, he usually makes payment in advance either by accepting a bill or by remitting a bank draft.

a) **Account Sale :** The consignee renders to his consignor regularly a statement showing sales, expenses incurred, commission charged and remittance made with the resultant balance due by him. This statement is known as 'Accounts Sales'.

b) On receipt of Account Sales the consignor shall make entries in his books of account and complete the Consignment account and the Consignee's account.

c) **Advance on Consignment :** It is common practice for the consignor to ask the consignee for some deposit as a security for goods sent on consignment to the consignee. It may be paid by any mode of payment-cheque, cash or even bills of exchange.

d) **Commission :** The consignee usually gets a commission for selling the goods on behalf of the consignor as a fixed percentage on sales. So more the sales more will be the commission earned by the consignor. But there are some other kinds of commission which are sometimes given to the consignee for extra burden and activities i.e. Del Credre Commission and over-riding Commission.

e) **Del Credre Commission :** Ordinarily the consignee is not responsible to the consignor for the payment of money by the purchasers but sometime he undertakes to guarantee payment due for all the goods he sells on credit and cash whether his customers pay him or not. In consideration of his this warranting the solvency of the buyers, he is paid an extra commission called a Del Credre Commission. The consignee will pay the consignor whether he himself receives payment from debtors or not. The commission is payable on total proceeds.

f) **Over-Riding Commission:** It is an extra commission in addition to ordinary commission. This commission is also calculated on sales like ordinary Commission. This commission is generally given by the consignor to the consignee to enhance the sale or to boost up the sales of a new product.

g) Performa Invoice : Since the goods sent on consignment cannot be treated as sales, the consignor does not prepare proper invoice. He simply prepares a Performa invoice and sends it to the consignee, along with the goods dispatched. This is prepared with a view to inform the consignee about price of goods, expenses incurred, mode of transportation and the minimum sale price at which the goods are to be sold.

h) Expenses : Expenses relating to consignment of goods are divided into two categories vis. (i) Non-recurring expenses and (ii) Recurring expenses.

i) **Non-Recurring Expenses :** All the expenses which are incurred for bringing goods to the godown of the consignee are non recurring in nature. Such expenses are generally goods have reached the consignee's place or godown.

They are recurring in nature because they may be incurred repeatedly by the consignor and consignee. The examples of recurring expenses incurred by the consignor are advertising, discount of bills, commission on collection of cheques, travelling expenses of salesmen, bad debts etc. The examples of recurring expenses incurred by the consignee are godown rent; godown insurance, sales promotion etc.

ACCOUNTING TREATMENT OF CONSIGNMENT TRANSACTIONS

(A) Books of the Consignor : The consignor opens three accounts in his ledger.

(1) Consignment Account : It is prepared to ascertain profit or loss on each consignment e.g. Consignment to Bombay Acount. It is not a personal account but a special Trading and Profit and Loss account or a nominal account.

(2) Consignee's Account : It is prepared to show the balance due to or from consignee at a particular date. It is a personal account; and

(3) Goods sent on Consignment Account : It is prepared to show the amount of goods sent to the consignee. This is real account. The balance is credited to Purchase or Trading Account.

Journal Entries

1 (a) When the goods are sent on consignment at cost or at invoice price:

Consignment A/c Dr.

To Goods sent on consignment A/c

(Being goods sent on Consignment at cost)

(b) If goods are sent at invoice price then one more entry is needed for making the adjustments. The amount of this entry is the difference between the invoice price and the cost price. The entry will be:

Goods sent on consignment A/c Dr.

To Consignment A/c

2. When expenses are incurred by the Consignor:

Consignment A/c Dr.

To Bank A/c

(Being expenses incurred)

3. When the Account Sales is received from the Consignee :

(i) Consignee A/c Dr.

To Consignment A/c

(Being the total sales by consignee)

(ii) Consignment A/c Dr.

To Consignee A/c

(Being the expenses incurred by consignee and with his

Commission)

4. When the consignee remits the cash or bills:

   Bank A/c/ Cash A/c/Bills receivable A/c Dr.

   To Consignee A/c

   (Being Cash/B/R received)

5. When bills is discounted with Bank:

   Cash A/c/ Bank A/c Dr.

   Discount A/c

   To Bills receivable A/c

   (Being B/R discounted with the Bank)

6. For Stock remaining unsold:

   Consignment stock A/c Dr.

   To Consignment A/c

   (Being the value of stock plus proportionate expenses)

7. For Abnormal Loss of stock:

   General Profit & Loss Account A/c Dr.

   (with unrecoverable loss)

   Insurance company A/c (with total recoverable loss) Dr.

   To Consignment A/c (with total loss)

   (For the abnormal loss of stock, amount recoverable and amount not recoverable)

ii) For Profit or loss on Consignment:

   (i) If there is profit on Consignment

   Consignment A/c Dr.

   To general Profit and Loss A/c

   (Being the Profit on consignment transferred to Profit and Loss A/c)

   (ii) If there is loss on Consignment

   General Profit and loss Account Dr.

To Consignment A/c

(Being the loss on Consignment transferred to Profit & Loss Account)

9. For settlement of account with consignee:

Bank/Bills recoverable Dr.

To Consignee A/c

(Being amount sent for final settlement)

The Goods sent on Consignment Account' which shows credit balance will now be transferred to the Trading Account. Then the entry is :

Goods sent on consignment Account Dr.

To Trading A/c

(Being the goods sent on consignment account transferred to trading account).

Ledgers

a) **Consignment Account :** Consignor prepares this account in his ledger. In it all transactions of a consignment are shown. This account discloses profit or loss incurred by each consignment. Debit side shows goods sent on consignment expenses incurred by consignor and consignee, consignees commission, bad debts etc. Credit side shows total sales (cash and credit), goods returned, and unsold stock etc. The difference between the debit and credit totals of Consignment Account is regarded as profit or loss which is transferred to the Profit and Loss Account and the Consignment Account stands closed. It is infact a nominal account and is just like Trading and Profit and Loss Account about which you must have studied earlier in final accounts. Therefore the principles applied to Trading and Profit and Loss Account hold good for this account also. Like Trading and Profit and loss Account all expenses and purchases are debited to this account and all sales and incomes are credited.

b) **Goods sent on consignment Account :** This account shows the goods transferred from the consignor to the consignee and goods returned by the consignee to the consignor. All the goods consigned by the consignor will be credited to this account and the goods returned by the consignee are debited to this account. The balance represents the cost of goods with consignee for sale, and is transferred to the Trading Account.

c) **Consignee's Account :** This account discloses what amount is due from the consignee. The consignee's account is debited with all cash and is credited by sales effected by the consignee. The various expenses incurred by the consignee, the commission charged by him as well as the advance remitted by him are credited to this account. This account usually shows a debit balance indicating the amount due from the consignee. At times it may show credit balance, if the advance given by the consignee is more than the sale affected by him. The balance revealed by this account is shown in the balance sheet of the consignor.

Illustration 1 : Vimal Mills Ltd. sent 100 pieces of suiting to Lal Garments House of Delhi on consignment basis. The consignees are entitled to receive 5 per cent commission plus expenses. The cost of Vimal Mills Ltd. is Rs. 200 per suiting. Lal Garments House pays following expenses :

Railway Freight	Rs. 500
Godown Rent & Insurance	Rs. 1,000

Vimal Mills Ltd. draw on the consignees a bill for Rs. 10,000 which is duly accepted. Subsequently it is discounted for Rs. 9,500. The consignees informed the consignor of the sale of the entire consignment for Rs. 28,500. Show journal entries and ledger accounts in the book of the consignor.

Solution

Journal entries in the Book of Vimal Mills Ltd. (Consignor)

Date	Particulars		Dr.	Cr.
	Consignment A/c	Dr.	20,000	
	To goods sent on consignment A/c			20,000
	(100 pieces of suiting consigned to Lal Garments House at cost Rs. 200 per suiting)			
	Bill receivable A/c	Dr.	10,000	
	To Lal Garment House			10,000
	(Being of the bills of exchange received from consignee)			
	Cash Account	Dr.	9,500	
	Discount Account	Dr.	500	
	To bill receivable A/c			10,000
	(being bill discounted with the bank)			
	Lal Garment House	Dr.	28,500	
	To Consignment A/c			28,500
	(Being gross proceeds of the goods sold)			
	Consignment A/c	Dr.	1,500	
	To Lal Garment House			15,00
	(being the expenses incurred by Lal Garment house)			

	Consignment A/c	Dr.	1,425	
	To Lal Garment House			1,425
	(Being Commission @ 5% on sales)			
	Consignment A/c	Dr.	5,575	
	To Profit & Loss A/c			5,575
	(Being profit on consignment transferred)			
	Goods sent on Consignment A/c	Dr.	30,000	
	To Trading A/c			30,000
	(Being goods sent on consignment A/c transferred to trading A/c			

Ledger Accounts

Consignment Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To goods sent on consignment A/c	20,000	By Lal Garment House (Sales)	28,500
To Lal Garments	1,500		
To Lal Garment House (commission)	1,425		
To Profit & Loss A/c (Profit on consignment)	5,575		
	28,500		28,500

Lal Garments House

Dr. Particulars	Rs.	Particulars	Cr. Rs.
To consignment A/c	28,500	By bills receivable	10,000
		By Consignment A/c (Expenditure)	1,500
		By Consignment A/c (Commission)	1,425
		By Balance c/d	15,575
	28,500		28,500

Goods Sent on Consignment Account

Particulars	Rs.	Particulars	Rs.
To Trading A/c (transferred)	20,000	By Consignment A/c	20,000
	20,000		20,000

B. Books of the Consignee

Consignee need not pass any entry in his books on the receipt of goods by him or for expenses incurred by the consignor. He should, in principle, open the Consignor's Account in his books and route all the transactions through it in the following manner:

1. When cash is remitted or bill is accepted

   Consignor A/c Dr.

   To Cash A/c/Bills payable A/c

   (Being cash remitted or bills accepted).

2. When expenses are incurred

Consignor A/c Dr.

To Cash A/c

(Being expenses incurred on consignment)

3. When sale is made on Consignment

(i) For cash sales

Cash a/c Dr.

To Consignor's A/c

(ii) For credit sales

Debtor's A/c Dr.

To Consignor A/c

(Being goods sold on credit)

4. On remitting balance to consignor after commission

Consignor's A/c Dr.

To Cash A/c/Bank A/c

To Commission A/c

(Being cash remitted after commission)

Note : (A) For unsold stock lying with consignee, no entry is to be passed in his book of account.

(B) Consignee does not pass any entry for profit or loss in his books.

The consignee also prepares ledger accounts after passing all the journal entries. The Consignor's Account and Commission Account are the two important account prepared by the consignee in his books. Of course he will also do the postings to the other accounts such as Consignment Debtor's Account, Consignment Expenses Account and Bills Payable Account etc.

(a) Consignor's Personal Account : It is the main account of Consignee's books which is prepared for working out the amount due to the consignor.

Whatever amount he receives from sales of goods is credited to this account. All expenses incurred by the consignor in relation to consignment the commission due to him and the advance given by him to the consignor will be debited to this account. Further, if the consignee does not get del credre commission, the bad debts on account of credit sales are also debited to the Consignor's Account. The balance of this account indicates the amount payable to the consignor. This account is just the opposite of the Consignee's Account in the books of the consignor.

(b) Commission Account : It is nominal account. It shows the income earned by the consignee for the services rendered by him. All types of commission whether ordinary or special, due to the consignee is credited to this account. The commission account will be debited with bad debts if the consignee is to bear such loss because of del credre commission.

To continue with the same illustration No. 1, the consignee will have the following journal entries and ledger accounts:

Journal Entries

Date	Particulars	L.F.	Dr.	Cr.
	Vimal Mills Ltd.	Dr.	10,000	
	To Bills payable A/c			10,000
	(Being bill accepted)			
	Vimal Mills Ltd.	Dr.	1,500	
	To Cash A/c			1,500
	(Being expenses (incurred)			
	Cash A/c	Dr.	28,500	
	To Vimal Mills			28,500
	(Being Sales proceeds			

received on consignment)			
Vimal Mills Ltd.	Dr.	1,425	
To Commission A/c			1,425
(Being 5% commission on total sales)			
B/P A/c	Dr.	10,000	
To Cash A/c			10,000
(Being bill met on maturity)			

Ledger Account

Vimal Mills Ltd. (Consignor)

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Bill payable A/c	10,000	By Cash (sale proceeds)	28,500
To Cash A/c (expenses)	1,500		
To Commission A/c	1,425		
To Balance c/d	15,575		
	28,500		28,500

Illustration 2. :- B. Ghosh of Bombay sent on consignment to Alok of Calcutta 300 cases @ Rs. 125 on 1st July 2006 to be sold on his account and at his risk for 10% commission B. Ghosh incurred Rs. 3,000 expenses on dispatching the goods to Alok. On July 10, 2006 B. Ghosh received a bill for Rs. 20,000 at 2 months from Alok. On September 30, 2006 Alok sent on account sales disclosing that 200 cases have been sold for Rs. 160/- each and the remaining cases @ Rs. 150/- each. The account sales also discloses that Alok has incurred unloading expenses Rs. 600 and selling expenses Rs. 900. He sends a draft for the net amount due.

You are required to :

(a) Prepare the account sales; and

(b) Enter the transactions in the books of both the parties.

Solution

Account sales of 300 cases received from B. Ghosh to be sold on his account and risk.

200 cases @ Rs. 160		32,000	
100 cases @ Rs. 150		15,000	47,000
Less : Expenses			
Unloading expenses	600		
Selling expenses	900	1,500	
Commission @ 10% on sales		4,700	6,200
RS. 47,000 (Rs. 32,000 + Rs. 15,000)			
			40,800
Less Bill given as an advance			20,000
on 10.7.1999			
Balance (draft enclosed herewith)			
			20,800

E & O. E. Alok

Calcutta 30th Sept., 2006

Journal Entries in the Books of B. Ghosh (Consignor)

Journal

Date	Particulars	L.F.	Dr.	Cr.
2006	Consignment A/c Dr.		37,500	
July1	To goods sent on			
	consignment A/c			37,500
	(Being 300 cases @ Rs. 125 sent			
	on consignment to Alok)			
July 1	Consignment A/c Dr.		3,000	
	To Bank A/c			3,000
	(Being expenses incurred			
	on account of goods sent on			

	consignment)			
Sep 10	Bills receivable A/c	Dr.	20,000	
	To Alok			20,000
	(Being an acceptance for 2 months bill from Alok as an Advance)			
Sep 13	Bank Account	Dr.	20,000	
	To Bills Receivable A/c			20,000
	(Being the acceptance of Alok on the due date)			
Sep 30	Consignment A/c	Dr.	1,500	
	To Alok			1,500
	(Being unloading expenses Rs. 600 and selling expenses Rs. 900/- incurred by Alok)			
Sep 30	Alok	Dr.	47,000	
	To Consignment A/c			47,000
	(Being goods sent on consignment sold by Alok-200 cases @ Rs. 160 and 100 case @ Rs. 150)			
Sep. 30	Consignment A/c	Dr.	4,700	
	To Alok			4,700
	(Being commission payable to Alok @ 10% on Rs. 47,000)			
Sep 30	Bank A/c	Dr.	20,800	
	To Alok			20,800

	(Being amount due from Alok received)			
Sep 30	Consignment A/c	Dr.	300	
	To Profit & Loss A/c			300
	(Being profit on consignment transferred to Profit and Loss A/c)			
Sep.30	Goods sent on consignment A/c	Dr.	37,500	
	To Trading A/c			37,500
	(Being goods sent on consignment transferred to Trading A/c)			

Ledger

Consignment Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006					
July1	To good sent on consignment A/c	37,500	Sep 30	By Alok (Sales) 200 cases @ 160 32,000 100 case @ Rs. 150 15,000	47,000
July 1	To Bank A/c (Exp)	3,000			
Sep 30	To Alok (Expenses)	1,500			
Sep 30	To Alok (Commission)	4,700			
Sep 30	To Profit transferred to profit & loss a/c	300			
		47,000			47,000

Goods sent on Consignment Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006					
Sept30	To Trading A/c	37,500	July1	By Consignment to	37,500
Sept30	To Trading A/c	37,500	July1	By Consignment to	37,500
				Calcutta a/c	
		37,500			37,500

ills Receivable Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006			**2006**		
Jul10	To Alok	20,000	Sep.13	By Bank A/c	20,000
		20,000			20,000

Alok

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006			2006		
Sept 30	To Consignment a/c	47,000	Jul 10	By bills receivable	20,000
	(Sales)		Sep 30	By consignment to	1,500
				Calcutta C/c (Exp)	
			Sep 30	By Consignment A/c	4,700
				(Commission)	
			Sep 30	By Bank a/c	20,800
		47,000			47,000

Bank Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006			**2006**		

July 1	To balance b/c		July 1	By consignment a/c	3,000
Sep 13	To Bills receivable	20,000			
Sep. 30	To Alok	20,800	Sep.30	By Bal. c/d	

Profit and Loss Account

	2006		
	Sep 30	By Consignment to Calcutta a/c	300

Entries in the Books of Alok (Consignee) Journal

Date	Particulars		Dr.	Cr.
Jul 10	B. Ghosh	Dr.	20,000	
	To Bills payable A/c			20,000
	(Being acceptance of bill for 2 months given)			
	Ghosh	Dr.	1,500	
	To Bank A/c			1,500
	(Being unloading expenses Rs. 600 and selling expenses Rs. 900 incurred on account of B. Ghosh)			
Sep 13	Bills payable A/c	Dr.	20,000	
	To Bank A/c			20,000
	(Being bill met on the due date)			
	Bank A/c	Dr.	47,000	
	To B. Ghosh			47,000
	(Being goods sold on behalf of B. Ghosh)			
Sep 30	B. Ghosh	Dr.	4,700	
	To Commission A/c			4,700
	(Being 10% commission on			

sales charged to B. Ghosh).

Sep 30	B. Ghosh	Dr.	20,800	
	To Bank A/c			20,800
	(Being bank draft sent to B. Ghosh for the amount due)			

B. Ghosh

2006				
Jul 10	To Bills payable A/c	20,000	By bank A/c (sales)	47,000
	To Bank A/c (expenses)	1,500		
Sep 30	To commission A/c	4,700		
Sep 30	To Bank A/c	20,800		
		47,000		47,000

Bills Payable Account

2006					
Sep 13	To Bank Account	20,000	July 10	B. Ghosh	20,000

Commission Account

			2006		
			Sep 13	B. Ghosh	4,700

Bank Account

2006					
July 1	To Balance b/d	? ?		By B. Ghosh	1,500
	To B. Ghosh	47,000	Sep 13	By Bills payable	20,000
			Sep 30	By B. Ghosh	20,800
		?			

Illustration 3

Suresh and Co. of Bombay sent on consignment to Mahesh & Co. of Delhi 60 cases cutlery goods costing Rs. 175 per case. Expenses incurred by the consignor at Bombay were : Freight Rs. 275, insurance Rs. 55 and loading charges Rs. 20.

Suresh & Co. draw on Mahesh & Co. 2 months bills at sight for Rs. 7,000 which the latter accepts. The charges paid by Mahesh & Co. at Delhi were unloading Rs. 30, Storage Rs. 85, insurance Rs. 15, Commission is payable to Mahesh & Co. at 2% on all sales in addition to 1½% del credere commission.

The consignee sells for prompt cash 30 cases @ Rs. 225 per case; 25 cases @ Rs. 250 per case and the balance @ Rs. 280 per case. The account was settled immediately by means of a bank draft.

Write up the transactions and ledger acconts in the books of both the parties.

Solution

Consignor's Books Journal

Consignment to Delhi Account	Dr.	10,500	
To Goods sent on consignment Account			10,500
(60 cases consigned @ Rs. 175 per case)			
Consignment to Delhi Account	Dr.	350	
To Bank			350
(expenses on consignment paid)			

Bills receivable Acount	Dr.	7,000	
To Mahesh & Co.			7,000
(Being Expenses incurred by consignee)			
Consignment to Delhi Account	Dr.	130	
To Mahesh & Co.			130
(Being Expenses incurred by consignee)			
Mahesh & Co.	Dr.	14,400	
To Consignment to Delhi Account			14,400
(Sales affected by consignee)			
Consignment to Delhi Account	Dr.	504	
To Mahesh & Co.			504
(Being Commission due to the consignee including del credre commission on sales i.e. 2% and 1½% of Rs. 14,400)			
Bank Account	Dr.	6,766	
To Mahesh & Co.			6,766
(Being Received bank draft in settlement of the accounts)			
Consignment to Delhi Account	Dr.	2,916	
To General Profit & Loss a/c			2,916
(Being Goods sent on consignment account closed)			

Ledger Account

Consignment to Delhi Account

Dr.				Cr.
July 1	To goods sent ton consignment a/c	10,500	By Mahesh & Co. (sales)	14,400
	To Bank (expenses)	350		
	To Mahesh & Co. 130 (Expenses)			
	To Mahesh & Co. 504 (Commission)	634		
	To General Profit & Loss A/c	2,916		
		14,400		14,400

M/s Mahesh & Co's Account

To consignment to Delhi A/c (sales)	14,400	By B/R A/c	7000
		By Consignment to Delhi Account Expenses 130 Commission 504	634
		By Bank a/c	6,766
	14,400		14,400

GOODS SENT ON CONSIGNMENT ACCOUNT

To Trading A/c (transfer)	10,500	By consignment to Delhi A/c	10,500

Consignee's Books

Journal

Suresh & Co.	Dr.	7,000	
To Bills payable accepted			7,000
(Suresh & Co's bill accepted)			
Suresh & Co.	Dr.	130	
To cash A/c			130
(Being cash sent on expenses)			

Cash account	Dr.	14,400	
To Suresh & Co.			14,400
(Sales effected on consignor's behalf)			
Suresh & Co.	Dr.	504	
To Commission A/c			504
(Commission @ 2% and del credre commission @ 1.5% on Rs. 14,400)			
Suresh & Co.	Dr.	6,766	
To Bank A/c			6,766
(Balance remitted vide draft No.__________ dt. ________)			

Ledger Accounts

M/s Suresh & Co's Account

To bills payable A/c	7,000	By cash (sales)	14,400
To cash (expenses)	130		
To Commission A/c	504		
To Bank A/c (draft)	6,766		
	14,400		14,400

Till now we have presumed that all the gods consigned are sold. But in practice we find that at the time of submitting the 'account sale', a part of goods consigned may still be unsold and may be lying with the consignee. In order to calculate the true profit or loss on consignment, the unsold stock should be valued and accounted for.

VALUATION OF STOCK ON CONSIGNMENT

Valuations of unsold stock is usually done at cost. Cost, in case of consignment stock, would include the cost at which the goods are consigned plus, the proportionate non-recurring expenses. All the non-recurring expenses, whether incurred by the consignor or by the consignees, are to be taken into account. In the absence of details of expenditure incurred by the consignee, all expenses incurred by him are to be taken as recurring expenses and thus are not to be considered in the calculation of closing stock. In other words, while valuing the closing stock we add such proportionate expenses to the cost price that have been incurred upto the time the goods are brought to the place of the consignee. Any other expenses paid by the consignor or the consignee after this point will not be considered as these expenses do not add to the value of the goods. Such expenses are godown rent, selling expenses, carriage outwards, godown insurance, discount etc.

Usually following expenses are added for calculation of closing stock : Carriage and Freight, Loading Charges, Custom Duty, Clearing Charges, Dock Dues, Carriage paid upto the Godown, and Unloading charges.

Following are the expenses which are not considered for calculation of closing stock : Godown rent, Discount, Bad Debts, Insurance of the goods in the Godown, and Selling and Distribution expenses.

One can notice that all expenses incurred by the consignor are considered for valuation of the closing stock. The problem arises only selecting recurring expenses in case of consignee.

The value of unsold stock affects the profit or loss on any consignment so its valuation and recording in the books of consignor is very important. It is shown on the credit side of Consignment Account for which the journal entry passed would be as :

Stock on Consignment A/c Dr.

To Consignment A/c

(Being the values of sold stock)

On the other hand the Consignee, will not pass any entry for the closing stock. It is because he is not the owner of the goods and does not pass any entry even when the goods are received or he returns the goods.

ACCOUNTING FOR LOSS OF GOODS

Goods sent on consignment may be lost or damaged in transit. The loss of goods may be either (i) normal or (ii) abnormal Treatment in the books of accounts will depend upon the nature of loss.

Normal Loss : Loss of goods is sold to be normal when it is natural, unavoidable and is due to inherent characteristic of the goods despatched like evaporation, sublimation etc. The amount of stock to be carried down is the proportion of the total cost that the number of units on hand bears to be the total number units as diminished by loss.

Deficiency of Stock : When there is deficiency of stock at the time of stock-taking and the consignee is under a liability to account for the missing stock, the entry will be:

Consignee Dr.

To Consignment a/c

(Being the deficiency of stock charged to the consignee).

If, on the other hand, he is not liable, the stock of the consignment will be shown at the gross figure and the consignment account will be debited with the loss in stock.

Abnormal Loss : There are the losses which are accidental and not natural like theft. Abnormal loss may occur in the godown of the consignee or in transit. Let us see the effect of abnormal loss on the closing stock under both situations.

When the abnormal loss occurs in the godown of the consignee the valuation of closing stock is not effected because the expenses incurred after they reach the godown of the consignee are not to be taken into account for the purpose. Hence, the normal formula will be followed for the valuation of closing stock.

Look at illustration 4 and see how the abnormal loss and the value of closing stock is calculated when the abnormal loss occurs in the godown of the consignee.

The treatment in accounts will depend upon whether the unforeseen loss has been insured against or not. In case of insurance the consignment account will be credited but the insurance companies or underwriter's account will be debited with the amount of loss (which shall be calculated like valuation of stock on consignment i.e. including proportionate non-recurring expenses of both the consignor and the consignee). If the goods are not insured, instead of Insurance Company's or Underwriter's Accounts being debited, Profit and Loss Account will be debited and consignment account will be credited. In this way the final net profit on consignment is not adversely affected.

Illustration 4 : X of Calcutta sent on 15th January, 2006, a consignment of 500 toys bicycles costing Rs. 100 each. Expenses of Rs. 700 met by the consignor. Y of Bombay spent Rs. 1,500 for clearance and the selling expenses were Rs. 10 per bicycle.

Y sold, on 4th April 2006, 300 pieces @ Rs. 160 per piece and again on 20th June 1999, 150 pieces @ Rs. 172.

Y was entitled to a commission of Rs. 25 per piece sold plus one fourth of the amount by which the gross proceeds less total commission thereon exceeded a sum calculated at the rate of Rs. 125 per piece sold. Y sent the amount due to X on 30th June 2006.

You are required to show the Consignment Account and Y's Account in the books of X.

Solution

Consignment Account

2006		Rs.	2006		Rs.
Jan 15	To goods sent on consignment a/c 500 @ Rs. 100	50,000	Apr 4	By Y-sale of 300 pieces @ Rs. 160	48,000
Jan 15	To Bank A/c - Exp.	700	June 20	By Y-sale of 150 Pieces @ 172	25,800
	To Y-Clearing Exp	1,500	June 30	By consignment stock A/c	5,220
Apr 4	To Y-selling Exp	3,000			
Jun 20	To Y- selling Exp	1,500			
Jun 30	To Commission A/c	12,510			
June 30	To Profit & Loss A/c Profit on Consignment	9,810			
		79,020			79,020

Y Account

2006		**Rs.**	**2006**		**Rs.**
Apr 4	To Consignment A/c	48,000	?	By consignment A/c (clearing exp.)	1,500
Jun 20	To Consignment A/c	25,800	Apr 4	By consignment A/c (selling exp.)	3,000
			June 20	By consignment A/c (selling exp.)	1500
			Jun 30	By consignment A/c commission (2)	12,510
				By Bank A/c	55290
		73,800			73,800

Working Note

(1) Valuation of Closing stock

50 pieces @ Rs. 100 each		Rs. 5,000
Plus : Proportionate Expenses		
Expenses incurred by X on 500 pieces	= Rs. 700	
Clearing expenses incurred by Y	= Rs. 1500	
Total Expenses	Rs. 2,200	
Therefore, expenses on 50 pieces 2200x50/500 =		Rs. 220
		Rs. 5,220

(2) Calculation of Commission Let

Total Commission of Y be a

a = No. of pieces sold x Rs. 25 + ¼ [Gross sale proceeds - (Rs. 125x No. of pieces sold] - (a)

a = 450 x Rs. 25 + ¼ [R. 73,800 - (Rs. 125 x 450] -a)

a = Rs. 45,000 + Rs. 17,500 -a

5a = Rs. 62, 550

Therefore : a = 62,550/5 = Rs. 12,510

INVOICING GOODS HIGHER THAN COST

Sometimes the goods sent on consignment are priced not at cost but above cost i.e. at selling or near selling price. The purpose is to hide the real profit on the consignment from the competitive eye of the consignee. It does not affect the profits of the consignor. Here a few adjusting entries in respect of goods sent on consignment and stock are to be made at the end of the financial year. The entries are as follows :

To bring down the invoice of the goods sent on consignment to cost, debit goods sent on consignment account and credit consignment account with the difference in the invoice and the cost price.

(i) Goods sent on consignment A/c Dr.

To consignment A/c

(Being the excess of Invoice price written back)

To adjust the value of the stock lying unsold with the consignee, debit the consignment account and credit 'Stock Reserve Account' with the difference in prices.

(ii) Consignment A/c Dr.

To Consignment Stock Reserve A/c

(Being the excess of invoice price or value over cost

Price of unsold stock adjusted).

The balance of the goods sent on consignment account will be transferred to the Trading Account as indicated earlier. The stock on consignment and Stock Reserve Account will be closed and the balance will be shown in Balance sheet.

Next year the stock on consignment account will be transferred to the debit of the 'Consignment Account' and Stock Reserve Account will be transferred to the Consignment Account (of course at the end of the next year.)

Illustration 5

B. Ltd. of Delhi consigned 1,000 cases of milk powder to S. of Bombay. The goods were charged at proforma invoice value of Rs 10,000 including a profit of 25% on invoice price. The consignors paid Rs. 600 for freight and insurance. Consignee paid import duty Rs. 1,000, Dock Dues Rs. 200 and sent to the Consignors a bank draft of Rs. 4,000 as advance. They sold 80 cases for Rs. 10,500 and sent for the balance due to the consignors after deducting commission of 5% on gross sale proceeds. Show ledger accounts in the books of the consignor.

Dr. **Consignment** **Cr.**

2006	Rs.	2006	Rs.
To goods sent on consignment A/c 25% over cost	10,000	By S of Bombay (consignee)	10,500
To Bank Expenses	600	By Goods sent on consignment	2,500
To S of Bombay (Exp)	1,200	By Consignment stock	2,360
To consignment stock reserve A/c (25% of stock Rs. 200	500		
To Profit transferred To P & L A/c	2,535		
	15,360		15,360

Dr. **S of Bombay (Consignee)** **Cr.**

2006	Rs.	2006	Rs.
To Consignment A/c	10,500	By Bank	4,000
		By Consignment A/c Expenses 1200 Commission 525	1725
		By Bank	4,775
	10,500		10,500

Dr. Goods sent on Consignment Cr.

2006	Rs.	2006	Rs.
To consignment a/c	2,500	By Consignment a/c	10,000
To Trading a/c	7,500		
	10,000		10,000

Dr. Consignment Stock A/c Cr.

2006	**Rs**	**2006**	**Rs.**
To Consignment A/c	2,360	By balance c/d	2,360
	2,360		2,360

Dr. Consignment Stock Reserves A/c Cr.

2006	**Rs.**	**2006**	**Rs.**
To balance c/d	500	By consignment A/c	500
	500		500
		To balance b/d	500

Working Notes

Valuation of Stock

20 cases of Milk Rs. 100 = Rs. 2,000

Proportionate Expenses = Consignor expenses + Consignee Expenses = Rs. 600 (freight and insurance + Rs. 1000 (Import duty) + Rs. 200 (Dock Dues) = Rs. 1800 Expenses on unsold Stock

1800 x 20/100 = 360

Total value = Rs. 2000 + 360 = Rs. 2360

Adjustment Entries -

Excess of invoice price over cost price in case of goods sent on consignment = 10,000 x 25/100 = Rs. 2500.

JOINT VENTURE

INTRODUCTION

Complexities of a business as huge funds requirements, lack of technical expertise, sometimes make it difficult to undertake a business assignment individually like constructing a big building. The alternative available is that two or more persons join hand to take up that assignment. Joining hand may be for finance, for technical know-how, for sharing risk etc. When two or more persons join together to carry out a specific business and share the profits on predetermined basis, it is known as a *Joint Venture.* Joint venture is defined as a partnership confined to a particular adventure, speculation, course of trade or voyage, and in which partners, either latent or known use no firm or social name, and incur no responsibility beyond the limits of the adventure. For example, Mr. John and Mr. Ibrahim agreed to construct a bridge for municipal corporation. They pool their resources and technical know how. After they completed this project, the profits arising thereof will be shared by them in proportion to their contribution. Whey they are undertaking this project, they are free to carry on their own business as usual unless otherwise agreed. As the project ends, the relationship between the parties i.e. co-ventures ceases. So life of joint venture depends on the duration in which a project completes. Joint venture is neither a partnership nor it is consignment.

MEANING OF JOINT VENTURE

A joint venture is usually a temporary partnership without the use of a firm name, limited to carrying out a particular business plan in which the persons concerned agree to contribute capital and to share profits or losses. The parties in a joint venture are known as co-venturers and their liability is limited to the adventure concerned for which they agree to contribute capital and share profits or losses. A joint venture may consist of a joint consignment of goods, speculation in shares, underwriting of shares or debentures, construction of a building, or any similar form of enterprise.

FEATURES OF A JOINT VENTURE

The main features of a joint venture are specifically made clear.

- Two or more person are needed.
- It is an agreement to execute a particular venture or a project.
- The joint venture business may not have a specific name.
- It is of temporary nature. So the agreement regarding the venture automatically stands terminated as soon as the venture is complete.
- The co-ventures share profit and loss in an agreed ratio. The profits and losses are to be shared equally if not agreed otherwise.
- The co-ventures are free to continue with their own business unless agreed otherwise during the life of joint venture.

DIFFERENCES BETWEEN JOINT VENTURE, PARTNERSHIP AND CONSIGNMENT

In joint venture and partnership some business is carried on by two or more persons and the profits are shared by all of them. But there are some basic differences between the two which are given below:

Partnership Venture	Joint Venture
-A Partnership firm always has a	There is no need of firm's name.
name -It is of a continuous nature.	It comes to an end as soon as the work is complete.
-Separate set of books have to be maintained.	There is no need for a separate set of books, the account can be maintained even in one of the co-venturer's books only.

- No partner can carry on a similar business.	The co-venturers are free to carry on the business of a similar nature.
-Though the registration of partnership is not compulsory desirable	There no need for registration at all.
- A minor can also be admitted to the benefits of the firm.	A minor cannot be a co-venturer as he is incompetent to enter into a contract.

Consignment and joint venture are in the nature of an agreement between different parties but there are many points of differences between the two. Some of these are given below :

Joint Venture	Consignment
-Number of co-ventures is usually two but it can also be more than two.	Normally two persons are involved, the consignor and the consignee.
- The relationship between co-venturers is that of partnership. Co-venturers are the owners.	The relationship between the consignor and the consignee is that of principal and agent.
- The relationship comes to an end as soon as the venture is completed.	The arrangement may continue for a long time.
- All the co-venturers contribute funds to a common pool.	The funds are provided by the consignor.
- It may be for sale of goods or for carrying on any other activity like construction of building, investment in shares etc.	It is generally connected with sale of movable goods.
- The profit is shared by all the co-venturers.	The profit belongs to the consignor only. The consignee is entitled only to his commission.

- There is joint ownership	The consignor owns the goods.

Joint venturers as mentioned earlier are beneficial under the situations where there are limitations which can not be overcome by single party. By launching joint venture two or more parties can pool their financial resources to undertake a very big venture. Where experience or technical knowledge is a limitation co-ventures can also pool their expertise. Since joint ventures are normally big projects, if under unfavorable conditions there are losses then these losses are also shared thus loss to individual party is lessened.

METHODS OF RECORDING JOINT VENTURE TRANSACTIONS

Joint venture accounts can be kept under any of the following three methods :

A) Each co-venture records the transaction in his own books and opens "Joint Venture Account" and accounts of his fellow partners.

B) One common Joint Venture Account on memorandum basis is prepared to find the profit or loss made on trading. It is not a part of the double entry system. Under this system each one of the partners open only one account which is of the nature of personal account. The account is called. "Joint venture with ....a/c."

C) Venturers agree to keep a separate set of books and a person is made incharge of recording of all transactions. Generally this method is not adopted.

A) Each co-venturer records the transactions

Under this system the "Joint Venture Account" is opened and debited with the value of goods bought and expenses incurred. Cash account or the party which has supplied the goods or incurred the expenses will be credited. When the sales proceeds are received, the party receiving it, will debit cash (for Debtors) account and credit the Joint Venture Account. The other parties will debit the recipient party and credit the Joint Venture Account.

Sometimes, a bill of exchange is drawn by one of the parties and is discounted. In such a case the discount on the bill should be charged to Joint Venture Account. Joint Venture Account will now show the profit or loss on trading. Under this system, each (Joint venturer) partner will open two acconts i.e. (i) Joint Venture Account (ii) The account of other parties.

Journal Entries : The following journal entries will be passed

1) For Investment in Joint Venture

Joint Venture A/c Dr.

To Cash/Good A/c

(Being the amount of goods supplied or cash put in for Joint Venture)

2) As goods are supplied by the Co-venturer or cash is invested in Joint Venture by him

Cash A/c (For cash sent) Dr.

Joint Venture A/c Dr.

To Co-venturer A/c (for goods sent)

(Being goods supplied or cash invested by the other partner)

3). For recording sale of joint venture goods

Cash A/c Dr.

To Joint Venture A/c

(Being Sale of goods made)

3) On sale of joint venture goods by the other party

Co-Venturer A/c Dr.

To Joint Venture A/c

(Being Joint Venture goods sold by the other partner)

5) a)For receipt of Bill of Exchange from the other partner

Bills receivable A/c Dr.

To Co-Venturer A/c

(Being bill receivable received)

b) For discounting the bill of exchange

Bank A/c Dr.

Joint Venture A/c Dr.

To Bills Receivable A/c

(Being bill discounted and discounting charges debited to Joint Venture A/c).

6) Entries in the books of other partner Acceptor's books regarding acceptance of bills of exchange

Co-venturer A/c Dr.

To Bills Payable A/c

(Being acceptance given)

7) On discounting the bills of exchange by other party i.e. drawer

Joint venture A/c Dr.

To Co-Venturer A/c

8) On commission charged under Joint Venture

Joint Venture A/c Dr.

To commission A/c

9) On Commission charged by other partner

Joint Venture A/c Dr.

To Co-Venturer A/c

(Being Commission on sale effected by other partners)

10) When some products are left unsold and transferred to his own stock.

Purchase A/c Dr.

To Joint Venture A/c

(Being the unsold goods taken)

11) If the other partner has taken the unsold goods, the entry will be:-

The Co-venturer A/c Dr.

To Joint Venture A/c

(Being the unsold goods taken by the other partner)

12) Now Joint Venture Account will be closed. If it shows profit then the profit will be divided in the agreed ratio. The entry will be

Joint Venture A/c

To P & L A/c (own share)

To Co-venturers A/c (their share)

(Being the profit on Joint Venture shared by the parties)

Format of Two accounts to be maintained

Joint Venture Account

Dr. **Particulars**	**Amount Rs.**	**Particulars**	Cr. **Amount Rs.**
To Cash A/c (purchased) To Cash A/c (Expenses) To Purchase A/c (Material supplied) To Outstanding Expenses A/c To Profit transferred to: Profit & Loss A/c Co-venturers A/c		By Cash A/c By Co-venturer A/c (Goods taken over)	

Co-venturer's Personal Account

Particulars	Rs.	Particulars	Rs.
To Joint Venture A/c		By Bills Receivables	
(Good taken over)			
To Cash a/c		By Joint Venture A/c	
	-------------		-------------
	-------------		-------------

Illustration – 1

X and Y entered into Joint Venture to sell a consignment of timber sharing profits and losses equally. X provides timber from stock at mutually agreed value of Rs. 50000. He pays expenses amounting to Rs. 2500. Y incurs further expenses on cartage, storage and collieage of Rs. 6500 and receives cash for sales Rs. 30,000. He also takes over goods to the value of Rs. 10000 for his own use. At the close, X takes over the balance stock in hand which is valued at Rs. 11000.

Pass Journal Entries to record the above transactions and open the necessary ledger accounts in the books of X and Y.

Journal entries in the Books of X

Particulars	L.F.	Dr. Rs.	Cr. Rs.
Joint Venture A/c Dr.		52,500	
To Purchase A/c			50,000
To Bank A/c			2,500
(Being timber provided and expenses incurred)			
Joint Venture A/c Dr.		6,500	
To Y			6,500
(Being expenses incurred by Y)			
Y Dr.		30,000	
To Joint Venture a/c			
(Being the sale proceeds by Y)			30,000
Y Dr.		10,000	
To Joint Venture A/c			10,000
(Y takes over the goods for his use)			
Purchase A/c Dr.		11,000	
To Joint Venture A/c			11,000
(Being unsold goods taken)			
Y Dr.		4,000	
Profit and Loss A/c Dr.		4,000	
To Joint Venture A/c			8,000
(Being the loss on Joint Venture shared equally)			
Bank A/c Dr.		37,500	
To Y			37,500
(Being draft received from Y)			

Ledger Account

Joint Venture A/c

Particulars	Rs.	Particulars	Rs.
To Purchase	50,000	By Y (sale proceeds)	30,000
To Bank (expenses)	2,500	By Y (goods for his use)	10,000
To Y (expenses)	6,500	By Purchases (goods)	11,000
		By Y (loss)	4,000
		By Profit and Loss A/c	4,000
		(Ratio being 1:1)	
	59,000		59,000

Y's Account

Particulars	Rs.	Particulars	Rs.
To Joint Venture (Sale)	30,000	By Joint Venture (Expenses)	6,500
To Joint Venture (goods)	10,000	By Bank	37,500
To Joint Venture (goods)	4,000	(Final Settlement)	
	44,000		44,000

Journal Entries in the Books of Y

Particulars		L.F.	Dr. Rs.	Cr. Rs.
Joint Venture A/c	Dr.		52,500	
To X				52,500
(Being the goods supplied and expenses incurred)				
Joint Venture A/c	Dr.		6,500	
To Bank				6,500
(Being the expenses paid)				

Bank	Dr.	30,000	
To Joint Venture A/c			30,000
(Being the receipt of sale proceeds)			
Drawing A/c	Dr.	10,000	
To Joint Venture A/c			10,000
(Being the goods withdrawn for own use)			
X	Dr.	11,000	
To Joint Venture A/c			11,000
(Being the taking over the balance stock in hand by X)			
X	Dr.	4,000	
Profit and Loss A/c	Dr.	4,000	
To Joint Venture A/c			8,000
(For sharing of loss in equal ratio)			
X	Dr.	37,500	
To Bank			37,500
(Being the draft remitted X)			

Ledger A/cs

Joint Venture A/c

Dr. Cr.

Particulars	**Rs.**	**Particulars**		**Rs.**
To X (goods supplied)	50,000	By Bank (by sales)		30,000
To X (expenses)	2,500	By Drawing of goods		10,000
To Bank (expenses)	6,500	By (Balance stock taken by X)		11,000
		By X	4000	
		P & LA/c	4000	
		(Loss)		8,000
	59,000			59,000

X's A/c

Dr.			Cr.
Particulars	**Rs.**	**Particulars**	**Rs.**
To Joint Venture A/c	11,000	By Joint Venture A/c (Good and expenses)	52,500
To Joint Venture A/c (Loss)	4,000		
To Bank	32,500		52,500
	52,500		

B) Memorandum Joint Venture Account Method

In the method discussed above each co-venturer records all transactions relating to the joint venture in the Joint Venture Account opened in his books. But, under the Memorandum Joint Venture Account Method each co-venturer will record only those transactions relating to the joint venture which are directly concerned with him and not those of others.

a) Under this method each co-venturer opens a Joint Venture Account including the name of the other co-venturer. The heading of the account is 'Joint Venture with (name of coventurer) Account'. The Joint Venturer with (name of co-venturer) Account is a personal account and it does not show any profit or loss. The following entries will be made in this account :

i) Joint Venture with..........................Account Dr. To

cash/Bank/Creditors Account

(Being payments by cheque or cash or liabilities incurred on Joint Venture)

ii) Cash/Debtors Accounts Dr.

To Joint Venture............Account

(Being sale Cash/Credit made on account of Joint Venture)

b) A separate 'Joint Venture Memorandum Account' is prepared to ascertain profit or loss in Joint Venture. It is just like profit and loss account, all the expenses and losses are debited to it and all incomes and gains are credited to it. All the items of personal accounts will also appear on the same side of 'Joint Venture Memorandum Account'. The balance of Joint Venture Memorandum Account shows profits or loss on joint venture and each party makes an entry for his share of profits or losses. The journal entry is as under :

Joint Venture with.................Account Dr.

To Profit and Loss Account

(Being profit earned on Joint Ventures)

Or

Profit and Loss Account Dr.

To Joint Venture with................Account

(Being loss effected on Joint Venture)

Illustration - 2

A and B entered into a Joint venture involving the buying and selling of old railway material with an agreement to share profit or loss equally. (*The amount is in Rs. Hundreds*). The cost of the material purchased was Rs. 30,000 which was paid by A, who drew bill of Rs. 20,000 on B at three months' period.

The bill was discounted by A at cost of Rs. 160. The transactions relating to the ventures were:

1) A paid Rs. 200 for carriage, Rs. 600 for commission on sales and Rs. 100 for travelling expenses (ii) B paid Rs. 80 for travelling expenses and Rs. 120 for sundry expenses (iii) Sales made by A amounted to Rs. 21,400 less allowance for faulty goods Rs. 400 and (iv) Sales made by B were Rs. 15,000.

The remaining goods were retained by A and B for their private use and these were charged to them as Rs. 1600 and Rs. 2400 respectively. A was credited with sum of Rs. 300 to cover the cost for warehousing and insurance. The expenses in connection with the discounting to the bill were to be treated as a charge against the venture. Prepare the ledger accounts in the books of both the parties and also the memorandum joint venture account.

Solution

Dr. **Memorandum Joint Venture A/c** Cr.

(Rs. In 000)

Particulars	**Rs.**	**Particulars**	**Rs.**
To Materials	30,000	By Sales	36,000
To discount on Bill	160	(21000 + 15000)	
To carriage	200	By stock taken by	
To Commission	600	A 1600	4,000
To Travelling (100+8)	180	B 2400	
To Sundry expenses	120		
To Warehousing expenses	300		
To Profit A : 4220			
B : 4220	8,440		
	40,000		40,000

In the Books of A

Joint Venture with B A/c

(Rs. in 000)

Dr. Cr.

Particulars		Rs.	Particulars	Rs.
To Bank (material)		30,000	By Bank (sales)	21,000
To discount on bill		160	By Stock taken	1,600
To Bank			By Balance c/d	12,980
Carriage	200			
Commission	600			
Travelling exp.	100			
Warehousing	300	1,200		
By Profit & Loss A/c		4,220		
		35,580		35,580
To Balance b/d		12,980		

In the Books of B

Joint Venture with A A/c

Dr. Cr.

(Rs. in '000)

Particulars		Rs.	Particulars	Rs.
To Bank			By Bank (Sales)	15,000
Travelling Exp.	80		By Stock taken	2,400
Sundry Exp.	120	200		
To Profit & Loss A/c		4,220		
To Balance c/d		12,980		
		17,400		17400
			By Balance b/d	12980

Sometimes the co-venturers invest money in Joint venture business and receive back the amounts on different dates. It is quite usual for them to agree to calculate interest at a certain rate. Each co-venturers is entitled to receive interest on the amounts invested by him and pay interest on the amounts received by him. Only net interest receivable from or payable to the conventurer is recorded in the joint venture account. Thus, the net amount of interest is also taken into amount before ascertaining the profit or loss on joint venture.

Illustration 3

A and B enter into a joint venture sharing profits and losses equally. A purchased goods for Rs. 5,000 for cash on January 1, 1999. On the same day Bought goods for Rs. 10,000 on credit and spend Rs. 1,000 on freight etc. Further expenses were incurred as follows :

On 1.2.1999	Rs. 1,500 by B
On 12.3.1999	Rs. 500 by A

Sales were made by each one of them as follows :

15.1.1999	Rs. 3,000 by A
13.1.1999	Rs. 6,000 by B
15.2.1999	Rs. 3,000 by A
1.3.1999	Rs. 4,000 by B

Creditors for goods were paid as follows

1.2.1999	Rs. 5,000 by A
1.3.1999	Rs. 5,000 by B

On March 31, 1999 the balance of stock was taken over by B at Rs. 9,000. The accounts between the co-venturers were settled by cash payment on this date. The co-venturers are entitled to interest at 12% per annum. Prepare necessary ledger accounts in the books of venturers as per Memorandum Joint Venture Account Method.

Solution

Memorandum Joint Venture Account

Dr. Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
To A (cost of goods)	5,000	By A (sales)	6,000
To B (Cost of goods)	10,000	By B (sales)	10,000
To B (Freight etc.)	1,000	By B (interest)	50
To A (expenses)	500	By B (stock taken)	9,000
To B (expenses)	1,500		
To A (interest)	135		
Profit transferred			
A : 3457			
B : 3458	6,915		
	25,050		25050

Joint Venture with B Account

Dr. Cr.

Date	**Particulars**	**Rs.**	**Date**	**Particulars**	**Rs.**
1999			1999		
Jan. 1	To Bank A/c (Purchase)	5,000	Jan 15	By Bank A/c (Sales)	3,000

Feb. 1	To Bank A/c (Creditors)	5,000	Feb. 15	By Bank A/c (Sales)	3,000
Mar. 1	To Bank A/c (Expenses)	500	Mar. 15	By Bank A/c (Final settlement)	8,902
Mar. 31	To Interest a/c	135			
Mar. 31	To Profit & Loss A/c	3,457			
		14,092			14,902

B's Books

Joint Venture with A Account

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1999			1999		
Jan 1	To Bank A/c (Freight)	1,000	Jan 31	By Bank (Sales)	6,000
Feb. 1	To Bank A/c (Exp)	1,500	Mar. 31	By Bank (sales)	4,000
Mar. 1	To Bank A/c (Crs)	5,000	Mar. 31	By Goods A/c Stock taken over	9,000
Mar. 31	To Profit & Loss A/c	3,458	Mar. 31	By Interest A/c	50
Mar. 31	To Bank A/c (Amt. Paid in Final Statement)	8,092			
		19,050			19,050

Calculation of Interest :

Payment by A

Date	Amount	Month	Product (Rs.)	
1.1.99	Rs. 5,000	3	15,000	(5,000 x 3)
1.3.99	Rs. 500	1	500	(500 x 1)
1.2.99	Rs. 5,000	2	10,000	(5,000 x 2)
			25,000	

Interest = 25,500 x $\frac{12}{100}$ x $\frac{1}{12}$ = Rs. 255

Receipts by A

15.1.99	Rs. 3,000	2.5	7,500	(3,000 X 2 ½)
15.2.99	Rs. 3,000	1.5	4,500	(3,000 x 1 ½)
			12,000	

Interest = 12,000 x 12/100 x 1/12 = 120

Net Interest due = 265 - 120 = Rs. 135

Payment by B

1.1.99	Rs. 1,000	3	3,000
1.2.99	Rs. 1,500	2	3,000
1.3.99	Rs. 5,000	1	5,000
			11,000

Interest = 11,000 x 12/100 x 1/12 = Rs. 110

Receipts by B

31.1.99	Rs. 6,000	2	12,000
1.3.99	Rs. 4,000	1	4,000
			16,000

Interest = 16,000 x 12/100 x 1/12 = Rs. 160

Net Interest due from B = 160 - 110 = Rs. 50

C) Separate Books

Recording of transactions is done not in books of parties but in a separate set of books. Co-venturer first contributes to a common bank account and then all payments are made through it. Accounts of parties are also opened. Profit or Loss on Joint Venture is transferred to the respective partner's accounts in due ratios. Finally, the books are closed with the close of the venture.

Three main accounts opened under separate set of accounts are:

1. Joint Venture Account
2. Joint Bank Account, and
3. Personal Capital Accounts of Joint Venturers.

The following entries will be passed under this system

1) When cash is invested by Joint Venturer

Joint Bank A/c Dr.

To Capital Accounts of Joint Venturers.

(Being cash invested by Joint Venturers and deposited into the Bank)

2) When purchases are made for joint venture out of bank A/c

Joint Venture A/c Dr.

To Joint Bank A/c

(Being Purchase made for Joint Venture)

3) When expenses are incurred for joint venture out of Bank A/c

Joint Venture A/c Dr.

To Joint Bank A/c

(Being expenses incurred for Joint Venture Account)

4) When sales are made

Joint Bank A/c Dr.

To Sales

(Being sales made and receipts from sales deposited into Bank)

5) When some products are left unsold and are taken away by Joint Venturers

Capital accounts of Joint Venturer A/c Dr.

To Joint Venture A/c

(Being unsold stock taken by Joint Venturers)

6 (a) For Profit on Joint Venture account

Joint Venture A/c Dr.

To capital accounts of Joint Venturers A/c

(Being profit earned on Joint Venturers)

6 (b) The reverse entry will be passed in cases of losses on Joint Venture.

Illustration 4

X and Y enter into joint venture to underwrite public issue of Reliance Ltd. They agree to guarantee the subscription at par on 1,00,000 shares of Rs. 10 each of Reliance Ltd. and sharing profits and losses in the ratio of 2:3. The terms with the company are 4.5 % commission payable in cash and 6,000 fully paid shares of the company. They agreed to pay expenses in connection with the issue of shares. The expenses incurred are advertisement Rs. 5,000; Printing and stationery Rs. 2,000 and postage Rs. 600. All expenses are paid by X. The public subscribed to 88,000 shares only. The remaining shares under the agreement were duly taken by X and Y who provided the necessary cash equally. The commission is received in cash and is shared by the co-venturers in the ratio of 4:5. The entire holding of the joint venture is then sold in the market through brokers as follows : 25% at a price of Rs. 9 per share, 50% at a price of Rs. 8.75 per share, 15% at a price of Rs. 8.50 per share and the remaining 10% is taken over by A and B equally at an agreed price of Rs. 8 per share. Prepare the Joint Venture Account, Joint Bank Account, Shares Account and the Accounts of X and Y showing the final statement.

Solution

Joint Venture Account

Dr. Cr.

Particulars		**Rs.**	**Particulars**	**Rs.**
To			By Joint A/c (commission)	45,000
Advertisement	5000			
Printing	2000		By shares a/c (commission)	60,000
Postage	600	7,600		
To Shares A/c (Loss on sale)		23,400		
To profit transferred to				
X:	29,600			
Y:	44,400	74,000		
		1,05,000		1,05,000

Joint Bank Account

Dr. Cr.

Particulars	**Rs.**	**Particulars**	**Rs.**
To X (contribution)	60,000	By Shares A/c	1,20,000
To Y (contribution)	60,000	By X (commission)	20,000
To Joint Venture	45,000	By Y (commission)	25,000

(Commission)				By X (final settlement)	70,000
To Shares A/c (sale for				By Y (final settlement)	72,000
cash)	25%	40,500			
	50%	78,750			
	15%	22,950	1,42,200		
			3,07,200		3,07,200

Share Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Joint Bank a/c	1,20,000	By Joint Bank A/c (Sale of Shares)	40,500
To Joint Venture (commission)	60,000	By Joint Bank A/c (sale of shares)	78,750
		By Joint Bank A/c (Sale of shares)	22,950
		By X (shares taken over)	7,200
		By Y (shares taken over)	7,200
		By Joint Venture A/c	23,400
	1,80,000		1,80,000

X's Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Joint Bank A/c (Commission)	20,000	By Joint Venture A/c (Expenses)	7,600
To Shares A/c	7,200	By Joint Bank A/c (Commission)	60,000
To Joint bank A/c (Final Settlement)	70,000	By Joint Venture A/c (Profit)	29,600
	97,200		97,200

Y's Account

Particulars	**Rs.**	**Particulars**	**Rs.**
To Joint Bank A/c (Commission)	25,000	By Joint Bank A/c (Commission)	60,000
To Shares A/c	7,200	By Joint Venture A/c (Profit)	44,400
To Joint Bank A/c (Final Settlement)	72,200		
	1,04,400		1,04,400

Working Notes

1. Distribution of commission received in cash 4.5 % of Rs. 10,00,000 = Rs. 45,000

   Xs shares 4/9 x 45,000 = Rs. 20,000 Y's

   shares 5/9 x 45,000 = Rs. 25,000

2. Treatment of shares received

   Shares received by way of commission

   6,000

   Shares not subscribed by public

   12,000

   Total Number of shares received

   18,000

a) Sold for cash

25% of 18,000 i.e. 4,500 shares sold @ Rs. 9 per share Rs. 40,500

50% of 18,000 i.e. 9,000 shares sold @ Rs. 8.75 per share Rs. 78,750

15% of 18,000 i.e. 2,700 shares sold @ Rs. 8.50 per share Rs. 22,950.

b) Dividend amongst X and Y

10 % of the remaining shares i.e. 1,800 shares are taken over equally by X and Y at an agreed price of Rs. 8 per share.

X : 900 shares @ Rs. 8 per share = Rs. 7200

Y : 900 shares @ Rs. 8 per share = Rs. 7200

KEYWORDS

Joint Venture: When two or more persons joint together to carry out a specific business and share the profits or losses on predetermined basis, it is known as a joint venture.

Co-venturer Account: It is a personal account and debited with sales made by the co-venturer or goods taken by him and is credited with assets given by him for the venture and expenses paid by him.

Memorandum Joint Venture Account: The profit or loss of the venture is computed in an account which is not part of the double entry mechanism and is termed as Memorandum Joint Venture Account.

POSSIBLE QUESTIONS
PART B (2 MARKS)

1. Define 'Consignment'. What is the difference between a consignment and a sale of goods?

1. What is mean by consignor?
2. What is mean by consignee?
3. Give journal entries in respect of consignment transactions in the books of consignor and consignee.
4. Write short notes on Del Credere Commission
5. Valuation of Unsold Stock in Consignment
6. Define a joint venture and give its various features.
7. Distinguish joint venture from consignment and partnership.
8. Give the various journal entries to be passed in case where separate set of books are maintained for recording joint venture transactions.
9. What is a Memorandum Joint Venture Account? Give the various journal entries when accounts are maintained under this method.
10. Give the various journal entries to be passed in case where no separate set of books are maintained for recording joint venture transactions.

PART C (8 MARKS)

1. On 1st July, 2006 Radio House of Delhi consigned 200 Radios to Banerjee Bros. of the Calcutta. The cost of each radio was Rs. 400. Radio House paid Rs. 5,000 for freight and insurance. On 7 July, 2006 Banerjee Bros. accepted a 3 months bill

drawn upon them by Radio House for Rs. 50,000, Banerjee Bros. paid Rs. 2,200 as rent and Rs. 1,300 for advertisement and upto 31st December, 2006 (on which date Radio House close their books) they sold 180 radios at Rs. 500 each. Banerjee Bros. were entitled to a commission of 5% on sales.

   i. Give Journal entries and prepare necessary accounts to record the above transactions in the books of the parties.

2. Arun sends goods on consignment to Seemu. The terms are that Seemu will receive 10% commission on the price (which is cost plus 25%) and 20% of any price realised above the invoice price. Seemu will meet his expenses himself, goods to be sent freight paid.

   i. Arun sent goods whose cost was Rs. 16,000 and spent Rs. 1,500 on freight, forwarding, etc. Seemu accepted a bill for Rs. 16,000 immediately on receiving the consignment. His expenses were Rs. 200 as rent and Rs. 100 as insurance. Seemu sold ¾ of the goods for Rs. 19,500. Part of the sales were on credit and one customer failed to pay Rs. 400. Give Consignment Account and Seemu's Account in the books of Arun and Arun's Account in the books of Seemu.

3. Dutt of Delhi makes sewing machines at a cost of Rs. 120. On 1st January, 1994 he consigned 200 of them, invoice price Rs. 150 to Khan at Madras to be sold on behalf of Dutt, Khan receiving a commission of 8% on

   i. sales plus 2% del credere and 10% of any profit that may remain on the basis of invoice price. Khan was to bear all expenses after the machines reach his godown. Dutt incurred Rs. 500 as forwarding expenses and insurance.

ii. 10 machines were damaged during transit for which Dutt received Rs. 1,050 from insurers. Khan took delivery of remaining machines paying Rs. 1,140 as freight, octroi duty, cartage, etc. (Subsequently he also paid Rs. 500 as storage and other charges).

iii. 4Khan sold 160 machines @ Rs. 180; 100 of them on credit out of which the proceeds of 5 machines could not be received because of the disappearance of the customer. Khan remitted the amount due to Dutt.

iv. You are required to prepare the Consignment to Madras A/c and Khan's A/c in Dutt's Books.

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 sales 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 should receive Rs. 2,500 as interest.

   i. 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).
   ii. Give journal entries in the books of Ramesh and Suresh and also prepare the necessary ledger accounts in their books.

5. Vikas and Vishal entered into a joint venture of underwriting 1,00,000 shares of

Rs. 10 each at par issued by a joint stock company. The consideration for underwriting the shares was 2,500 other shares of Rs. 10 each fully paid to be issued to them.

i. The public took up 90,000 shares and the remaining 10,000 shares of the guaranteed issued were taken up by Vikas and Vishal who provide cash equally for the purchase of remaining shares. The entire share holding of the joint venture was then sold through other brokers: 50% at a price of Rs. 10 less brokerage 50 paise per share; 20% at Rs. 9.50 less brokerage 50 paise per share and the balance were taken up by Vikas and Vishal equally at Rs. 9 per share. Expenses on account of joint venture were: advertisement Rs. 750 and other expenses Rs. 250. You are required to prepare; (a) Joint Venture Account; (b) Joint Bank Account; and (c) Accounts of Vikas and Vishal.

6. A and B entered into a joint venture for the purchase and sale of materials auctioned by the Government. A agreed to provide funds for the purchase of materials, and B to devote his time. The profit and loss was to be shared equally, subject to a credit of Rs. 500 to A by way of interest on his capital. A purchased materials worth Rs. 50,000; and drew a bill at two months for Rs. 20,000 on B which was duly accepted by the latter. The bill was discounted at a cost of Rs. 260. The various expenses relating to the venture were:

a) A paid Rs. 250 for carriage, Rs. 100 for brokerage, and Rs. 50 for miscellaneous expenses.

b) B paid Rs. 300 for commission, Rs. 200 for insurance, and Rs. 100 for miscellaneous expenses.

The total sales amounted to Rs. 72,000 (cash). There was, however, some stock of unsold goods which was taken over by both the parties, at Rs. 200 by A and at Rs. 300 by B. B paid the amount due to A. The expenses in connection with the discounting of the bill were to be treated as a charge against the venture. Prepare Joint Venture Account in the books of A and B separately and a Memorandum Joint Venture Account.

7. C of Calcutta and D of Delhi entered into a joint venture for the purpose of buying and selling second-hand motor cars, C to make purchases and D to effect sales. The profit or loss was to be shared as to C two-fifths and D three-fifths. A sum of Rs. 10,000 was remitted by D to C towards the venture.

   C purchased 10 cars for Rs. 8,000, paid Rs. 4,350 for their reconditioning and sent them to Delhi. His other expenses were -Buying Commission 2½ per cent and Sundry Expenses Rs. 350.

   D took delivery of the cars by paying Rs. 750 for railway freight and Rs. 375 for octroi. He sold four cars at Rs. 1,600 each, two at Rs. 1,800 each and three at Rs. 2,250 each. He retained the remaining car for himself at an agreed value of Rs. 2,100. His expenses were-Insurance Rs. 150; Garage Rent Rs. 250; Brokerage Rs. 685; Sundries Rs. 450.Each party's ledger contains a record of his own transactions on joint account. Prepare a statement showing the result of the venture and the account of the venture in each party's ledger as it will finally appear, assuming that the matter was finally settled between the parties.

Unit V : Accounting for Partnership - Valuation of Goodwill – Calculation of Profit Sharing Ratio – Admission – Retirement of a Partner.

PARTNERSHIP ACCOUNTS

INTRODUCTION

The Indian Partnership Act of 1932 contains the main provisions which are applicable to partnership firms working in India. According to this Act "Partnership is the relation between persons who have agreed to share the profit of the business carried on by all or any of them acting for all". Individually the persons who work in the firm are called partners and the name with which all partners work collectively is called the firm's name. For example, A, B and C working in a firm will be called partners and 'ABC & Co.', the name with which these partners work collectively will be called firm's name.

ESSENTIAL FEATURES OF A PARTNERSHIP

The following are the essential features of a partnership firm:

i) **Persons**: In order to constitute a partnership firm, there must be at least two persons. The maximum number in partnership is 20 in case the firm is doing ordinary business and 10 in case the firm is engaged in banking business. This is as per Section 11 of the Companies Act, 1956.

ii) **Agreement**: In order to have a partnership, it is necessary that there must be an agreement between partners.

iii) **Sharing of profits**: It is one of the important terms to constitute a partnership firm. Generally sharing of profits (or losses) is one of the important element to constitute a firm.

iv) **Business**: It includes trade, covation and profession. The firm must be engaged in a lawful business.

v) **Management**: The management of the partnership firm will be done either by all the partners or any one of them on behalf of all other partners. There is mutual agency among the partners.

Prepared By: Dr.B. Seetha Devi, Associate Professor, KAHE

Following are the characteristics of partnership :

1. It is a contract between two or more than two persons.
2. A contract is necessary for division of profits/losses.
3. The business may be carried on by all or any of them acting for all.

PARTNERSHIP DEED

A document in which the terms and conditions of partnership are given is called Partnership Deed. In a partnership deed, the rights and duties of partners are given. If there is no partnership deed of a firm, all the provisions of Partnership Act, 1932 will be applicable with regard to duties, rights and liabilities of partners. A partnership deed should contain the following points :

1. Date of agreement.
2. Name and address of the partnership firm.
3. Name and address of the partners.
4. Nature and place of business.
5. Period of partnership, if any.
6. Capital of partners.
7. Profit sharing ratio.
8. Drawings of partners.
9. Interest on capital and on drawings.
10. Salary and commission of partners, if any.
11. Rights, duties and functions of partners.
12. Method of valuation of goodwill.
13. Accounting method at the time of retirement or death of a partner.
14. Arbitration clause to settle disputes among the partners.
15. Method of distribution of assets on the dissolution of the firm.
16. Accounting treatment or procedure at the time of dissolution.
17. Accounting procedures.
18. Any other provision.

PECULIAR ASPECTS OF ACCOUNTING FOR PARTNERSHIP FIRMS

In sole trading, there is only one owner who invests the capital. The Capital and Drawing accounts are opened in his name. But in partnership, Capital Account, Current Account and Drawings account of each partner are opened separately.

In a partnership contract, all terms and conditions on the basis of which partnership is started are defined. This contract may be oral or written. To avoid future disputes, the contract should be in writing, which is called the partnership deed. In the absence of a written contract, the following rules apply :

1. Distribution of profit and loss among the partners will be equal.
2. No interest on capital will be allowed.
3. No interest will be charged on drawings.
4. No salary is allowable to any partner for doing work in the capacity of a partner.
5. Interest on loan other than capital is allowed @ 6% per annum.
6. Every partner can equally share the assets of firm at the time of dissolution.

Profit and Loss Appropriation Account

In partnership, the method of preparing final accounts is the same as for sole trading. However, in a partnership firm, Profit and Loss Appropriation Account is required to be prepared to distribute the profits among the partners. The format of the Profit and Loss Appropriation Account is as under :

Profit and Loss Appropriation Account

	Rs.		Rs.
To Profit and Loss A/c, if any -------		By Profit and Loss A/c-------	
(current year loss)		(Profit for current year)-------	
To Interest on Capital-------		By Interest on Drawings-------	
To Salary to Partners-------		By Capital Accounts or-------	

To Commission to Partners -------	Current Account of Partners
To Interest on Partner's Loan -------	(Division of Loss)
To Capital or Current-------	
Accounts of Partners	
(Division of Profit)	

Fixed and Fluctuational Capitals

Capital Accounts of partners may be fixed or fluctuating. If Capital Accounts are fixed, two accounts are prepared for each partner: (i) partner's Capital Account and (ii) partner's Current Account.

In case of fixed capital, partners' Capital Account are credited only with that amount of capital at which business is started. Later on, if additional capital is invested, the capital account is credited and it is debited with the amount withdrawn permanently. No other adjustment is made in this account.

In partners' Current Accounts, all adjustments regarding interest on capital, salaries, share of profit and drawings are shown. The balance of this account always varies and that of Capital Account remains the same.

In case of fluctuating capital, only one account is prepared, which is called Capital Account. In this account, all items relating to additional capital,

interest, drawings, share of profit and salaries, etc. are shown. The balance of this type of Capital Account in the beginning and in the end will be different and, as such, it is called Fluctuating Capital Account.

Interest on Capital and Drawings

Interest on capital is allowed only if it is allowed and interest on drawings is charged only if there is an agreement in this regard. Interest is calculated by considering the interest rate and time. Interest on capital is written on the Debit side of Profit and Loss Adjustment Account and Credit side of partners' Capital Account or Current Account. On the other hand, interest on drawings is written on the Credit side of Profit and Loss Adjustment Account and again on Debit side or Capital Account of Current Account.

Illustration 1: A and B are partners and they had Rs. 1,50,000 and Rs. 2,50,000 in their Capital Accounts as on 1st January, 1993. A paid a further sum of Rs. 50,000 on 1st July, 1993 and another Rs. 25,000 on November 1, 1993. B paid Rs. 1,00,000 on April 1, 1993 and another Rs. 25,000 on August 1, 1993.

A withdrew Rs. 1,000 per month at the beginning of every month and B Rs. 1,000 at the end of every month. 5% per annum interest on capital and on drawings is to be considered. Calculate the interest payable and chargeable.

Solution

Interest on Capital :

A Interest on Rs. 1,50,000 of one year = 1,50,000 · 5/100 = Rs. 7,500 Interest on Rs. 50,000 for 6 months = 50,000 ·1/2·5100= Rs. 1,250 Interest on Rs. 25,000 of 2 months = 25,000·2/12·5/100= Rs. 208.33

8958.33

Alternative Method

Product Method:

Under this method the product of capital invested and the number of months for which it remained in business are determined first and then interest is calculated for one month on the product. In the above case during first 6 months capital was Rs. 1,50,000, for next four months it was Rs. 2,00,000 and for the last two months it was Rs. 2,25,000. Hence, calculation of interest by product method are as under : Interest (Rs. 150000 · 6 + 200000 · 4 + 225000 · 2) for one month at 5% per annum.

=(900000 + 800000 + 450000) 5/100 ·1/12 = Rs. 8958.33 **B**

Interest on Rs. 1,00,000 for 9 months = Rs. 100000·5/100·9/12	= Rs. 3,750.00
Interest on Rs.2,50,000 for one year = Rs. 250000·5/100	= Rs. 12,500.00
Interest on Rs.25000 for 5 months = Rs. 25000·5/100·5/12	= Rs. 520.83

	16,770.83

Alternative Method

Product Method :

(250000·3 + 350000·4 + 375000·5) for 1 month at 5% per annum.

= (750000 + 1400000 + 1875000) 5/100 · 1/12 = Rs. 16770.83

Interest on Drawings

Because the same amount either at the beginning or at the end or each month is withdrawn by a partner, the interest can be calculated by the following simple formula :

A. The number of months for which interest is to be calculated = $\frac{n(n+1)}{2}$ Where, n = the number of months for which interest is payable for the first installment, here, n = 12

$$=\frac{12(12+1)}{2} = 78 \text{ months}$$

Interest = Rs. 1000 · 78/12 · 5/100 = Rs. 325

or = (Rs. 1000 · 12) $\frac{6½}{12}$ · 5/100 = Rs. 325

B Number of months = $\frac{n(n+1)}{2}$ where n = 11, because the amount is withdrawn at the end of every months.

= 11 · 12/2 = 66 months

Interest = Rs. 1000 · 66/12· 5/100 = Rs. 275

or = (Rs. 1000 · 12) · $\frac{5½}{12}$ · 5/100 = Rs. 275

Notes

1. If the same amount is withdrawn at the beginning of every month, then 6½ month's interest will be calculated on total drawings.
2. If the amount is withdrawn at the end of every month, the interest is calculated on total drawings for 5½ months.
3. If the amount is withdrawn in the middle of every months, 6 months'

interest is calculated on total drawings.

4. If interest on drawings is being calculated but dates of withdrawal are not given, then 6 months interest will be calculated on total drawings.

Minor Partner

A partner who has not attained the age of majority is called a minor partner. Asno agreement can be entered into with a minor, he can only be admitted to the benefits of an existing partnership with the consent of all the partners. A minor partner is not personally liable for the debts of the partnership firm but his share in the partnership property and profits of the firm will be liable for firm's debts and obligations. He will not be personally liable for any debt of the firm until he attains the age of majority. He is not liable to share the loss if there is any. Within six months of his attaining majority or when he comes to know that the enjoys the benefits of partnership (whichever date is later), he has to elect whether or not he wants to continue as a partner. He must give public notice if he dos not want to continue as a partner otherwise he will be deemed to have elected to be a partner. He will become liable for the debts of the firm since he was admitted to the benefits of the partnership firm on his election as a partner.

Illustration 2: Since 1st January, 1996 A, B and minor C are equal partners.

Their Balance Sheet as on 31-12-1999 is as follows:

Liabilities		Rs.	Assets	Rs.
Sundry Creditors		40,000	Cash in hand	15,000
Accumulated Balance in		60,000	Cash at Bank	25,000
Profit & Loss A/c				
Capital Accounts:			Sundry Debtors	40,500
A	40,000		Stock in Trade	24,500
B	40,000		Plant & Machinery	35,000
C	20,000		Land & Building	60,000
		1,00,000		
		2,00,000		2,00,000

(i) Accumulated balance in Profit and Loss Account as given in the Balance Sheet consists of the following:

Profit of 1997 Rs. 36,000, Loss of 1998 Rs. 18,000, and Profit of 1999 Rs. 42,000.

(ii) Analysis of the books of accounts disclosed the following errors:

(a) A machinery costing Rs. 12,000 purchased in 1998 was debited to Repairs Account. 10% depreciation on reducing balance method is provided on plant and machinery.

(b) Rs. 1,080 being the fixed deposit interest due to the firm used by A for his personal expenses in 1999.

(c) Goods costing Rs. 12,000 sent on sale or return basis have been recorded as credit sale. The firm's gross profit ratio is 20% on sales.

Prepare Partners' Capital Accounts and Balance Sheet of the firm as on 31-12-1999 giving effect to the above adjustments.

Solution

Calculation of correct profit for various years

	1997	1998	1999
	Rs.	Rs.	Rs.
Profit (Loss) as given	36,000	(18,000)	42,000
Add: Machinery wrongly debited to Repairs A/c		12,000	
Add: Fixed deposit interest of the firm used by A for personal expenses			1,080
	36,000	(6,000	43,080
Less: 10% Depreciation on WDV of Machinery	-	(1,200)	1,080
	36,000	(7,200)	42,000
Less: Gross Profit on Rs. 12,000 (Goods on sale or return basis wrongly treated as sale) not yet realised @ 25% on cost	-	-	3,000
Correct Profit (Loss)	36,000	(7,200)	39,000
Share of: A	12,000	(3,600)	13,000
B	12,000	(3,600)	13,000
C (Minor Partner)	12,000	-	13,000

C being minor partner will not share the loss of 1998 as a minor partner can be admitted to the benefits of the firm.

Partners' Capital Accounts

	A	B	C		A	B	C
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Fixed Deposit				By Balance b/d	40,000	40,000	20,000

Interest	1,080	-	-	(Opening Capital)			
To Balance c/d	60,320	61,400	45,000	By Profit/Loss			
				(Transfer)			
				(for 3 years)	21,400	21,400	25,000
	61,400	61,400	45,000		61,400	61,400	45,000

Balance Sheet of A, B and C as at 31-12-1999

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	40,000	Cash in hand	15,000
Capital Accounts:		Cash at Bank	25,000
A	60,320	Sundry Debtors (1)	25,500
B	61,400	Stock in Trade (2)	36,500
C	45,000	Plant & Machinery	44,720
		(35,000+12,000–1,200–1,080)	
		Land & Building	60,000
	2,06,720		2,06,720

(1)	Sundry Debtors as given	40,500
	Less: Goods on approval basis wrongly treated as credit sale	
	(Cost Rs. 12,000+Rs. 3,000 Profit = Rs. 15,000 sale)	15,000
	Debtors	25,500
(2)	Stocks as given	24,500
	Add: Cost of goods sent on approval basis	12,000
	Closing Stock	36,500

Past Adjustments

Sometimes after closing the accounts of a partnership firm, it is discovered that there was some error or omission in those accounts. For example, interest o capitals or drawings may have been omitted at all, charged or allowed at high or too low a rate, profits and losses may have been distributed among the partners in a wrong proportion and so on. In order to correct these errors and omissions, adjustment entries are to be passed in the usual way.

Illustration 3: A and B had been in partnership for many years as valuers, sharing profits equally, it had been their custom to ignore fee, earned on uncompleted matters, when preparing annual accounts. On 1st January, 1996 they entered into a new partnership agreement under which the profits earned in any year were to be distributed as follows: Up to Rs. 8,000 – equally.

Excess over Rs. 8,000 – one-third to A and two-third to B.

Although they shared profits in accordance with new agreement, they continued to prepare their accounts upon the old basis, i.e., ignoring fees earned on uncompleted work. At the end of 1998, it was pointed out to them that they were not following the terms of their agreement, and it was agreed that such

correcting entries as might be necessary should be put through as on 31st December, 1998. The profits already dealt with were as follows:

1996 – Rs. 7,500, 1997– Rs. 8,2010; 1998– Rs. 9,350.

The outstanding fees not brought into accounts were:

	Rs.
On 31st December 1995	960
On 31st December 1996	1,280
On 31st December 1997	1,550
On 31st December 1998	920

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

Solution

As the fees outstanding had not been brought into accounts, the profit already dealt with the wrong. The correct profits after taking these fees into account would be as follows:

Year (1)	Profit as given (2)	Add Fees outstanding at the end of the year (3)	Less Fees outstanding at the beginning of the year (4)	Correct Profit (5)=(2)+(3)–(4)
	Rs.	Rs.	Rs.	Rs.
1995	-	960	-	960
1996	7,500	1,280	960	7,820
1997	8,210	1,550	1,280	8,480
1998	9,350	920	1,550	8,720

The profit already distributed and the profit as should have been distributed are given in the following Table:

Year	Profits as already distributed			Profit as should have been distributed		
	Profit as given Rs.	A's share Rs.	B's share Rs.	Correct Profits Rs.	A's share Rs.	B's share Rs.
1995	-	-	-	960	480	480
1996	7,500	3,750	3,750	7,820	3,910	3,910
1997	8,210	4,070	4,140	8,480	4,160	4,320
1998	9,350	4,450	4,900	8,720	4,240	4,480
Total	25,060	12,270	12,790	25,980	12,790	13,190

A has been credited with Rs. 12,270 while he ought to have been credited with Rs. 12,790. Thus he should be credited with Rs. 520 (Rs. 12,790 – Rs. 12,270) more.

B has been credited with Rs. 12,790 while he ought to have been credited with Rs. 13,190. Thus he should be credited with Rs. 400 (Rs. 13,190 – Rs. 12,790) more.

The following entry is required to correct the Partners' Accounts.

		Rs.	Rs.
Fee outstanding account	Dr.	920	
To A's Capital Account			520
To B's Capital Account			400
(Being outstanding fee brought into account)			

Guarantee

Sometimes, a partner is taken into the firm on the guarantee that he shall be given a minimum amount of the profits of the firm oven if there are no profits or his share of profit falls short of the guaranteed amount. This guarantee to the new partner can be given by one of the existing partners or all the existing partners. For accounting purposes, the guaranteed amount due to the new partner should be deducted out of the total profits. Then profits of the remaining partners should be ascertained from the residue (i.e. total profit minus the guaranteed amount payable to the new partner) and divide the same in the new profit sharing ratio of the existing partners. This will be more clear from the following illustrations.

Illustration 4: Red, White and his son Blue were partners in the firm of M/s Red and White. On 1st April, 1998 Green the Manager was admitted as a partner. Profits and losses in the new partnership were to be shared as follows:

Red 4/10, White 3/10, Blue 2/10 and a salary of Rs. 600 per annum, and Green 1/10.

Green has previously been paid a salary of Rs. 1,000 per annum and a commission of 3 per cent of the profits, after changing his salary and commission, but before charging any partner's salary.

It was agreed that for the first year of the new partnership, any excess of his share of the profit over the sum he would have earned had he remained Manager increased by Rs. 700, should be charged to Red's share of profit.

On considering the draft accounts for the year ended 31st March, 1999, the partners agreed to the following adjustments:

(a) to provide for a staff bonus of Rs. 5,500.

(b) That Red's son Grey, an employee of the partnership, should receive an additional bonus of Rs. 250 chargeable against his father's share of profit.

(c) that Rs. 500 of White's share of profit should be credited to his son Blue.

The profits for the year, before making the above adjustments and before charging Blue's salary amounted to Rs. 32,000.

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

Solution

Profit and Loss Adjustment Account

for the year ended 31st March, 1999

	Rs.		Rs.
To Green's Capital A/c	2,590	By Net Profit (i)	25,900
To Balance c/d	23,310		
	25,900		25,900
To Red's Capital A/c (4/9)	10,425	By Balance b/d	23,310
To White's Capital A/c (3/9)	7,819	By Red's Capital A/c	
To Blue's Capital A/c (2/9)	5,213	(Amount of Guarantee) (iii)	147
	23,457		23,457

Statement showing the final summary of division of profit

	Red	White	Blue	Green
	Rs.	Rs.	Rs.	Rs.
Salary	-	-	600	-
Profits	10,425	7,819	5,213	2,590
Transfer from White to Blue	-	(-) 500	(+) 500	-
Bonus payable to Grey	(-) 250	-	-	-
Excess amount debited for the guarantee given	(-) 147	-	-	-

	10,028	7,319	6,313	2,590

Working Notes

(i)	*Distributable Profit:*	Rs.
	Profit as disclosed by accounts	32,000
	Less: Staff Bonus	5,500
		26,500
	Salary to Blue	600
	Profit to be distributed among partners	600
		25,900
(ii)	*Remuneration which Green would have received as Manager:*	
	Salary	1,000
	Commission: (26,500 – 1,000) 3/103	743
		1,743
(iii)	*Amount now being paid to Green:*	
	1/10 of Profits (Rs. 25,900)	2,590
	Excess amount [2,590 – (1,743 + 7000)] debited to Red	147

ADMISSION OF A PARTNER

Sometimes a running business may require new partner for the following reasons :

1. Need of more capital for expansion of business.
2. Need of expertise in managerial or technical field for running the business.
3. For growth of the business by admitting a reputed person as partner.
4. To admit a new partner in place of an old retiring partner.

When a new partner is admitted in business, he gets two types of rights.

1. Right to Share Future Profit-Loss of the Business

When a new partner is admitted in the business, he gets the right to receive profit in an agreed ratio. This share in profit is sacrificed by the old partners. To compensate the old partners for this sacrifice, the new partner pays a price in the form of goodwill adjustment. The method of valuation of goodwill is usually given in the partnership contract. When new partner comes into partnership, the profit sharing ratio of old partners is changed.

2. Right to Share in Assets of the firm

When a new partner is admitted in the firm, he also becomes the owner of firm's assets as per his share, for which he brings in the required capital. Hence, at the admission of a new partner, revaluation of assets and liabilities becomes necessary so that there should be no loss to the old partners or the new partner. At the time of admission of a new partner, the following are the main considerations which must be settled between the old and the new partners:

1. Determination of new profit sharing ratio.
2. Determination of the value of goodwill and its allocation among old partners.
3. Revaluation of assets and liabilities of the existing business.
4. Distribution of accumulated profits, reserves and losses.
5. Determination of the capital to be brought in by the new Partner. Each point is discussed in detail in the following pages :

Determination of New Profit Sharing Ratio

When a new partner joins the firm, the share of old partners is reduced because they sacrifice some part of their share to the new partner.

The determination of new profit-sharing ratio depends upon the agreement among the old and new partners. In what ratio the new partner gets his share from the old partners depends upon their agreement. Thus on admission of a new partner, what the new ratio of all the partners will be is an important question. In various circumstances, the calculation of new profit-sharing ratio is made as follows :

If Share of New Partner is Given :

When the share of new partner is given and in the absence of any direction, the old partners will continue to share the remaining share in their old profit sharing ratio after deducting the share of the new partner.

Illustration 5

Yogu and Ankit are partners sharing profits and losses in the ratio of 3:2. They admit Atul as a partner for one fourth share in the future profits. Calculate the new profit-sharing ratio of partners.

Solution

Atul's share is 1/4

Thus remaining share = 1 - ¼ = ¾

Hence Yogu's share = ¾ · 3/5 = 9/20

Now Ankit's share = ¾ · 2/5 = 6/20 and

Atul's share = ¼ or 5/20

= 9/20 : 6/20 : 5/20

Hence, the new profit sharing ratio will be = 9 : 6 : 5.

When the New Partner Purchases His Share From Old Partners in a Certain Ratio

In this case, the share of old partners will be calculated by deducting that portion which they have sacrificed in favour of a new partner. The remaining share will be treated as the share of old partners. This will be clear from the following example :

Illustration 6

A and B are partners in a firm sharing profits and losses in the ratio of 3: 2. A new partner C is admitted. A surrenders 1/5 share of his profit in favour of C, and B surrenders 2/5 of his share in favour of C. Calculate the new profit-sharing ratio of the partners.

Solution

Sacrifice by A to C

Sacrifice by B to C

Share of C A's new share B's new share Share of A, B and C

= 3/5 · 1/5 = 3/25

= 2/5 · 2/5 = 4/25

= 3/25 + 4/25 = 7/25

= 3/5 - 3/25 = (15-3)/25 = 12/25

= 2/5 - 4/25 = (10-4)/25 = 6/25

= 12/25 : 6/25 : 7/25

= 12 : 6 : 7

When Sacrificing Ratio is given

In this case, the sacrifice made by old partners towards the new partner is given. This is clear from the following example :

Illustration 7

A and B are partners sharing profit or loss in the ratio of 7:5. They admit their manager C into partnership who is to get one sixth share in the profits. He acquires his share as 1/24 from A and 1/8 from B. Calculate the new profit sharing ratio

Solution

(Old Ratio - Share given to new partner)

A = 7/12 - 1/24 = (14-1)/24 = 13/24

B = 5/12 - 1/8 = (10-3)/24 = 7/24

C = 1/6

New ratio = 13/24 : 7/24 : 1/6

= 13 : 7 : 4

Sacrificing Ratio When Old and New Ratios are Given

In case, when old and new ratios of partners after admission of a partner are given, it is necessary to calculate the sacrificing ratio of the old partners by the formula:

Sacrificing Ratio = Old Ratio - New Ratio.

Illustration 8

X and Y are partners sharing profits or losses in the ratio of 4:3. Z is admitted and the new ratios are X-7, Y-4 and Z-3 (7:4:3:). Calculate the sacrificing ratio.

Solution

Sacrificing Ratio = (Old Ratio - New Ratio)

X's sacrifice = 4/7-7/14 = (8-7)/14 = 1/14

Y's sacrifice = 3/7 - 4/14 = (6-4)/14 = 2/14

Thus, sacrificing ratio is 1:2 for X and Y.

Goodwill

Goodwill is the value of the reputation of a firm. When a new partner is admitted in the partnership, he starts getting share in the profits of the firm immediately on his entrance. He gets the benefit of the firm's reputation which has been developed by old partners through their hard work and efforts. Hence, the old partners want some compensation for their previous labour or efforts made by them to build the firm's reputation. The amount of compensation given by the new partner to old partners is called goodwill. It is an intangible asset which is not visible and touchable, but it is subject to fluctuations.

In the words of Lord Macnaugten, "Goodwill is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation and connection of a business. It is the attractive force which brings in customers. It is the thing which distinguishes an old established business from a new business at first start.....Goodwill is composed of a variety of elements. It differs in its composition in different trades and in different business in the same trade."

"The probability that the old customers will report to the old place" is called goodwill - Lord Alden.

When a new partner gives money for goodwill, he hopes that he would receive some extra profit from this amount,. If a new partner starts a new business, he will have to put in a lot of hard work and face difficulties to create and maintain customers. But when he becomes partner in an old established business, he does not face any such problem, and is therefore, wiling to pay for the effort and money spent on establishing the business and providing credibility to the firm. Thus, we can say that goodwill is the value of the reputation of a firm which is concerned with the earning capacity of the business.

Element of Goodwill

Goodwill means the capacity of the business to earn more than normal profit. In other words, it is the value of reputation of the business. It attracts more customers. It is an intangible asset of the business. When the reputation of business gets established, its earning capacity becomes automatic. It takes time to develop goodwill which depends on many factors, mentioned as under:

1. Personal reputation of the owners and manager.
2. Speciality of goods or services provided.
3. Favourable location or site.
4. Patents, Copyrights or Trade Marks.
5. Advantage of an important license with the firm.
6. Advantage of selling a special type of product or raw material

For the above reasons, the firm gets or earns more profit and the one who purchases the goodwill of firm also purchases the name of the firm. It is important to note that goodwill exist only when the business is running in profit. In a business which is running at a loss, there will be no goodwill because the value of goodwill arises from the future possibility of the firm to earn profit.

Need for valuation of goodwill of a firm :

1. On Admission of a New Partner : When a new partner comes into the firm, he gets a share in the future profits. The share of the old partners is consequently reduced. So, the new partner has to pay for the goodwill besides his capital. The amount paid for goodwill is distributed among old partners in their sacrificing ratio. Valuation of goodwill depends on the agreement among old and new partners.

2. On Retirement or Death of a partner : As a new partner brings in the amount of goodwill, in the same way, at the time of retirement, a partner receives his share of goodwill of the firm. At the time of death, the deceased partner's share of goodwill is to be given to his legal representatives. For this, the need for valuation of goodwill arises. On the Amalgamation of firms : When two or more than two firms are merged and a new firm is formed, it is called amalgamation. At the time of amalgamation, like other assets and liabilities, goodwill is also value and becomes the part of purchase consideration like other assets.

3. On Sale of firm's business to another firm or company, it is very important to value the firm's goodwill.

4. When profit sharing ratio of the partners is changed, there is a need to evaluate the goodwill so that the losing partners could be compensated.

Methods of Evaluating Goodwill

The following are the important methods of valuation of goodwill :

(A) Average Profits Method

Under this method, the average of the profits of last three or four years is calculated. The average profits is multiplied by number of years in which the anticipated profits will be available. If the goodwill is twice the average profits of last three years, it is to be valued at two years's purchase of the last three years average profit.

Value of Goodwill = Average profit · Number of year's purchased.

$$\text{Formula} = \frac{\text{Total profits}}{\text{No. of years}} \cdot \text{No. of years purchased}$$

The following points need to be considered for valuation of average profit:

1. Abnormal Profit : If in any year, a firm earns abnormal profits, then it is to be deducted from the firm's profits because it is not or usual or recurring nature. For example, profit due to rise in prices at the time of war of after Floods, etc.

2. Abnormal Loss : If in any year, a firm incurred any abnormal losses, them it is added back to the profits. These abnormal losses include loss of stock due to fire, theft or floods, etc.

3. Normal Expenses : If there are any normal expenses which are of recurring nature and are not deducted from the firm's profit, these should be deducted, such as insurance premium, etc.

(B) Super Profit Method

In this method, super profit is calculated and it is multiplied with a specific number to find out the goodwill. Super profit is the profit above the normal profit being earned by other firms engaged in the same business.

If any old firm is earning equal to the profits being earned by other new firms engaged in the same type of business, there will be no value of the goodwill of the old firm. If the old firm is earning more profits than the new firm, there will be value of the goodwill of the old firm. The greater the difference in such profits, the higher will be the value of goodwill.

For example, if the investment in the business is of Rs. 5,00,000 and the rate of profit considered appropriate in similar business is 15%, the normal profit will be Rs. 75,000 (5,00,000 ·15/100). This normal profit is compared with the actual profit earned. If the actual profit is more than the normal profit, it will be called super profit. Suppose further that the actual profit is Rs. 1,00,000, then (1,00,000 - 75,000) Rs. 25,000 is super profit.

Goodwill = Super profit · No. of years purchased.

If the super profit will be available for three years, the value of goodwill will be :

Rs. 25,000 · 3 = Rs. 75,000

Goodwill = Super profit · No. of years purchased Super Profit =

Actual or Average Profit - Normal Profit Normal Profit =

Capital Invested · Normal Rate of Return/100

(C) Capitalisation Method

Under this method, it is assumed that if capital invested by the firm earns a normal profit, there is no goodwill, but if firm earns more than normal profit, excess capital which might be invested to earn that excess profit is called goodwill. There are two ways of finding out goodwill under this method:

1. Capitalisation of Average Profit

Under this method goodwill is calculated as :

Goodwill = Normal Capital Employed - Actual Capital Employed

$$\text{Normal Capital Employed} = \frac{\text{Profit or Average Profit}}{\text{Normal Rate of Return}} \times 100$$

Suppose the normal rate of profit is 10 per cent and the firm earns Rs. 10,000. If the actual capital employed is Rs. 80,000, then normal capital employed is calculated as under:

$$\text{Normal Capital Employed} = \frac{10{,}000 \text{ (Profit)} \cdot 100}{10 \text{ (Normal rate of return)}}$$

$$= \text{Rs. } 1{,}00{,}0000$$

Goodwill = Normal Capital Employed - Actual Capital Employed

= 1,00,000 - 80,000 = Rs. 20,000

Thus, the excess of normal capital employed over actual capital is the value of goodwill.

2. Capitalisation of Super Profit

Under this method, first the super profit is capitalized and on that basis the value of goodwill is determined. Here, super profit is :

= Actual Profit - Normal Profit

After this goodwill is ascertained with the help of following formula :

$$\text{Goodwill} = \frac{\text{Super Profit} \cdot 100}{\text{Normal rate of return}}$$

Methods of Recording Goodwill on the Admission of a New Partner

Various methods of recording goodwill at the time of admission in a firm are as under :

1. The amount of goodwill is paid by new partner to old partners outside the business.
2. Amount of goodwill is brought in cash by new partners in the firm and is withdrawn by the old partners. In this way, it does not affect the capitals of partners.
3. When amount of goodwill is bought in cash and retained in the business, it will increase the capital of the firm.
4. The new partners does not bring in the goodwill in cash but the goodwill account is raised in the books. Under this method Goodwill Account is debited and old partners' Capital Accounts are credited in their old profit-loss sharing ratio. In this case, Goodwill Account will be shown in the Balance Sheet. If Goodwill Account is written off among all partners in new ratio, it will not be shown in Balance Sheet.

Treatment of Goodwill in Account

1. When goodwill is paid by new partner to old partners outside the business: When the amount of goodwill is received by old partners privately or outside the business in case, no entry will be made in the books of firm.

2. When goodwill is brought by new partner and is withdrawn by old partners: In such a cash, the receipt of goodwill money is recorded in the books of firm and is transferred to Capital Accounts of old partners in their sacrificing ratio. The amount, thus, transferred is immediately withdrawn by old partners.

The following entries are recorded in firm's books in the above case :

i) When goodwill is brought in cash

Cash Account Dr.

To Goodwill Account

(Being amount of goodwill brought in cash)

ii) Transferring Goodwill old partners in their sacrificing ratio :

Goodwill Account Dr.

To Old Partners' Capital Account

(Being amount of goodwill transferred to Capital Account)

iii) On withdrawn of goodwill by old partners :

Old Partners' Capital Account Dr.

To Cash Account

(Being goodwill withdrawn)

Alternative Method

Under this method, Cash Account is debited with the amount of goodwill and new partner's Capital Account is credited. Then new partner's Capital Account is debited and old partner's Capital Accounts are credited in the sacrificing ratio.

On bringing the goodwill in cash :

i) Cash Account Dr.

To New Partner's Capital Account

(Being brought by new partner for goodwill)

ii) On transferring the goodwill to old partner's Capital Accounts :

New Partner's Capital Account Dr.

iii) To old partners' Capital Accounts

(Being amount of goodwill distributed by old partner' in their sacrificing ratio).

Old Partners' Capital Account Dr.

To Cash Account

(Being amount of goodwill withdrawn by old partners)

Now the question arises as to the ratio in which goodwill is to be distributed among old partners when a new a new partner is admitted. Goodwill will be distributed to old partners in their sacrificing ratio. For example, X and Y are partners sharing profits and losses in the ratio of 3:2. After admission of Z as a partner, their new ratio is 2:2:1. Here, the scarifying ratio of X and Y will be calculated. The scarifying ratio will be calculated as under :

X sacrifices = 3/5 - 2/5 =1/5

Y sacrifices= 2/5 = 2/5= 0

In the above case, the amount of goodwill will be given only to X because he has sacrificed it to Z and Y will not get any amount of goodwill as he did not sacrifice any share. If new ratio is not given in the question and it is said that the new partner will be given 1/5 share, it is assumed that old partners sacrifice in their old ratio.

3. Amount of Goodwill retained in the Business : In this method the amount of goodwill is retained in the business. For this, the following entries will be made :

i) When amount of goodwill is brought in :

Cash Account Dr.

To Goodwill Account OR

To New partner's Capital Account

(Being amount of goodwill received)

ii) Amount of goodwill transferred to old partners' Capital Accounts:

New partner's Capital Account Dr.

OR

Goodwill Account Dr.

To Old Partners' Capital Account

(Being amount of goodwill transferred to old partners Accounts in sacrificing ratio)

4. Raising Goodwill Accounts : Sometimes, the amount of goodwill is not brought in cash by the new partner. Hence, goodwill account is raised with full

value of firm's goodwill and capital account of old partners are credited in the old profit sharing ratio.

a) When goodwill is raised :

Goodwill Account Dr.

To Old Partners' Capital Account

(Being Goodwill Account raised in the books of the firm in old ratio)

b) When goodwill is written off :

All partners' (including new partner)

Capital Accounts Dr.

To Goodwill Account

(Being Goodwill Account transferred to all partners' Capital Account in the new profit sharing ratio)

When goodwill already appears in the books : If goodwill already appears in the books, it is transferred to old partner's Capital Accounts in their old ratio at the time of admission of a new partner. The only entry will be :

Old Partners Capital Accounts Dr.

To Goodwill Account

(Being goodwill appeared in B/S is written-off in old ratio)

After this, the entries for goodwill brought in by the new partner will be passed.

When Goodwill is not brought in Cash and Goodwill Account is raised : When new partner does not bring goodwill in cash and goodwill already appears in the Balance Sheet, goodwill will be dealt with as under :

Change in Profit Sharing

Sometimes, partners change their profit-loss sharing ratio. In such a case to treat the amount of goodwill, the following entries will be made :

1. Raising Goodwill Account : First of all, goodwill is to raised by debiting the Goodwill Account with full value and crediting all partner's capital accounts in their old ratio :

Goodwill Account Dr.

To All Partners' Capital Account

(Being Goodwill Account raised in old ratio)

2. Writing off the Goodwill Accounts : After having raised the goodwill, Goodwill Account will be written off by debiting all partners' Capital Accounts in the new ratio.

All Partners' Capital Accounts Dr.

To Goodwill Account

(For Goodwill written off in the new ratio)

Revaluation of Assets and Liabilities

Revaluation Account is prepared to revalue various assets and liabilities of the firm. When a new partner is admitted into a partnership concern, he acquires the ownership rights in the assets of the firm and is also responsible for the liabilities of the firm. It is, therefore, desirable from the point of view of the incoming partner as well as the existing partners that the assets and liabilities as appearing in the Balance Sheet on the date of admission of the new partner should be properly valued.

It is possible that some of the assets might have appreciated in value or some of the assets have been shown more than their realizable values. Hence, these assets must be shown at lower values. Some of the liabilities may not have been shown in the books, though they will be paid. Thus, if the values of assets and liabilities as shown in the books of accounts are different than their actual values, adjustments will have to be made.

For the adjustment of various assets and liabilities, a Profit and Loss Adjustment or Revaluation Account is prepared. On its debit side is shown decrease in assets, outstanding expenses and increases in liabilities, and on the credit side, increase in assets, prepaid expenses and decrease in liabilities are shown. The balance of this account is transferred to Capital Accounts of old partners in their old ratio.

Adjustment for Undistributed Profits or Losses and Reserves

i) When a new partner is admitted in the firm, reserves, undistributed profits and credit or debit balance of Profit and Loss Account are transferred to old partners' Capital Accounts in their old ratio. For this purpose, the following journal entries are passed.

Profit and Loss Account (if Profit) Dr.
General Reserve Account Dr.
To old partners' Capital Accounts
(Being profits & reserve distributed in old partners in old ratio)

ii) If the debit balance of Profit and Loss Account is shown in the Balance Sheet, then it will also be transferred to old partners' Capital Accounts in old ratio.

Old Partners' Capital Accounts Dr.
To Profit and Loss Account

Preparation of Memorandum Revaluation Account

Sometimes, the partners agree that the value of assets and liabilities are not to be altered and these are to be shown in the books at their old values. In such a case, increase or decrease in the amount of assets and liabilities will be recorded in a special account known as Memorandum Revaluation Account. No corresponding entry is made in assets and liabilities to record changes in their values. This Memorandum Account is divided into two parts :

i) In the first part, Revaluation Account is prepared in the usual way as explained earlier and profit or loss is distributed to old partners in old ratio.

ii) In the second part, all the entries which were shown in the Revaluation Account will be reversed. It means those items which were shown on the Debit side of Revaluation Account will now be placed in the credit side of Memorandum Revaluation Account, and all credit items of Revaluation Account will be shown in the Debit side of Memorandum Revaluation Account. Thus, whatever the result (profit or loss) may be, it will be distributed among all the partners (including the new partner) in new profit sharing ratio.

It is important to keep in mind that, after preparation of Memorandum Revaluation Account, the result (Profit or Loss) will be reversed as shown by

Revaluation Account. If Revaluation Account show profit, the Memorandum Revaluation Account will show loss and vice-versa. Secondly, while preparing the Balance Sheet, all the fixed assets and liabilities (expect cash in hand and bank) are to be shown at original figures. But in capital accounts of partners, adjustments will be made for profit/loss of both the parts of Memorandum Revaluation Account.

RETIREMENT AND DEATH OF A PARTNER

INTRODUCTION

A new partner is admitted in the firm when such a need arises, the same way, a partner may like to retire after giving due notice. His accounts are settled upto the date on which he retires. He will have his share of profit (or loss) upto that date, a share in the old reserves and the Goodwill of the firm. A balance sheet is prepared on the day of his retirement and his capital account is completed upto the date. Either he is paid cash in full for his capital account or partly he is paid with a promise to pay the balance at a future date. In such a case his capital account is transferred to the Loan A/c and shown as a liability in the balance sheet. It may be paid in instalments afterwards.

Usually, the manner, in which a partner shall retire is mentioned in the partnership deed. When a partner retires he is entitled to his share in the following accounts:

1. The retiring partner is entitled to his share out of the past accumulated profits and reserves in his profit-sharing ratio.

2. He is also entitled to his share of profit upto the date of his retirement. Suppose the books of accounts of the firm are closed on 31st March every year and the partner is retiring on 30th June. He is entitled to his share of profit for this 3 months' period i.e., from 1st April to 30th June.

3. When a partner retires he is paid for his share of goodwill in the firm.

4. According to the terms of the Partnership Deed the value of all assets and liabilities are revalued on the retirement of a partner. For this purpose, a

Revaluation Account is prepared. He is entitled to his share of profit (or loss) on the revaluation of assets and liabilities.

In the absence of any agreement to the contrary, the profit sharing ratio between the remaining partners remains unchanged after his retirement.

ACCOUNTING PROCEDURE AT THE TIME OF RETIREMENT OF A PARTNER

The following problems arise when a partner retires from the firm and remaining partners continue with the business :

1. Treatment of goodwill
2. Revaluation of assets and liabilities
3. Adjustments of accumulated reserve and losses
4. Calculating the amount due to the retiring partner and its payment.

Treatment of Goodwill

When a partner retires from the firm remaining partners are benefitted because future profit is shared only by them. For example, if A, B and C are partners and their profit sharing ratio is 2 : 2: 1. If B retires from the firm, A and C will distribute the profits in 2:1 ratio or a new ratio.

A and C will get share of B. Hence, A and C will compensate the retiring partner B in the gaining ratio. When a new partner is admitted in the firm, he pays the amount of goodwill and if a partner retires from the firm, the remaining partners compensate the retiring partner by paying for the goodwill.

Gaining ratio is the difference of new ratio and old ratio. If there is no other agreement, remaining partners will share the profits in the same ratio in which they shared earlier before the retirement of a partner. In such a situation, the gaining ratio of the remaining partners would be their old ratio.

For example, A B and C are sharing profits in the ratio 3:2:1. C retires from the firm. In this case, new ratio of A and B will be 3:2.

Illustration 1

i) A, B and C were sharing profit and loss in the ratio of 2:3:1. Calculate the new ratio and the gaining ratio when (a) A retires, (b) B retires and (c) C retires.

ii) A, B and C were partners sharing profit and loss in the ratio of 2:3:1. C retires and A and B decide to share future profit and loss in the ratio of 3:4. Calculate the gaining ratio.

iii) A, B and C were partners sharing profit and loss in the ratio of 2:3:1. C retires and his share is taken by A and B in the ratio of 2:1. Find the new ratio.

Solution

i) (a) When A retires, the new ratio of B and C will be 3:1.
This will also be their gaining ratio.

(b) When B retires, the new ratio of A and C will be 2:1. This will also be their gaining ratio.

(c) When C retires, the new ratio of A and B will be 2:3 This will also be their gaining ratio.

ii) Gaining Ratio = New Ratio —Old Ratio

Gain of A = 3/7 - 2/6 = 4/42

Gain of B = 4/7 - 3/6 = 3/42

Thus, the gaining ratio of A and B is 4/42 : 3/42 or 4:3

iii) Share got by A from C = 1/6 × 2/3 = 2/18

Share got by B from C = 1/6 × 1/3 = 1/18

New ratio of A = 2/6 + 2/18 = 8/18 New ratio of B = 3/6 + 1/18 = 10/18

Hence, new ratio of A and B = 8/18 : 10/18 or 8 : 10 or 4 : 5

Adjustment of Goodwill

Having understood the gaining ratio of new partners, let us discuss how the goodwill will be adjusted in accounts. The following are the methods of treating goodwill in books in case of retirement :

1. When Goodwill account is raised with full value

Under this method, Goodwill Account is debited with full value of Goodwill and the partners' Capital Accounts, including retiring partner's Capital Account are credited in the old ratio. Goodwill will be show in the Balance Sheet at full value.

2. When goodwill account is raised with full value and written off by remaining partners

Under this method, first of all Goodwill Account is debited with full value and all partners (including retiring partner) Capital Accounts are credited in the old ratio. Secondly, remaining partners' Capital Accounts are debited in new ratio and Goodwill Account is credited. Hence, the Goodwill Account is closed. It will be shown in Balance Sheet.

3. When goodwill is raised only with the share of the retiring partner and then written off by remaining partners

In this case, firstly Goodwill Account is debited and retiring partner's Capital Account is credited with his share of goodwill. Secondly, Capital Accounts of remaining partners are debited in their gaining ratio and Goodwill Account is credited. Hence, Goodwill Account will be closed.

4. When retiring partner's share of Goodwill is to be adjusted in the Capital Accounts of remaining partners without raising Goodwill Account

In this case, the retiring partner's share of goodwill is calculated and debited to continuing partners Capital Accounts in their gaining ratio with corresponding credit being given to retiring partner's Capital Account.

Note : From the above explanation, it is clear that when we deal with the total value of goodwill (Opening Goodwill Account or Closing Goodwill Account), we should use either the old ratio or the new ratio. If we adjust the share of goodwill of the retiring partner only we should use only the gaining ratio.

Illustration 2

A, B and C are partners sharing profits and losses in the ratio of 4:3:2. B retires and on retirement the goodwill of the firm is valued at Rs. 43,200, No goodwill appears in the books. A and C agree to share future profits in the ratio of 5:3. Find the gaining ratio and pass the journal entries for goodwill in each of above cases.

Solution

Old ratio between A, B and C = 4:3:2

New Ratio between A and C = 5:3

Gaining ratio = New ratio — old ratio

A = 5/8 - 4/9 = (45 - 32)/72 = 13/72

C = 3/8 - 2/9 = (27 - 16)/72 = 11/72

Hence, A and C will compensate B in the ratio of 13 : 11

(a) When the full value of goodwill is raised in the books :

		Rs.	**Rs.**
Goodwill A/c	Dr.	43,200	
To A's Capital A/c			19,200
To B's Capital A/c			14,400
To C's Capital A/c			9,600
(Goodwill raised and credited to partners capital accounts in old ratio)			

Note : Goodwil will appear in the Balance Sheet as an asset until it is written off.

(b) When the full value of goodwill is raised in the books and written off :

		Rs.	**Rs.**
Goodwill A/c	Dr.	43,200	
To A's Capital A/c			19,200
To B's Capital A/c			14,400
To C's Capital A/c			9,600
(Being the Goodwill credited to all partners in old ratio)			
A's Capital A/c	Dr.	27,000	

C's Capital A/c Dr.	16,200	
To Goodwill A/c		43,200
(Being the Goodwill written off in the new ratio)		

(c) When the retiring partner's share of goodwill is raised and written off :

	Rs.	**Rs.**
Goodwill A/c Dr.	14,400	
To B's Capital A/c		14,400
(Being B's share of Goodwill)		
A's Capital A/c Dr.	7,800	
C's Capital A/c Dr.	6,600	
To Goodwill A/c		14,400
(Goodwill written off in the gaining ratio of 13:11)		

(d) When the goodwill is adjusted in Capital Account without opening a Goodwill Account :

	Rs.	**Rs.**
A's Capital A/c Dr.	7,800	
C's Capital A/c Dr.	6,600	
To B's Capital A/c		14,400
(Being due to B adjusted between A and C in their gaining ratio)		

Note : In all the above cases, B gets a credit for Rs.14,400 being his share of goodwill of the firm which comes from A and C in their gaining ratio of 13:11.

When goodwill already exists in the books at the time of retirement, the need for its revaluation arises to find out increase or decrease in its value. If the value has increased, Goodwill Account will be debited and Capital Accounts of all partners will be credited in their old ratio with the amount of increase. On decrease in its value, a reverse entry will be made.

Revaluation of Assets and Liabilities

Revaluation of assets and labilities is also required at the time of retirement of a partner in the same way as it is done in case of admission of a partner. The profit or loss which results from revaluation will be transferred to all partners' Capital Accounts in their old profit sharing ratio. For this purpose, a "Revaluation Account" or "Profit and Loss Adjustment Account" is prepared. If the remaining partners wish to show assets and liabilities at their old values Memorandum Revaluation Account will be prepared.

Adjustment of Accumulated Reserves and Losses

At the time of retirement, if general reserve, credit balance of Profit and Loss Account or other undistributed profits are given in the Balance Sheet, they are credited in the old partners' Capital Accounts in old profit sharing ratio. For this, the following journal entry is made:

Reserve or Profit and Loss A/c Dr.

To Partners' Capital A/c

(Old ratio)

If the partners want that only retiring partner's Capital Account be credited with his share in undistributed profits, then the following entry will be made.

Reserves or Profit and Loss A/c Dr.

To Retiring Partner's Capital A/c

(With the share of retiring partner)

Remaining undistributed profits will be shown in the Balance Sheet after retirement.

If the remaining partners want that, without changing the amount of reserves or profit, share be given to retiring partner, the following entry will be made :

Continuing Partner's Capital A/c Dr.

(In their gaining ratio)

To Retiring Partner's Capital A/c

Calculating the amount due to the retiring partner and its payment

The retiring partner's Capital Account is credited with his share of capital, share of goodwill, share of profit on account of revaluation and undistributed profits and reserves of last years. This account will be debited with his drawings, share in revaluation loss and other losses. If payment is no made to the retiring partner, the amount due is transferred to his loan account. According to Section 37 of Partnership Act, the retiring partner can have either interest @ 6% per annum on this amount due or the profit earned by remaining partners with the help of this amount from the date of retirement. For this, the journal entry will be :

Retiring Partner's Capital A/c Dr.

To Retiring Partner's Loan A/c

If remaining partners bring cash to pay off the retiring partner then, journal entry will be :

Bank A/c Dr.

To Continuing Partner's Capital A/c

(For cash brought in by partners in the

agreed ratio to pay off the retiring partner)

Payment in Instalments

Capital Account of the retiring partner is settled as per agreement. It may be settled in two ways :

1) Payment in instalments with interest
2) Payment in a fixed number of instalments of equal amount (including interest).

Amount of instalment can be calculated with the help of Annuity Table.

Note : In the absence of any information, balance of retiring partner's Capital Account will be transferred to his Loan Account.

Illustration 3

A, B and C were carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1, respectively. On 31st December, 1985, the Balance Sheet of the firm stood as follows :

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	13,590	Cash	5,900
Capital Accounts :		Debtors	8,000
A : 15,000		Stock	11,690
B : 10,000		Building	23,000
C : 10,000	35,000		
	48,590		**48,590**

B retires on the above mentioned date on the following terms :

(i) Building be appreciated by Rs. 7,000.

(ii) Provision for bad debts be made @ 5% on Debtors.

(iii) Goodwill of the firm be valued at Rs. 9,000 and adjustment in respect be made without raising a Goodwill Account.

(iv) Rs. 5,000 be paid to B immediately and the balance due to him be treated as loan carrying interest @ 6% per annum. Such loan is to be paid in three equal annual instalments together with interest.

Pass the journal entries to record the above mentioned transactions and show the Balance Sheet of the firm as it would appear immediately after B's retirement. Prepare B's Loan Account till it is finally closed.

Solution

Journal

Particulars		Dr. Rs.	Cr. Rs.
Building A/c	Dr.	7,000	
To Revaluation A/c			7,000
(Being appreciation in the value of Building)			
Revaluation A/c	Dr.	400	
To Provision for Bad Debts			400
(Being provision for bad debts created on debtors)			
Revaluation A/c	Dr.	6,600	
To A's Capital A/c			3,300
To B's Capital A/c			2,200
To C's Capital A/c			1,100
(Being profit on revaluation credited to old partners)			
A's Capital A/c	Dr.	2,250	
C's Capital A/c	Dr.	750	
To B's Capital A/c			3,000
(Being B's share of goodwill adjusted in gaining ratio of 3:1 in A and C)			
B's Capital A/c	Dr.	5,000	
To Bank A/c			5,000
(Being the amount paid to B on retirement)			
B's Capital A/c	Dr.	10,200	
To B's Loan A/c			10,200
(Balance of amount due to B transferred to his loan account)			

Balance Sheet

as on 1st January, 1986

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	13,590	Cash	900
B's Loan A/c	10,200	Debtors 8,000	
Capital Accounts :		Less : Prov. for bad debts 400	7,600
A : 16,050		Stock	11,690
B : 10,350	26,400	Building 23,000	
		Add : Appreciation 7,000	30,000
	50,190		**50,190**

B's Loan Account

1986	Rs.	1986	Rs.
Dec.31 To Bank	3,816	Jan. 1 By Balance b/d	10,200
To Balance c/d	6,996	Dec. 31 By Interest A/c	612
	10812		**10,812**
1987		1987	
Dec. 31 To Bank	3,816	Jan. 1 By Balance b/d	6,996
To Balance c/d	3,600	Dec.31 By Interest A/c	420
	7,416		**7,416**
1988		1988	
Dec.31 To Bank	3,816	Jan. 1 By Balance b/d	3,600
		Dec. 31 By Interest A/c	216
	3,816		**3,816**

Working Notes

(i) New Profit-Loss sharing Ratio :

Old Profit-sharing Ratio of A, B and C = 3/6 : 2/6 : 1/6, After B's retirement the ratio between A & C will be = 3 : 1 or 3/4 : 1/4

(ii) Gaining Ratio of A and C :

Gain to A = 3/4 - 3/6 = (18-12)/24 = 6/24

Gain to C = 1/4 - 1/6 = (6-4)24 = 2/24 Hence

the gaining ratio is 6/24 : 2/24 or 3 : 1

(iii) According to Annuity Table .37410981 should paid every your to repay rupee one with 6 per cent interest in 3 years. The annual instalment for payment of Rs. 10,200 comes to Rs. 10,200 × .37410981 = Rs. 3,816

Illustration 4

P and Q were working in partnership profits and losses equally. On 31 December, 1996, P decided to retire and in his place his son R was admitted as partner from 1 January, 1997, with 1/3 share of profit.

Balance Sheet

as on December 31, 1996

Liabilities	**Rs.**	**Assets**	**Rs.**
Sundry Creditors	14,700	Goodwill	15,000
Capital Accounts :		Land & Building	40,050
P : 54,300		Motor Car	12,000
Q : 48,000	1,02,300	Furniture	9,300
		Sundry Debtors	24,150
		Cash at Bank	16,500
	1,17,000		**1,17,000**

It was decided that:

a) The goodwill would be raised to Rs. 20,000.

b) The car would be taken over by P at its book value.

c) The value of land and buildings would be increased by Rs. 8,280.

d) Q and R would introduce sufficient capital to pay off P and to leave thereafter a sum of Rs. 7,350 as bank balance, so as to make their capital proportionate to their share of profits.

e) The Capital payable by R was to be gifted to him by his father.

f) The new partners decided not to show goodwill as an asset.

The new arrangements were duly complied with. Show the partners Capital Account and the Bank Account.

Solution

Capital to be brought in by the partners :

Total Capital of the new firm :

	Rs.
Goodwill	20,000
Land and Buildings	48,330
Furniture	9,300
Sundry Debtors	24,150
Cash at Bank	7,350
Total Assets	**1,09,130**
Less : Creditors	14,700
Total Capital of Q and R	94,430
Q's Capital = 94,430 × 2/3	62,953
R's Capital = 94,430 × 1/3	31,477

Amount payable to P :

		Rs.
P's Capital		54,300
His share of profit on revaluation :		
Goodwil	5,000	
Land & Buildings	8,280	
13,280 ×1/2 =		6,640

		60,940
Less : Capital of R to be gifted by P		31,477
		29,463
Less : Car taken over	12,000	
Balance payable in cash		17,463

Amount to be brought in by Q :	Rs.
Q's Capital	48,000
His share, 1/2 of profit on revaluation	6,640
Existing Capital	54,640
Q's share in the new firm	62,953

Cash to be brought in by Q = Rs. 62,953 - Rs. 54,640 = Rs. 8,313

Capital Accounts

	P	Q	R		P	Q	R
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To R's Capital A/c	31477	-	-	By Balance b/d	54300	48000	-
To Motor Car A/c	12000	-	-	By Revaluation A/c	6640	6640	-
To Bank A/c	17463	-	-	By Bank A/c	-	8313	-
To Goodwill A/c	-	13333	6667	By P's Capital A/c	-	-	31477
To balance c/d	-	49620	24810				
	60940	62953	31477		60940	62953	31477

Bank Account

	Rs.		Rs.
To Balance b/d	16500	By P's Capital A/c17463	
To Q's Capital A/c	8313	By Balance c/d	7350
	24813		**24813**

Illustration 5

A, B and C share profits and Losses as 1 : 2 : 2. On 31 st December, 1989 when A decided to retire, their capitals were Rs. 27,000; Rs. 54,000 and Rs. 54,000 respectively. A agreed to keep his capital in the firm as a loan subject to 6% per annum interest. However, he was to receive a share in the profits after charging interest on capital and loan of new firm for the year 1990, of only an amount equal to 1/3 of his share in the old firm. On 1st January, 1990 D was admitted who paid Rs. 18,000 for his capital and Rs. 12,000 for his 1/7 share of goodwill. The goodwill was shared by B and C in their respective ratios.

In 1990, the firm earned a profit of Rs. 67,020, before charging interest on loan of A and on capital @ 5 percent. Show the profit sharing ratios for the year 1990. Also show the Capital of the partners on 31st December. 1990.

Solution

Profit and Loss Account

for the year ended 31st December, 1990

Particulars		Rs.	Particulars	Rs.
To interest on A's Loan (6% on Rs. 27,000)		1620	By Net profit	67020
To Interest on Capital : (@ 5%)				
B on Rs. 60000	3000			
C on Rs. 60000	3000			
D on Rs. 18000	900	6900		
To A's Loan A/c (1/15 of Rs. 58,500)		3900		
To Profit Transferred to Capital Accounts				
B : 3/7	23400			
C : 3/7	23400			
D : 1/7	7800	54600		
		67020		**67020**

Capital Accounts

	P	Q	R		P	Q	R
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
1990				1990			
Dec. 31				Jan. 1			
To Balance c/d	86400	86400	26700	By Balance b/d	54000	54000	-
				By Goodwill A/c	6000	6000	-
				By Cash	-	-	18000
				Dec. 31			
				By Interest A/c	3000	3000	900
				By P & L A/c	23400	23400	7800
	86400	86400	26700		86400	86400	26700

Working Notes

(1) A is entitled to 1/3 of his previous share = 1/5 × 1/3 = 1/15

(2) Profit sharing ratio among B, C and D for 1990 and 1991 and 1991 will be 3/7, 3/7 and 1/7 respectively, calculated as :

B + C = 1 - 1/7 = 6/7

B's Share = 6/7 × 1/2 = 3/7

C's Share = 6/7 ×1/2 = 3/7

(3) A's share in firm's profit = Rs. (Rs. 67,020 - Rs. 1,620 - Rs. 6,900) × 1/15 = Rs. 3,900

5.2.3 DEATH OF A PARTNER

The accounting treatment at the time of death of a partner is same as at the time of retirement. Main difference between the two is that of closing of the account of business. Deceased partner's capital account is credited with his opening capital, interest on capital up to his death, his share in undistributed profits, revaluation profits, firm's

Profits from the date of the last balance sheet up to his death and with his share of goodwill. Drawings, interest on drawings and losses are debited in the deceased partner's Capital Account and the remaining amount is transferred to his legal representative's account. Legal representative can receive either interest at 6 per cent per annum, on the amount due from the date of death to the date of settlement or the profit earned with the help of that amount.

Most of the points have already been discussed in the retirement of a partner but the following two points require special attention:

i) Calculation of deceased partner's share of profit.

ii) Treatment of life policy or policies.

These will be discussed one by one.

5.2.3.1 Calculation of Deceased Partner's Share of Profit

The deceased partner's share of profit is to be determined either on the basis of time or turnover.

(a) On the basis of time: In this case, it is assumed that the profit during the previous year has been earned uniformly in all months during the year, provided previous year is taken as the base for calculation of profit. Sometimes average profits of the past three or four years is taken as base rather than the previous year. Whatever base may be taken, it is to be multiplied by the period for which the deceased partner remained in the firm and also his profit sharing ratio at the time of his death. For example A, B, and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. B dies on 14th March, 1996. The average of the last three years is Rs. 30,000. B's share of profit on the basis of time is calculated as under:

Average yearly profit = Rs. 30,000

Profit for 73 days i.e., Jan. 1 to March 14, 1996 = $\frac{\text{Rs. } 30{,}000 \cdot 73}{365}$ = Rs. 6,000

B's share = 2/6 × 6,000 = Rs. 2,000

(b) On the basis of turnover: In this method, average past profit is divided into two portions i.e., before the death and after the death on the basis of ratio of turnover to the date of death to average turnover and then deceased partner's share is calculated and credited to his capital account. For example, A, B and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. B dies on 14th March, 1996. Turnover from 1st January, to 14th March, 1996 is Rs. 42,000. Average turnover of the last three years is Rs. 60,000 and profit is Rs. 30,000. B's share of profit on this basis will be calculated as under:

Average turnover = Rs. 60,000

Sales to the date of death = Rs. 42,000.

Profit to the date of death = Rs. 42,000 × ……. = Rs. 21,000

B's share of profit = × 21,000 = Rs. 7,000.

5.3.2.2 Treatment of Life Policies

To make an arrangement for the paym1ent of amount belonging to deceased partner
3
to his legal representative, the firm can get insured the life of all the partners jointly or individually. Premiums on life policies are paid out of firm's funds and this is debited to firm's Profit and Loss Account. Amount received in the form of claim from the life insurance company is credited to all the partners in their profit/loss sharing ratio. In the case of individual policies also, the deceased partner is entitled to his share in the surrender value of policies of all the partners. Other partners are also entitled to their respective share in the amount of policy of the deceased partner.

Illustration 6

Brown and Smith are partners. The partnership deed provides inter alia:

i) That the Account be balanced on 31st December each year.

ii) That the profits be divided as follows : Brown 1/2; Smith 1/3 and carried to a Reserve account 1/6.

iii) That in the event of the death of a partner, his executors be entitled to be paid :

(a) The capital to his credit at the date of death.

(b) His proportion of reserve at the date of last balance sheet.

(c) His proportion of profit to date of death based on the average profits of the last three completed years.

(d) By way of goodwill his proportion of the total profits for the three preceding years.

On 31st December, 1989, the Ledger balance were :

	Rs.	Rs.
Brown's Capital		9,000
Smith's Capital		6,000
Reserve		3,000
Creditors		3,000
Bills Receivable	2,000	
Investments	5,000	
Cash	14,000	
	21,000	**21,000**

The profit for three years were :

1987 Rs. 4200, 1988 Rs. 3900, 1989 Rs. 4500. Smith died on 1st May, 1990

Show the accounts as between the firm and Smith's died on 1st May, 1990

Solution

Effective profit sharing ratio between Brown and Smith is 3 : 2 Smith's share in the profits to the date of death :

	Rs.
Profit for 1987	4,200
Profit for 1988	3,900
Profit for 1989	4,500
Total Profits	12,600

Average = Rs. 12,600/3 = Rs. 4,200

Profit for 4 months upto May 1, 1990 = 4,200 × 1/3 = Rs. 1,400

Smith's share therein = Rs. 1,400 × 2/5 = 560

Smith's share in Goodwill :

Goodwill = Rs. 12,600

Smith's share = Rs. 12,600 × 2/5 = Rs. 5,040

Smith's Capital Account

	Rs.		Rs.
1990		1990	
May, 1		May 1	
To Smith's Executors' A/c	12,800	By Balance b/d	6,000
		By Reserve A/c	1,200
		By P & L suspense A/c	560
		(Profit upto death)	
		By Goodwill A/c	5,040
	12,800		**12,800**

Smith's Executors' Account

		Rs.
	1990	
	May 1	
	By Smith's Capital A/c	12,800
		12,800

Joint Life Policy

Accounting treatment of Joint Life Policy may be done by any of following methods:

1. First Method: When payment of premium is considered as a business expenditure

Under this method, the amount of premium is charged to Profit and Loss Account of each year and the amount received from insurance company on the death of any partner is treated as income. Bank Account will be debited and Joint Life Policy Account will be credited with the amount received from the insurance company on the death of a partner. Then Joint Life Policy Account is closed by transferring it to all the partners Capital Accounts (including the deceased partner) in their profit sharing ratio. The main problem in this method is that no surrender value of policy is shown in the books.

2. Second Method : When surrender value is treated as an asset

In this method at the time of payment of premium, the Joint Life Policy Account is debited and Bank Account is credited. That amount of premium which is more than surrender value at the end of year, it is assumed as loss with which Profit and Loss Account is debited and Joint Life Policy Account is credited. Joint Life Policy Account (Surrender Value) is shown as asset in the Balance Sheet.

At the time of death of any partner, Bank Account is debited and Joint Life Policy Account is credited with the amount received. Credit balance of Joint Life Policy Account is considered as profit and transferred to all partners' capital accounts in their profit-loss sharing ratio.

The main advantage of this method is that surrender value is considered as an asset and disadvantage is that the premium is not shown fully as an expense in Profit and Loss Account.

3. Third Method : When premium is considered as an asset

With the amount of premium paid, Joint Life Policy Account is debited and Bank Account is credited. Joint Life Policy Account is shown as an asset in the Balance Sheet. At the time of death of any partner, Bank Account is debited and Joint Life Policy Account is credited. After his, if there is any credit balance in Joint Life Policy Account, it is distributed among all partners in their profit sharing ratio.

4. Fourth Method : When payment of premium is treated as an investment and a Reserve Account is opened -

1. Premium is debited to Joint Life Policy Account.
2. Every year amount equal to the premium is debited to Profit and Loss Appropriation Account and credited to Joint Life Policy Reserve Account.
3. Joint Life Policy Account and Joint Life Policy Reserve Account are adjusted in such a way that the balance in each account is equal to surrender value of the policy.
4. At the death of a partner Joint Policy Account is credited with the amount received. Credit balance of Joint Policy Reserve Account is transferred to Joint Life Policy Account and Joint Life Policy Account is closed by transferring to Capital Accounts of all the partners in their profit sharing ratio.

Under this method, surrender value is shown on the assets side and Joint Life Policy Reserve Account on liabilities side of Balance Sheet.

Main advantage of this method is that surrender value is shown in Balance Sheet and all premium is charged from Profit and Loss Appropriation Account.

Illustration 7: (a) A and B are partners in a firm. On April 1, 1997 they took out a Joint Life Policy without profits for Rs. 30,000 upon which an annual premium of Rs. 1,400 is payable. A and B share profits in the ratio of 2 : 1. On March 31, 1998

B died and Rs. 30,000 is received from the Insurance Company.

Journalise the above transactions. Premium is to be adjusted through Profit and Loss Account.

(b) A and B who shared profits in the ratio of 3 : 2 took a joint life policy on May 1, 1995 for Rs. 30,000. The annual premium was Rs. 1,300. The surrender value of the policy was:

1995 Nil; 1996 Rs. 400; 1997 Rs. 900; 1998 Rs. 1,450

B died on September 15, 1995 and the amount of the policy was received on Dec. 341, 1998. The books are closed on Dec. 31, each year.

Show Joint Life Policy Account and Joint Life Policy Reserve Account assuming that premiums were written off through Joint life Policy Reserve Account.

Solution

Journal Entries

1997			Rs.	Rs.
April 1	Joint Life Policy Premium A/c	Dr.	1,400	
	To Bank A/c			1,400
	(Being the payment of annual premium)			
1998				
Mar. 31	Profit and Loss Account	Dr.	1,400	
	To Joint Life Policy Premium A/c			1,400
	(Being Premium charged to P & L A/c)			
Mar. 31	Insurance Company A/c	Dr.	30,000	
	To Joint Life Policy A/c			30,000
	(Being the amount of J.L.P. due for receipt)			

Mar. 31 Bank Account	Dr.	30,000	
To Insurance Company A/c			30,000
(Being the receipt of claim from Insurance Company)			
Mar. 31 Joint Life Policy A/c	Dr.	30,000	
To A's Capital A/c			20,000
To B's Capital A/c			10,000
(Being the amount of policy distributed between partners in the ratio of 2 : 1)			

(b) **Joint Life Policy Account**

1995		Rs.	1995		Rs.
May 1	To Bank A/c	1,300	Dec. 31	By J.L.P. Reserve A/c	1,300
1996			1996		
May 1	To Bank A/c	1,300	Dec. 31	By J.L.P. Reserve A/c	900
				By Balance c/d	400
		1,300			1,300
1997			1997		
Jan. 1	To Balance b/d	400	Dec. 31	By J.L.P. Reserve A/c	800
May 1	To Bank A/c	1,300		By Balance c/d	900
		1,700			1,700
1998			1998		
Jan. 1	To Balance b/d	900	Sept. 15	By Bank A/c	30,000
May 1	To Bank A/c	1,300		By J.L.P. Reserve A/c	900
Dec. 31	To Capital A/c:				
	A	17,220			
	B	11,480			
		30,900			**30,900**

Joint Life Policy Reserve Account

1995		Rs.	1995		Rs.
Dec. 31	To Joint Life		Dec. 31	By P & L	
	Policy A/c	1,300		Approp. A/c	1,300
1996			1996		
Dec. 31	To Joint Life		Dec. 31	By P. & L	
	Policy A/c	900		Approp. A/c	1,300
	To Balance c/d	400			
		1,300			1,300
1997			1997		
Dec. 31	To Joint Life		Dec. 31	By Balance b/d	400
	Policy A/c	800		By P & L Approp. A/c	1,300
	To Balance c/d	900			
	1,700			1,700	
1998		1998			
Sept. 15	To Joint Life		Sept. 15	By Balance b/d	900
	Policy A/c	900			

POSSIBLE QUESTIONS

PART B (2 MARKS)

1. What is partnership?
2. What is partnership deed?
3. What do you mean by retirement of a partner?
4. What is mean by admission of a partner?
5. What is the difference between gaining ratio and sacrificing ratio?

PART C (8 MARKS)

1. P, Q and R are in the partnership and on 1st January, 1995 their respective capitals were Rs. 20,000, Rs, 12,000 and Rs, 10,000. Q is entitled to a salary of Rs. 2,500 and R Rs. 2,000 per annum, payable before division of profits. Interest is allowed on capital @ 5% per annum but is not charged on drawings. Of the net divisible profits of first Rs. 10,000; P is entitled to 40%, Q to 35% and R to 25% and over that amount profits are shared equally. The profit for the year ended 31st December, 1995 after debiting partnership salaries, but before charging interest on capitals, was Rs. 18,000 and partners had withdrawn Rs. 800 each. Prepare partners' accounts for the year.
2. Ravi, Shanker and Sastry are partners sharing profits and losses as 6:5:4. They have a Joint Life Policy for Rs. 2,00,000 on which they pay Rs. 7,500 per annum as premium and debit the same to Profit and Loss Account as premium. Accounts are closed annually on 31 December.
    a. Shanker died on 1st April, 1995 and his legal representatives are entitled to :
        i. His capital as appearing in the last Balance Sheet.
        ii. Interest on capital at 6 per cent per annum to the date of death.
    b. His share of profit calculated till date of his death on the basis of the previous years profit; and
    c. His share of goodwill calculated as two years purchase on the average of

the last three years' profit before inclusion of the policy premium as business expense.

d. Shanker's drawing in 1995 amounted to Rs. 3000. His capital shown in 1994 Balance Sheet was Rs. 80000. The profit for the three years 1992, 1993 and 1994 after inclusion of the policy premium as business expense amounted to Rs. 65000, Rs. 64000 and Rs. 69000 respectively.

e. Prepare Shanker's Capital Account

3. Explain goodwill and describe various methods of valuing goodwill.

4. Explain the treatment of goodwill in case of admission of a new partner with journal entries.

5. What is Revaluation Account ? How is it prepared ? How is it different from Memorandum Revaluation Account.

		Semester I
		L T P C
17CMU101	FINANCIAL ACCOUNTING	5 - - 5

Scope

Financial Accounting has wide scope and area of application. It is not only for the business world, but spread over in all the spheres of the society in all professions. As accounting is a dynamic subject, its scope and area of operation have been always increasing, keeping pace with the changes in socio-economic changes.

Objective

The objective of this paper is to help students to learn the basic concepts and conventions of accounting and basic accounting framework, to know about the final accounts of the company, and promoting students to know the various accounting systems

Unit I

Theoretical Framework - Accounting information system: Users and their Needs. Characteristics of Accounting - Functions, Advantages and Limitations of Accounting. Branches of Accounting- Bases of Accounting: - Concepts and Conventions –Accounting Standards – Journal- Ledger – Subsidiary Books – Trial Balance

Unit II

Business Income – Revenue Recognition – Depreciation – methods – straight line method – Diminishing Balance Method – Change in method of depreciation – Final Accounts – preparation of final accounts for non- corporate business entities

Unit III

Accounting for Hire-Purchase and Installment System- Transactions - Journal Entries and ledger accounts including Default and Repossession.

Unit IV

Consignment - Features, Accounting treatment - Consignor and Consignee. Joint Venture - Accounting procedures: Joint Bank Account, Records Maintained by Co-venturer of (a) all transactions (b) only his own transactions. (Memorandum joint venture account).

Unit V

Accounting for Partnership - Valuation of Goodwill – Calculation of Profit Sharing Ratio – Admission – Retirement of a Partner.

Note:

Distribution of marks - 20% theory and 80% problems

Suggested Readings

Text Book

1. Reddy T.S.& Moorthy.A. (2012), *Financial Accounting*, Chennai, Margham Publications.

Reference Books:

1. Shukla, M.C. Grewal T.S. & Gupta. S.C. (2013) Revised Edition, *Advanced Accounts*. New Delhi.Vol.-I. S. Chand & Co.,
2. Maheshwari, S.N. & Maheshwari S. K. (2013) *Financial Accounting*. New Delhi Vikas Publishing House.
3. Deepak Sehgal. (2014) *Financial Accounting*. New Delhi, Vikas Publishing House,
4. Tulsian, P.C. (2004) *Financial Accounting*, Pearson Education.
5. *Compendium of Statements and Standards of Accounting*.(2012) New Delhi, The Institute of Chartered Accountants of India,

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DEPARTMENT OF COMMERCE

B.COM

SUBJECT / CODE :FINANCIAL ACCOUTING /: 17CMU101

SEMSTER : I

LECTURE PLAN

UNIT-1

S.No	LECTURE DURATION (Hr)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Accounting information System – Definition of accounting, Users and their Needs,	T-1.2 R1-1.7 – 1.8
2	1	Characteristics of Accounting – Functions, Advantages and Limitations of Accounting	R1 -1.8 – 1.9
3	1	Branches and Bases of Accounting, Concept & Conventions Accounting Standards	R1 -1.8 – 1.14 T -2.2 – 2.11 W1
4	1	Journal – Meaning – General format- Rules- Sums	R1 - 4.1 – 4.3
5	1	Journal Entries – Sums	T - 2.35 – 2.53
6	1	Journal Entries – Sums	T - 2.35 – 2.53
7	1	Ledger – Meaning – General format- Rules- Sums	R7 - 4.35
8	1	Ledger – Problems	T -2.54 – 2.79
9	1	Ledger – Problems	T -2.54 – 2.79
10	1	Trial Balance – General Format - Sums	T -3.4 – 3.12
11	1	Subsidiary Books- Types- Purchase and Purchase Return Book & Sales and Sales Return Book	R1 -6.1 – 6.3
12	1	Preparation of Cash Book , Single, Double and Triple Column Cash Book – Problems to be worked	T -2.79 – 2.87
13	1	Preparation of Cash Book - Problems to be worked	T -2.79 – 2.87
14	1	Triple column cash book	T -2.79 – 2.87

15	1	Recapitulation and important questions discussion	
		Total no. of hours planned for unit - I	15

SUPPORT MATERIALS

Text book

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2015)

W1 www.iasplus.com/en/standards

W2 www.accountingtools.com>revenue_regonition.

UNIT-II

S.No.	LECTURE DURATION (Hr)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Business Income- Revenue Recognition, Meaning and aspect Regarding to Revenue Recognition	W2
2	1	Depreciation meaning, Definition and causes of depreciation , Need and significance of depreciation,	R1 -12.1 – 12.2 T -11.1 – 11.3
3	1	Straight Line Method - Problems to be Worked	T -11.9 – 11.16
	1	Straight Line Method - Problems to be Worked	T -11.9 – 11.16
4	1	Diminishing Balance Method - Problems to be Worked	T -11.7 – 11.8
5	1	Diminishing Balance Method - Problems to be Worked	T -11.7 – 11.8
6	1	Final Accounts - Meaning and Advantages, Trading Account and Profit And Loss Account And Balance sheet Format	R1 -10.1 – 10.9
7	1	Preparation of Trading Account - Problems to be Worked	T -5.17 – 5.48
8	1	Preparation of Trading and Profit And Loss Account and Meaning and Format – sums	T -5.17 – 5.48
9	1	Preparation of final accounts - sums	T -5.17 – 5.48
10	1	Preparation of final accounts - sums	T -5.17 – 5.48

11	1	Preparation of final accounts - sums	T -5.17 – 5.48
12	1	Preparation of final accounts with adjustments - sums	T -5.17 – 5.48
13	1	Preparation of final accounts with adjustments - sums	T -5.17 – 5.48
14	1	Preparation of final accounts - sums	T -5.17 – 5.48
15	1	Recapitulation and important questions discussion	
		Total no. of hours planned for unit – II	15

SUPPORT MATERIALS

Text book

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2015)

W1 www.iasplus.com/en/standards

W2 www.accountingtools.com>revenue_regonition.

UNIT – III

S.No.	LECTURE DURATION (Hr)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Hire Purchase system– Definition, features of hire purchase system	R2-18.1 – 18.2
2	1	Accounting treatment of high value goods – Entries in the books of hire purchaser	R2 -18.3
3	1	Journal Entries in the books of hire vendor - sums	R2: -18.3 – 18.7
4	1	Journal Entries in the books of hire vendor - sums	R2: -18.3 – 18.7

5	1	Default and repossession – sums	R2: 18.4-18.16
6	1	Partial and complete repossession – procedure , sums	R2: 18.4-18.16
7	1	Hire purchases trading account – procedure – sums	R2-18.14 – 18.16
8	1	Instalment Purchases system , Comparison with hire purchases system	R2-18.16 – 18.21
9	1	Calculation of interest – Problems to be worked	R2-18.8 – 18.14
10	1	Methods of computation of profit- Debtors method and debtors and stock method problems to be worked	R2-18.29 – 18.32 R2-18.33 – 18.35
11	1	Methods of computation of profit- Debtors method and debtors and stock method problems to be worked	R2-18.29 – 18.32 R2-18.33 – 18.35
12	1	Instalment purchase system – Sums	R2-18.35 – 18.39
13	1	Instalment purchase system – Sums	R2-18.35 – 18.39
14	1	Accounting under instalment purchase system – problems	R2-18.35 – 18.39
15	1	Recapitulation and important questions discussion	
		Total no. of hours planned unit – III	15

SUPPORT MATERIALS

Text book

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(20105)

W1 www.iasplus.com/en/standards

W2 www.accountingtools.com>revenue_regonition.

UNIT – IV

S.No.	LECTURE DURATION (periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Consignment, Meaning, Definition and Features, Difference between sale and Consignment	T -25.1 – 25.2
2	1	Valuation of stock at cost and invoice price	T -25.7 – 25.10
3	1	Journal Entries and Ledger in the books of Consignor – Sums	T -25.13 – 25.16
4	1	Preparation of Journal Entries and Ledger in the books of Consignee – Sums	T -25.16 – 25.18
5	1	Preparation of Journal Entries and Ledger in the books of Consignee – Sums	T -25.16 – 25.18
6	1	Consignment Account - Problems to be Worked	T -25.19 – 25.73
7	1	Consignment Account - Problems to be Worked	T -25.19 – 25.73
8	1	Preparation of Journal entries and ledger accounts – Consignment account – sums	T -25.19 – 25.73
9	1	Consignment account – sums	T -25.19 – 25.73
10	1	Joint Venture accounts - Definition and Features	T -26.1
11	1	Difference between Joint Venture, consignment and Partnership	T -26.2
12	1	Preparation of Joint Venture account when separate set of books are maintained – Sums	T -26.4
13	1	Preparation of Joint Venture account when separate set of books are maintained – Sums	T -26.4
14	1	Preparation of Joint Venture account when separate set of books are not maintained – Sums	T -26.8
15	1	Recapitulation and important questions discussion	
		Total no. of hours planned unit – IV	15

SUPPORT MATERIALS

Text book

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2015)

W1 www.iasplus.com/en/standards

W2 www.accountingtools.com>revenue_regonition.

UNIT – V

S.No.	LECTURE DURATION (periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1	1	Accounting for Partnership – Definition and features	T -21.1
2	1	Admission of Partner: Fixed Capital Method and Fluctuating Capital Method	T -21.5 – 21.15
3	1	Calculation of profit Sharing Ratio – Sums	T -22.1 – 22.3
4	1	Methods of Valuation Goodwill – Sums	T -22.3 – 22.10
5	1	Admission of a partner - sums	T -22.11 – 22.38
6	1	Retirement of Partner- Definition and features	T -23.1 – 23.3
7	1	Calculation of profit Sharing Ratio – Sums	T -23.3 – 23.4
8	1	Calculation of goodwill – Sums	T -23.3 – 23.4
9	1	Preparation of Realisation account - sums	T -23.3 – 23.4
10	1	Retirement of Partner – Sums	T -23.8 – 23.30
11	1	Retirement of Partner – Sums	T -23.8 – 23.30
12	1	Recapitulations and discussion of important questions	
13	1	Discussion of previous year ESE question papers	
14	1	Discussion of previous year ESE question papers	
15	1	Discussion of previous year ESE question papers	
		Total no. of hours planned unit – V	15

SUPPORT MATERIALS

Text book

T1- Financial Accounting, (2016) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R6 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2015)

W1 www.iasplus.com/en/standards

W2 www.accountingtools.com>revenue_regonition.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed University Established Under Section 3 of UGC Act 1956)
Coimbatore - 641021.
(For the candidates admitted from 2017 onwards)
DEPARTMENT OF COMMERCE

SUBJECT : FINANCIAL ACCOUNTING
SEMESTER : I
SUBJECT CODE : 17CMU101 CLASS : I B.Com. - B

UNIT-I

Theoretical Framework : Accounting information system: Users and their needs. Characteristics of accounting - Functions, Advantages and limitations of accounting. Branches of accounting. Bases of accounting: - Concepts and Conventions – Bases of Accounting – Accounting standards – Journal- Ledger – Subsidiary Books – Trial Balance.

Suggested Readings:

Text Book

1. Reddy and Moorthy. (2016). *Financial Accounting* Chennai. Margham Publications.

Reference Book

1. M.C.Shukla, T.S. Grewal and S.C.Gupta. (2013).*Advanced Accounts.* [Vol.-I Revised Edition] New Delhi, S. Chand & Co.
2. S.N. Maheshwari, and. S. K. Maheshwari.(2013). *Financial Accounting.*[First Edition]. New Delhi, Vikas Publishing House.
3. Deepak Sehgal. (2014). *Financial Accounting.*[4th Ed]. New Delhi, Vikas Publishing House,
4. Tulsian, P.C. (2013). *Financial Accounting,* [4th Ed]. New Delhi, S.Chand Publishing
5. Compendium of Statements and Standards of Accounting. (2013). New Delhi, The Institute of Chartered Accountants of India.

UNIT – I

ACCOUNTING INFORMATION SYSTEM

ACCOUNTING

"Accounting is as old as money itself". Since in early ages commercial activities were based on barter system, record keeping was not a necessity. The Industrial Revolution of 19th century along with rapid rise in population, paved way for the development of commercial activities, mass production and credit terms. Thus recording of business transaction has become an important feature. In recent years with the change of technologies and marketing along with stiff competition, accounting system has undergone remarkable changes.

IMPORTANCE OF ACCOUNTING

When a person starts a business, whether large or small, his main aim is to earn profit. He receives money from certain sources like sale of goods, interest on bank deposits etc. He has to spend money on certain items like purchase of goods, salary, rent, etc. These activities take place during the normal course of his business. He would naturally be anxious at the year end, to know the progress of his business. Business transactions are numerous, that it is not possible to recall his memory as to how the money had been earned and spent. At the same time, if he had noted down his incomes and expenditures, he can readily get the required information. Hence, the details of the business transactions have to be recorded in a clear and systematic manner to get answers easily and accurately for the following questions at any time he likes.

i.What has happened to his investment?

ii. What is the result of the business transactions?

iii. What are the earnings and expenses?

iv. How much amount is receivable from customers to whom goods have been sold on credit?

v. How much amount is payable to suppliers on account of credit purchases?

vi. What are the nature and value of assets possessed by the business concern?

vii. What are the nature and value of liabilities of the business concern?

USES AND THEIR NEEDS OF ACCOUNTING

I. Internal users of accounting information

The internal users comprise of owners, management and employees.

i Owners : the sole traders or partners or shareholders who have provided the capital of a business unit are interested in its performance and progress. They are primarily interested in the revenue and expenses, profit or loss, net worth and external liabilities.

ii Management: sole traders and partners usually manage their own business. But companies are managed by paid professionals. Management of a business involves making day to day decisions on routine matters and also policy decisions, whenever needed. Accounting data is the basic for most of the decisions made by management.

iii Employees: the work force is interested in the profitability of the business which affects their bonus , incentives and working conditions. The success or failure of the business is linked to their livelihood. Labour unions use the accounting data in their bargaining strategies with the management.

II. External users of accounting information :

Various outside groups and individuals make use of accounting information for their own purpose:

i. Creditors and financiers : suppliers of goods and services , commercial banks, public deposit holders, debentures holders, etc., are included in this category. They are interested in the liquidity position and repaying capacity of the business.

ii. Potential investors: those who are interested in investing their surplus funds should know about the financial conditions of a business unit while making their investment decisions . They are more interested in future earning and risk.

iii. Consumers: Those who use the products and their services of a firm are interested in knowing the justification for the prices changed to them. They examine the expenses, sales, and profit to see if they are paying fair prices for the products and service

CHARACTERISTICS OF ACCOUNTING

1. The accounting principles are developed for practical purposes. They cannot be validated or proved like the principles of mathematics, physics and chemistry. They are the best possible suggestions based on practical experiences ,reasoning and observation of the professional accountants.
2. The principles are for common usage to ensure uniformity and understanding. They are not rigid. They can be adapted to the changing needs and circumstances of business units . They enhance the usefulness of the data relating to the activities of a firm.
3. They are not specifically made or legislated by any government or legal authority. They are not legally enforceable.

4. They are in the process of evolution and are likely to change as per the dictates of changing circumstances and technology.

FUNCTIONS OF ACCOUNTING

i. Identifying: Identifying the business transactions from the source documents.

ii. Recording: The next function of accounting is to keep a systematic record of all business transactions, which are identified in an orderly manner, soon after their occurrence in the journal or subsidiary books.

iii. Classifying: This is concerned with the classification of the recorded business transactions so as to group the transactions of similar type at one place. i.e., in ledger accounts. In order to verify the arithmetical accuracy of the accounts, trial balance is prepared.

iv. Summarising : The classified information available from the trial balance are used to prepare profit and loss account and balance sheet in a manner useful to the users of accounting information.

v. Analysing: It establishes the relationship between the items of the profit and loss account and the balance sheet. The purpose of analysing is to identify the financial strength and weakness of the business. It provides the basis for interpretation.

vi. Interpreting: It is concerned with explaining the meaning and significance of the relationship so established by the analysis. Interpretation should be useful to the users, so as to enable them to take correct decisions.

vii. Communicating: The results obtained from the summarised, analysed and interpreted information are communicated to the interested parties.

ADVANTAGE OF ACCOUNTING

The following are the main advantage of accounting:

Systematic records: all the business transactions are recorded in the books of accounting records. Any events or happening which has financial effect is included in the accounting records. They are always at disposal of the management for decision making.

Preparation of financial statements: Results of business operations and the financial position of the concern are provided by accounting periodically. This is essential for distributing of profits to the owners and for planning the future policies and programs by the management.

LIMITATION OF ACCOUNTING

- In spite of its indispensible position in modern business establishments, accounting has its own limitations.
- It cannot record all the events and transactions taking place in all enterprise .it ignores transaction which cannot be expressed in terms of money. It cannot measures the qualitative aspects of the product, policies, management and the workers. It cannot quantify the movable of employees in the organization.
- Accounting relies on estimate and forecasts in several important matters like useful life of machinery, market value of investment .similarly ,subjective opinions of the accountant can influences valuation of stocks, provision on debtors for doubtful debts and discount etc. Accounting results may not be accurate and reliable due to such estimate and subjective influences of individual accountants.
- Accountants rely on historical cost of recording the fixed asset. Depreciation is also provided on the recorded cost of the assets. When the time for replacement cost is usually for more than the accumulated funds through depreciation. Accounting also ignores the price level changes which drastically alter the value of asset and liabilities. Inflation which is an universal phenomenon makes the profit ascertained and financial position shown by accounting unrealistic and unreliable.

Every one of these limitation has been engaging the attention of the professional bodies. Recent developments like human resources accounting. Inflation accounting, International Accounting standards etc., have been aimed at improving the usefulness of accounting by overcoming

BOOK-KEEPING

Book-keeping is that branch of knowledge which tells us how to keep a record of business transactions. It is often routine and clerical in nature. It is important to note that only those transactions related to business which can be expressed in terms of money are recorded. The activities of book-keeping include recording in the journal, posting to the ledger and balancing of accounts.

OBJECTIVES

The objectives of book-keeping are

i. To have permanent record of all the business transactions.
ii. To keep records of income and expenses in such a way that the net profit or net loss may be calculated.
iii. To keep records of assets and liabilities in such a way that the financial position of the business may be ascertained.
iv. To keep control on expenses with a view to minimize the same in order to maximize profit.
iv. To know the names of the customers and the amount due from them.
v. To know the names of suppliers and the amount due to them.
vi. To have important information for legal and tax purposes.

ACCOUNTING

Book-keeping does not present a clear financial picture of the state of affairs of a business. When one has to make a judgment regarding the financial position of the firm, the information contained in these books of accounts has to be analysed and interpreted. It is with the purpose of giving such information that accounting came into being.

Accounting is considered as a system which collects and processes financial information of a business. These information are reported to the users to enable them to make appropriate decisions.

Definition

American Accounting Association defines accounting as "the process of identifying, measuring and communicating economic information to permit informed judgments and decision by users of the information".

Objectives

The main objectives of accounting are

- To maintain accounting records.
- To calculate the result of operations
- To ascertain the financial position.
- To communicate the information to users.

Difference between Book-keeping and Accounting

Sl. No.	Basis of distinction	Book-keeping	Accounting
1.	Scope	Recording and maintenance of books of accounts.	It is not only recording and maintenance of books of accounts but also includes analysis, interpreting and communicating the information.
2.	Stage	Primary stage.	Secondary stage.
3.	Objective	To maintain systematic records of business transactions.	To ascertain the net result of the business operation.
4.	Nature	Often routine and clerical in nature.	Analytical and executive in nature.
5.	Responsibilities	A book-keeper is responsible for recording business transactions.	An accountant is also responsible for the work of a book-keeper.
6.	Supervision	The book-keeper does not supervise and check the work of an Accountant.	An accountant supervises and checks the work of the book-keeper.
7.	Staff involved	Work is done by the junior staff of the organization.	Senior staff performs the accounting work.

BRANCHES OF ACCOUNTING

Providing information according to the needs of internal and external users has been recognized as the primary objectives of accounting. Modern business world has become highly competitive and technology oriented. Management of business units has become highly complex, needing varied types of information to satisfy the additional demand of movement for information, several new branches of accounting have been developed. The following are the most important of the branches of accounting:-

1. Financial Accounting: the accounting for revenues, expenses, assets and liabilities that is commonly carried on in the general office of business is known as FINANCIAL

ACCOUNTING. The financial accounting information is expressed in two main type of financial statement, viz :

2. Cost Accounting: it is that brace of accounting which deals with classification recording allocation summarization of current and prospective cost. It determines cost of production and distribution by department, function, products etc. cost accounting is essential for pricing of product and services and for cost reduction and cost control

3. Management Accounting: it is that brace of accounting which is meant exclusively for managerial decision making. it provides necessary information to the management for discharging its function of planning organizing co-coordinating, direction and controlling its usually provides data on funds and cash flow, investment projects, preparation and implementation of budgets etc. almost all the policy decision of management are made on the basic of primary data provides by management accounting

BASES OF ACCOUNTING

ACCOUNTING ASSUMPTIONS

Accounting Entity Assumption

According to this assumption, business is treated as a unit or entity apart from its owners, creditors and others. In other words, the proprietor of a business concern is always considered to be separate and distinct from the business which he controls. All the business transactions are recorded in the books of accounts from the view point of the business. Even the proprietor is treated as a creditor to the extent of his capital.

Money Measurement Assumption

In accounting, only those business transactions and events which are of financial nature are recorded. For example, when Sales Manager is not on good terms with Production Manager, the business is bound to suffer. This fact will not be recorded, because it cannot be measured in terms of money.

Accounting Period Assumption

The users of financial statements need periodical reports to know the operational result and the financial position of the business concern. Hence it becomes necessary to close the accounts at regular intervals. Usually a period of 365 days or 52 weeks or 1 year is considered as the accounting period.

Going Concern Assumption

As per this assumption, the business will exist for a long period and transactions are recorded from this point of view. There is neither the intention nor the necessity to wind up the business in the foreseeable future.

CONCEPTS OF ACCOUNTING

These concepts guide how business transactions are reported. On the basis of the above four assumptions the following concepts (principles) of accounting have been developed.

Dual Aspect Concept

Dual aspect principle is the basis for Double Entry System of book-keeping. All business transactions recorded in accounts have two aspects - receiving benefit and giving benefit. For example, when a business acquires an asset (receiving of benefit) it must pay cash (giving of benefit).

Revenue Realisation Concept

According to this concept, revenue is considered as the income earned on the date when it is realised. Unearned or unrealised revenue should not be taken into account. The realisation concept is vital for determining income pertaining to an accounting period. It avoids the possibility of inflating incomes and profits.

Historical Cost Concept

Under this concept, assets are recorded at the price paid to acquire them and this cost is the basis for all subsequent accounting for the asset. For example, if a piece of land is purchased for Rs.5,00,000 and its market value is Rs.8,00,000 at the time of preparing final accounts the land value is recorded only for Rs.5,00,000. Thus, the balance sheet does not indicate the price at which the asset could be sold for.

Matching Concept

Matching the revenues earned during an accounting period with the cost associated with the period to ascertain the result of the business concern is called the matching concept. It is the basis for finding accurate profit for a period which can be safely distributed to the owners.

Full Disclosure Concept

Accounting statements should disclose fully and completely all the significant information. Based on this, decisions can be taken by various interested parties. It involves proper classification and explanations of accounting information which are published in the financial statements.

Verifiable and Objective Evidence Concept

This principle requires that each recorded business transactions in the books of accounts should have an adequate evidence to support it. For example, cash receipt for payments made. The documentary evidence of transactions should be free from any bias. As accounting records are based on documentary evidence which is capable of verification, it is universally acceptable.

ACCOUNTING CONVENTIONS OR PRINCIPLES

To make the accounting information useful to various interested parties, the basic assumptions and concepts discussed earlier have been modified. These modifying principles are as under.

Cost Benefit Principle

This modifying principle states that the cost of applying a principle should not be more than the benefit derived from it. If the cost is more than the benefit then that principle should be modified.

Materiality Principle

The materiality principle requires all relatively relevant information should be disclosed in the financial statements. Unimportant and immaterial information are either left out or merged with other items.

Consistency Principle

The aim of consistency principle is to preserve the comparability of financial statements. The rules, practices, concepts and principles used in accounting should be continuously observed and applied year after year. Comparisons of financial results of the business among different accounting period can be significant and meaningful only when consistent practices were followed in ascertaining them. For example, depreciation of assets can be provided under different methods, whichever method is followed, it should be followed regularly.

Prudence (Conservatism) Principle

Prudence principle takes into consideration all prospective losses but leaves all prospective profits. The essence of this principle is "anticipate no profit and provide for all possible losses". For example, while valuing stock in trade, market price or cost price whichever is less is considered.

ACCOUNTING STANDARDS

To promote world -wide uniformity in published accounts, the International Accounting Standards Committee (IASC) has been set up in June 1973 with nine nations as founder members. The purpose of this committee is to formulate and publish in public interest, standards to be observed in the presentation of audited financial statements and to promote their world-wide acceptance and observance. IASC exist to reduce the differences between different countries' accounting practices. This process of harmonisation will make it easier for the users and preparers of financial statement to operate across international boundaries. In our country, the Institute of Chartered Accountants of India has constituted Accounting Standard Board (ASB) in 1977. The ASB has been empowered to formulate and issue accounting standards, that should be followed by all business concerns in India.

ACCOUNT

Every transaction has two aspects and each aspect has an account. It is stated that 'an account is a summary of relevant transactions at one place relating to a particular head'.

Classification of Accounts

Transactions can be divided into three categories.

i. Transactions relating to individuals and firms

ii. Transactions relating to properties, goods or cash

iii. Transactions relating to expenses or losses and incomes or gains.

Therefore, accounts can also be classified into Personal, Real and Nominal. The classification may be illustrated as follows

I. Personal Accounts: The accounts which relate to persons. Personal accounts include the following.

i. Natural Persons: Accounts which relate to individuals. For example, Mohan's A/c, Shyam's A/c etc.

ii. Artificial persons: Accounts which relate to a group of persons or firms or institutions. For example, HMT Ltd., Indian Overseas Bank, Life Insurance Corporation of India, Cosmopolitan club etc.

iii. Representative Persons: Accounts which represent a particular person or group of persons. For example, outstanding salary account, prepaid insurance account, etc. The business concern may keep business relations with all the above personal accounts, because of buying goods from them or selling goods to them or borrowing from them or lending to them. Thus they become either Debtors or Creditors.

The proprietor being an individual his capital account and his drawings account are also personal accounts.

II. Impersonal Accounts: All those accounts which are not personal accounts. This is further divided into two types viz. Real and Nominal accounts.

i. Real Accounts: Accounts relating to properties and assets which are owned by the business concern. Real accounts include tangible and intangible accounts. For example, Land, Building, Goodwill, Purchases, etc.

ii. Nominal Accounts: These accounts do not have any existence, form or shape. They relate to incomes and expenses and gains and losses of a business concern. For example, Salary Account, Dividend Account, etc.

Illustration: 1 Classify the following items into Personal, Real and Nominal Accounts.

1. Capital
2. Sales
3. Drawings
4. Outstanding salary
5. Cash
6. Rent
7. Interest paid
8. Indian Bank
9. Discount received
10. Building
11. Bank
12. Chandrasekar
13. Murugan Lending Library
14. Advertisement
15. Purchases
16. Mohan Kumar

Solution:

1. Personal account
2. Real account
3. Personal account
4. Personal (Representative) account
5. Real account
6. Nominal account
7. Nominal account
8. Personal (Legal Body) account
9. Nominal account
10. Real account
11. Personal account
12. Personal account
13. Personal account
14. Nominal account
15. Real account
16. Personal account

Golden Rules of Accounting

All the business transactions are recorded on the basis of the following rules.

S. No.	Name of Account	Debit	Credit
1.	Personal	The receiver	The giver

2.	Real	What comes in	What goes out
3.	Nominal	All expenses and losses	All incomes and gains.

Books of Original Entry

The books in which a transaction is recorded for the first time from a source document are called *Books of Original Entry* or *Prime Entry*. *Journal* is one of the books of original entry in which transactions are originally recorded in a chronological (day-to-day) order according to the principles of Double Entry System.

Journal

Journal is a date-wise record of all the transactions with details of the accounts debited and credited and the amount of each transaction.

Format

Journal

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)

Explanation:

1. *Date:* In the first column, the date of the transaction is entered. The year and the month are written only once, till they change. The sequence of the dates and months should be strictly maintained.

2. *Particulars:* Each transaction affects two accounts, out of which one account is debited and the other account is credited. The name of the account to be debited is written first, very near to the line of particulars column and the word Dr. is also written at the end of the particulars column. In the second line, the name of the account to be credited is written, starts with the word 'To', a few space away from the margin in the particulars column to the make it distinct from the debit account.
3. *Narration:* After each entry, a brief explanation of the transaction together with necessary details is given in the particulars column with in brackets called narration. The words 'For' or 'Being' are used before starting to write down narration. Now, it is not necessary to use the word 'For' or 'Being'.
4. *Ledger Folio (L.F):* All entries from the journal are later posted into the ledger accounts. The page number or folio number of the Ledger, where the posting has been made from the Journal is recorded in the L.F column of the Journal. Till such time, this column remains blank.
5. *Debit Amount:* In this column, the amount of the account being debited is written.
6. *Credit Amount:* In this column, the amount of the account being credited is written.

Steps in Journalising

The process of analysing the business transactions under the heads of debit and credit and recording them in the Journal is called Journalising. An entry made in the journal is called a 'Journal Entry'.

Step 1: A Determine the two accounts which are involved in the transaction.

Step 2: A Classify the above two accounts under Personal, Real or Nominal.

Step 3: A Find out the rules of debit and credit for the above two accounts.

Step 4: A Identify which account is to be debited and which account is to be credited.

Step 5: A Record the date of transaction in the date column. The year and month is written once, till they change. The sequence of the dates and months should be strictly maintained.

Step 6: A Enter the name of the account to be debited in the particulars column very close to the left hand side of the particulars column followed by the abbreviation Dr. in the same line. Against this, the amount to be debited is written in the debit amount column in the same line.

Step 7: A Write the name of the account to be credited in the second line starts with the word 'To' a few space away from the margin in the particulars column. Against this, the amount to be credited is written in the credit amount column in the same line.

Step 8: A Write the narration within brackets in the next line in the particulars column.

Step 9: A Draw a line across the entire particulars column to separate one journal entry from the other.

Ledger

In the Journal, each transaction is dealt with separately. Therefore, it is not possible to know at a glance, the net result of many transactions. So, in order to ascertain the net effect of all the transactions relating to a particular account are collected at one place in the Ledger.

A Ledger is a book which contains all the accounts whether personal, real or nominal, which are first entered in journal or special purpose subsidiary books.

According to L.C. Cropper, **'the book which contains a classified and permanent record** of all t**he transactions of a business is called the Ledger'.**

The ledger that is normally used in a majority of business concern is a bound note book. This can be preserved for a long time. Its pages are consequently numbered. Each account in the ledger is opened preferably on a separate page. If one page is completed, the account will be continued in the next or some other page. But in bigger concerns, it is not practical to keep the ledger as a bound note book; Loose-leaf ledger now takes the place of a bound note book. In a loose-leaf ledger, appropriate ruled sheets of thick paper are introduced and fixed up with the help of a binder. Whenever necessary additional pages may be inserted, completed accounts can be removed and the accounts may be arranged and rearranged in the desired order. Therefore, this type of ledger is known as Loose-leaf Ledger.

Utility

Ledger is a principal or main book which contains all the accounts in which the transactions recorded in the books of original entry are transferred. Ledger is also called the **'Book of Final Entry'** or **'Book of Secondary Entry'**, because the transactions are finally incorporated in the Ledger. The following are the advantages of ledger.

i. Complete information at a glance:

All the transactions pertaining to an account are collected at one place in the ledger. By looking at the balance of that account, one can understand the collective effect of all such transactions at a glance.

ii. Arithmetical Accuracy

With the help of ledger balances, Trial balance can be prepared to know the arithmetical accuracy of accounts.

iii. Result of Business Operations

It facilitates the preparation of final accounts for ascertaining the operating result and the financial position of the business concern.

iv. Accounting information

The data supplied by various ledger accounts are summarized, analysed and interpreted for obtaining various accounting information.

FORMAT

Ledger Account

Dr. Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)

Year Month Date	To (Name of Credit Account in Journal)			Year Month Date	By (Name of Debit Account in Journal)		

Explanation:

i. Each ledger account is divided into two parts. The left hand side is known as the debit side and the right hand side is known as the credit side. The words **'Dr.' and 'Cr.' are used to denote Debit and Credit.**

ii. The name of the account is mentioned in the top (middle) of the account.

iii. The date of the transaction is recorded in the date column.

iv. **The word 'To' is used before the accounts which appear on the debit** side of an **account in the particulars column. Similarly, the word 'By' is used before the** accounts which appear on the credit side of an account in the particulars column.

v. The name of the other account which is affected by the transaction is written either in the debit side or credit side in the particulars column.

vi. The page number of the Journal or Subsidiary Book from where that particular entry is transferred, is entered in the Journal Folio (J.F) column.

vii. The amount pertaining to this account is entered in the amount column.

Recording of Transactions in the ledger

Before recording transactions, we shall follow few steps that will help us know which account is debited and which account is credited. Please remember that in accounting we always look at things from the point of view of the business only.

1. State what are the accounts affected
2. Categorise each account under assets, liabilities, equity, revenue and expenses.
3. State whether each item is increasing or decreasing.
4. Translate the increase and decrease into debit and credit by using the table of balances below. (Same was given when we learnt the rules for assets, liabilities, equity, expenses and revenue)

CATEGORY	BALANCE	INCREASE	DECREASE

Assets	Dr	Dr	Cr
Liabilities	Cr	Cr	Dr
Equity	Cr	Cr	Dr
Revenue	Cr	Cr	Dr
Expenses	Dr	Dr	Cr

5. Verify that there are one debit entry and one credit entry of the same amount.

6. Record the transaction.

Problem 1. Pass journal entries for the following transactions in the books of Nikhil Bhusan:

1997 Jan. 1 Commenced business with a capital Rs. 20,000

3 Amount deposited in S.B.I Rs. 5,000

6 Goods purchased for cash Rs. 7,000

10 Furniture purchased from Chinmoy Rs. 5,000

11 Goods sold to Anil Majumdar for cash Rs. 8,000

13 Goods sold to Ashim Das Rs. 2,000

25 Cash drew for private uses Rs. 500

31 Salaries paid Rs. 800

Solution:

Journal

Date	Particulars	L. F.	Dr. Amount ₹	Cr. Amount ₹
1997 Jan. 1	Cash Account Dr. To Capital Account (Being capital invested)		20,000	20,000
3	Bank Account Dr. To Cash Account (Being cash deposited into bank)		5,000	5,000
6	Purchase Account Dr. To Cash Account (Being goods purchased for cash.)		7,000	7,000
10	Furniture Account Dr. To Chinmoy's Account (Being furniture purchased from Chinmoy.)		5,000	5,000
11	Cash Account Dr. To Sales Account (Being goods sold to Mazumdar on cash.)		8,000	8,000
13	Ashim Das' Account Dr. To Sales Account (Being goods sold to Ashim Das.)		2,000	2,000
25	Drawings Account Dr. To Cash Account (Being cash drew for personal use)		500	500
31	Salaries Account Dr. To Cash Account (Being salaries paid.)		800	800

Problem 2. Journalise the following transactions in the books of Amar and post them in the Ledger and Balance them:-

2004

March 1 Bought goods for cash Rs. 25,000 2
Sold goods for cash Rs. 50,000

3 Bought goods for credit from Gopi Rs.19,000

5 Sold goods on credit to Robert Rs.8,000

7 Received from Robert Rs. 6,000

9 Paid to Gopi Rs.5,000

20 Bought furniture for cash Rs. 7,000

Solution :

Journal of Amar

Date	Particulars	LF.	Debit Rs.	Debit P.	Credit Rs.	Credit P.
2004 Mar 1	Purchases A/c Dr. To Cash A/c (Cash purchases)		25,000	_	25,000	_
2	Cash A/c Dr. To Sales A/c (Cash Sales)		50,000	_	50,000	_
3	Purchases A/c Dr. To Gopi A/c (Credit purchases)		19,000	_	19,000	_
5	Robert A/c Dr. To Sales A/c (Credit Sales)		8,000	_	8,000	_
7	Cash A/c Dr.		6,000	_		_

	To Robert A/c (Cash received)					6,000	
9	Gopi A/c Dr. To Cash A/c (Cash paid)			5,000	–	5,000	–
20	Furniture A/c. Dr. To Cash A/c (furniture purchased)			7,000	–	7,000	–

Ledger Accounts
Cash Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 5	To Sales A/c		50,000	Mar 1	By Purchases A/c		25,000
7	To Robert A/c		6,000	9	By Gopi A/c		5,000
				20	By Furniture A/c		7,000
				31	By Balance c/d		19,000
			56,000				56,000
April 1	To Balance b/d		19,000				

Purchases Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 1	To Cash A/c		25,000	Mar 31	By Balance c/d		44,000
3	To Gopi A/c		19,000				
			44,000				44,000
April 1	To Balance b/d		44,000				

Sales Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004 Mar 31	To Balance c/d		58,000	2004 Mar 2	By Cash A/c		50,000
				5	By Robert A/c		8,000
			58,000				58,000
				April 1	By Balance b/d		58,000

Furniture Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			

Mar 20	To Cash A/c		7,000	Mar 31	By Balance c/d		7,000
			7,000				7,000
Apr 1	To Balance b/d		7,000				

Gopi Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 19	To Cash A/c		5,000	Mar 3	By Purchases A/c		19,000
31	To Balance c/d		14,000				
			19,000				19,000
				April 1	By Balance b/d		14,000

Robert Account

Dr. Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2004				2004			
Mar 5	To Sales A/c		8,000	Mar 7	By Cash A/c		6,000
				31	By Balance c/d		2,000
			8,000				8,000
Apr 1	To Balance b/d		2,000				

SUBSIDIARY BOOKS

Periodical details of some important business transactions cannot be known, from the journal easily, e.g., monthly sales, monthly purchases.

Such a system does not facilitate the installation of an internal check system since the journal can be handled by only one person.

The journal becomes bulky and voluminous.

NEED FOR SUBSIDIARY BOOKS

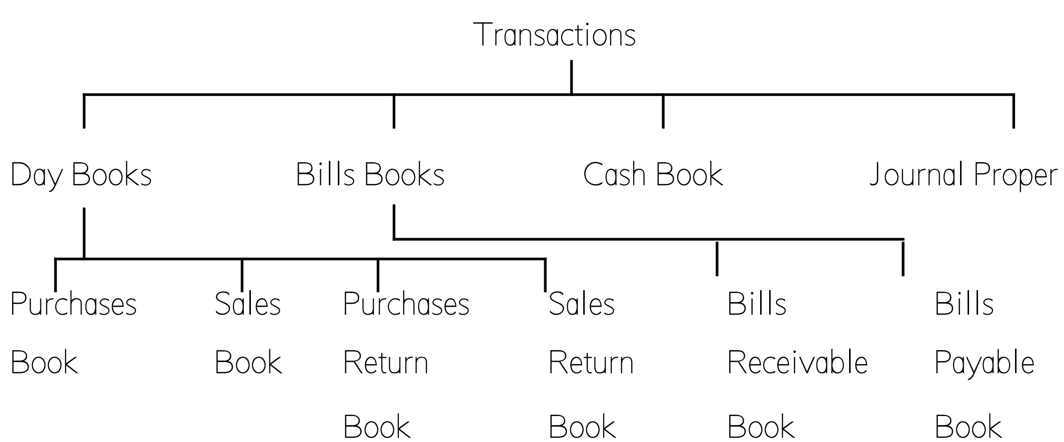
Moreover, transactions can be classified and grouped conveniently according to their nature, as some transactions are usually of repetitive in nature. Generally, transactions are of two types:

Cash and Credit. Cash transactions can be grouped in one category whereas credit transactions can be grouped in another category. Thus, in practice, the main journal is sub-divided in such a way that a separate book is used for each category or group of transactions which are repetitive and sufficiently large in number.

Each one of the subsidiary books is a special journal and a book of original or prime entry. Though the usual type of journal entries are not passed in these sub-divided journals, the double entry principles of accounting are strictly followed.

KINDS OF SUBSIDIARY BOOKS

The number of subsidiary books may vary according to the requirements of each business. The following are the special purpose subsidiary books.



PURPOSE OF SUBSIDIARY BOOK

Purchases Book records only credit purchases of goods by the trader.
Sales Book is meant for entering only credit sales of goods by the trader.
Purchases Return Book records the goods returned by the trader to suppliers.
Sales Return Book deals with goods returned (out of previous sales) by the customers.
Bills Receivable Book records the receipts of bills (Bills Receivable).
Bills Payable Book records the issue of bills (Bills Payable).
Cash Book is used for recording only cash transactions i.e., receipts and payments of cash.
Journal Proper is the journal which records the entries which cannot be entered in any of the above listed subsidiary books.

ADVANTAGES OF SUBSIDIARY BOOKS

The advantages of maintaining subsidiary books can be summarised as under :

Division of Labour : The division of journal, resulting in division of work, ensures more clerks working independently in recording original entries in the subsidiary books.

Efficiency : The division of labour also helps the reduction in work load, saving in time and stationery. It also gives advantages of specialisation leading to efficiency.

Prevents Errors and Frauds : The accounting work can be divided in such a manner that the work of one person is automatically checked by another person. With the use of internal check, the possibility of occurrance of errors and frauds may be avoided.

Easy Reference : It facilitates easy references to any particular item. For instance total credit sales for a month can be easily obtained from the Sales Book.

Easy Postings : Posting from the subsidiary books are made at convenient intervals depending upon the nature of the business.

1. Purchases Book

Purchases book also known as Bought Day Book is used to record all credit purchases of goods which are meant for resale in the business. Cash purchases of goods, cash and credit purchases of assets are not entered in this book.

Before discussing the Purchase Day Book, in detail we are to explain the most significant terms, Trade Discount and Cash Discount.

Problem 3: From the following transactions of Ram for July, 2003 prepare the Purchases Book and ledger accounts connected with this book.

2003

July 5 Purchased on credit from Kannan & Co.

50 Iron boxes @ Rs. 500

10 Grinders @ Rs. 3,000

6 Purchased for cash from Siva & Bros.

25 Fans @ Rs. 1,250

10 Purchased from Balan & Sons on credit

20 Grinders @ Rs. 2,500

10 Mixie @ Rs. 3,000

20 Purchased, on credit, one Computer from Kumar for Rs. 35,000.

Solution :

In the books of Ram
Purchases Book

Date	Particulars	Inward Invoice No.	L.F.	Amount Details Rs.	Amount Total Rs.
2003	Kannan & Co.			25,000	
July 5	50 Iron boxes @ Rs. 500			30,000	
	10 Grinders @ Rs. 3,000				
	Goods purchased vide their				55,000
	bill No....... Dated......				
10	Balan & Co.				
	20 Grinders @ Rs.2,500			50,000	
	10 Mixie @ Rs. 3,000			30,000	
	Goods purchased vide their				80,000
	bill No....... Dated......				
	Total				1,35,000

Ledger Accounts

Dr. Purchases Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 July	To Sundries as per Purchases Book		1,35,000				

Dr. Kannan & Co. Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 July 5	By Purchases A/c		55,000

Dr. Balan & Co. A/c Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 July 10	By Purchases A/c		80,000

Sales Book

The sales book is used to record all credit sales of goods dealt with by the trader in his business. Cash sales, cash and credit sales of assets are not entered in this book. The entries in the sales book are on the basis of the invoices issued to the customers with the net amount of sale.

Problem 4. From the transactions given below prepare the Sales Book of Ram for July 2003.

2003				
July 5	Sold on credit to S.S. Traders			
	10 Chairs	@ Rs. 250	Less 10%	
	10 Tables	@ Rs. 850	Discount	
8	Sold to Raja for cash			
	15 Chairs	@ Rs. 250		
20	Sold to Mohan & Co.			
	5 Almirah	@ Rs. 2,200		
	10 Tables	@ Rs. 850		
23	Sold on credit to Narayanan old computer for Rs. 5,000			
28	Sold to Kumaran for cash			
	15 Chairs	@ Rs. 250		

Solution:

In the books of Ram
Sales Book

Date	Particulars	Outward Invoice No.	L.F.	Amount Details Rs.	Amount Total Rs.
2003					
July 5	S.S. Traders & Co.				
	10 Chairs @ Rs. 250			2,500	
	10 Tables @ Rs. 850			8,500	
				11,000	
	Sold to S.S. Traders,			1,100	
	Invoice No....... dated				

					9,900
20	Mohan & Co 5 Almirah @ Rs. 2,200			11,000	
	10 Tables @ Rs. 850			8,500	
	Sales as per Invoice No...... dated				19,500
	Total				29,400

Ledger Accounts

Dr. Sales Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 July 31	By Sundries as per sales book		29,400

Dr. **S.S. Trader's Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 July 5	To Sales A/c		9,900				

Dr. **Mohan & Co.'s Account** Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003							

July 5	To Sales A/c		19,500				

Returns Books

Returns Books are those books in which the goods returned to the suppliers and goods returned by the customers are recorded.

The reasons for the return of goods are

- not according to the order placed.
- not upto the samples which were already shown.
- due to damage condition.
- due to difference in the prices charged.
- undue delay in the delivery of the goods.

Kinds of Returns Books

The following are the kinds of Returns Books;

- Purchases Return or Returns outward book
- Sales Return or Returns inward book

When the business concern returns a part of the goods purchased on credit, the returns fall under the category Purchases Return or Returns Outward.

When the business concern receives a part of the goods sold on credit, the returns fall under the category of Sales Return or Returns Inward.

Purchases Return Book

This book is used to record all returns of goods by the business to the suppliers. The entries in the Purchases Returns Book are usually made on the basis of debit note issued to the suppliers or credit note received from the suppliers. We call it a debit note because the party's (supplier) account is debited with the amount written in this note. The same note is termed as credit note from the receiving party's point of view because he will credit the account of the party from whom he has received the note together with goods.

Problem 5. Enter the following transactions in the purchases return book of Hari and post them into the ledger.

2003 Jan 5 Returned goods to Anand 5 chairs @ Rs.200 each, not in accordance with order.

Returned goods to Chandran 4 chairs @ Rs.200 each and
10 tables @ Rs.350 each, due to inferior quality.

Solution :

In the books of Hari
Purchases Return Book

Date	Particulars	Debit Note No.	L.F.	Amount Details Rs.	Amount Total Rs.	Remarks
2003 Jan 5	Anand 5 Chairs @ Rs.200				1,000	Not in accordance with order
14	Chandran 4 Chairs @ Rs.200 10 Tables @ Rs.350			800 3,500	4,300	Due to inferior quality
	Total				5,300	

Ledger Accounts
Dr. Purchases Return Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.

				2003 Jan 31	By Sundries as per Purchases return book		5,300

Dr. Anand Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Jan 5	To Purchases Return A/c		1,000				

Dr. Chandran Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 Jan 14	To Purchases Return A/c		4,300				

Sales Return Book

This book is used to record all returns of goods to the business by the customers. The entries in the sales return book are usually on the basis of credit notes issued to the customers or debit notes issued by the customers.

Problem 6. Enter the following transactions in Returns Inward Book:
2003
April 6 Returned by Shankar 30 shirts each costing Rs.150, due to inferior quality.

Amar Tailors returned 10 Baba suits, each costing Rs.100, on account of being not in accordance with their order.

T.N. Stores returned 12 Salwar sets each costing Rs.200, being not in accordance with order.

Solution:

Sales Return Book

Date	Particulars	Credit Note No.	L.F.	Details Rs.	Amount Rs.	Remarks
2003 April 6	Shankar 30 shirts @ Rs.150			4,500		Due to inferior quality
8	Amar Tailors 10 Baba suits @ Rs. 100			1,000		Not in accordance with the order
21	T.N Stores 12 Salwar sets @ Rs.200			2,400	7,900	Not in accordance with the order
	Total				7,900	

Ledger Accounts

Dr. Sales Return Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
2003 April 30	To Sundries as per Sales return book		7,900				

Dr. Shankar Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 April 6	By Sales Return A/c		4,500

Dr. Amar Tailors Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.
				2003 April 8	By Sales Return A/c		1,000

Dr. T.N. Stores Account Cr.

Date	Particulars	J.F	Amount Rs.	Date	Particulars	J.F	Amount Rs.

				2003 April 21	By Sales Return A/c		2,400

CASH BOOKS

In every business house there are cash transactions as well as credit transactions. All credit transactions will become cash transactions when payments are made to creditors or cash received from debtors. Since, cash transactions will be numerous, it is better to keep a separate book to record only the cash transactions.

FEATURES OF CASH BOOKS

A cash book is a special journal which is used to record all cash receipts and cash payments. The cash book is a book of original entry or prime entry since transactions are recorded for the first time from the source documents. The cash book is a ledger in the sense that it is designed in the form of a cash account and records cash receipts on the debit side and cash payments on the credit side. Thus, the cash book is both a journal and a ledger. Cash Book will always show debit balance, as cash payments can never exceed cash available. In short, cash book is a special journal which is used for recording all cash receipts and cash payments.

ADVANTAGES OF CASH BOOKS

Saves time and labour: When cash transactions are recorded in the journal a lot of time and labour will be involved. To avoid this all cash transactions are straight away recorded in the cash book which is in the form of a ledger.

To know cash and bank balance: It helps the proprietor to know the cash and bank balance at any point of time.

Mistakes and frauds can be prevented: Regular balancing of cash book reveals the balance of cash in hand. In case the cash book is maintained by business concern, it can avoid frauds. Discrepancies if any, can be identified and rectified.

Effective cash management: Cash book provides all information regarding total receipts and payments of the business concern at a particular period. So that, effective policy of cash management can be formulated.

KINDS OF CASH BOOK

The various kinds of cash book from the point of view of uses may be as follow:

Kinds of cash book

I	II	III	IV
Single column cash book	Double column cash book a) With discount and cash columns b) With cash and bank columns	Triple column cash book with discount, cash and bank columns	Petty cash book

SINGLE COLUMN CASH BOOK

Single column cash book (simple cash book) has one amount column in each side. All cash receipts are recorded on the debit side and all cash payments on the credit side. In fact, this book is nothing but a Cash Account. Hence, there is no need to open cash account in the ledger.

Problem 6. Mr. M starts business with Rs. 20,000 on 1st April 2012. Of this he pays Rs. 15000 into his bank account. His cash transactions during the week were:
April 1 Purchased stationery for cash Rs. 100
April 2 Purchased goods for cash Rs. 2500
April 2 Cash Sales Rs.1500
April 3 Received from J Brown Cash on account Rs. 1000
April 4 Paid to J. R Cash Rs. 2200
April 5 Paid for Advertisement Rs. 400
April 6 Cash Sales Rs. 1800
April 6 Purchased old machinery Rs. 800
April 6 Purchase from sham on credit Rs. 6000

Solution: single column cash book .

Dr.	Single Cash Book								Cr.
Date	Receipts	V.No.	L.F.	Amount	Date	Payments	V.No.	L.F.	Amount
April 1, 2012	To Capital a/c			20000	April 1, 2012	By Bank a/c			15000
Apr-02	To Sale a./c			1500	Apr-01	By Stationery a/c			100

Apr-03	To J. Brown a/c			1000	Apr-01	By Purchase a/c			2500
Apr-06	To Sales a/c			1800	Apr-04	By J.R. a/c			2200
					Apr-05	By Advertisement a/c			400
					Apr-06	By Machinery a/c			800
					Apr-06	By Bal. c/d			3300
				24300					24300
Apr-07	By Bal. b/d			3300					

DOUBLE COLUMN CASH BOOK

On either side of the single column cash book, another column is added to record discount allowed and discount received.

Problem 7. From the following transactions prepare a two column cash book and post entries therefore to ledger accounts.

Year: 2016

Jan. 01: Opening balance of cash Rs.4,500.
Jan. 03: Received cash from R & Co. Rs.3,880 and allowed them a discount of Rs.20.
Jan. 05: Paid cash to H & Co. Rs.3,590 and received a discount of Rs.10.
Jan. 07: Merchandise purchased for cash Rs.940.
Jan. 09: Received interest on investment Rs.365.
Jan. 12: Purchased machinery for cash Rs.4,100.
Jan. 15: Cash sales for the first half of the month Rs.6,500.
Jan. 17: Paid cash for stationary Rs.635.
Jan. 20: Paid for office furniture Rs.710.
Jan. 21: Paid to H & Co. Rs.970 and received a cash discount of Rs.30.
Jan. 28: Cash received from R & Co. Rs.670 and allowed them a discount of Rs.30.
Jan. 31: Cash sales for the second half of the month Rs.7,600.
Jan. 31: Paid for salaries Rs.1,250.

Solution: Double Column Cash Book

Dr. (Receipts) CASH BOOK Cr. (Payments)

Date	Description	V.No.	PR	Disc.	Cash	Date	Description	V.No.	PR	Disc.	Cash
2016						2016					
Jan. 01	Balance b/d				4,500	Jan. 05	H & Co.		116	10	3,590
Jan. 03	R & Co.		120	20	3,880	Jan. 07	Purchases		108		940
Jan. 09	Interest income		104		365	Jan. 12	Machinery		110		4,100
Jan. 15	Sales		106		6,500	Jan. 17	Stationary exp.		112		635
Jan. 28	R & Co.		120	30	670	Jan. 20	Office furniture		114		710
Jan. 31	Sales		106		7,600	Jan. 23	H & Co.		116	30	970
						Jan. 31	Salaries exp.		118		1,250
						Jan. 31	Balance c/d				11,320
				50	23,515					40	23,515
Feb. 01	Balance b/d				11,320						

TRIPLE COLUMN

Large business concerns receive and make payments in cash and by cheques. Where cash discount is a regular feature, a Triple Column Cash Book is more advantageous. This cash book has three amount columns (cash, bank and discount) on each side. All cash receipts, deposits into bank and discount allowed are recorded on debit side and all cash payments, withdrawals from bank and discount received are recorded on credit side.

Problem 8. The John trading company has undertaken the following transactions during the month of May 2016.

Year: 2016
May 01: Cash balance Rs.2,200, bank overdraft Rs.365.
May 03: Paid J & Co. by check Rs.1,200, discount received from him Rs.15.
May 05: Received from A & Co. a check for Rs.980, discount allowed to them Rs.20.
May 07: Deposited into bank the check received from A & Co. on May 05.
May 10: Purchased stationary for cash, Rs.150.
May 15: Purchased merchandise for cash, Rs.1,300.

May 15: Cash sales for the first half of the month, Rs.2,350.
May 16: Deposited into bank Rs.1,600.
May 18: Cash withdrawn from bank for personal expenses Rs.150.
May 19: Issued a check for merchandise purchased, Rs.1,650.
May 21: Drew from bank for office use, Rs.650.
May 24: Received a check from S & Sons and deposited the same into bank, Rs.1,560.
May 25: Paid a check to Ali Inc. for Rs.400 and received a discount of Rs.15.
May 27: Bought furniture for cash for office use, Rs.390.
May 29: Paid office rent by check, Rs.450.
May 30: Cash sales for the second half of the month Rs.4,300.
May 31: Paid salaries by check Rs.1,760.
May 31: Withdrew from bank for office use Rs.1,470.

Required: Record the above transactions in a three/triple column cash book.

Solution: Triple Column Cash Book

Dr. (Receipts) CASH BOOK Cr. (Payments)

Date	Description	V.No.	PR	Disc.	Cash	Bank	Date	Description	V.No.	PR	Disc.	Cash	Bank
2016							2016						
May 01	Balance b/d				2,200		May 01	Balance b/d					365
May 05	A & Co.		96	20	980		May 03	J & Co.		105	15		1,200
May 07	Cash		C			980	May 07	Bank		C		980	
May 15	Sales		94		2,350		May 10	Stationery		98		150	
May 16	Cash		C			1,600	May 15	Purchases		100		1,300	
May 21	Bank		C		650		May 16	Bank		C		1,600	
May 24	S & Sons		97			1,560	May 18	Drawings		101		150	
May 30	Sales		4		4,300		May 19	Purchases		100			1,650
May 31	Bank		C		1,470		May 21	Cash		C			650
May 31	Balance c/d					3,805	May 25	Ali Inc.		106	15		400
							May 27	Furniture		102		390	
							May 29	Rent exp.		103			450
							May 31	Salaries exp.		104			1,760
							May 31	Cash		C			1,470
							May 31	Balance c/d				7,380	
				20	11,950	7,945					30	11,950	7,945
Jun. 01	Balance b/d				7,380		Jun. 01	Balance b/d					3,805

PETTY CASH

In every business, of whatever size, there are many small cash payments such as conveyance, carriage, postage, telegram, etc. These expenses are generally repetitive in nature. If all these small payments are recorded in the cash book, it will be difficult for the cashier to maintain the records all by himself. In order to make the task of the cashier easy, these small and recurring expenses are recorded in a separate cash book called **"Petty Cash Book"** and the person who maintains the petty cash is called the **"Petty Cashier"**.

Petty means 'small'. The petty cash book is a book where small recurring payments like carriage, cartage, postage and telegram, printing and stationery etc., are recorded by the petty cashier, a person other than the main cashier.

IMPREST SYSTEM

Imprest **means 'money advanced on loan'. Under this system the amount** required to meet out various petty expenses is estimated and given to the petty cashier at the beginning of the specified period, usually a month. All the payments are supported by vouchers. At the end of the given period or earlier, when the petty cashier has spent the petty cash amount, he closes the petty cash book for the period and balances it. Then he submits the accounts to the cashier. He verifies the petty cash book with the vouchers. After satisfying himself as to the correctness and genuineness of the payments an amount equal to the cash spent is given to the petty cashier. This amount together with the unspent amount will bring up the cash in hand to the amount with which he originally started i.e., the imprest amount. Thus the system of reimbursing the amount spent by the petty cashier at fixed period, is known as the imprest system of petty cash.

For example, On June 1, 2002, Rs.1,000 was given to the petty cashier. He had spent Rs.940 during the month. He will be paid Rs.940 on 30th June by the cashier so that he may again have Rs.1,000 for the next month i.e., July.

Problem 9.From the following particulars prepare a Petty Cash Book under Imprest System. 2005

Jan. 1. Received from the Chief Cashier as imprest cash Rs.400.

Jan. 2. Paid Taxi hire Rs.20.

Jan. 3. Paid postage Rs.28 and stationery Rs.60.

Jan. 4. Purchased stationery Rs.48.

Jan. 5. Paid telegram charges Rs.28 and bus fare Rs.4.

Jan. 6. Bought postage stamps Rs.96.

Jan. 7. Paid Rs.72 for repairs of typewriter.

Solution:

Petty Cash Book

Amount Received	Date	Particulars	V. No.	Total	Traveling Expenses	Postages	Stationery	Office Expenses	Misc. Expenses
400	2005 Jan 1	Cash Received							

	Jun. 2	Taxi hire A/c		20	20				
	Jun. 3	Postage A/c		28		28			
	Jun. 3	Stationery A/c		60			60		
	Jun. 4	Stationery A/c		48			48		
	Jun. 5	Telegram A/c		28		28			
	Jun. 5	Bus fare A/c		4	4				
	Jun. 6	Postage A/c		96		96			
	Jun. 7	Repairs A/c		72				72	
				356	24	152	108	72	
		Balance c/d		44					
400				400					
44	Jun. 8	Balance b/d							
356		Cash received							

TRIAL BALANCE

In the previous chapters, you have learnt how to record and classify the transactions in the various accounts along with balancing thereof. The next step in the accounting process is to prepare a statement to check the arithmetical accuracy of the transactions recorded so for. This statement is called **'Trial Balance'**.

Trial balance is a statement which shows debit balances and credit balances of all accounts in the ledger. Since, every debit should have a corresponding credit as per the rules of double entry system, the total of the debit balances and credit balances should tally (agree). In case, there is a difference, one has to check the correctness of the balances brought forward from the respective accounts. Trial balance can be prepared in any date provided accounts are balanced.

Definition

"Trial balance is a statement, prepared with the debit and credit balances of **ledger accounts to test the arithmetical accuracy of the books"** – J.R. Batliboi.

Objectives of Trial Balance

The objectives of preparing a trial balance are:

- To check the arithmetical accuracy of the ledger accounts.
- To locate the errors.
- To facilitate the preparation of final accounts.

Advantages of Trial Balance

The advantages of the trial balance are

- It helps to ascertain the arithmetical accuracy of the book-keeping work done during the period.
- It supplies in one place ready reference of all the balances of the ledger accounts.
- If any error is found out by preparing a trial balance, the same can be rectified before preparing final accounts.
- It is the basis on which final accounts are prepared.

Methods of Trial Balance

A trial balance can be prepared in the following methods.

The Total Method : According to this method, the total amount of the debit side of the ledger accounts and the total amount of the credit side of the ledger accounts are recorded.

The Balance Method : In this method, only the balances of an account either debit or credit, as the case may be, are recorded against their respective accounts.

The balance method is more widely used, as it supplies ready figures for preparing the final accounts.

Problem 10. The following balances were extracted from the ledger of Rahul on 31st March, 2003. You are requested to prepare a trial balance as on that date in the proper form.

	Rs.		rs.
Salaries	36,320	Purchases	1,44,670
Sales	1,73,500	Sundry Debtors	1,430
Plant & Machinery	34,300	Travelling Expenses	2,630
Commission Paid	1,880	Carriage Inward	240
Stock on 1.4.2002	11,100	Sundry Creditors	14,260
Repairs	1670	Capital, 1.4.2002	62,500

Sundry Expenses	460	Drawings	3,500
Returns Inward	1,000	Cash at Bank	1,090
Discount Allowed	1,150	Returns Outward	400
Rent and Rates	3,220	Investments	6,000

Solution:

Trial Balance of Rahul as on 31/3/2003

S. No.	Name of the Account	L. F.	Dr. Rs.	Cr. Rs.	Nature of Balance (Why Dr. or Cr.)
1.	Salaries		36,320	–	Nominal A/c-expense
2.	Sales		–	1,73,500	Real A/c - goods
3.	Plant and Machinery		34,300	–	Real A/c - asset
4.	Commission Paid		1,880	–	Nominal A/c expense
5.	Stock on 1.4.2002		11,100	–	Real A/c - goods
6.	Repairs		1,670	–	Nominal A/c-expense
7.	Sundry Expenses		460	–	Nominal A/c-expense
8.	Returns Inward		1,000	–	Real A/c - goods
9.	Discount Allowed		1,150	–	Nominal A/c - loss
10.	Rent & Rates		3,220	–	Nominal A/c-expense
11.	Purchases		1,44,670	–	Real A/c - goods
12.	Sundry Debtors		1,430	–	Personal A/c – customers
13.	Travelling Expenses		2,630	–	Nominal A/c-expense
14.	Carriage Inward		240	–	Nominal A/c-expense
15.	Sundry Creditors		–	14,260	Personal A/c – suppliers
16.	Capital 1.4.2002		–	62,500	Personal A/c - owner
17.	Drawings		3,500	–	Personal A/c - owner
18.	Cash at Bank		1,090	–	Real A/c - asset
19.	Returns Outward		–	400	Real A/c - goods
20.	Investments		6,000	–	Real A/c. - asset
	TOTAL		2,50,660	2,50,660	

UNIT - I

POSSIBLE QUESTIONS

PART - B

1. What do you mean by accounting?
2. Define Accounting.
3. Briefly explain the users and their need for accounting information.
4. What are the branches of accounting?
5. What are the basic assumptions of accounting?
6. What do you mean by business entity assumption?
7. Write short notes on the following assumption.
   a) Money measurement b) Accounting period
8. What do you mean by going concern assumption?

9. What are the basic concepts of accounting?
10. What do you understand by revenue realisation concept?
11. What do you mean by historical cost concept?

PART - C

1. Enter the following transactions in the proper subsidiary books of Mr.Somu

2003 Nov.

1	Bought from Gopal 300 bags of wheat Rs.1,000 per bag less trade discount 10%
3	Purchased from Madhavan 150 bags of rice Rs.900 per bag less trade discount 10%
5	Returned to Gopal 10 bags of wheat which were purchased on 1.11.03.
7	Sold to Shiva 50 bags of rice Rs.1,200 per bag less Trade Discount 5%.
12	Sold to Sharma 25 bags of Wheat Rs.1,300 per bag less Trade Discount 10%.
14	Returned 15 bags of rice to Madhavan.
15	Shiva returned 5 bags of rice.
17	Bought from Rajan 200 bags of wheat Rs.950 per bag
24	50 bags of wheat returned to Rajan

2. Journalise the following transactions of Ms. Sneha for the Month of May 2016.

		Rs.
May 1	Started business with cash	1,00,000
5	Bought furniture	15,000
6	Cash purchase	90,000
7	Cash sales	40,000
12	Cash purchase	25,000
13	Credit sales to Moorthy	15,000
14	Credit purchase from Mr. Venkat	15,000
17	Cash sales	44,000
19	Allowed discount	500
21	Paid to Venkat	14,700
27	Advertisement	4,000
28	Sales	72,000
29	Rent	4,000
30	Telephone Charges	6,700

3. Journalise the following transactions and post them into ledger of Mr. Sekar for the Month of Sep 2015

Sep	4	Bought goods for Cash	Rs.29,500
	9	Sold goods to Rajesh on credit	Rs.50,000
	11	Received Commission	Rs.4,000
	17	Cash Sales	Rs.1,10,000
	19	Bought goods from Lashmi	Rs. 70,000
	21	Withdrew cash for office use	Rs.12,000
	27	Paid Salaries	Rs.30,000
	28	Paid wages	Rs.5,500
	29	Paid rent	Rs.7,000
	30	Bought stationery for cash	Rs. 2,000

4. Journalise the following transactions of Mr. Balan and post them to proper ledger accounts relating to the month of January 2012.

	Rs
Jan 1 Started business with	45,00,000
3 Goods purchased	7,00,000
5 Doods sold	150,000
10 Goods purchased from Sridhar	20,00,000
16 Goods returned to Ram kumar	50,000
23 Drew from bank	300,000
26 Furniture purchased	100,000
26 Settled Ram kumar's account	
30 Paid rent	25,000
31 Salaries paid.	120,000

5. Enter the following transaction in the sales book of M/s saran raj& sons and

Post them into the ledger.

1999

May 2 Sold to M/s Ragul Bros:

200 pieces long cloth at Rs. 90 per piece

300 pieces shirting @ Rs. 110 per piece

May 5 sold to M/s gupta & verma:

20 pieces coating @ Rs.250 per piece.

May 16 sold to M/s Mathur & jain:

250 blankets @ Rs. 50 each

120 blankets @ Rs. 75 each

May 20 sold 20 shirts to cheap stores @ Rs. 30 each for cash.

May 25 sold furniture to M/s santhosh & Co. on credit Rs. 800.

It is the practice followed by M/s saran raj & sons to allow 10% Trade discount on all sales.

6. From the following transaction, prepare Three- column cash book of Arjun for the month of Jul2009.

Jul 2009		Rs.
1	Cash balance	20,000
	Bank balance	23,000
3	Paid rent by cheque	5,000
4	Cash received on account of cash sales	6,000
6	Payment for cash purchase	2,000
8	Deposited into bank	8,000
9	Bought goods by cheque	3,000
10	Sold goods to Nathan on credit	7,120
12	Received cheque from madhan	2,900
	Discount allowed to him	100
13	Withdrew from bank for office use	4,350
14	Purchased furniture by cheque	1,260

15	Received a cheque for Rs.7000 from Nadhan in full settlement of his account, Which is deposited into bank	
17	Withdrew cash for personal use from the bank	1,200
18	Swamy, our customer has paid directly into our bank account	4000
19	parthi settled his account for Rs. 1,250 by Giving a cheque for	1,230
20	**parthi's cheque sent to bank for collection**	
21	Received from a ravi a currency note for Rs.1000 and gave him a change for it.	
22	Received cheque from kamal for Rs.6000 In full settlement for his account of Rs. 6,200	
	Deposited kamal's cheque into bank.	
25	paid into bank	9,000
29	**parthi's cheque returned dishonoured**	
31	paid salaries	10,000

7. Prepare trial balance from the following information

Particulars	Amount
Cash account	1,22,200
Capital	4,50,000
Bank	1,40,000
Purchases	2,20,000

Furniture	50,000
Sales	125,000
Returns outward	10,000
Discount	200
Drawing	10,000
Telephone rent	4,000
Stationery	2,000
Rent	10,000
Salaries	25,000
Returns inwards	2,000

KARPAGAM ACADEMY OF HIGHER EDUCATION
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Coimbatore - 641021.
(For the candidates admitted from 2017 onwards)
DEPARTMENT OF COMMERCE WITH COMPUTER APPLICATIONS

SUBJECT : FINANCIAL ACCOUNTING
SEMESTER : I
SUBJECT CODE : 17CCU101 CLASS : I B.Com.CA

UNIT- II

Business Income – Revenue Recognition – Depreciation – Methods – Straight line method – Diminishing Balance Method – Change in Method of Depreciation – Final Accounts – preparation of final accounts for non- corporate business entities

Suggested Readings:

Text Book

1. Reddy and Moorthy. (2013). *Financial Accounting* Chennai. Margham Publications.

Reference Book

1. M.C.Shukla, T.S. Grewal and S.C.Gupta. (2013).*Advanced Accounts.* [Vol.-I Revised Edition] New Delhi, S. Chand & Co.
2. S.N. Maheshwari, and. S. K. Maheshwari.(2013). *Financial Accounting.*[First Edition]. New Delhi, Vikas Publishing House.
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4. Tulsian, P.C. (2013). *Financial Accounting*, [4th Ed]. New Delhi, S.Chand Publishing
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UNIT – II
BUSINESS INCOME

REVENUE RECOGNITION

Revenue recognition is an accounting principle under generally accepted accounting principles (GAAP) that determines the specific conditions under which revenue is recognized or accounted for. Generally, revenue is recognized only when a specific critical event has occurred and the amount of revenue is measurable. However, there are several situations in which exceptions may apply.

BREAKING DOWN REVENUE RECOGNITION

Revenue is at the heart of business performance. Everything hinges on the sale. As such, regulators know how tempting it is for companies to push the limits on what qualifies as revenue, especially when not all revenue is collected when the work is being done. Lawyers tend to bill clients in billable hours and present the bill after the case is completed. Construction managers often bill clients on a percentage-of-completion method. As a result, analysts like to know that revenue recognition policies for a company are relatively standard for the industry. This also helps to ensure an apples-to-apples comparison is being made between metrics using line items from the income statement.

Revenue Recognition Examples

If you pay for a candy bar with cash, it is considered a sale. If you pay for the candy bar with a piece of Monopoly money, it is not considered a sale. So, for example, assume Sue the store owner must report sales to her investors and knows that revenue is not the same as cash on paper. Sue is desperate to look good on paper, so she takes the Monopoly money and recognizes it as revenue. Investors think the company has positive earnings, but the revenues aren't real. Thankfully, investors are protected against such a scenario for many reasons, one of which is because there are certain rules about recognizing revenue to prevent managers like Sue from recording a fake sale.

Revenue recognition states that revenue should not be recorded until it is earned. However, not all sales are made in cash. The speed with which credit sales become cash is also a critical component of revenue recognition.

The classic case of misguided revenue recognition is a furniture company that is having a bad year. As a promotional gesture, the manager extends credit terms with no money down. The furniture company sells out of furniture and recognizes sales as revenue on the income statement, but the manager received no cash. The company is revenue-rich and cash-poor.

GAAP Changes to Revenue Recognition Policies

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) jointly issued Accounting Standards Codification (ASC) 606, regarding revenue from contracts with customers. ASC 606 provides a uniform framework for recognizing revenue with contracts. The old guidance was based on industry specific guidance, which created a system of fragmented policies. The new guidance is industry-neutral and therefore more transparent. Most companies have until 2018 to implement changes.

Revenue is the amount of money that a company actually receives during a specific period, including discounts and deductions for returned merchandise. It is the "top line" or "gross income" figure from which costs are subtracted to determine net income.

Revenue is calculated by multiplying the price at which goods or services are sold by the number of units or amount sold.

BREAKING DOWN REVENUE

Revenue is the amount of money that is brought into a company by its business activities. Revenue is also known as sales, as in the price-to-sales ratio, an alternative to the price-to-earnings ratio that uses revenue in the denominator.

There are different ways of calculating revenue, depending on the accounting method a business employs. Accrual accounting will include sales made on credit as revenue, as long as the goods or services have been delivered to the customer. It is therefore necessary to check the cash flow statement to assess how efficiently a company collects the money it is owed. Cash accounting, on the other hand, will only count sales as revenue if the payment has been received. When cash is paid to a company, this is known as a "receipt" to distinguish it from revenue. It is possible to have receipts without revenue, if the customer paid in advance for a service that has not been rendered or goods that have not been delivered.

Revenue is known as the "top line" because it is displayed first on a company's income statement. Expenses are then deducted from revenue in order to obtain net income, or profit – the "bottom line."

A company's revenue may be subdivided according to the divisions that generate it. For example, a recreational vehicles department might have a financing division, which could be as a separate source of revenue. Revenue can also be divided into "operating revenue," or sales from a company's core business, and "non-operating revenue," which derives from other, secondary sources. As these non-operating revenue sources are often not predictable or recurring, they can be referred to as one-time events or gains. For example, proceeds from the sale of an asset, a windfall from investments or money awarded through litigation would be considered non-operating revenue.

Investors will often consider a company's revenue and net income separately to determine the health of a business. It is possible for net income to grow while revenue remains stagnant, as a result of cost-cutting; such a situation does not bode well for a company's long-term growth. When public companies report quarterly earnings, the two figures that receive the most attention are typically revenue and earnings per share ("earnings" being equivalent to net income). Subsequent price movement in stocks generally correlates to whether a company beat or missed analysts' revenue and earnings per share expectations.

In the case of government, revenue is the money received from taxation, fees, fines, inter-governmental grants or transfers, securities sales, mineral rights and resource rights, as well as any sales that are made.

For non-profits, revenue is often referred to as "gross receipts." Its components include donations from individuals, foundations and companies; grants from government entities; investments; fundraising activities; and membership fees.

CASH COST

Cash cost is a cash basis accounting cost recognition process that classifies costs as they are paid for in cash, and is recognized in the general ledger at the point of sale. This method is contrary to the accrual cost recognition method, which directly influences the operating cash flow figure.

BREAKING DOWN CASH COST

Cash costs are costs that businesses pay for when using cash, or a check, but not credit. On a cash accounting basis, the costs paid for by using credit would not be recorded in the general ledger until the actual cash has been paid. This is the main reason why firms moved away from the cash accounting method to the accrual method, as the accrual method will recognize credit transactions as well as cash transactions.

DEPRECIATION

All assets whose benefit is derived for a long period of time, usually more than one year period are called as Fixed Assets. These assets decrease in value year after year due to wear and tear or lapse of time. This reduction in value of Fixed Assets is called Depreciation.

Generally, the term 'depreciation' is used to denote decrease in value, but in accounting, this term is used to denote decrease in the book value of a fixed asset. Depreciation is the permanent and continuous decrease in the book value of a fixed asset due to use, effluxion of time, obsolescence, expiration of legal rights or any other cause.

For instance, a factory owner, owns a machinery worth Rs.1,00,000, may estimate the life of the machinery as five years. This means that the value of the asset is reducing every year. Hence, it is necessary to spread the cost over five years during which the benefit of the asset is derived. Thus depreciation Rs.20,000 (Rs.1,00,000 / 5 years) is to be treated as an expense, which is debited to Profit and Loss account.

DEFINITION

In the words of Spicer and Pegler, "Depreciation is the measure of the exhaustion of the effective life of an asset from any cause during a given period".

Carter defines depreciation as **"the gradual and permanent decrease in the value of an asset from any cause".**

According to ICMA (Institute of Cost and Management Accountants - London) **Terminology "Depreciation is the diminution in intrinsic value of asset due to use and lapse of time".**

The above definitions reveal that when fixed assets are used in business to generate income, they lose their production capacity or earning capacity and at a particular point of time they render themselves useless. This reduction in the production capacity or earning capacity is termed as depreciation.

NEED FOR PROVIDING DEPRECIATION

The need for providing depreciation in accounting records arises due to any one or more of the following reasons.

1. To ascertain correct profit / loss

For proper matching of cost with revenues, it is necessary to charge depreciation against revenue in each accounting year, to calculate the correct net profit or net loss.

2. To present a true and fair view of the financial position

If the amount of depreciation is not provided on fixed assets in the books of account, the **value of fixed assets will be shown at a higher value than it's real value in the balance** sheet. As such it will not reflect the true and fair financial position of the business. Hence, to present a true and fair view of the financial position of the business, it is necessary that depreciation must be deducted from the book value of the assets in the balance sheet.

3. To ascertain the real cost of production

For ascertaining the real cost of production, it is necessary to provide depreciation.

4. To comply with legal requirements

As per Section 205(1) of the Companies Act 1956, it is compulsory for companies to provide depreciation on fixed assets before it declares dividend.

5. To replace assets

Depreciation is provided to replace the assets when it becomes useless.

CAUSES OF DEPRECIATION

The causes of depreciation may be internal or external. The internal causes arise from operation of any cause natural to or inherent in the asset itself. External causes arise from the operation of forces outside the business. These are being discussed below:

I. INTERNAL CAUSES

1. Wear and tear: Wear and tear is an important cause of depreciation in case of tangible fixed asset. It is due to use of the asset.
2. Disuse: When a machine is kept continuously idle, it becomes potentially less useful.
3. Maintenance: The value of machine deteriorates rapidly because of lack of proper maintenance.
4. Depletion: It refers to the physical deterioration by the exhaustion of natural resources eg., mines, quarries, oil wells etc.

II. EXTERNAL CAUSES
1. Obsolescence: The old asset will become obsolete (useless) due to new inventions, improved techniques and technological advancement.
2. Effluxion of time: When assets are exposed to forces of nature, like weather, wind, rain, etc., the value of such assets may decrease even if they are not put into any use.
3. Time Factor: Lease, copy-right, patents are acquired for a fixed period of time. On the expiry of the fixed period of time, the assets cease to exist.

TERMS USED FOR DEPRECIATION
1. Amortization: This refers to loss in the value of intangible assets such as goodwill, patents and preliminary expenses.
2. Depletion: Decrease in the value of mineral wealth such as coal, oil, iron ore, etc. is termed as depletion. The more we extract mineral wealth, the more they are depleted.
3. Obsolescence: When an asset becomes useless due to new inventions, improved techniques and technological advances, it is termed as obsolescence.

FACTORS DETERMINING THE AMOUNT OF DEPRECIATION
1. Original cost of the asset It implies the cost incurred on its acquisition, installation, commissioning and for additions or improvements thereof which are of capital nature
2. Estimated life: It implies the period over which an asset is expected to be used.
3. Residual value : It implies the value expected to be realised on its sale on the expiry of its useful life. This is otherwise known as scrap value or turn-in value.
METHODS OF CALCULATING DEPRECIATION
1. Straight line method or fixed instalment method.

2. Written down value method or diminishing balance method
3. Annuity method.
4. Depreciation Fund method.
5. Insurance Policy method.
6. Revaluation method

Straight Line Method or Fixed Instalment Method or Original Cost Method

Under this method, the same amount of depreciation is charged every year throughout the life of the asset. The amount and rate of depreciation is calculated as under.

1) Amount of depreciation

= Total cost - Scrap value / Estimated Life

2) Rate of depreciation

= Amount of Depreciation / Original Cost x100

Problem 1

A company purchased Machinery for Rs.1,00,000. Its installation costs amounted to Rs.10,000. It's estimated life is 5 years and the scrap value is Rs.5,000. Calculate the amount and rate of depreciation

Solution:

Total cost = Purchase Price + Installation Charges

= Rs.1,00,000 + Rs.10,000

= Rs. 1,10,000

Amount of depreciation = Total cost - Scrap value / Estimated life

= Rs.1,10,000-Rs.5,000 / 5

= Rs.1,05,000 / 5

= Rs.21,000

Merits:

1. Simplicity: It is very simple and easy to understand.
2. Easy to calculate: It is easy to calculate the amount and rate of depreciation.

3. Assets can be completely written off: Under this method, the book value of the asset becomes zero or equal to its scrap value at the expiry of its useful life.

Demerits:

The amount of depreciation is same in all the years, although the usefulness of the machine to the business is more in the initial years than in the later years.

Written Down Value Method or Diminishing Balance Method or Reducing Balance Method

Under this method, depreciation is charged at a fixed percentage each year on the reducing balance (i.e., cost less depreciation) of asset. The amount of depreciation goes on decreasing every year. For example, if the asset is purchased for Rs.1,00,000 and depreciation is to be charged at 10% p.a. on reducing balance method, then

Depreciation for the 1st year = 10% on Rs.1,00,000, ie., Rs.10,000

Depreciation for the 2nd year = 10% on Rs.90,000
(Rs.1,00,000 – Rs.10,000)
= Rs. 9,000

Depreciation for the 3rd year = 10% on Rs.81,000
(Rs.90,000 - Rs.9,000)
= Rs.8,100

Merits:

1. Uniform effect on the Profit and Loss account of different years: The total charge (i.e., depreciation plus repairs and renewals) remains almost uniform year after year, since in earlier years the amount of depreciation is more and the amount of repairs and renewals is less, whereas in later years the amount of depreciation is less and the amount of repairs and renewals is more.

2. Recognised by the Income Tax authorities: This method is recognised by the Income Tax authorities

3. Logical Method: It is a logical method as the depreciation is calculated on the diminished balance every year.

Demerits:

It is very difficult to determine the rate by which the value of asset could be written down to zero.

Distinction between Straight Line Method and Diminishing Balance Method:

Points of distinction	Straight line method	Diminishing balance method
1. Charge of depreciation	Depreciation is charged on the original cost of the asset.	Depreciation is charged on the written down value of the asset.
2. Change in Depreciation amount	Throughout the life of the asset, the amount of depreciation remains to be equal	Amount of depreciation is more during earlier years of the life of asset than later years and therefore amount is never equal.
3. Balance in Asset's account	**Asset's account at the expiry of** the expected life becomes nil.	**Asset's account never becomes nil.**
4.Overall charge	The overall charge, i.e., depreciation and repairs taken together go on increasing from year to year.	Overall charge remains same for every year throughout the life of the asset.
5. Profits	Profits under this method are more during the earlier years of the life of the asset because of less charge of repairs.	Profits are less during the earlier years than the later years because of higher charge for depreciation.
6. Suitability	It is suitable for assets having shorter life and lesser value.	It is suitable for assets having long life and requiring additions or extensions in its life and substantial repairs in later years.

Annuity Method:

The annuity method considers that the business besides loosing the original cost of the asset in terms of depreciation and also looses interest. On the amount used for buying the asset. This is based on the assumption that the amount invested in the asset would have earned in case the same amount would have been invested in some other form of investment. The annual amount of depreciation is determined with the help of annuity table. This method is used to calculate depreciation amount on lease.

Depreciation Fund Method or Sinking Fund Method :

Under this method, funds are made available for the replacement of asset at the end of its useful life. The depreciation remains the same year after year and is charged to Profit and

Loss account every year through the creation of depreciation fund. The amount of annual depreciation is invested in good securities bearing interest at a specified rate. The aggregate amount of interest and annual provision is invested every year. When the asset is completely written off or is to be replaced, the securities are sold and the amount so realised by selling securities is used to replace the old asset.

Insurance Policy Method:

According to this method, an Insurance policy is taken for the amount of the asset to be replaced. The amount of the policy is such that it is sufficient to replace the asset when it is worn out. A sum equal to the amount of depreciation is paid as premium every year. The amount goes on accumulating at a certain rate of interest and is received on maturity. The amount so received is used for the purchase of new asset, replacing the old one.

Revaluation Method:

Under this method, the assets like loose tools are revalued at the end of the accounting period and the same is compared with the value of the asset at the beginning of the year. The difference is considered as depreciation.

RECORDING DEPRECIATION

Depreciation is directly charged against the asset by debiting Depreciation account and crediting the Asset account. Depreciation account is closed by transferring to Profit and Loss account at the end of the year. The entries will be as under:

1) For the amount of depreciation to be provided at the end of the year:

Depreciation A/c Dr.

To Asset A/c

2) For transferring the amount of depreciation at the end of the year.

Profit and Loss A/c Dr.

To Depreciation A/c

Asset Account will be shown at cost less depreciation i.e., written down value at the end of the year in the Balance sheet.

1. On 1-1-99, A ltd., purchased machinery for Rs. 1,20,000 and on 30th June 2000, it acquired additional machinery at a cost of Rs.20,000. On 31st March 2001, one of the original machines, which had cost Rs.5,000 was found obsolete and sold as scrap for

Rs.500. It was replaced on that date by a new machine costing Rs.8,000. Depreciation is provided at the rate of 15% per annum on the written down value.

Show the ledger accounts for the first three years
(a) When depreciation is written off in the asset account; and
(b) When depreciation is accumulated in a separate account.

Solution:

Machinery Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1-1-99	To Bank a/c	1,20,000	31-12-99	By Depreciation a/c	18,000
				By Balance C/d	1,02,000
		1,20,000			1,20,000
1-1-00	To Balance B/d	1,02,000	31-12-00	By Depreciation a/c	16,800
30-6-00	To Bank a/c	20,000		By Balance C/d	1,05,200
		1,22,000			1,22,000
1-1-01	To Balance B/d	1,05,200	31-3-01	By Bank	500
31-3-01	To Bank a/c	8,000		By Depreciation a/c	135
				By P&L a/c	2,977
			31-12-01	By Depreciation a/c (15,238 + 900)	16,138
			31-12-01	By Balance C/d	93,450
		1,13,200			1,13,200
1-1-02	To Balance B/d	93,450			

Depreciation account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
31-12-99	To Machinery a/c	18,000	31-12-99	By P&L a/c	18,000
		18,000			18,000
31-12-00	To Machinery a/c	16,800	31-12-00	By P&L a/c	16,800
		16,800			16,800
31-3-01	To Machinery a/c	135	31-12-01	By P&L a/c	16,273
31-12-01	To Machinery a/c	16,138			
		16,273			16,273

(b) When depreciation is accumulated in a separate account:

Machinery Account:

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1-1-99	To Bank a/c	1,20,000	31-12-99	By Balance C/d	1,20,000
		1,20,000			1,20,000
1-1-00	To Balance B/d	1,20,000	31-12-00	By Balance C/d	1,40,000
30-6-00	To Bank a/c	20,000			
		1,40,000			1,40,000
1-1-01	To Balance B/d	1,40,000	31-3-01	By Bank	500
31-3-01	To Bank a/c	8,000		By Prov. For dep. A/c	1,523
				By P & L a/c	2,977
			31-12-01	By Balance C/d	1,43,000
		1,48,000			1,48,000

Provision for Depreciation Account

Machinery Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
31-12-99	To Balance C/d	18,000	31-12-99	By Depreciation a/c	18,000
		18,000			18,000
31-12-00	To Balance C/d	34,800	1-1-00	By Balance B/d	18,000
			31-12-00	By Depreciation a/c	16,800
		34,800			34,800
31-12-01	To Machinery a/c	1,523	1-1-01	By Balance B/d	34,800
31-12-01	To Balance C/d	49,550	31-3-01	By Depreciation a/c	135
			31-12-01	By Depreciation a/c	16,138
		51,073			51,073

Depreciation Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
31-12-99	To Prov. For Dep. A/c	18,000	31-12-99	By P & L a/c	18,000
		18,000			18,000
31-12-00	To Prov. For Dep. A/c	16,800	31-12-00	By P & L a/c	16,800
		16,800			16,800
31-3-01	To Prov. For Dep. A/c	135			
31-12-01	To Prov. For Dep. A/c	16,138	31-12-01	By P & L a/c	16,273
		16,273			16,273

Workings:
Original cost of asset sold as on 1-1-99 Rs. 5,000

Less. Depreciation @ 15% for 1999 on 5,000 Rs. 750
Balance as on 1-1-2000 Rs. 4,250
Less: Depreciation @ 15% for 2000 on 4,250 Rs. 638
Balance as on 1-1-2001 Rs. 3,612
Less: Depreciation @ 15% for 3 months Rs. 135
(on 3,612) Rs. 3,477
Less: Sold as Scrap Rs. 500
Loss transferred to P&L a/c Rs. 2,977

Illustration 2:
The cost of Machinery in use with a firm on 1-1-2000 was Rs.50, 000 against which the depreciation provision stood at Rs.19,190 on that date; the firm provided depreciation at 10% per annum on straight line method.

The firm started its business on 1-1-1996. On 30-9-2000 two machines costing Rs.3,000 and Rs.2,400 respectively, both purchased on 1-7-1997 had to be discarded because of damage and had to be replaced by new machines costing Rs.4,000 and Rs.3,000 respectively.

One of the discarded machines is sold for Rs. 1,600; against the other it was expected that Rs.600 would be realized. Show the Machinery Account, Provision for Depreciation Account and Machinery Disposal Account for the year 2000.

Solution:

Machinery Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1-1-00	To Balance B/d	50,000	30-9-00	By Machine Disposal a/c	5,400
30-9-00	To Bank a/c	7,000	31-12-00	By Balance C/d	51,600
		57,000			57,000
1-1-01	To Balance B/d	51,600			

Provision for Depreciation Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
30-9-00	To Machine Disposal a/c	1,350	1-1-00	By Balance B/d	19,190
31-12-00	To Balance C/d	22,475	31-12-00	By Depreciation a/c (On machinery in use)	4,635
		23,825			23,825
			1-1-01	By Balance B/d	22,475

Machinery Disposal Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
30-9-00	To Machinery a/c	5,400	30-9-00	By Prov. For Dep. A/c	1,350
				By Depreciation a/c (On two machines for 9 months)	405
				By Bank a/c	1,600
				By P & L a/c	1,445
			31-12-00	(Balancing figure) By Balance C/d	600
		5,400			5,400
1-1-01	To Balance B/d	600			

Working Notes:
1. Depreciation provided on two discarded machines
(Rs.3000 + 2400)
For 1997 (for 6 months) Rs. 270
For 1998 540
For 1999 540
Total depreciation till 1-1-2000 1350
Depreciation for 9 months to 30-9-2000 405

2. Depreciation on Machinery in use:

Cost of Machinery on 1-1-2000	Rs.50,000
Less: Cost of discarded machines	5,400
	44,600
Depreciation for one year on Rs.44,600	4,460
Depreciation for 3 months on Rs.7,000	175
Total depreciation on machinery in use	4,635

FINAL ACCOUNTS

Trial balance proves the arithmetical accuracy of the business transactions, but it is not the end. The businessman is interested in knowing whether the business has resulted in profit or loss and what the financial position of the business is at a given period. In short, he wants to know the profitability and the financial soundness of the business. The trader can ascertain these by preparing the final accounts. The final accounts are prepared at the end of the year from the trial balance. Hence the trial balance is said to be the connecting link between the ledger accounts and the final accounts.

Parts of Final Accounts

The final accounts of business concern generally include two parts. The first part is Trading and Profit and Loss Account. This is prepared to find out the net result of the business. The second part is Balance Sheet which is prepared to know the financial position of the business. However manufacturing concerns, will prepare a Manufacturing Account prior to the preparation of trading account, to find out cost of production.

Trading Account

Trading means buying and selling. The trading account shows the result of buying and selling of goods.

Need

At the end of each year, it is necessary to ascertain the net profit or net loss. For this purpose, it is first necessary to know the gross profit or gross loss. The trading account is prepared to ascertain this. The difference between the selling price and the cost price of the goods is the gross earning of the business concern. Such gross earning is called as gross profit. However, when the selling price is less than the cost of goods purchased, the result is gross loss.

Adjustments

1. Closing Stock

The unsold goods in stock at the end of the accounting period are called as closing stock. This is to be valued at cost or market price whichever is lower.

Value of closing stock will appear

i) On the credit side of trading account and

ii) On the assets side of balance sheet.

2. Outstanding Expenses

Expenses which have been incurred but not yet paid during the accounting period for which the final accounts are being prepared are called as outstanding expenses.

Outstanding expenses will be shown

i) On the debit side of Profit and Loss account by way of additions to the particular expenses and

ii) On the liabilities side of the Balance Sheet.

3. Prepaid Expenses

Expenses which have been paid in advance are called as prepaid (unexpired) expenses.

Prepaid expenses will be shown

i) On the debit side of the Profit and Loss account by way of deduction from the particular expenses and

ii) On the assets side of the Balance Sheet.

4. Accrued Incomes or Outstanding Incomes

Income which has been earned but not received during the accounting period is called as accrued income.

Accrued income will be shown

i) On the credit side of Profit and Loss account by way of addition to particular income and

ii) On the assets side of the Balance Sheet

5. Incomes Received in Advance

Income received during a particular accounting period for the work to be done in future period is called as income received in advance.

Incomes received in advance will be shown

i) On the credit side of the Profit and Loss account by way of deducting from the particular income and

ii) On the liabilities side of the Balance sheet.

6. Interest on Capital

In order to see whether the business is really earning profit or not, it is desirable to charge interest on capital at a certain rate.

Interest on capital will be shown

i) On the debit side of Profit and Loss account and

ii) On the liabilities side of the Balance Sheet by way of addition to the capital.

7. Interest on Drawings

Amount withdrawn by the owner for his personal use is called as drawings. When interest on capital is allowed, then interest on drawings is charged from the owner. Interest on drawings is an income for the business and will reduce the capital of the owner.

Interest on drawings will be shown

i) On the credit side of Profit and Loss account and

ii) On the liabilities side of the Balance Sheet by way of addition to the drawings which are ultimately deducted from the capital.

8. Interest on Loan (Outstanding)

Borrowings from banks, financial institutions and outsiders for business are called loans. Amount payable towards interest on loan is an expense for the business.

Interest on loan outstanding will be shown

i) On the debit side of the Profit and Loss account by way of addition to the appropriate interest account and

ii) On the liability side of the Balance sheet by way of addition to the particular loan account.

9. Interest on Investment:

Interest receivable on investments is an income for the business.

Accrued interest on investments (outstanding interest receivable) will be shown

i) On the credit side of the Profit and Loss account by way of addition to the appropriate interest account and

ii) On the assets side of the balance sheet by way of addition to the investments account.

10. Depreciation

Depreciation is the reduction in the value of fixed assets due to its use or obsolescence. Generally depreciation is charged at some percentage on the value of fixed asset.

Depreciation will be shown

i) On the debit side of Profit and Loss account and

ii) On the assets side of the Balance Sheet by way of deduction from the value of concerned asset.

11. Bad Debts

Debts which cannot be recovered are called bad debts. It is a loss for the business.

Bad debts will be shown

i) On the debit side of Profit and Loss account and

ii) On the assets side of the Balance Sheet by way of deduction from sundry debtors.

12. Provision for Bad and Doubtful Debts

Every business suffers a percentage of bad debts over and above the debts definitely known as irrecoverable and written off as Bad (Bad debts written off). If Sundry debtors figure is to be shown correctly in the Balance sheet provision for bad and doubtful debts must be adjusted. This Provision for bad and doubtful debts is generally provided at a certain percentage on Debtors, based on past experience.

While preparing final accounts, the bad debts written off given in adjustment is first deducted from the Sundry debtors then on the balance amount (Sundry debtors – Bad debt written off) provision for bad and doubtful debts calculated.

Provision for bad and doubtful debts will be shown

i) On the debit side of Profit and Loss Account and

ii) On the assets side of the Balance sheet by way of deduction from Sundry debtors (after Bad debts written off if any).

13. Provision for Discount on Debtors

To motivate the debtors to make prompt payments, cash discount may be allowed to them. After providing provision for bad and doubtful debts, the remaining debtors are called as good debtors. They may pay their dues in time and avail themselves of the cash discount permissable. So a provision for discount on good debtors at a certain percentage may have to be created.

Provision for discount on debtors will be shown

i) On the debit side of Profit and Loss account and

ii) On the asset side of the Balance sheet by way of deduction from Sundry debtors (after deducting bad debts written off and provision for bad and doubtful debts).

14. Provision for Discount on Creditors

Similar to cash discount allowed to debtors, the firm may have a chance to receive the cash discount from the creditors for prompt payment. Provision for discount on Creditors is calculated at a certain percentage on Sundry Creditors.

Provision for discount on creditors will be shown

i) On the credit side of Profit and Loss account and

ii) On the liabilities side of the Balance sheet by way of deduction from Sundry creditors.

SPECIMEN OF FINAL ACCOUNTS

Trading and Profit and Loss Account of Thiru ………… for the year ending 31st March, ……….

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Opening Stock		xxx	By Sales	xxx	
To Purchases	xxx		Less: Sales Return (or)	xxx	
Less: Purchase Return	xxx		Returns inward		

(or)		xxx			xxx
Returns Outward	xxx				
	xxx		By Closing Stock		xxx
To Wages		xxx			
Add: Outstanding	xxx				
Wages	xxx				
		xxx			
To Factory Rent					
Less: Prepaid Factory		xxx			
Rent		xxx			
		xxx			
To Freight		xxx			
To Carriage Inward		xxx			
To Clearing charges		xxx			
To Packing charges		xxx			
To Dock dues					
To Power (Factory)		xxx			
To Octroi Duty		xxx			xxx
To Gross Profit c/d					
(Transferred to Profit					
and Loss A/c)	xxx		By Gross Profit b/d		xxx
	xxx	xxx	(Transferred to Trading		
To Salaries			A/c)		
Add: Outstanding				xxx	
Salaries			By Commission received	xxx	xxx
			Add: Commission	xxx	
	xxx	xxx	accrued but not yet	xxx	
	xxx		received		xxx
			By Rent received		
To Insurance Premium			Less: Rent received in		xxx
Less: Prepaid Insurance			advance		xxx

Premium		xxx		xxx	
			By Interest on drawings		
	xxx		By Discount received	xxx	
			By (New) Provision for		
Interest on Capital	xxx	xxx	discount creditors (given		xxx
			in adjustments)		
Interest on Loan		xxx	Less: (Old) Provision for		
Add: Interest on Loan			discount on creditors		
Outstanding					
To Depreciation on:	xxx				
Fixed Assets, Building,	xxx				
Machinery, Furniture,	xxx				
etc.,					
	xxx				
To Bad Debts	xxx				
Add: (New) Bad Debts					
(given in adjustment)					
	xxx				
Add: (New) Provision					
for bad and doubtful					
debts (given in		xxx			
adjustment)					
Less: (Old) Provision					
for bad and doubtful	xxx				
debts					
To Discount Allowed	xxx	xxx			

		xxx			
To (New) Provision for discount on debtors (given in adjustment) Less: (Old) Provision for discount on debtors		xxx			
To Net profit (Transferred to Capital A/c)					

Balance Sheet of Thiru………… as on 31st March, …………

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
Capital	xxx		Cash in Hand		xxx
Add: Net Profit	xxx		Cash at Bank		xxx
(or) Less: Net loss			Sundry Debtors	xxx	
	xxx		Less: (New) Bad Debts written off	xxx	
Less: Drawings xxx				xxx	
Interest on Drawings xxx	xxx		Less: (New) Provision for Bad & Doubtful debts	xxx	
	xxx			xxx	
Less: income tax	xxx	xxx	Less: Provision for Discount on Debtors	xxx	xxx
Sundry Creditors	xxx				
Less: Provision for discount on creditors	xxx	xxx	Land and Building	xxx	
Loan	xxx		Less: Depreciation	xxx	xxx
Add: Interest on loan outstanding	xxx	xxx			
Outstanding Expenses		xxx	Plant and Machinery	xxx	
Income received in advance		xxx	Less: Depreciation	xxx	xxx

Bank overdraft			Furniture Less: Depreciation	xxx xxx	xxx
			Goodwill Less: Written off	xxx xxx	xxx
			Closing Stock Prepaid Expenses Accrued Commission		xxx xxx xxx
		xxx			xxx

Classification of Assets and Liabilities

Classification of Assets:

The properties and possessions of a business are called assets and they are classified into the following classes:

Fixed assets:

Fixed assets are assets which are acquired not for sale but for permanent use in the business e.g., land and buildings, plant and machinery, furniture etc. These assets help the business to be carried on.

Current Assets or Circulating Assets or Floating Assets:

Current assets denote those assets which are held for sale or to be converted into cash after some time e.g., sundry debtors. bills receivables, stock of goods etc.

Liquid Assets:

Liquid assets are those assets which are with us in cash or easily converted into cash e.g., cash in hand, cash at bank, investments etc.

Wasting Assets:

The assets that depreciate through "wear and tear", whose values expire with lapse of time or that become exhausted through working are known as wasting assets. This is a sub-class of fixed assets e.g., plant machinery, mines etc.

Intangible or Fictitious Assets:

There are assets which have no physical existence. Which can neither be seen with eyes not touched with hands. These are called intangible assets or fictitious assets. They do not represent anything valuable. They include debit balance of profit and loss account, goodwill etc.

Contingent Assets:

A contingent asset is one which comes into existence upon the happening of a certain event. If that event happens the asset becomes available, otherwise not. For example uncalled capital of a limited company.

Outstanding Assets:

Expenses paid in advance i.e., prepaid expenses, and income earned but not received are known as outstanding assets.

Classification of Liabilities:

The liabilities of a business are classified as follows:

Fixed Liabilities:

These are the liabilities which are payable immediately or in the near future. These liabilities are payable after a long period. Long term loans, capital of the proprietor are the examples of such kind of liabilities.

Current Liabilities:

These are the liabilities which are payable immediately or in the near future, such as creditors, bank loans etc.

Contingent Liabilities:

Contingent liabilities are those liabilities which arise only on the happening of some event. The event may or may not happen. Thus a contingent liability may or may not involve the payment of money. Examples of contingent liabilities are:

1. Liabilities on bills discounted: In case the bill is dishonored by the acceptor, the holder may be called upon to pay the amount to the discounter.
2. Liability under guarantee: In case the debtor fails to fulfill his obligation, the man who has given a guarantee or surety have to make good the loss to the creditor.
3. Liability in respect of a pending suit: A suit pending against a person in a court is a contingent liability because if the decision of the court goes against him, he may thereby become liable to pay compensation.

Contingent liabilities are not recorded in the books not they are included in the balance sheet. They are simply referred to by way of foot notes on the balance sheet.

Outstanding Liabilities:

Outstanding expenses and unearned income are examples of outstanding liabilities.

Classification of Capital:

The surplus or excess of assets over liabilities is called the capital or the proprietor. Capital may be classified as follows on the basis of the capital fund invested:

Trading Capital:

The portion of the funds of a concern which is represented by the fixed and floating assets is called the trading capital

Fixed Capital:

The portion of the funds of a concern which is represented by the fixed assets is called fixed capital.

Circulating Capital:

The portion of the funds of a concern which is represented by the floating or circulating assets is called the circulating or floating capital.

Working capital:

It is the amount which remains for the working of the business after the liabilities for acquiring the fixed assets have been discharged. The excess of the floating assets over the floating liabilities is also called the working capital.

Loan Capital:

The debentures and other fixed loans are sometimes called loan capital.

Watered Capital:

It is represented by fictitious assets.

PROBLEMS:

1. Prepare Trading, Profit & Loss A/c and Balance sheet from the following Trial Balance of Mr. V. Mohan Kumar.

Debit Balances	Amount Rs.	Credit Balances	Amount Rs.
Sundry Debtors	92,000	**Mohan Kumar's Capital**	70,000
Plant and Machinery	20,000	Purchase return	2,600
Interest	430	Sales	2,50,000
Rent, Rates, Taxes, & Insurance	5,600	Sundry Creditors	60,000
Conveyance charges	1,320	Bank overdraft	20,000
Wages	7,000		
Sales Returns	5,400		
Purchases	1,50,000		
Opening Stock	60,000		
Mohan Kumar's Drawing	22,000		
Trade expenses	1,350		
Salaries	11,200		
Advertising	840		
Discount	600		
Bad Debts	800		
Business premises	12,000		
Furniture and Fixtures	10,000		
Cash in hand	2,060		
	4,02,600		4,02,600

Adjustments:

(i) Stock on hand on 31-12-1996 Rs. 90,000

(ii) Provide depreciation on premises at 2.5%; Plant and Machinery at 7.5% and Furniture and Fixtures at 10%.

(iii) Write off Rs. 800 as further bad debts.

(iv) Provide for doubtful debts at 5% on sundry debtors.

(v) Outstanding rent was Rs. 500 and outstanding wages Rs. 400.

(vi) Prepaid insurance Rs. 300 and prepaid salaries Rs. 700.

Solution:

Trading and Profit and Loss A/c of V. Mohan Kumar for the year ending 31-12-96

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
To Opening stock		60000	By Sales	250000	
To Purchases	150000		Less: Sales return	5400	244600
Less: Purchase returns	2600	147400	By Closing stock		90000
To Wages	7000				
Add: Outstanding	400	7400			
To Gross Profit c/d (transferred to Profit and Loss A/c)		119800			
		334600			334600
To Trade Expenses		1350	By Gross Profit c/d (transferred from Trading A/c)		119800
To Salaries	11200				
Less: Prepaid salaries	700	10500			
To Conveyance Charges		1320			
To Advertising		840			
To Rent, Rates, Taxes and Insurance	5600				
Add: Outstanding rent	500				
	6100				
Less: Prepaid Insurance	300	5800			
To Discount		600			
To Interest		430			
To Bad Debts	800				
Add: Additional Bad Debts	800				
Add: (New) Provision for Bad Debts	4560	6160			

To Depreciation:					
Premises	300				
Plant and Machinery	1500				
Furniture and Fixtures	1000	2800			
To Net Profit transferred to Capital A/c		90000			
		119800			119800

Balance sheet of V. Mohan Kumar as on 31-3-1996

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	70000		Cash in Hand		2060
Less: Drawings	22000		Sundry Debtors	92000	
	48000		Less: Bad Debts	800	
Add: Net profit	90000	138000		91200	
Sundry Creditors		60000	Less: Provision for Bad and Doubtful Debts	4560	86640
Bank Overdraft		20000			
Outstanding:			Prepaid:		
Rent	500		Insurance	300	
Wages	400	900	Salaries	700	1000
			Plant & Machinery	20000	
			Less: Depreciation	1500	18500
			Business premises	12000	
			Less: Depreciation	300	11700
			Furniture & Fixtures	10000	
			Less: Depreciation	1000	9000
			Closing Stock		90000
		218900			218900

2. From the following balances as at31st December 1994 of trader, prepare a Trading and Profit & loss A/c for the year 1994 and a Balance Sheet as on that date:

Debit Balances	Amount Rs.	Credit Balances	Amount Rs.
Salaries	5,500	Creditors	9,500
Rent	1,300	Sales	32,000
Cash	1,000	Capital	30,000
Debtors	40,000	Loans	10,000
Trade expenses	600		
Purchases	25,000		
Advances	2,500		
Bank balance	5,600		
	81500		81500

Adjustments:

(i) The closing stock amounted to Rs. 9,000.

(ii) **One month's Salary is outstanding.**

(iii) **One month's rent has been paid in advance.**

(iv) Provide 5% for doubtful debts.

Solution:

Trading and Profit and Loss Ac of a Trader for the year ended as on 31-12-1994

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
To Purchases		25000	By Sales		32000
			By Closing Stock		9000
To Gross Profit C/d		16000			
		41000			41000
To Trade expenses		600	By Gross Profit B/d		16000
To Salaries	5500				
Add: Outstanding Salaries	500	6000			

To Rent	1300				
Less: Rent paid in Advance	118	1182			
To Provision for Bad and Doubtful debts		2000			
To Net Profit C/d		6218			
		16000			16000

Balance Sheet a Trader as on 31-12-1994

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	30000		Bank Balances		5600
Add: Net Profit	6218	36218	Cash		1000
Creditors		9500	Debtors	40000	
Loans		10000	Less: Provision for Bad and Doubtful debts	2000	38000
			Advances		2500
Outstanding Salaries		500	Rent paid in Advance		118
			Closing Stock		9000
		56218			56218

3. From the following Trial Balance of Thiru. Rehman as on 31st March 1995, prepare Trading and Profit & Loss A/c and Balance Sheet taking into account the adjustment:

Debit Balances	Amount Rs.	Credit Balances	Amount Rs.
Land and Buildings	42,000	Capital	62,000
Machinery	20,000	Sales	98,780
Patents	7,500	Return Outwards	500
Stock 1-4-1994	5,760	Sundry Creditors	6,300
Sundry debtors	14,500	Bills payable	9,000
Purchases	40,675		
Cash in hand	540		
Cash at Bank	2,630		
Return Inwards	680		

Wages	8,480		
Fuel & power	4,730		
Carriage on Sales	3,200		
Carriage on Purchases	2,040		
Salaries	15,000		
General expenses	3,000		
Insurance	600		
Drawings	5,245		
	1,76,580		1,76,580

Adjustments:

(i) Stock on 31-3-1995 was Rs. 6,800.

(ii) Salary outstanding Rs. 1,500.

(iii) Insurance Prepaid Rs. 150.

(iv) Depreciate Machinery @ 10% and Patents @ 20%.

(v) Create a provision of 2% on debts for bad debts.

Solution:

1. Trading and Profit and Loss A/c Thiru Rehman for the year ending as on 31st March 1995

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
To Opening Stock		5760	By Sales	98780	
To Purchases	40675		Less: Returns Inwards	680	98100
Less: Return Outward	500	40175	By Closing Stock		6800
To Wages		8480			
To Fuel and Power		4730			
To Carriage on Purchases		2040			
To Gross Profit C/d		43715			
		104900			104900
To Salaries	15000		To Gross Profit B/d		43715
Add: Outstanding Salaries	1500	16500			
To Insurance	600				
Add: Prepaid Insurance	150	450			
To Carriage on Sales		3200			

To General Expenses		3000			
To Depreciation:					
Machinery	2000				
Patent	1500	3500			
To Provision for Bad Debts		290			
To Net Profit C/d		16775			
		43715			43715

Balance Sheet of Thiru Rehman as on 31st March 1995

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	62000		Cash in Hand		540
Add: Net Profit	16775		Cash at Bank		2630
	78775		Sundry Debtors	14500	
Less: Drawings	5245	73530	Less: Provision for Bad Debts	290	14210
Sundry Creditors		6300	Land and Building		42000
Bills Payable		9000	Machinery	20000	
Outstanding Salary		1500	Less: Depreciation	2000	18000
			Patents	7500	
			Less: Depreciation	1500	6000
			Prepaid Insurance		150
			Closing Stock		6800
		90330			90330

4. From the following trial Balance prepare Trading, profit and loss A/c for the year ended 31-12-1981 and Balance Sheet as on that date:

Dr. Balance	Rs.	Cr. Balance	Rs.
Purchases	11,870	Capital	8,000
Debtors	7,580	Bad debts recovered	250

Return inwards	450	Creditors	1,250
Bank Deposits	2,750	Return outwards	350
Rent	360	Bank overdraft	1,570
Salaries	850	Sales	14,690
Travelling expenses	300	Bills Payable	1,350
Cash	210		
Stock	2,450		
Discount allowed	40		
Drawings	600		
	27,460		27,460

Adjustments:

(i) The Closing Stock on 31-12-81 was Rs. 4,200

(ii) Write off Rs. 80 as Bad Debts and create a reserve for bad debts at 5% 0n sundry debtors.

(iii) Three month rent is outstanding

Solution:

Trading and profit and Loss A/c for the year ended as on 31-12-1981

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
To Opening Stock		2450	To Sales	14690	
To Purchase	11870		Less: Return Inwards	450	14240
Less: Return Outwards	350	11520	To Closing Stock		4200
To Gross Profit C/d		4470			
		18440			18440
To Rent	360		By Gross Profit B/d		4470
Add: Outstanding Rent	120	480	By Bad Debts Recovered		250
To Bad Debts		80			
To Reserve for Bad Debts		375			
To Salaries		850			
To Travelling Expenses		300			

To Discount Allowed		40			
To Net Profit		2595			
		4720			4720

Balance Sheet as on 31-12-1981

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	8000		Cash		210
Add: Net Profit	2595		Bank Deposit		2750
	10595		Debtors	7580	
Less: Drawings	600	9995	Less: Bad Debts	80	
Creditors		1250		7500	
			Less: Reserve for Bad		
Bank Overdraft		1570	Debts	375	7125
Bills Payable		1350	Closing Stock		4200
Outstanding Rent		120			
		14285			14285

5. From the following Trial Balance of Senthur Traders, prepare Trading and Profit & Loss Account for the year ending December 31, 2006 and Balance sheet as on that date:

Dr. Balance	Rs.	Cr. Balance	Rs.
Land & Building	60,000	Capital	96,000
Plant and Machinery	33,000	Sundry Creditors	15,000
Stock	12,000	Sales	60,000
Investment	15,000	Provision for Bad & Doubtful Debts	1,100
Purchases	45000	Loan	20,000
Wages	2000	Rent Received in advance	1,000
Carriage	2000	Commission Received	3,000
Salary	5000	Bills payable	15,000
Rent	2,000		
Cash at Bank	3000		

Sundry Debtors	30,000		
Discount	300		
Bad Debt	500		
Sales Returns	1300		
	2,11,100		2,11,100

Additional Information:

1. Closing stock valued at Rs. 12,000.
2. Bad Debt 500 and Provision for Bad & Doubtful Debts at 5%.
3. Salary outstanding Rs. 1000.
4. Commission Received in advance 1,000.
5. Depreciate Machinery @ 3% & land and Builders @ 2%.

2. Trading and profit and Loss A/c of Senthur Traders for the year ending as on 31-12-2006

Particulars	Amount Rs.	Amount Rs.	Particulars	Amount Rs.	Amount Rs.
To Opening Stock		12000	By Sales	60000	
To Purchases		45000	Less: Sales Returns	1300	58700
To Wages		2000	By Closing Stock		12000
To Carriage		2000			
To Gross Profit C/d		9700			
		70700			70700
To Salary	5000		By Gross Profit B/d		9700
Add: Salary	1000	6000	By Commission Received	3000	
To Rent		2000	Less: Commission Received in Advance	1000	2000
To Discount		300	By Rent Received in Advance		1000
To Bad Debts	500				
Add: Bad Debts	500				
	1000				

Add: Provision for Bad and Doutful Debts	1475				
	2475				
Less: Provision for Bad and Doutful Debts	1100	1375			
To Depreciation:					
Plant and Machinery	990				
Land abd Building	1200	2190			
To Net Profit C/d		835			
		12700			12700

Balance Sheet of Senthur Trader as on 31-12-2006

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capital	96000		Cash at Bank		3000
Net Profit	835		Investment		15000
		96835	Sundry Debtors	30000	
Outstanding Salary		1000	Less: Bad Debts	500	
Loan		20000		29500	
Commission Received in Advance		1000	Less: Provision for Bad and Doubtful Debts	1475	28025
Bills Payable		15000			
Sundry Creditors		15000	Land and Building	60000	
			Less: Depreciation	1200	58800
			Plant and Machinery	33000	
			Less: Depreciation	990	32010
			Closing Stock		12000
		148835			148835

FINAL ACCOUNTS OF NON-TRADING CONCERNS

1. Receipts and Payments Account
2. Income and Expenditure Account, and
3. Balance Sheet.

1. Receipts and Payments Account:

It is a Real Account. It is a consolidated summary of Cash Book. It is prepared at the end of the accounting period. All cash receipts are recorded on the debit side and all cash payments are recorded on the credit side.

Cash Book consisting of entries of receipts and payments in a chronological order while the Receipts and payments is a summary of total cash receipts and cash payments.

It starts with opening balance of Cash and Bank and ends with closing balance of Cash and Bank. It does not take into account outstanding amounts of receipts and payments. Receipts and Payments may be of Capital or Revenue nature; they may relate to the current or previous year or subsequent year; so long as they are actually received or paid, they must appear in this account.

Features of Receipts and Payment Account, In Brief:

ADVERTISEMENTS:

1. It starts with opening balance and ends with closing balance
2. It is the summary of cash and bank transactions.
3. Actual cash transactions are entered.
4. It includes capital as well as revenue items.
5. It follows cash system of accounting
6. It shows cash position and excludes all non-cash items.
7. It is a real account.
8. It does not take any income/expense outstanding at the beginning or at the end.

2. Income and Expenditure Account:

It is a Nominal Account. It is in the form of Profit and Loss Account. It is concerned with only revenue items—expenses and incomes. It records all losses and expenses on its debit side and all incomes and gains on its credit side of the incomes and expenses of revenue nature, only the portion pertaining to the current year is shown in the Income and Expenditure Account i.e. amount relating to the previous year or future year are excluded. Again, the incomes and expenses of current year, whether received or not, must be shown.

In other words, incomes and expenses have to be adjusted for both out-standing and pre-payments. All non-cash items, Depreciation, Bad Debts, Provision for Doubtful Debts etc. are taken into account.

The difference between the debit side and the credit side is either surplus or deficit for the year concerned and the difference will be transferred to the Capital Fund (also called General Fund or Accumulated Fund) appearing in Balance Sheet.

Features of Income and Expenditure Account, In Brief:

1. It is prepared in lieu of Profit and Loss Account.
2. It is a nominal account.
3. It is based on mercantile system of accounting.
4. There is no opening balance.
5. It ends with Surplus or Deficit.
6. It excludes all capital income and capital expenses.
7. It includes only revenue items.
8. It records all expenses whether paid or not, and all incomes whether received or not.

Distinction between Receipts and Payments Account and Income and Expenditure Account

Receipts and Payment Account	*Income and Expenditure Account*
1. It is a Real Account	1. It is a Nominal Account
2. It starts with opening balance.	2. It does not start with opening balance.
3. It ends with closing balance either cash in hand or at bank.	3. It ends with a surplus (excess of income over expenditure) or deficit (excess of expenditure over incomes)
4. It is similar to Cash Book.	4. It is similar to Profit and Loss Account.
5. Receipts are shown on the debit side and payments are shown on the credit side.	5. Expenses or losses are shown on the debit side and incomes and gains are shown on the credit side.
6. It contains both Capital and Revenue items.	6. It contains only Revenue items.
7. It includes receipts and payments whether they relate to any period past, previous and subsequent.	7. It includes only revenue items of the current year only.
8. No adjustments are made for outstanding or prepaid incomes and expenses	8. It takes into account the outstanding expenses and incomes.
9. Generally, it is not followed by Balance Sheet.	9. It is followed by Balance Sheet.
10. This is based on Cash system of accounting.	10. This is based on mercantile system.

3. Balance Sheet:

Balance Sheet in case of non-trading concern is prepared in the usual manner and consists of all liabilities and assets on the date on which it is prepared. The excess of assets over liabilities is termed Capital Fund or General Fund.

Again, The Capital Fund are accumulated with Capital Receipts, Receipts that are capitalized and further increased by surplus or decreased by deficit, during the year. At the inception of a non-trading concern, there will be no formal Capital Fund and in such case, the Surplus, if any, earned during the year constitute the Capital Fund at the end of the year.

Treatment of Special Items:
Subscriptions from members are collected periodically. These are regular revenue incomes and credited to Income and Expenditure Account. These are the major source of income for the non-trading concern. However, special subscriptions, if collected are kept separately from the General Fund for the specific purpose.

There are certain items which are peculiar to non-trading concerns and they need special treatment and are:
1. Donations:
Charitable institution may receive donations from time to time. If the amount is small and if such collections are frequent, then they may be treated as an income. Donations may also be of two types— General Donations and Specific Donations. Any donations received, not for a specific purpose, are treated as General Donations.

The General Donations of comparatively small amount may be taken to Income and Expenditure Account. General Donations of comparatively huge amount, which are of non-recurring nature, may be added to the Capital Fund. The nature and size of the organisation decide about the amount of donation being small or big.

In case of donations received for any specific purpose then it is termed Specific Donations. Such amount cannot be used for any other purpose, except the purpose of donor. Therefore, such amount may be shown in Balance Sheet (liability side).

All the Donations debited to Receipts and Payments Account and these amounts may be credited to Income and Expenditure Account or Liability side of the Balance Sheet, if it is for a specific purpose.

2. Legacy:

It is like donation. It is the amount given to a non-trading concern as per the will of deceased person. It is taken to the Receipts and Payments Account as Capital Receipts. These are not income but may appear in Balance Sheet. These types of receipts are of non-recurring nature.

3. Life Members Fee:

Non-trading concerns usually collect subscriptions every month from their ordinary members. There are another category of members called "Life Members", from whom the subscriptions are collected as a lump sum.

Such subscriptions are called life subscription and are capital receipts. This can also be kept in a separate account and an amount equal to annual subscription can be transferred to subscription account. The balance in such account, on the death of the member must be transferred to Capital Fund.

4. Entrance Fee (Admission Fee):

These are the fees collected from every member at the time of his admission into membership. It is paid only once by the new entrants on becoming a member of a society or a club. Generally, there may be bye-laws as regards the accounting treatment of such amount. In the absence of any bye-laws, it is taken as an item for income.

Against treating it as an income, there are arguments favouring it as a capital receipt as the members pay such fees only once and therefore treat it as a capital receipt. In the absence of any instruction, it may be treated as an income and is credited to Income and Expenditure Account.

5. Sale of Old Sports Materials and Old Newspapers:

The amount received on account of sale of old sports materials and old newspapers are recurring incomes to a concern and therefore, treated them as revenue incomes. The purchases of balls, nets, etc. are revenue expenditure.

6. Purchase of Equipment:

The price paid for acquiring any equipment is a Capital Expenditure.

7. Honorarium Paid:
It is a payment of remuneration to a person who is not an employee of the organisation. Such as any special performance is done, by an outsider, at the organisation, then the payment is honorarium and is taken to Income and Expenditure Account as it is a revenue expenditure.

8. Subscription:
It is a primary source of income of a non-profit organisation. It is usually collected every month from all the ordinary members. Subscription is the amount paid by the members to keep their membership alive.

The subscription amounts are treated as revenue receipts. Subscription received from members is credited to Income and Expenditure Account on accrual basis i.e. total amount receivable from all the members as subscription should be considered as income for the year.

9. Special Fund:
If there is any specific fund, such as Prize Distribution Fund, the expenses or incomes relating to the fund may be adjusted to the fund itself (on the liability side of the Balance Sheet). Such expenses or incomes may not be taken to Income and Expenditure Account.

10. Sale of Old Assets:
If any asset is sold, the amount is debited to Receipts and Payments Accounts. It is not taken to Income and Expenditure Account. The profit or loss made on sale of old asset is recorded in Income and Expenditure Account.

Some Important Adjustments:
(A) Subscription:
Subscription received from members is treated as revenue income. In income and Expenditure Account, subscription for current year will be shown. If total subscription received as per Receipts and Payments Account during the year is given, adjustments will

be made for outstanding subscription in the beginning and at the end of the year; and advance subscription in the beginning and at the end of the year.

(B) Expenses:

Total expenses paid during the year are shown in Receipts and Payments Account. These expenses may include outstanding of previous year and advance for next year. Similarly, some account may still be outstanding. Therefore, to calculate correct figure of expenses to be shown in Income and Expenditure Account, adjustments will have to be made.

(C) Consumable Items:

If institution consumes certain items such as medicines by hospital or sports items by clubs, relevant figures for Receipts and Payments Account and Income and Expenditure Account will be calculated. The value of goods consumed is shown in Income and Expenditure Account and the amount paid to creditors is shown in Receipts and Payments Account.

Problem

1. Calculate the amount to be posted to Income and Expenditure Account for the year ended 2004:

Receipts and Payments Account show that subscriptions received Rs 9,000. This account of subscriptions includes Rs 800 outstanding in the previous year and Rs 1,000 for the next year. Rs 2,000 is still outstanding for current year.

Solution:

Income and Expenditure Account
for the year ended Dec. 2004

Dr.				Cr.
			Rs	*Rs*
	By Subscription received		9,000	
	Add: Outstanding for the current year:		2,000	
			11,000	
	Less: Outstanding for previous year:	800		
	Less: Received for next year:	1,000	1,800	9,200

2. In 2004, the subscriptions received were Rs 17,500 which includes Rs 400 for 2003 and Rs 600 for 2005. At the end of 2004 subscriptions outstanding were Rs 500. The subscriptions due but not received at the end of the previous year i.e., 2003 were Rs 600. What amount should be credited to Income and Expenditure Account as subscriptions?

Solution:

Income and Expenditure Account
for the year ended 31st Dec. 2004

		Rs	Rs
	By Subscription (2004)	17,500	
	Less: Subscriptions received for 2003	400	
		17,100	
	Less: Subscriptions received for 2005	600	
		16,500	
	Add: Subscriptions outstanding for 2004	500	
			17,000

3.During the year 2004, the expenses actually paid were Rs 3,250.

Find out the actual expenses chargeable to Income and Expenditure Account for the year ended 2004, if prepaid and outstanding are as follows:

Prepaid Expenses on 31.12.2003 Rs 300

Prepaid Expenses on 31.12.2004 Rs 400

Outstanding Expenses on 31.12.2003 Rs 450

Outstanding Expense on 31.12.2004 Rs 500

SOLUTION

Income and Expenditure Account
for the year ended 31st Dec., 2004

	Rs	Rs	
To Expenses Paid	3,250		
Add: Prepaid expeses in 2003	300		
Add: Outstanding expenses in 2004	500		
	4,050		
Less: Prepaid Expenses in 2004	400		
	3,650		
Less: Expenses Outstanding in 2003	450		
		3,200	

Problem 4

1. Subscriptions received as per Receipts and Payment Accounts during the year 2004 — Rs 15,960
2. Subscriptions received in advance for 2005, during 2004 — Rs. 1,500
3. Subscriptions outstanding on Dec. 2003 — Rs 750
4. Subscriptions received in advance *i.e.* for 2004, during 2003 — Rs 710
5. Subscriptions outstanding on 31st Dec. 2004 — Rs 500

SOLUTION

		Rs
Subscriptions as per Receipts and Payment Account		15,960
Add: Subscriptions received in 2003 for 2004		710
Add: Subscriptions outstanding on 31st Dec. 2004		500
	Rs	17,170
Less: Subscription received during 2004 for the year 2005	1,500	
Less: Subscriptions outstanding for 2003	750	2,250
Subscriptions to be credited to Income and Expenditure Account during 2004		14,920

Problem 5:

Calculate the amount of stationery to be debited to Income and Expenditure Account during 2004:

1.	Amount paid for stationery during the year 2004, as per Receipts and Payments Account	Rs 1,750
2.	Stock of stationery on 1.1.2004	Rs 150
3.	Paid advance for stationery on 31.12.2004	Rs 200
4.	Paid advance for stationery during Dec. 2003 but received stationery during the year 2004	Rs 250
5.	Creditors for stationery on 1.1.2004	Rs 370
6.	Stock of stationery on 31.12.2004	Rs 415
7.	Creditors for stationery on 31.12.2004	Rs 300

SOLUTIONS

	Rs	*Rs*
Amount paid for stationery as per Receipts and Payment Account		1,750
Add: Stock of stationery on 1.1.2004		150
Add: Paid advance during Dec. 2003 and received during 2004		250
Add: Creditors for stationery on 31.12.2004 (Stationery has been received but the payment is outstanding)		300
		2,450
Less: Paid advance for stationery 31.12.2004 (payment has been made but stationery not received)	200	
Less: Creditors for stationery 1.1.2004 (Stationery has been received during 2003 but the payment is made in 2004)	370	
Less: Stock of stationery on 31.12.2004 (Not consumed)	415	985
Amount of stationery to be debited to Income and Expenditure Account		1,465

6. Calculate the amount to be shown in Receipts and Payments Account for the year ended 31st Dec. 2004

1. Income and Expenditure Account shows a sum of Rs 7,500 against subscription during 2004.

2. Subscriptions outstanding at Dec. 2003—Rs 600.

3. Subscriptions received in advance in Dec. 2003—Rs 450

4. Subscriptions received in advance in Dec. 2004—Rs 270

5. Subscriptions outstanding at Dec. 2004—Rs 750

Solution:

Receipts and Payment Account
Dr. **for the year ended 31st December 2004** Cr.

	Rs	Rs	
To subscriptions as per Income and Expenditure Account	7,500		
Add: Subscriptions outstanding for 2003	600		
Add: Subscriptions received for 2005	270		
	8,370		
Less: Subscriptions received in 2003	450		
	7,920		
Less: Subscriptions outstanding in 2004	750		
		7,170	

Illustration 7:

From the following, find out the amount of subscriptions to be credited to Income and Expenditure Account for the year 2006.

Subscriptions received in 2006 – Rs. 48,000 which include Rs. 4,000 for 2005 and Rs. 8,000 for 2007.

Subscriptions due but not received at the end of the year 2006 were Rs. 20,000.

Subscriptions received in 2005 in advance for 2006 were Rs. 12,000

Solution:

Computations of subscriptions for 2006

	Rs
Subscriptions received during the year	48,000
Less: Received for previous year (2005)	4,000
	44,000
Less: Received for the next year (2007)	8,000
	36,000
Add: Outstanding subscriptions for 2006	20,000
	56,000
Add: Received in advance in 2005 for 2006	12,000
Subscriptions to be credited to Income and Expenditure Account for 2006	68,000

Types of Accounting Problems:

1. Preparation of Income and Expenditure Account and Balance Sheet from a given Receipts and Payment Account with additional information.

2. Preparation of Opening Balance Sheet and Closing Balance Sheet from a given Receipt and Payment Account and Income and Expenditure Account.

3. Preparation of Receipt and Payment account from a given income and Expenditure Account and other information given.

4. Income and Expenditure Account and Balance Sheet from a given Trial Balance with additional information.

1. Preparation of Income and Expenditure Account and Balance Sheet from a given Receipts and Payment Account with additional information:

The Income and Expenditure Account is simply another name for the Profit and Loss Account drawn up for a non-profit organisation. In this account, all losses and expenses relating to the period are debited and all gains and incomes relating to the same period are credited. It must be remembered that only the revenue items relating to the period are dealt within this Account.

In examinations, sometimes, Receipts and Payments Account is given and the students are required to prepare Income and Expenditure Account and in such situation, the following steps are to be followed:

1. Do not take the opening balance and closing balance of Cash in hand and at Bank.
2. Do not take Capital Receipts and Capital Expenditure.
3. Pick up only the revenue receipts and revenue payments and exclude the portions relating to previous and subsequent years.
4. Add the portions of incomes and expenses prepaid in the previous year on account of current year.
5. Add also the portions of incomes and expenses of the current year due but remaining unpaid.
6. Provide for depreciation, Reserve for doubtful debts etc. as needed in the problems.
7. Surplus or Deficit will be transferred to Capital Fund.

Problem 8. The Calcutta Cricket Club gives you the following information:

Dr. **Income and Expenditure Account for 2004** Cr.

	Rs			Rs
To Remuneration to Coach	4,500	By Donation and Subscriptions		25,500
To Wages	5,000	By Bar Room: Receipts:	3,000	
To Rent	2,500	Payments:	2,500	500
To Printing and Stationery	2,600	By Interest on Saving A/c		500
To Repairs	4,500	By Proceeds of Club:		
To Honorarium to Secretary	6,000	Night:	8,800	
To Depreciation on Equipment	4,700	Expenses:	4,000	4,800
To Surplus	1,500			
	31,300			31,300

Balance Sheet as on 31st Dec. 2004

31.12.2003	*Liabilities*		*31.12.2004*	*31.12.2003*	*Assets*	*31.12.2004*
Rs			*Rs*	*Rs*		*Rs*
	Expenses Unpaid:			1,000	Cas in hand	500
1,000	Printing and Stationery		800	3,000	Cash at Bank	1,000
	Wages		2,000	20,300	Savings Bank	21,100
4,000	Honorarium to Secretary		6,000	1,500	Subscriptions Outstanding	1,000
800	Subscriptions received in Advance		300	8,000	Equipment	17,500
28,000	Capital Fund	28,000				
	Entrance Fees	2,500				
	Surplus	1,500	32,000			
33,800			41,100	33,800		41,100

Prepare the Receipts and Payments Account of the Club for 2004. (*M.Com., Kolkata*)

Solution:

In the Books of Kolkata Cricket Club
Receipts and Payments Accounts
For the year ended 31st Dec. 2004

Dr. Cr.

	Rs		Rs
To Balance b/d:		By Remuneration to Coach	4,500
Cash in hand	1,000	By Wages[4]	3,000
Cash at Bank:		By Rent	2,500
Current Account	3,000	By Printing and Stationery[2]	2,800
Savings Account	20,300	By Repairs	4,500
To Donations and Subscriptions[1]	25,500	By Honorarium to Secretary[3]	4,000
To Bar Room Receipts	3,000	By Bar Room Expenses	2,500
To Interest on Savings A/c	500	By Night Club Expenses	4,000
To Proceeds of Night Club	8,800	By Equipment[5]	14,200
To Entrance Fees	2,500	By Balance c/d:	
		Cash	500
		Cash at Bank:	
		Current Account	1,000
		Savings Account	21,100
	64,600		64,600

Workings:

		Rs.
1.	*Donations and Subscriptions received in 2004*	
	As per Income and Expenditure Account:	*25,500*
	Add: Outstanding on 31st Dec. 2003	*1,500*
		27,000
	Add: Received in advance for 2005	*300*
		27,300
	Less: Outstanding on 31st Dec. 2004	*1,000*
		26,300
	Less: Received in advance during 2003	*800*
		25,500

2.	*Printing and Stationery paid in 2004*	
	As per Income and Expenditure	*Rs 2,600*
	Less: Outstanding on 31st Dec. 2004	*800*
		1,800
	Add: Outstanding on 31st Dec. 2003	*1,000*
		2,800
3.	*Honorarium to Secretary paid in 2004*	
	As per Income and Expenditure	*Rs 6,000*
	Add: Outstanding on 31st Dec. 2003	*4,000*
		10,000
	Less: Outstanding on 31st Dec. 2004	*6,000*
		4,000
4.	*Wages paid in 2004*	
	As per Income and Expenditure	*Rs 5,000*
	Less: Outstanding on 31st Dec. 2004	*2,000*
		3,000
5.	*Purchase of Equipment in 2004*	
	Equipment on 31st Dec. 2004	*17,500*
	Add: Depreciation charged	*4,700*
		22,200
	Less: Opening Balance	*8,000*
		14,200

9. Calicut Sports Association extracts the following Receipts and Payments Account for the year ended 31st December 2004. From the particulars given, prepare Income and Expenditure Account for the year ended 31st December 2004.

Receipts and Payments Account
for the year ended 31st Dec. 2004

Dr. Cr.

	Rs		Rs
To Balance b/d	1,125	By Newspapers	750
To Subscriptions	2,900	By Rent	250
To Tournament Fund	750	By Salaries	1,800
To Life Membership	1,000	By Office Expenses	1,200
To Enterance Fees	100	By Sports Equipments	1,150
To Donations for Building	1,500	By Tournament Expenses	450
To Sales of Newspapers	50	By Balance c/d	1,825
	7,425		7,425

Subscriptions outstanding on 31st December 2003 Rs 450 and on 31st December 2004 Rs 400. A subscription received includes Rs 100 on account of the year 2005.

Sports equipment was valued on 31st December 2003 at Rs 550 and on 31st December 2004 at Rs 1,090.

Office expenses include Rs 150 for 2003 whereas Rs 200 is still payable on this account for 2004.

Tournament Fund is treated as Capital Receipt. (B.Com., Calicut)

Solution:

Income and Expenditure Account
for the year ended 31st December 2004

Dr. Cr.

Expenditure		*Rs*	*Income*		*Rs*
To Newspaper		750	By Subscriptions:	2,900	
To Rent		250	Less: for 2003	450	
To Salaries		1,800		2,450	
To Office Expenses	1,200		Add: Outstanding (2004)	400	
Less: Paid for 2003	150			2,850	
	1,050		Less: Received for 2005	100	2,750
Add: Outstanding for 2004	200	1,250	By Entrance Fees		100
			By Sale of Newspaper		50
To Depreciation on Equipment:		610	By Excess Expenditure over Income		1,760
		4,660			4,660

Note: Life members' fee is capitalised. Tournament Expenses are shown separately.

POSSIBLE QUESTIONS

UNIT – II

PART - B

1. A company purchased Furniture for Rs.28,000. Depreciation is to be provided annually according to the Straight Line Method. The useful life of the furniture is 5 years and the residual value is Rs.2,000.
You are required to find out the amount of depreciation.

2. From the following particulars, find out the rate of depreciation, under Straight Line Method.
Cost of Fixed Asset Rs. 50,000
Residual Value Rs. 5,000
Estimated Life 10 years

4. Define Depreciation.
5. What is Fixed Asset?
6. What is residual value?
7. What is obsolescence?
8. What is outstanding expense?
9. What is prepaid expense?
10. What is accrued income?
11. What is income received in advance?
12. What is bad debt?
13. Write notes on Provision for bad and Doubtful debts.
14. Write notes on Provision for discount on Debtors.
15. Write notes on Provision for discount on Creditors.

PART - C

1. On 1 April, 2001, Excel Company Limited purchased a machine for Rs.56,000. On the date of purchase it was estimated that the effective life of the machine will be 10 years and after 10 years it's scrap value will be Rs.6,000. Prepare Machine Account and Depreciation Account for three years, Depreciation is charged on Straight Line Method. Accounts are closed on 31st March of every year.

2. A garment company purchased a Plant on 1 April 2001 for Rs.1,00,000. After having used it for three years it was sold for Rs.80,000. Depreciation is to be provided at the rate of 10% per annum on Fixed Instalment Method. Accounts are closed on 31st March every year. Find out the Profit or Loss on sale of Plant.

3. On 1st October 2000, a company purchased a plant for Rs.6,00,000. They spent Rs.40,000 on its erection. The firm writes off depreciation at the rate of 20% on Reducing Balance Method. The books are closed on 31st March every year. Prepare Plant account and Depreciation account for three years.

4. From the following balances as at 31st December 1994 of trader, prepare a Trading and Profit & loss A/c for the year 1994 and a Balance Sheet as on that date:

Debit Balances	Amount Rs.	Credit Balances	Amount Rs.
Salaries	5,500	Creditors	9,500
Rent	1,300	Sales	32,000
Cash	1,000	Capital	30,000
Debtors	40,000	Loans	10,000
Trade expenses	600		
Purchases	25,000		
Advances	2,500		
Bank balance	5,600		
	81500		81500

Adjustments:

(v) The closing stock amounted to Rs. 9,000.

(vi) **One month's Salary is outstanding.**

(vii) **One month's rent has been paid in advance.**

(viii) Provide 5% for doubtful debts.

5. From the following Trial Balance of Senthur Traders, prepare Trading and Profit & Loss Account for the year ending December 31, 2006 and Balance sheet as on that date:

Dr. Balance	Rs.	Cr. Balance	Rs.
Land & Building	60,000	Capital	96,000
Plant and Machinery	33,000	Sundry Creditors	15,000
Stock	12,000	Sales	60,000
Investment	15,000	Provision for Bad & Doubtful Debts	1,100
Purchases	45000	Loan	20,000
Wages	2000	Rent Received in advance	1,000
Carriage	2000	Commission Received	3,000
Salary	5000	Bills payable	15,000
Rent	2,000		
Cash at Bank	3000		
Sundry Debtors	30,000		
Discount	300		
Bad Debt	500		
Sales Returns	1300		

	2,11,100		2,11,100

Additional Information:

1. Closing stock valued at Rs. 12,000.
2. Bad Debt 500 and Provision for Bad & Doubtful Debts at 5%.
3. Salary outstanding Rs. 1000.
4. Commission Received in advance 1,000.
5. Depreciate Machinery @ 3% & land and Builders @ 2%.

6. From the following, find out the amount of subscriptions to be credited to Income and Expenditure Account for the year 2006.

Subscriptions received in 2006 – Rs. 48,000 which include Rs. 4,000 for 2005 and Rs. 8,000 for 2007.

Subscriptions due but not received at the end of the year 2006 were Rs. 20,000.

Subscriptions received in 2005 in advance for 2006 were Rs. 12,000

7. Calculate the amount to be posted to Income and Expenditure Account for the year ended 2004:

Receipts and Payments Account show that subscriptions received Rs 9,000. This account of subscriptions includes Rs 800 outstanding in the previous year and Rs 1,000 for the next year. Rs 2,000 is still outstanding for current year.

Unit III : Accounting for Hire-Purchase and Installment System

Accounting for Hire-Purchase and Installment System- Transactions - Journal Entries and ledger accounts including Default and Repossession.

Introduction

By now you must have been familiar to various aspects of Book-keeping and Accountancy. You must have understood the concept of double entry system. Now-a-days the books of accounts are maintained under double entry system by all big business houses and multinationals. You know that the sales is the Key factor of success of business. The profit of a business always depends on the volume of its sales. A big business house can effect sales on cash basis as well as on credit basis. The credit sales are very important and essential for the growth of business. The sale proceeds under such sales are not immediately collected but are collected under certain arrangements such as Hire-purchase system or Instalment payment system or collection after a certain period together with interest on outstanding balances. Hire-purchase system is the most secured and effective tool of collecting the proceeds of a credit sale.

Meaning and Concept of Hire-purchase system

Hire-puchase system is a special system of purchase and sale of goods. Under this system purchaser pays the price of the goods in instalments. The instalments may be annual, six monthly, quarterly, monthly fortnightly etc. Under this system the goods are delivered to the purchaser at the time of agreement before the payment of instalments but the title on the goods is transferred after the payment of all instalments as per the hire-purchase agreement. The special feature of a hire-purchase transaction is that the payment of every instalment is treated as the payment of hire charges by the purchaser to the hire vendor till the payment of the last instalment.. After the payment of the last instalment, the amount of various instalments paid is appropriated towards the payment of the price of the goods sold and the ownership or the goods is transferred to the purchaser. Thus hire-purchase means a transaction where the goods are sold by vendor to the purchaser under the following conditions :

- the goods will be delivered to the purchaser at the time of agreement.
- the purchaser has a right to use the goods delivered.
- the price of the goods will be paid in installments.
- every installment will be treated to be the hire charges of the goods which is being used by the purchaser.
- if all installments are paid as per the terms of agreement , the title of the goods is transferred by vendor to the purchaser.

- if there is a default in the payment of any of the instalments, the vendor will take away the goods from the possession of the purchaser without refunding him any amount received earlier in the form of various installments.

Characteristics of Hire-purchase system

Before discussing the characteristics of hire-purchase system, we must know what is a hire purchase agreement and what are the contents of a hire-purchase agreement. Hire-purchase agreement means a contract between the hire vendor and the hire purchaser regarding the sale of goods under certain conditions. Usually every hire-purchase agreement shall contain the following terms:

- the cash price of the goods, cash price means the price at which goods may be purchased against cash payment.
- the hire-purchase price, hire purchase price means the total amount which is payable by the hire-purchaser under the agreement.
- the date on which the hire-purchase agreement will commence.
- the description of the goods that will be delivered to the hire-purchaser at the commencement of the agreement.
- the number of instalments to be paid by the hire-purchaser along with the amount of each instalment and the date of payment of each instalment.
- the down payment if any, the down payment means the amount which is required to be paid by hire-purchaser to the hire vendor at the time of commencement of hire-purchase agreement.
- the rate interest charged by the hire vendor (optional).

Characteristics of Hire-Purchase System
The characteristics of hire-purchase system are as under

- Hire-purchase is a credit purchase.
- The price under hire-purchase system is paid in instalments.
- The goods are delivered in the possession of the purchaser at the time of commencement of the agreement.
- Hire vendor continues to be the owner of the goods till the payment of last instalment.
- The hire-purchaser has a right to use the goods as a bailer.
- The hire-purchaser has a right to terminate the agreement at any time in the capacity of a hirer.

- The hire-purchaser becomes the owner of the goods after the payment of all instalments as per the agreement.
- If there is a default in the payment of any instalment, the hire vendor will take away the goods from the possession of the purchaser without refunding him any amount.

Difference between Hire-purchase system and Instalment payment system

Instalment Payment System is system of purchase and sale of goods in which title of goods is immediately transferred to the purchaser at the time of sale of goods and the sale price of the goods is paid in instalments. In the event of default in payment of any instalment, the seller has no right to take back goods from the possession of the purchaser. He can file a suit for the recovery of the outstanding balance of the price of goods sold. The followings are the differences between Hire-purchase system and Instalment payment system:

- In Hire-purchase system, the transfer of ownership takes place after the payment of all instalments while in case of Instalment payment system, the ownership is transferred immediately at the time of agreement.
- In Hire-purchase system, the hire-purchase agreement is like a contract of hire though later on it may become a purchase after the payment of last instalment while in Instalment payment system, the agreement is like a contract of credit purchase.
- In case of default in payment , in Hire-purchase system the vendor has a right to back goods from the possession of the hire-purchaser while in case of Instalment payment system, the vendor has no right to take back the goods from the possession of the purchaser; he can simply sue for the balance due.
- In Hire-purchase system, if the purchaser sells the goods to a third party before the payment of last instalment, the third party does not get a better title on the goods purchased. But in case of Instalment payment system, the third party gets a better title on the goods purchased.
- In Hire-purchase system the provisions of the Hire-purchase Act apply to the transaction while in case of Instalment payment system, the provisions of Sale of Goods Act apply to the transaction.

Accounting In the books of Hire-purchaser

- There are two methods of accounting in the books of Hire-purchaser. Their detailed description is as under:-
- Asset Accrual Method:
  Under this method it is considered that the hire-purchaser is the owner of the asset up to

the value of the cash price paid by him in the from of down payment or the cash price paid included in various instalments. The following journal entries are recorded under this method.

- (i)On taking the delivery of asset:

- No entry is recorded.

- (ii)On making the down payment (if any)

- Asset A/c Dr. (Amount of down payment)
- To Cash/Bank A/c.

- (iii)On becoming the instalment due

- Asset a/c. Dr (Balancing figure)
- Intt. A/c. Dr. (Amt. of Intt.)
- To Hire-Vendor A/c. (Amt. of Instalment)

- (iv)On payment of instalment:

- Hire-Vendor A/c Dr. (Amt. of Instalment)
- To Cash/Bank A/c.

- (v)On charging the Depreciation:

- Depreciation A/c Dr. (Amt. of Depreciation)
- To Asset A/c.

- (vi)On Transfer of interest and depreciation to P/L A/c:

- P/L A/c. (Total amt.)
- To Interest A/c (Bal. of Intt. A/c.)
- To Depreciation A/c. (Bal. of Dep. A/c.)

- Under Total Assets Value Method: Under this method of accounting in the books of hire-purchaser, is done on the assumption that the ownership of the asset is also transferred to the purchaser with the delivery of goods. The following journal entries are recorded under this method.
- (i)On taking the delivery of assets at the time of agreement:

- Asset A/c Dr. (Cash price of Asset)
- To Hire vendor A/c.

- (ii)On making the down-payment (if any):

- Hire-Vendor……. A/c. Dr. (Amount of down payment)
- To Cash/Bank A/c

- (iii)On becoming the instalment due:

- Interest A/c. Dr. (Amount of interest)
- To Hire-Vendor A/c

- (iv)On payment of instalment:

- Hire-Vendor a/c Dr. (Amount of instalment)
- To Cash/Bank A/c

- (v)On charging the depreciations:

- Depreciation A/c. Dr. (Amount of depreciation)
- To Asset A/c.

- (vi)On Transfer of interest and depreciation to P/L A/c:

- P/L A/c. Dr. (Total)

- To Interest A/c. (Bal. of Intt. A/c.)
- To Depreciation A/c. (Bal. of Dep. A/c.)

- Posting in Ledger Accounts: After passing journal entries under any of the methods discussed above, the following ledger accounts are opened in the ledger and the postings are made accordingly.
- (i) Asset A/c. (e.g. Trucks A/c, Machinery A/c. etc.)
  (ii) Vendor's A/c.
  (iii) Interest A/c.
  (iv) Depreciation A/c.
- Note: Before recording the entries the amounts of interest and depreciation will be calculated in two separate tables showing the calculations of interest and depreciation.
- Calculation of Interest
- The total payment made under hire-purchase system is more than cash price. In fact, this excess of payment over the cash price is interest. It is very essential to calculate interest because the amount paid for interest is charged to revenue and the asset is capitalized at cash price. Thus normally all instalments will include a part of cash price and a part of interest on the outstanding balance. However the amount paid at the time of agreement (down payment) will not include any interest. The calculation of interest is made under two conditions:
- (a) When interest is included in amount of instalment: Where the hire-purchase price i.e. payment made in the form of down payment and all instalments is more than the cash price, it is regarded that the interest is included in instalments. It is explained in the following example.
- Worked out Example-1 (Calculation of Interest)
  On Ist April,2005 Mr. X purchased from M/s Y & Co. one 'Motor Truck' under hire-purchase system, Rs. 5,000 being paid on delivery and the balance in five annual instalments of Rs. 7,500 each payable on 31st March each year. The cash price of the motor truck is Rs. 37,500 and vendors charge interest at the rate of 5 per cent per annum on yearly balances. Find out the amounts of principal and interest included in each instalment.

Calculation of Interest

Calculation of Intt.		Cash Price	Instalments		
			Principal	Intt.	Total
		Rs.	Rs.	Rs.	Rs.
Cash Price		37,500			
Less paid on delivery		- 5,000	5,000	-	5,000
		32,500			
First Instalment	7,500				
Less Intt. on Rs. 32,500 @ 5%	1,625				
Principal	5,875	-5,875	5,875	1,625	7,500
		26,625			
Second Instalment	7,500				
Less Intt. on Rs. 26,625 @ 5%	1,331				
Principal	6,169	- 6,169	6,169	1,331	7,500
		20,456			
Third Instalment	7,500				
Less Intt. on Rs. 20,456 @ 5%	1,023				
Principal	6,477	-6,477	6,477	1,023	7,500
		13,979			
Fourth Instalment	7,500				
Less Intt. on Rs. 13,979 @ 5%	699				
Principal	6,801	- 6801	6,801	699	7,500
		7,178			
Fifth Instalment	7,500				
Less Amount unpaid	7,178				
Interest	322	- 7,178	7,178	322	7,500
Total:		x	37,500	5,000	42,500

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(b) When interest is not included in instalments: Where the total amount paid in the form of down payment and all instalments is exactly equal to the cash price, it is regarded that the interest is not included in instalments. It means that interest is payable in addition to the agreed amount of instalment. It is explained in the following example.

Workedout Example-2 (Calculation of Interest): On April 1,2005, A Transport Company purchased a Motor Lorry from Motor Supply Co. Ltd. on hire-purchase basis, the cash price being Rs. 60,000. Rs. 15,000 on signing of the contract and balance in three annual instalments of Rs. 15,000 each on 31st March every year. In addition to it, interest at 5 per cent per annum was also payable to vendors on outstanding balances.

Calculation of Interest

Calculation of Intt.		Cash Price	Instalments		
			Principal	Intt.	Total
		Rs	Rs	Rs.	Rs.
Cash Price		60,000			
Less: Down payment		15,000	15,000	-	15,000
		45,000			
Ist Instalment	15,000				
Int. @ 5% on 45,000	2,250				
Total:	17,250	15,000	15,000	2,250	17,250
		30,000			
2nd Instalment	15,000				
Int. @ 5% on 30,000	1,500				
Total:	16,500	15,000	15,000	1,500	16,500
		15,000			
3rd Instalment	15,000				
Int. @ 5% on 15,000	750				
Total:	15,750	-	15,000	750	15,750
		15,000			
Total:		Nil	60,000	4,500	64,500

Accounting in the books of Hire-vendor

Hire Vendor: There is only one method of recording the entries in the books of hire-vendor. Irrespective of the fact whether the entries in the books of hire-purchaser are passed under the Asset Accrual Method or under the Total asset value Method.But the accounting entries in the books of hire-vendor are always passed under the total Asset Method. These entries are as under:-

(i)On delivery of goods to the hire-purchaser at the time of agreement:

Hire – purchaser A/c Dr.	Cash Price
To Hire – Sales A/c.	

(ii)On receipt of cash at the time of agreement (down payment), if any:

Cash/Bank A/c. Dr.	(Amt. of down payment)
To Hire-Purchaser	

(iii)On interest being due:

Hire – Purchaser A/c Dr.	Amt. of Interest
To Interest A/c.	

(iv)On receipt of instalment:

Cash/bank A/c.	(Amt. of Instalment)
To Hire – Purchaser	

(v)On Transfer of Balance of Hire-Sales A/c. to Trading A/c. (at the end of first year only):

Hire – Sales A/c Dr.	Cash Price
To Trading A/c.	

(vi)On Transfer of amount of interest to P/L A/c:

Interest A/c. Dr.	(Balance of Intt. A/c.)
To P/L A/c.	

Note: In solving a numerical problem, before recording the entries, the amount of interest included in various instalments will be separately calculated as already explained.

Posting in Ledger Accounts:

After passing entries in the journall of hire – vendor the following accounts will be opened in the ledger of hire – vendor and the postings will be made accordingly.

- (i) Hire – Purchaser A/c.
- (ii) Hire – Sales A/c. (only in first year)
- (iii) Interest A/c.

Calculate the amount of annual instalment, and show the Journal entries and necessary ledger accounts in the books of Moti Ltd. for three years. The present value of Annuity of Rupees one for three years at 5% is 2.72325.

Worked out examples-3:

On 1st April,2005 X Company Ltd. purchased a machine from Y Machines Ltd. on hire-purchase basis, the cash price being Rs. 55,850 Rs. 15,000 was paid on the signing of the contract and the balance in three annual instalments of Rs. 15,000 each on 31st March each year. Interest is charged at 5% per annum. Depreciation was written off at rate of 10% per annum on the diminishing balance system.

Give journal entries in the books of X Company Ltd. whose accounting year ends on 31st March each year, under Asset Accrual Method.

Solution:

(a) under Asset Accrual Method

Journal Entries in the Books of X Co. Ltd.

Date	Particulars	LF	Dr.(Rs.)	Cr.(Rs.)
2005 April 1	**Machinery A/c ……………..Dr.** To Bank A/c		15,000	15,000

	(Being down payment made at the time of delivery)			
2006 March 31	Machinery A/c ……………………………………...Dr. Interest A/c ....Dr. To Y Machine Ltd. (Being the first instalment due).		12,957 2,043	15,000
"	Y MachinesLtd. …………………Dr. To Bank (Being the amount paid in first instalment)		15,000	15,000
"	Depreciation A/c …………………Dr. To Machinery A/c (Being the depreciation charged)		5,585	5,585
"	Profit & Loss A/c …………………Dr. To Interest A/c ToDepreciation A/c (Being the amount transferred)		7,628	2,043 5,585
2007 March 31	Machinery A/c ……………………………………...Dr.		13,605	15,000

	Interest A/c ....Dr. To Y Machine Ltd. (Being the second instalment due).		1,395	
"	**Y Machines Ltd. …………………Dr.** To Bank (Being the amount paid in second instalment)		15,000	15,000
"	Depreciation **A/c …………………Dr.** To Machinery A/c (Being the depreciation charged)		5,027	5,027
"	**Profit & Loss A/c …………………Dr.** To Interest A/c ToDepreciation A/c (Being the amount transferred)		6,422	1,395 5,027
2008 March 31	Machinery A/c **……………………………………...Dr.** Interest A/c ....Dr. To Y Machine Ltd. (Being the third instalment due).		14,288 712	15,000

"	**Y Machines Ltd. …………………Dr.** To Bank (Being the amount paid in third instalment)		15,000	15,000
"	**Depreciation A/c …………………Dr.** To Machinery A/c (Being the depreciation charged)		4,524	4,524
"	**Profit & Loss A/c …………………Dr.** To Interest A/c To Depreciation A/c (Being the amount transferred)		5,236	712 4,524

Note1: Interest has been calculated in the manner already explained in workedout example-1.

Calculation of Cash Price, if Cash Price is not given

Some times in a problem of hire-purchase, cash price of goods sold is not given. Only hire-purchase price is given under such situation first of all, cash price is to be calculated in order to find out the amount of interest included in each instalment. the cash price can be calculated under following two situations.

(a)By Annuity Method, if the annity value of Re. 1 is given:

Cash Price = (Annuity, Value of Re.1 x Amt. of one instalment) + down payment if, any.

Calculation of Cash Price by Annuity Method

Worked out Example-4

On 1st April,2005 a manufacturing company buys on Hire-purchase system a machinery for Rs. 60,000, payable by three equal annual instalments combining principal and interest, the rate of interest was 5% per annum. Calculate the amount of cash price and interest. The present value of an annuity of one rupee for three years at 5% interest is Rs. 2,72325.

Solution:

Calculation of Cash Price – The present value of an annuity of Re. 1 paid for 3 year @ 5% = Rs. 2,72325 Then the present value of Rs. 20,000 for 3 years = 2,72325 x 20,000 = Rs. 54,465 Cash Price Rs. 54,465

(b) By Arithmetic Method, if the annuity value of Re. 1 is not given:

? First take the last instalment and calculate interest included in that instalment. Interest: = (Amount of instalment x Rate of Int) / 100+Rate of Int.

Thereafter interest included in last but one instalment should be calculated. Interest = [(Amt. of last but one instalment + principal price included in the last instalment) x Rate of Interest] / 100+ Rate of Int.

- ? Interest included in all proceeding instalment should be calculated in the same manner.
- ? In the end, interest included in each instalment should be added. It should be remembered that down payment does not include any interest.
- ? Finally cash price = Hire purchse price – Total interest included in various instalments.

Calculation of Cash Price by Arithmetic Method

Worked out Example-5

Mr. X purchased a machine on Hire-Purchase system on 1st April,2005. He paid Rs. 5,000 at spot and then three annual instalments of Rs. 5,000 each. The rate of interest was 5% per annum. Find out the amount of interest included in instalments and cash price of the machine.

Solution:

(1)First of all Interest included in the 3rd instalment is to be calculated.

Interest=(5000x5)/105=Rs. 238,Principal= 5000-238=4762

(2)Interest included in second instalment = [(5000+4762)x5]/105 = 465, Principal=4535

(3)Interest included in 1st instalment = [(5000+4762+4535)x5]/105 = 681,Principal=4319

Cash Price = 4762+4535+4319+down payment Rs.5000 = Rs.=18616

Total Interest=Rs20000-18616=1384. I Yr. rs.681, IIYr. Rs465, III Yr.Rs238

Note: Now you can make the interest table in the usual manner as explained in worked out example-1 and check your calculation of amount of interest.

Calculation of Amount of Interest, if Rate of Interest is not given

Wherever, rate of interest is not given in the problem, again there can be two situations.

(a) When cash price and the amounts of instalments are given and the amount of each instalment is same. the following worked out example will make the calculation clear.

Worked out Example-6

(Calculation of Interest When Rate of Interest is not given) A machine was sold on hire-purchase system on 1st April,2005 Rs. 10,000 was paid at spot and rest was paid by four equal quarterly installments of 22,000 each. The cash price of machine was Rs. 90,000. Find out the amount of interest included in each installment.

Soluton:

Hire-purchase Price = 10,000 + (22,000 × 4) = Rs.98,000 Less: Cash Price Rs.90,000 Total Interest= Rs.8,000

The total Interest of Rs 8,000 is to be apportioned among the various installments i.e. 4th, 3rd, 2nd and 1st instalment in the ratio of 1:2:3:4 (i.e. among 1st, 2nd, 3rd and 4th installment in the ratio of 4:3:2:1)

(1)Share of 1st instalment in the Interest= 8,000×4/10 = Rs.3,200

(2)Share of 2nd instalment in the Interest= 8,000×3/10 = Rs.2,400

(3)Share of 3rd instalment in the interest= 8,000×2/10 = Rs.1,600

(4)Share of 2nd instalment in the interest= 8,000×1/10 = Rs. 800

(b) When cash price and amounts of instalments are given but the amount of each instalment is not equal: The following worked out example will clear the doubts.

Rate of Interest not known and Instalments of different amounts

Worked out Example-7

Cash price of a machine is Rs. 37,400 on 1st January,2003. Its hire-purchase price is Rs. 50,000. This hire-purchase price is paid in five annual instalments in the following manner: Rs. 15,000 at the end of the first year Rs. 12,000 at the end of second year; Rs. 10,000 at the end of third year, Rs. 8,000 at the end of fourth year, Rs. 5,000 at the end of fifth year. Calculate interest and cash price included in each instalment.

Solution:

Calculation of Interest Included in each Instalment

Total Interest= Hire-purchase price-Cash Price

Total Interest=Rs.50,000-37,400=12600

Total Interest of Rs12,600 is to be apportioned among the five instalments in the following manner:

Instalment No	Unpaid Amount(Rs.)	Calculation of Int.(Rs.)
First	50000	(12600x50000)/126000=5000
Second	50000-15000=35000	(12600x35000)/126000=3500
Third	35000-12000=23000	(12600x23000)/126000=2300
Fourth	23000-10000=13000	(12600x13000)/126000=1300
Fifth	13000-8000=5000	(12600x5000)/126000=500
Total	126000	

Calculation of Cash Price included in each instalment

Instalment No.	Instalment(Rs.)	Interest(Rs.)	Cash Price(Rs.)
First	15000	5000	10000
Second	12000	3500	8500
Third	10000	2300	7700
Fourth	8000	1300	6700
Fifth	5000	500	4500
Total	50000	12600	37400

POSSIBLE QUESTIONS

PART – B (2 MARKS)

1. What is meant by Installment System?
2. What is meant by Default?
3. What do meant by repossession?
4. Define down payment.
5. Define Hire purchase.
6. Define Hire Vendor.

POSSIBLE QUESTIONS
PART – C (8 MARKS)

7. The Madras Trading Co. purchased a motor car from Bombay motor Co. on hire purchase agreement on 1.1.80, paying cash Rs.10,000 and agreeing to pay further three instalments of Rs.10,000 each on 31^{st} December each year. The cash price of the car is Rs.37,250 and the Bombay motor co charges interest at 5% p.a.

   The Madras Trading Co. writes off 10% p.a as depreciation on the reducing balance method. Journalise the above in the books of both the parties.

8. Sundar sells goods on H.P system at cost plus 60%. From the following prepare Hire purchase Trading a/c.

Jan 1 Goods out on H.P system at H.P Price	Rs.32,000
Dec 31 Instalments not due and unpaid	Rs.72,000
Instalments due and unpaid	Rs. 4,000

   The following transactions took place during the year:-

a) Goods sold on H.P price	Rs.1,60,000
b) Cash received from customers at H.P price	Rs.1,12,000
c) Goods received back on default valued at	Rs. 800

   (Instalment due Rs.4,000)

9. Mr. P Purchased 4 Cars for Rs.14,000 each 1.1.13 under the hire purchase system. The hire purchase price for all the 4 cares Rs.60,000 to be paid as Rs. 15,000 down payment and 3 equal instalments of Rs.15,000 each at the end of each year. Interest is charged at 5% p.a. The buyer depreciates the car at 10% p.a on straight line method.
   From the above particulars give journal entries in both the parties.

10. i. On 1-1-2008 Mr. Joel purchased machinery on hire purchase system. The payment is to be made Rs.40, 000 down(on signing of the contract) and Rs.40,000 annually for three years. The cash price of the machinery is Rs.1,49,000 and rate of interest is 6%. **Calculate the interest in each year's installment.**
   ii.Mr. Nakul purchased a machine on hire purchase system. As per terms, he is required to pay Rs.4000 down, Rs.2000 at the end of the first year, Rs.1500 at the end of the second year and Rs.2800 at the end of third year. Interest is charged at 5% p.a. Calculate the total cash price of the machine and the amount of interest payable on each instilment.

11. Marimuthu Brought 10 Cars for Rs.4,50,000 each 1.1.15 under the hire purchase system. The hire purchase price for all the 10 Cars Rs.5,00,000 to be paid as Rs. 1,00,000 down payment and 4 equal installments of Rs.1,00,000 each at the end of each year. Interest is charged at 5% p.a. The buyer depreciates the car at 10% p.a on straight line method. From the above particulars give journal entries in both the parties.
12. On 1-1-98 Z purchased machinery on hire purchase system. The payment is to be made Rs.4,000 down(on signing of the contract) and Rs.4,000 annually for three years. The cash price of the machinery is Rs.14,900 and rate of interest is 5%. Calculate the interest **in each year's installment.**
13. Mr. P purchased 4 cars for Rs 14,000 each on 1.1.92 under the hire purchase system. The hire purchase price for all 4 cars was Rs. 60,000 to be paid as Rs. 15,00 down payment and 3 equal installments of Rs. 15,000 each at the end of each year. Interest is charged at 5% p.a. the buyer depreciates the car at 10% p.a. on straight line method. From the above particulars give journal entries and relevant accounts in the books of Mr. P and in the books of Hire Vendor.

14. Revathi & co sells goods on H.P system at cost plus 60. From the following information prepare Hire Purchase Trading account to ascertain the profit and loss Account.

    1.1.2016 Goods with H.P customer(at H.P Price) Rs. 16,000

    31.12.2016 Goods sold on H.P during the year at H.P price Rs. 80,000

    Cash received during the year from customer Rs. 56,000

    Goods repossessed from customer (installments due Rs. 2,000) valued at Rs 300

    Goods with the H.P customer at H.P Price 36,000

15. VSS sells goods on Hire purchase system at cost plus 50%. From the following prepare Hire purchase Trading a/c.

Jan 1 Goods out on hire purchase system at hire purchase Price	Rs.64,000
Dec 31 Installments not due and unpaid	Rs.1,44,000
Installments due and unpaid	Rs. 8,000
The following transactions took place during the year:-	
a)Goods sold on H.P price	Rs.3,20,000
b) Cash received from customers at H.P price	Rs.2,24,000
c) Goods received back on default valued at	Rs. 1600
(Installment due Rs.4,000)	

(Or)

16. The Chennai Super King Trading Co. purchased a motor van from Mumbai Indians Motor Co. on hire purchase agreement on 1.1.2000, paying cash Rs.10,000 and agreeing to pay further three installments of Rs.10,000 each on 31st December each year. The cash price of the car is Rs.37,250 and the Mumbai Indian Motor co charges interest at 5% p.a. The Chennai Super King Trading Co. writes off 10% p.a as depreciation on the reducing balance method. Journalize the above in the books of both the parties.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed University Established Under Section 3 of UGC Act 1956)
Coimbatore –641021.
(For the candidates admitted from 2017 onwards)
DEPARTMENT OF COMMERCE

SUBJECT : FINANCIAL ACCOUNTING
SEMESTER : I
SUBJECT CODE : 17CMU101 CLASS : I B.Com. - B

UNIT- IV

Consignment: Features, Accounting treatment – Consignor and Consignee. Joint Venture: Accounting procedures: Joint Bank Account, Records Maintained by Co-venturer of (a) all transactions (b) only his own transactions. (Memorandum joint venture account).

Suggested Readings:

Text Book

1. Reddy and Moorthy. (2016). *Financial Accounting* Chennai. Margham Publications.

Reference Book

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Unit: IV
CONSIGNMENT ACCOUNTS

INTRODUCTION

Now-a-days it is quite common that manufacturers or wholesale dealers despatch goods to their agents at home and abroad to increase their sales. The knowledge of the agent of the local conditions where he resides proves useful in increasing the sales. Moreover it is very expensive for the manufactures to sell the goods directly either in home market or in foreign market. Therefore, different agents are appointed for different places.

MEANING OF CONSIGNMENT

It is common practice with practically all manufacturers or wholesalers to sell goods through agents both within the country and abroad. The goods are sent to be kept and sold on behalf of and at the risk of sender by the recipient. The person who forwards the goods for sale is consignor, the person to whom goods are forwarded for sale is **'consignee' and goods so sent are called 'Goods sent on Consignment'. Consignment is a** means of facilitating sale but is not actually a sale. Consignment is different from sales. A consignment is returnable if goods are not sold but in case of sale, the goods are not returnable except for special reasons, such as on account of damage or if below standard goods are supplied. When goods are sold to a person the property in them passes to that person, but when goods are consigned to a person the legal ownership of the goods remains with the consignor. Hence when goods are sold the relationship between two parties is that of a creditor and debtor but when the goods are consigned relationship **between the consignors and consignee is that of 'principal' and 'an agent'.**

DISTINCTION BETWEEN CONSIGNMENT AND SALE

The following points summarize clearly, the difference between a consignment and a sale.

Sr. Basis	Consignment	Sale
1. Property in goods i.e. Ownership	Ownership remains with the consignor	Ownership passed to the buyer
2. Relation	Consignee is the agent of the consignor	Buyer is debtor of seller until the account is settled.
3. Risk and damage	Consignee holds the goods at the risk of the consignor therefore subsequent damage to the goods is the loss of the consignor	Any subsequent damage to the goods is the loss of the buyer
4. Return of goods	Goods may be returned if not sold	Goods are not returnable except for special reasons e.g. wrong kind or defective goods etc.
5. Expenses after delivery	Recoverable from the consignor	To be borne by the buyer
6. Forwarding letter	Proforma invoice	Invoice

PROCEDURE TO BE FOLLOWED IN CASE OF CONSIGNMENT

When the goods are despatched by the consignor to the consignee, the consignor makes

out a statement known as 'proforma invoice' like a regular invoice giving details about the consignment and price which is normally at cost, but occasionally it may be at invoice price which is above the cost.

The consignee does not become liable for the payment of amount named in the invoice, but as matter of advance for goods, he usually makes payment in advance either by accepting a bill or by remitting a bank draft.

a) Account Sale : The consignee renders to his consignor regularly a statement showing sales, expenses incurred, commission charged and remittance made with the resultant **balance due by him. This statement is known as 'Accounts Sales'.**
b) On receipt of Account Sales the consignor shall make entries in his books of account and **complete the Consignment account and the Consignee's account.**
c) Advance on Consignment : It is common practice for the consignor to ask the consignee for some deposit as a security for goods sent on consignment to the consignee. It may be paid by any mode of payment–cheque, cash or even bills of exchange.
d) Commission : The consignee usually gets a commission for selling the goods on behalf of the consignor as a fixed percentage on sales. So more the sales more will be the commission earned by the consignor. But there are some other kinds of commission which are sometimes given to the consignee for extra burden and activities i.e. Del Credre Commission and over–riding Commission.
e) Del Credre Commission : Ordinarily the consignee is not responsible to the consignor for the payment of money by the purchasers but sometime he undertakes to guarantee payment due for all the goods he sells on credit and cash whether his customers pay him or not. In consideration of his this warranting the solvency of the buyers, he is paid an extra commission called a Del Credre Commission. The consignee will pay the consignor whether he himself receives payment from debtors or not. The commission is payable on total proceeds.

f) Over-Riding Commission: It is an extra commission in addition to ordinary commission. This commission is also calculated on sales like ordinary Commission. This commission is generally given by the consignor to the consignee to enhance the sale or to boost up the sales of a new product.

g) Performa Invoice : Since the goods sent on consignment cannot be treated as sales, the consignor does not prepare proper invoice. He simply prepares a Performa invoice and sends it to the consignee, along with the goods dispatched. This is prepared with a view to inform the consignee about price of goods, expenses incurred, mode of transportation and the minimum sale price at which the goods are to be sold.

h) Expenses : Expenses relating to consignment of goods are divided into two categories vis. (i) Non-recurring expenses and (ii) Recurring expenses.

i) Non-Recurring Expenses : All the expenses which are incurred for bringing goods to the godown of the consignee are non recurring in nature. Such expenses are generally **goods have reached the consignee's place or godown.**

They are recurring in nature because they may be incurred repeatedly by the consignor and consignee. The examples of recurring expenses incurred by the consignor are advertising, discount of bills, commission on collection of cheques, travelling expenses of salesmen, bad debts etc. The examples of recurring expenses incurred by the consignee are godown rent; godown insurance, sales promotion etc.

ACCOUNTING TREATMENT OF CONSIGNMENT TRANSACTIONS

(A) Books of the Consignor : The consignor opens three accounts in his ledger.

(1) Consignment Account : It is prepared to ascertain profit or loss on each consignment e.g. Consignment to Bombay Acount. It is not a personal account but a special Trading and Profit and Loss account or a nominal account.

(2) **Consignee's Account :** It is prepared to show the balance due to or from

consignee at a particular date. It is a personal account; and

(3) Goods sent on Consignment Account : It is prepared to show the amount of goods sent to the consignee. This is real account. The balance is credited to Purchase or Trading Account.

Journal Entries

1 (a) When the goods are sent on consignment at cost or at invoice price:

Consignment A/c Dr.

To Goods sent on consignment A/c

(Being goods sent on Consignment at cost)

(b) If goods are sent at invoice price then one more entry is needed for making the adjustments. The amount of this entry is the difference between the invoice price and the cost price. The entry will be:

Goods sent on consignment A/c Dr.

To Consignment A/c

2. When expenses are incurred by the Consignor:

Consignment A/c Dr.

To Bank A/c

(Being expenses incurred)

3. When the Account Sales is received from the Consignee :

(i) Consignee A/c Dr.

To Consignment A/c

(Being the total sales by consignee)

(ii) Consignment A/c Dr.

To Consignee A/c

(Being the expenses incurred by consignee and with his

Commission)

4. When the consignee remits the cash or bills:

Bank A/c/ Cash A/c/Bills receivable A/c Dr.

To Consignee A/c

(Being Cash/B/R received)

5. When bills is discounted with Bank:

Cash A/c/ Bank A/c Dr.

Discount A/c

To Bills receivable A/c

(Being B/R discounted with the Bank)

6. For Stock remaining unsold:

Consignment stock A/c Dr.

To Consignment A/c

(Being the value of stock plus proportionate expenses)

7. For Abnormal Loss of stock:

General Profit & Loss Account A/c Dr.

(with unrecoverable loss)

Insurance company A/c (with total recoverable loss) Dr.

To Consignment A/c (with total loss)

(For the abnormal loss of stock, amount recoverable and amount not recoverable)

ii) For Profit or loss on Consignment:

(i) If there is profit on Consignment

Consignment A/c Dr.

To general Profit and Loss A/c

(Being the Profit on consignment transferred to Profit and Loss A/c)

(ii) If there is loss on Consignment

General Profit and loss Account Dr.

To Consignment A/c

(Being the loss on Consignment transferred to Profit & Loss Account)

9. For settlement of account with consignee:

Bank/Bills recoverable Dr.

To Consignee A/c

(Being amount sent for final settlement)

The Goods sent on Consignment Account' which shows credit balance will now be transferred to the Trading Account. Then the entry is :

Goods sent on consignment Account Dr.

To Trading A/c

(Being the goods sent on consignment account transferred to trading account).

Ledgers

a) Consignment Account : Consignor prepares this account in his ledger. In it all transactions of a consignment are shown. This account discloses profit or loss incurred by each consignment. Debit side shows goods sent on consignment expenses incurred by consignor and consignee, consignees commission, bad debts etc. Credit side shows total sales (cash and credit), goods returned, and unsold stock etc. The difference between the debit and credit totals of Consignment Account is regarded as profit or loss which is transferred to the Profit and Loss Account and the Consignment Account stands closed. It is infact a nominal account and is just like Trading and Profit and Loss Account about which you must have studied earlier in final accounts. Therefore the principles applied to Trading and Profit and Loss Account hold good for this account also. Like Trading and Profit and loss Account all expenses and purchases are debited to this account and all sales and incomes are credited.

b) Goods sent on consignment Account : This account shows the goods transferred from the consignor to the consignee and goods returned by the consignee to the consignor. All the goods consigned by the consignor will be credited to this account and the goods returned by the consignee are debited to this account. The balance represents the cost of goods with consignee for sale, and is transferred to the Trading Account.

c) **Consignee's Account :** This account discloses what amount is due from the **consignee. The consignee's account is debited with all cash** and is credited by sales effected by the consignee. The various expenses incurred by the consignee, the commission charged by him as well as the advance remitted by him are credited to this account. This account usually shows a debit balance indicating the amount due from the consignee. At times it may show credit balance, if the advance given by the consignee is more than the sale affected by him. The balance revealed
by this account is shown in the balance sheet of the consignor.

Illustration 1 : Vimal Mills Ltd. sent 100 pieces of suiting to Lal Garments House of Delhi on consignment basis. The consignees are entitled to receive 5 per cent commission plus expenses. The cost of Vimal Mills Ltd. is Rs.
200 per suiting. Lal Garments House pays following expenses :

Railway Freight	Rs. 500
Godown Rent & Insurance	Rs. 1,000

Vimal Mills Ltd. draw on the consignees a bill for Rs. 10,000 which is duly accepted. Subsequently it is discounted for Rs. 9,500. The consignees informed the consignor of the sale of the entire consignment for Rs. 28,500. Show journal entries and ledger accounts in the book of the consignor.

Solution

Journal entries in the Book of Vimal Mills Ltd. (Consignor)

Date	Particulars		Dr.	Cr.
	Consignment A/c	Dr.	20,000	
	To goods sent on consignment A/c			20,000
	(100 pieces of suiting consigned to Lal Garments House at cost Rs. 200 per suiting)			
	Bill receivable A/c	Dr.	10,000	
	To Lal Garment House			10,000
	(Being of the bills of exchange received from consignee)			
	Cash Account	Dr.	9,500	
	Discount Account	Dr.	500	
	To bill receivable A/c			10,000
	(being bill discounted with the bank)			
	Lal Garment House	Dr.	28,500	
	To Consignment A/c			28,500
	(Being gross proceeds of the goods sold)			
	Consignment A/c	Dr.	1,500	
	To Lal Garment House			15,00
	(being the expenses incurred by Lal Garment house)			

Consignment A/c	Dr.	1,425	
To Lal Garment House			1,425
(Being Commission @ 5% on sales)			
Consignment A/c	Dr.	5,575	
To Profit & Loss A/c			5,575
(Being profit on consignment transferred)			
Goods sent on Consignment A/c	Dr.	30,000	
To Trading A/c			30,000
(Being goods sent on consignment A/c transferred to trading A/c			

Ledger Accounts

Consignment Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To goods sent on consignment A/c	20,000	By Lal Garment House (Sales)	28,500
To Lal Garments	1,500		
To Lal Garment House (commission)	1,425		
To Profit & Loss A/c (Profit on consignment)	5,575		
	28,500		28,500

Lal Garments House

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To consignment A/c	28,500	By bills receivable	10,000
		By Consignment A/c (Expenditure)	1,500
		By Consignment A/c (Commission)	1,425
		By Balance c/d	15,575
	28,500		28,500

Goods Sent on Consignment Account

Particulars	Rs.	Particulars	Rs.
To Trading A/c (transferred)	20,000	By Consignment A/c	20,000
	20,000		20,000

B. Books of the Consignee

Consignee need not pass any entry in his books on the receipt of goods by him or for expenses incurred by the consignor. He should, in principle, open the **Consignor's Account in his books and route** all the transactions through it in the following manner:

1. When cash is remitted or bill is accepted

   Consignor A/c Dr.

   To Cash A/c/Bills payable A/c

   (Being cash remitted or bills accepted).

2. When expenses are incurred

Consignor A/c Dr.

To Cash A/c

(Being expenses incurred on consignment)

3. When sale is made on Consignment

(i) For cash sales

Cash a/c Dr.

To Consignor's A/c

(ii) For credit sales

Debtor's A/c Dr.

To Consignor A/c

(Being goods sold on credit)

4. On remitting balance to consignor after commission

Consignor's A/c Dr.

To Cash A/c/Bank A/c

To Commission A/c

(Being cash remitted after commission)

Note : (A) For unsold stock lying with consignee, no entry is to be passed in his book of account.

(B) Consignee does not pass any entry for profit or loss in his books.

The consignee also prepares ledger accounts after passing all the journal entries. The Consignor's Account and Commission Account are the two important account prepared by the consignee in his books. Of course he will also do the postings to the other accounts such as Consignment Debtor's Account, Consignment Expenses Account and Bills Payable Account etc.

(a) **Consignor's Personal Account :** It is the main account of Consignee's books which is prepared for working out the amount due to the consignor.

Whatever amount he receives from sales of goods is credited to this account. All expenses incurred by the consignor in relation to consignment the commission due to him and the advance given by him to the consignor will be debited to this account. Further, if the consignee does not get del credre commission, the bad debts on account of credit sales are also debited to the Consignor's Account. The balance of this account indicates the amount payable to the consignor. This account is just the opposite of the Consignee's Account in the books of the consignor.

(b) Commission Account : It is nominal account. It shows the income earned by the consignee for the services rendered by him. All types of commission whether ordinary or special, due to the consignee is credited to this account. The commission account will be debited with bad debts if the consignee is to bear such loss because of del credre commission.

To continue with the same illustration No. 1, the consignee will have the following journal entries and ledger accounts:

Journal Entries

Date	Particulars	L.F.	Dr.	Cr.
	Vimal Mills Ltd.	Dr.	10,000	
	To Bills payable A/c			10,000
	(Being bill accepted)			
	Vimal Mills Ltd.	Dr.	1,500	
	To Cash A/c			1,500
	(Being expenses (incurred)			
	Cash A/c	Dr.	28,500	
	To Vimal Mills			28,500
	(Being Sales proceeds			

received on consignment)			
Vimal Mills Ltd.	Dr.	1,425	
To Commission A/c			1,425
(Being 5% commission on total sales)			
B/P A/c	Dr.	10,000	
To Cash A/c			10,000
(Being bill met on maturity)			

Ledger Account

Vimal Mills Ltd. (Consignor)

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Bill payable A/c	10,000	By Cash (sale proceeds)	28,500
To Cash A/c (expenses)	1,500		
To Commission A/c	1,425		
To Balance c/d	15,575		
	28,500		28,500

Illustration 2. :- B. Ghosh of Bombay sent on consignment to Alok of Calcutta 300 cases @ Rs. 125 on 1st July 2006 to be sold on his account and at his risk for 10% commission B. Ghosh incurred Rs. 3,000 expenses on dispatching the goods to Alok. On July 10, 2006 B. Ghosh received a bill for Rs. 20,000 at 2 months from Alok. On September 30, 2006 Alok sent on account sales disclosing that 200 cases have been sold for Rs. 160/–each and the remaining cases @ Rs. 150/–each. The account sales also discloses that Alok has incurred unloading expenses Rs. 600 and selling expenses Rs. 900. He sends a draft for the net amount due.

You are required to :

(a) Prepare the account sales; and

(b) Enter the transactions in the books of both the parties.

Solution

Account sales of 300 cases received from B. Ghosh to be sold on his account and risk.

200 cases @ Rs. 160		32,000	
100 cases @ Rs. 150		15,000	47,000
Less : Expenses			
Unloading expenses	600		
Selling expenses	900	1,500	
Commission @ 10% on sales		4,700	6,200
RS. 47,000 (Rs. 32,000 + Rs. 15,000)			
			40,800
Less Bill given as an advance on 10.7.1999			20,000
Balance (draft enclosed herewith)			
			20,800

E & O. E. Alok

Calcutta 30th Sept., 2006

Journal Entries in the Books of B. Ghosh (Consignor)

Journal

Date	Particulars	L.F.	Dr.	Cr.
2006 July1	Consignment A/c Dr. To goods sent on consignment A/c (Being 300 cases @ Rs. 125 sent on consignment to Alok)		37,500	37,500
July 1	Consignment A/c Dr. To Bank A/c (Being expenses incurred on account of goods sent on		3,000	3,000

	consignment)			
Sep 10	Bills receivable A/c	Dr.	20,000	
	To Alok			20,000
	(Being an acceptance for 2 months bill from Alok as an Advance)			
Sep 13	Bank Account	Dr.	20,000	
	To Bills Receivable A/c			20,000
	(Being the acceptance of Alok on the due date)			
Sep 30	Consignment A/c	Dr.	1,500	
	To Alok			1,500
	(Being unloading expenses Rs. 600 and selling expenses Rs. 900/– incurred by Alok)			
Sep 30	Alok	Dr.	47,000	
	To Consignment A/c			47,000
	(Being goods sent on consignment sold by Alok–200 cases @ Rs. 160 and 100 case @ Rs. 150)			
Sep. 30	Consignment A/c	Dr.	4,700	
	To Alok			4,700
	(Being commission payable to Alok @ 10% on Rs. 47,000)			
Sep 30	Bank A/c	Dr.	20,800	
	To Alok			20,800

	(Being amount due from Alok received)			
Sep 30	Consignment A/c	Dr.	300	
	To Profit & Loss A/c			300
	(Being profit on consignment transferred to Profit and Loss A/c)			
Sep.30	Goods sent on consignment A/c	Dr.	37,500	
	To Trading A/c			37,500
	(Being goods sent on consignment transferred to Trading A/c)			

Ledger

Consignment Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006					
July1	To good sent on consignment A/c	37,500	Sep 30	By Alok (Sales)	
				200 cases @ 160 32,000	
				100 case @ Rs. 150 15,000	47,000
July 1	To Bank A/c (Exp)	3,000			
Sep 30	To Alok (Expenses)	1,500			
Sep 30	To Alok (Commission)	4,700			
Sep 30	To Profit transferred to profit & loss a/c	300			
		47,000			47,000

Goods sent on Consignment Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006					
Sept30	To Trading A/c	37,500	July1	By Consignment to	37,500
Sept30	To Trading A/c	37,500	July1	By Consignment to Calcutta a/c	37,500
		37,500			37,500

ills Receivable Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006			2006		
Jul10	To Alok	20,000	Sep.13	By Bank A/c	20,000
		20,000			20,000

Alok

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006			2006		
Sept 30	To Consignment a/c (Sales)	47,000	Jul 10	By bills receivable	20,000
			Sep 30	By consignment to Calcutta C/c (Exp)	1,500
			Sep 30	By Consignment A/c (Commission)	4,700
			Sep 30	By Bank a/c	20,800
		47,000			47,000

Bank Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2006			2006		

July 1	To balance b/c		July 1	By consignment a/c	3,000
Sep 13	To Bills receivable	20,000			
Sep. 30	To Alok	20,800	Sep.30	By Bal. c/d	

Profit and Loss Account

		2006		
		Sep 30	By Consignment to Calcutta a/c	300

Entries in the Books of Alok (Consignee) Journal

Date	Particulars		Dr.	Cr.
Jul 10	B. Ghosh	Dr.	20,000	
	To Bills payable A/c			20,000
	(Being acceptance of bill for 2 months given)			
	Ghosh	Dr.	1,500	
	To Bank A/c			1,500
	(Being unloading expenses Rs. 600 and selling expenses Rs. 900 incurred on account of B. Ghosh)			
Sep 13	Bills payable A/c	Dr.	20,000	
	To Bank A/c			20,000
	(Being bill met on the due date)			
	Bank A/c	Dr.	47,000	
	To B. Ghosh			47,000
	(Being goods sold on behalf of B. Ghosh)			
Sep 30	B. Ghosh	Dr.	4,700	
	To Commission A/c			4,700
	(Being 10% commission on			

sales charged to B. Ghosh).

Sep 30 B. Ghosh Dr. 20,800

To Bank A/c 20,800

(Being bank draft sent to B. Ghosh for the amount due)

B. Ghosh

2006				
Jul 10	To Bills payable A/c	20,000	By bank A/c (sales)	47,000
	To Bank A/c (expenses)	1,500		
Sep 30	To commission A/c	4,700		
Sep 30	To Bank A/c	20,800		
		47,000		47,000

Bills Payable Account

2006					
Sep 13	To Bank Account	20,000	July 10	B. Ghosh	20,000

Commission Account

			2006		
			Sep 13	B. Ghosh	4,700

Bank Account

2006					
July 1	To Balance b/d	? ?		By B. Ghosh	1,500
	To B. Ghosh	47,000	Sep 13	By Bills payable	20,000
			Sep 30	By B. Ghosh	20,800
		?			

Illustration 3

Suresh and Co. of Bombay sent on consignment to Mahesh & Co. of Delhi 60 cases cutlery goods costing Rs. 175 per case. Expenses incurred by the consignor at Bombay were : Freight Rs. 275, insurance Rs. 55 and loading charges Rs. 20.

Suresh & Co. draw on Mahesh & Co. 2 months bills at sight for Rs. 7,000 which the latter accepts. The charges paid by Mahesh & Co. at Delhi were unloading Rs. 30, Storage Rs. 85, insurance Rs. 15, Commission is payable to Mahesh & Co. at 2% on all sales in addition to 1½% del credere commission.

The consignee sells for prompt cash 30 cases @ Rs. 225 per case; 25 cases @ Rs. 250 per case and the balance @ Rs. 280 per case. The account was settled immediately by means of a bank draft.

Write up the transactions and ledger acconts in the books of both the parties.

Solution

Consignor's Books Journal

Consignment to Delhi Account	Dr.	10,500	
To Goods sent on consignment Account			10,500
(60 cases consigned @ Rs. 175 per case)			
Consignment to Delhi Account	Dr.	350	
To Bank			350
(expenses on consignment paid)			

Bills receivable Acount	Dr.	7,000	
To Mahesh & Co.			7,000
(Being Expenses incurred by consignee)			
Consignment to Delhi Account	Dr.	130	
To Mahesh & Co.			130
(Being Expenses incurred by consignee)			
Mahesh & Co.	Dr.	14,400	
To Consignment to Delhi Account			14,400
(Sales affected by consignee)			
Consignment to Delhi Account	Dr.	504	
To Mahesh & Co.			504
(Being Commission due to the consignee including del credre commission on sales i.e. 2% and 1½% of Rs. 14,400)			
Bank Account	Dr.	6,766	
To Mahesh & Co.			6,766
(Being Received bank draft in settlement of the accounts)			
Consignment to Delhi Account	Dr.	2,916	
To General Profit & Loss a/c			2,916
(Being Goods sent on consignment account closed)			

Ledger Account

Consignment to Delhi Account

Dr. Cr.

July 1	To goods sent ton consignment a/c	10,500	By Mahesh & Co. (sales)	14,400
	To Bank (expenses)	350		
	To Mahesh & Co. 130 (Expenses)			
	To Mahesh & Co. 504 (Commission)	634		
	To General Profit & Loss A/c	2,916		
		14,400		14,400

M/s Mahesh & Co's Account

To consignment to Delhi A/c (sales)	14,400	By B/R A/c	7000
		By Consignment to Delhi Account Expenses 130 Commission 504	634
		By Bank a/c	6,766
	14,400		14,400

GOODS SENT ON CONSIGNMENT ACCOUNT

To Trading A/c (transfer)	10,500	By consignment to Delhi A/c	10,500

Consignee's Books

Journal

Suresh & Co.	Dr.	7,000	
To Bills payable accepted			7,000
(Suresh & Co's bill accepted)			
Suresh & Co.	Dr.	130	
To cash A/c			130
(Being cash sent on expenses)			

Cash account	Dr.	14,400	
To Suresh & Co.			14,400
(Sales effected on consignor's behalf)			
Suresh & Co.	Dr.	504	
To Commission A/c			504
(Commission @ 2% and del credre commission @ 1.5% on Rs. 14,400)			
Suresh & Co.	Dr.	6,766	
To Bank A/c			6,766
(Balance remitted vide draft No.__________ dt. ________)			

Ledger Accounts

M/s Suresh & Co's Account

To bills payable A/c	7,000	By cash (sales)	14,400
To cash (expenses)	130		
To Commission A/c	504		
To Bank A/c (draft)	6,766		
	14,400		14,400

Till now we have presumed that all the gods consigned are sold. But in practice we find that at the time of submitting the 'account sale', a part of goods consigned may still be unsold and may be lying with the consignee. In order to calculate the true profit or loss on consignment, the unsold stock should be valued and accounted for.

VALUATION OF STOCK ON CONSIGNMENT

Valuations of unsold stock is usually done at cost. Cost, in case of consignment stock, would include the cost at which the goods are consigned plus, the proportionate non-recurring expenses. All the non-recurring expenses, whether incurred by the consignor or by the consignees, are to be taken into account. In the absence of details of expenditure incurred by the consignee, all expenses incurred by him are to be taken as recurring expenses and thus are not to be considered in the calculation of closing stock. In other words, while valuing the closing stock we add such proportionate expenses to the cost price that have been incurred upto the time the goods are brought to the place of the consignee. Any other expenses paid by the consignor or the consignee after this point will not be considered as these expenses do not add to the value of the goods. Such expenses are godown rent, selling expenses, carriage outwards, godown insurance, discount etc.

Usually following expenses are added for calculation of closing stock : Carriage and Freight, Loading Charges, Custom Duty, Clearing Charges, Dock Dues, Carriage paid upto the Godown, and Unloading charges.

Following are the expenses which are not considered for calculation of closing stock : Godown rent, Discount, Bad Debts, Insurance of the goods in the Godown, and Selling and Distribution expenses.

One can notice that all expenses incurred by the consignor are considered for valuation of the closing stock. The problem arises only selecting recurring expenses in case of consignee.

The value of unsold stock affects the profit or loss on any consignment so its valuation and recording in the books of consignor is very important. It is shown on the credit side of Consignment Account for which the journal entry passed would be as :

Stock on Consignment A/c Dr.

To Consignment A/c
(Being the values of sold stock)

On the other hand the Consignee, will not pass any entry for the closing stock. It is because he is not the owner of the goods and does not pass any entry even when the goods are received or he returns the goods.

ACCOUNTING FOR LOSS OF GOODS

Goods sent on consignment may be lost or damaged in transit. The loss of goods may be either (i) normal or (ii) abnormal Treatment in the books of accounts will depend upon the nature of loss.

Normal Loss : Loss of goods is sold to be normal when it is natural, unavoidable and is due to inherent characteristic of the goods despatched like evaporation, sublimation etc. The amount of stock to be carried down is the proportion of the total cost that the number of units on hand bears to be the total number units as diminished by loss.

Deficiency of Stock : When there is deficiency of stock at the time of stock–taking and the consignee is under a liability to account for the missing stock, the entry will be:

Consignee Dr.

To Consignment a/c

(Being the deficiency of stock charged to the consignee).

If, on the other hand, he is not liable, the stock of the consignment will be shown at the gross figure and the consignment account will be debited with the loss in stock.

Abnormal Loss : There are the losses which are accidental and not natural like theft. Abnormal loss may occur in the godown of the consignee or in transit. Let us see the effect of abnormal loss on the closing stock under both situations.

When the abnormal loss occurs in the godown of the consignee the valuation of closing stock is not effected because the expenses incurred after they reach the godown of the consignee are not to be taken into account for the purpose. Hence, the normal formula will be followed for the valuation of closing stock.

Look at illustration 4 and see how the abnormal loss and the value of closing stock is calculated when the abnormal loss occurs in the godown of the consignee.

The treatment in accounts will depend upon whether the unforeseen loss has been insured against or not. In case of insurance the consignment account will be credited but the insurance companies or underwriter's account will be debited with the amount of loss (which shall be calculated like valuation of stock on consignment i.e. including proportionate non-recurring expenses of both the consignor and the consignee). If the goods are not insured, instead of Insurance Company's or Underwriter's Accounts being debited, Profit and Loss Account will be debited and consignment account will be credited. In this way the final net profit on consignment is not adversely affected.

Illustration 4 : X of Calcutta sent on 15th January, 2006, a consignment of 500 toys bicycles costing Rs. 100 each. Expenses of Rs. 700 met by the consignor. Y of Bombay spent Rs. 1,500 for clearance and the selling expenses were Rs. 10 per bicycle.

Y sold, on 4th April 2006, 300 pieces @ Rs. 160 per piece and again on 20th June 1999, 150 pieces @ Rs. 172.

Y was entitled to a commission of Rs. 25 per piece sold plus one fourth of the amount by which the gross proceeds less total commission thereon exceeded a sum calculated at the rate of Rs. 125 per piece sold. Y sent the amount due to X on 30th June 2006.

You are required to show the Consignment Account and Y's Account in the books of X.

Solution

Consignment Account

2006		Rs.	2006		Rs.
Jan 15	To goods sent on consignment a/c 500 @ Rs. 100	50,000	Apr 4	By Y–sale of 300 pieces @ Rs. 160	48,000
Jan 15	To Bank A/c – Exp.	700	June 20	By Y–sale of 150 Pieces @ 172	25,800
	To Y–Clearing Exp	1,500	June 30	By consignment stock A/c	5,220
Apr 4	To Y–selling Exp	3,000			
Jun 20	To Y – selling Exp	1,500			
Jun 30	To Commission A/c	12,510			
June 30	To Profit & Loss A/c Profit on Consignment	9,810			
		79,020			79,020

Y Account

2006		Rs.	2006		Rs.
Apr 4	To Consignment A/c	48,000	?	By consignment A/c (clearing exp.)	1,500
Jun 20	To Consignment A/c	25,800	Apr 4	By consignment A/c (selling exp.)	3,000
			June 20	By consignment A/c (selling exp.)	1500
			Jun 30	By consignment A/c commission (2)	12,510
				By Bank A/c	55290
		73,800			73,800

Working Note

(1) Valuation of Closing stock

50 pieces @ Rs. 100 each		Rs. 5,000
Plus : Proportionate Expenses		
Expenses incurred by X on 500 pieces	= Rs. 700	
Clearing expenses incurred by Y	= Rs. 1500	
Total Expenses	Rs. 2,200	
Therefore, expenses on 50 pieces 2200x50/500 =		Rs. 220
		Rs. 5,220

(2) Calculation of Commission Let

Total Commission of Y be a

a = No. of pieces sold x Rs. 25 + ¼ [Gross sale proceeds – (Rs. 125x No. of pieces sold] – (a)

a = 450 x Rs. 25 + ¼ [R. 73,800 – (Rs. 125 x 450] – a)

a = Rs. 45,000 + Rs. 17,500 – a

5a = Rs. 62, 550

Therefore : a = 62,550/5 = Rs. 12,510

INVOICING GOODS HIGHER THAN COST

Sometimes the goods sent on consignment are priced not at cost but above cost i.e. at selling or near selling price. The purpose is to hide the real profit on the consignment from the competitive eye of the consignee. It does not affect the profits of the consignor. Here a few adjusting entries in respect of goods sent on consignment and stock are to be made at the end of the financial year. The entries are as follows :

To bring down the invoice of the goods sent on consignment to cost, debit goods sent on consignment account and credit consignment account with the difference in the invoice and the cost price.

(i) Goods sent on consignment A/c Dr.

To consignment A/c

(Being the excess of Invoice price written back)

To adjust the value of the stock lying unsold with the consignee, debit the **consignment account and credit 'Stock Reserve Account' with the difference in** prices.

(ii) Consignment A/c Dr.

To Consignment Stock Reserve A/c

(Being the excess of invoice price or value over cost Price of unsold stock adjusted).

The balance of the goods sent on consignment account will be transferred to the Trading Account as indicated earlier. The stock on consignment and Stock Reserve Account will be closed and the balance will be shown in Balance sheet.

Next year the stock on consignment account will be transferred to the debit **of the 'Consignment Account' and Stock Reserve Account** will be transferred to the Consignment Account (of course at the end of the next year.)

Illustration 5

B. Ltd. of Delhi consigned 1,000 cases of milk powder to S. of Bombay. The goods were charged at proforma invoice value of Rs 10,000 including a profit of 25% on invoice price. The consignors paid Rs. 600 for freight and insurance. Consignee paid import duty Rs. 1,000, Dock Dues Rs. 200 and sent to the Consignors a bank draft of Rs. 4,000 as advance. They sold 80 cases for Rs. 10,500 and sent for the balance due to the consignors after deducting commission of 5% on gross sale proceeds. Show ledger accounts in the books of the consignor.

Dr.	Consignment		Cr.
2006	Rs.	2006	Rs.
To goods sent on consignment A/c 25% over cost	10,000	By S of Bombay (consignee)	10,500
To Bank Expenses	600	By Goods sent on consignment	2,500
To S of Bombay (Exp)	1,200	By Consignment stock	2,360
To consignment stock reserve A/c (25% of stock Rs. 200	500		
To Profit transferred To P & L A/c	2,535		
	15,360		15,360

Dr.	S of Bombay (Consignee)		Cr.
2006	Rs.	2006	Rs.
To Consignment A/c	10,500	By Bank	4,000
		By Consignment A/c Expenses 1200 Commission 525	1725
		By Bank	4,775
	10,500		10,500

Dr. Goods sent on Consignment Cr.

2006	Rs.	2006	Rs.
To consignment a/c	2,500	By Consignment a/c	10,000
To Trading a/c	7,500		
	10,000		10,000

Dr. Consignment Stock A/c Cr.

2006	Rs	2006	Rs.
To Consignment A/c	2,360	By balance c/d	2,360
	2,360		2,360

Dr. Consignment Stock Reserves A/c Cr.

2006	Rs.	2006	Rs.
To balance c/d	500	By consignment A/c	500
	500		500
		To balance b/d	500

Working Notes

Valuation of Stock

20 cases of Milk Rs. 100 = Rs. 2,000

Proportionate Expenses = Consignor expenses + Consignee Expenses = Rs. 600 (freight and insurance + Rs. 1000 (Import duty) + Rs. 200 (Dock Dues) = Rs. 1800 Expenses on unsold Stock

1800 x 20/100 = 360

Total value = Rs. 2000 + 360 = Rs. 2360

Adjustment Entries –

Excess of invoice price over cost price in case of goods sent on consignment = 10,000 x 25/100 = Rs. 2500.

JOINT VENTURE

INTRODUCTION

Complexities of a business as huge funds requirements, lack of technical expertise, sometimes make it difficult to undertake a business assignment individually like constructing a big building. The alternative available is that two or more persons join hand to take up that assignment. Joining hand may be
for finance, for technical know–how, for sharing risk etc. When two or more persons join together to carry out a specific business and share the profits on predetermined basis, it is known as a *Joint Venture*. Joint venture is defined as a partnership confined to a particular adventure, speculation, course of trade or voyage, and in which partners, either latent or known use no firm or social name, and incur no responsibility beyond the limits of the adventure. For example, Mr. John and Mr. Ibrahim agreed to construct a bridge for municipal corporation. They pool their resources and technical know how. After they completed this project, the profits arising thereof will be shared by them in proportion to their contribution. Whey they are undertaking this project, they are free to carry on their own business as usual unless otherwise agreed. As the project ends, the relationship between the parties i.e. co–ventures ceases. So life of joint venture depends on the duration in which a project completes. Joint venture is neither a partnership nor it is consignment.

MEANING OF JOINT VENTURE

A joint venture is usually a temporary partnership without the use of a firm name, limited to carrying out a particular business plan in which the persons concerned agree to contribute capital and to share profits or losses. The parties in a joint venture are known as co–venturers and their liability is limited to the adventure concerned for which they agree to contribute capital and share profits or losses. A joint venture may consist of a joint consignment of goods, speculation in shares, underwriting of shares or debentures, construction of a building, or any similar form of enterprise.

FEATURES OF A JOINT VENTURE

The main features of a joint venture are specifically made clear.

- Two or more person are needed.
- It is an agreement to execute a particular venture or a project.
- The joint venture business may not have a specific name.
- It is of temporary nature. So the agreement regarding the venture automatically stands terminated as soon as the venture is complete.
- The co–ventures share profit and loss in an agreed ratio. The profits and losses are to be shared equally if not agreed otherwise.
- The co–ventures are free to continue with their own business unless agreed otherwise during the life of joint venture.

DIFFERENCES BETWEEN JOINT VENTURE, PARTNERSHIP AND CONSIGNMENT

In joint venture and partnership some business is carried on by two or more persons and the profits are shared by all of them. But there are some basic differences between the two which are given below:

Partnership Venture	Joint Venture
–A Partnership firm always has a name	There is no need of firm's name.
–It is of a continuous nature.	It comes to an end as soon as the work is complete.
–Separate set of books have to be maintained.	There is no need for a separate set of books, the account can be maintained even in one of the co–venturer's books only.

–No partner can carry on a similar business.	The co–venturers are free to carry on the business of a similar nature.
–Though the registration of partnership is not compulsory desirable	There no need for registration at all.
–A minor can also be admitted to the benefits of the firm.	A minor cannot be a co–venturer as he is incompetent to enter into a contract.

Consignment and joint venture are in the nature of an agreement between different parties but there are many points of differences between the two. Some of these are given below :

Joint Venture	Consignment
–Number of co–ventures is usually two but it can also be more than two.	Normally two persons are involved, the consignor and the consignee.
–The relationship between co–venturers is that of partnership. Co–venturers are the owners.	The relationship between the consignor and the consignee is that of principal and agent.
–The relationship comes to an end as soon as the venture is completed.	The arrangement may continue for a long time.
–All the co–venturers contribute funds to a common pool.	The funds are provided by the consignor.
–It may be for sale of goods or for carrying on any other activity like construction of building, investment in shares etc.	It is generally connected with sale of movable goods.
–The profit is shared by all the co–venturers.	The profit belongs to the consignor only. The consignee is entitled only to his commission.

–There is joint ownership	The consignor owns the goods.

Joint venturers as mentioned earlier are beneficial under the situations where there are limitations which can not be overcome by single party. By launching joint venture two or more parties can pool their financial resources to undertake a very big venture. Where experience or technical knowledge is a limitation co–ventures can also pool their expertise. Since joint ventures are normally big projects, if under unfavorable conditions there are losses then these losses are also shared thus loss to individual party is lessened.

METHODS OF RECORDING JOINT VENTURE TRANSACTIONS

Joint venture accounts can be kept under any of the following three methods :

A) Each co–venture records the transaction in his own books and opens "Joint Venture Account" and accounts of his fellow partners.

B) One common Joint Venture Account on memorandum basis is prepared to find the profit or loss made on trading. It is not a part of the double entry system. Under this system each one of the partners open only one account which is of the nature of personal account. The account is called. "Joint venture with ....a/c."

C) Venturers agree to keep a separate set of books and a person is made incharge of recording of all transactions. Generally this method is not adopted.

A) Each co-venturer records the transactions

Under this system the "Joint Venture Account" is opened and debited with the value of goods bought and expenses incurred. Cash account or the party which has supplied the goods or incurred the expenses will be credited. When the sales proceeds are received, the party receiving it, will debit cash (for Debtors) account and credit the Joint Venture Account. The other parties will debit the recipient party and credit the Joint Venture Account.

Sometimes, a bill of exchange is drawn by one of the parties and is discounted. In such a case the discount on the bill should be charged to Joint Venture Account. Joint Venture Account will now show the profit or loss on trading. Under this system, each (Joint venturer) partner will open two acconts i.e. (i) Joint Venture Account (ii) The account of other parties.

Journal Entries : The following journal entries will be passed

1) For Investment in Joint Venture

Joint Venture A/c Dr.

To Cash/Good A/c

(Being the amount of goods supplied or cash put in for Joint Venture)

2) As goods are supplied by the Co–venturer or cash is invested in Joint Venture by him

Cash A/c (For cash sent) Dr.

Joint Venture A/c Dr.

To Co–venturer A/c (for goods sent)

(Being goods supplied or cash invested by the other partner)

3). For recording sale of joint venture goods

Cash A/c Dr.

To Joint Venture A/c

(Being Sale of goods made)

3) On sale of joint venture goods by the other party

Co–Venturer A/c Dr.

To Joint Venture A/c

(Being Joint Venture goods sold by the other partner)

5) a)For receipt of Bill of Exchange from the other partner

Bills receivable A/c Dr.

To Co–Venturer A/c

(Being bill receivable received)

b) For discounting the bill of exchange

Bank A/c Dr.

Joint Venture A/c Dr.

To Bills Receivable A/c

(Being bill discounted and discounting charges debited to Joint Venture A/c).

6) Entries in the books of other partner Acceptor's books regarding acceptance of bills of exchange

Co–venturer A/c Dr.

To Bills Payable A/c

(Being acceptance given)

7) On discounting the bills of exchange by other party i.e. drawer

Joint venture A/c Dr.

To Co–Venturer A/c

8) On commission charged under Joint Venture

Joint Venture A/c Dr.

To commission A/c

9) On Commission charged by other partner

Joint Venture A/c Dr.

To Co–Venturer A/c

(Being Commission on sale effected by other partners)

10) When some products are left unsold and transferred to his own stock.

Purchase A/c Dr.

To Joint Venture A/c

(Being the unsold goods taken)

11) If the other partner has taken the unsold goods, the entry will be:–

The Co–venturer A/c Dr.

To Joint Venture A/c

(Being the unsold goods taken by the other partner)

12) Now Joint Venture Account will be closed. If it shows profit then the profit will be divided in the agreed ratio. The entry will be

Joint Venture A/c

To P & L A/c (own share)

To Co–venturers A/c (their share)

(Being the profit on Joint Venture shared by the parties)

Format of Two accounts to be maintained

Joint Venture Account

Dr. Particulars	Amount Rs.	Particulars	Amount Rs. Cr.
To Cash A/c (purchased) To Cash A/c (Expenses) To Purchase A/c (Material supplied) To Outstanding Expenses A/c To Profit transferred to: Profit & Loss A/c Co–venturers A/c		By Cash A/c By Co–venturer A/c (Goods taken over)	

Co-venturer's Personal Account

Particulars	Rs.	Particulars	Rs.
To Joint Venture A/c		By Bills Receivables	
(Good taken over)			
To Cash a/c		By Joint Venture A/c	

Illustration – 1

X and Y entered into Joint Venture to sell a consignment of timber sharing profits and losses equally. X provides timber from stock at mutually agreed value of Rs. 50000. He pays expenses amounting to Rs. 2500. Y incurs further expenses on cartage, storage and collieage of Rs. 6500 and receives cash for sales Rs. 30,000. He also takes over goods to the value of Rs. 10000 for his own use. At the close, X takes over the balance stock in hand which is valued at Rs. 11000.

Pass Journal Entries to record the above transactions and open the necessary ledger accounts in the books of X and Y.

Journal entries in the Books of X

Particulars		L.F.	Dr. Rs.	Cr. Rs.
Joint Venture A/c	Dr.		52,500	
To Purchase A/c				50,000
To Bank A/c				2,500
(Being timber provided and expenses incurred)				
Joint Venture A/c	Dr.		6,500	
To Y				6,500
(Being expenses incurred by Y)				
Y	Dr.		30,000	
To Joint Venture a/c				
(Being the sale proceeds by Y)				30,000
Y	Dr.		10,000	
To Joint Venture A/c				10,000
(Y takes over the goods for his use)				
Purchase A/c	Dr.		11,000	
To Joint Venture A/c				11,000
(Being unsold goods taken)				
Y	Dr.		4,000	
Profit and Loss A/c	Dr.		4,000	
To Joint Venture A/c				8,000
(Being the loss on Joint Venture shared equally)				
Bank A/c	Dr.		37,500	
To Y				37,500
(Being draft received from Y)				

Ledger Account

Joint Venture A/c

Particulars	Rs.	Particulars	Rs.
To Purchase	50,000	By Y (sale proceeds)	30,000
To Bank (expenses)	2,500	By Y (goods for his use)	10,000
To Y (expenses)	6,500	By Purchases (goods)	11,000
		By Y (loss)	4,000
		By Profit and Loss A/c	4,000
		(Ratio being 1:1)	
	59,000		59,000

Y's Account

Particulars	Rs.	Particulars	Rs.
To Joint Venture (Sale)	30,000	By Joint Venture (Expenses)	6,500
To Joint Venture (goods)	10,000	By Bank	37,500
To Joint Venture (goods)	4,000	(Final Settlement)	
	44,000		44,000

Journal Entries in the Books of Y

Particulars		L.F.	Dr. Rs.	Cr. Rs.
Joint Venture A/c	Dr.		52,500	
To X				52,500
(Being the goods supplied and expenses incurred)				
Joint Venture A/c	Dr.		6,500	
To Bank				6,500
(Being the expenses paid)				

Bank	Dr.	30,000	
To Joint Venture A/c			30,000
(Being the receipt of sale proceeds)			
Drawing A/c	Dr.	10,000	
To Joint Venture A/c			10,000
(Being the goods withdrawn for own use)			
X	Dr.	11,000	
To Joint Venture A/c			11,000
(Being the taking over the balance stock in hand by X)			
X	Dr.	4,000	
Profit and Loss A/c	Dr.	4,000	
To Joint Venture A/c			8,000
(For sharing of loss in equal ratio)			
X	Dr.	37,500	
To Bank			37,500
(Being the draft remitted X)			

Ledger A/cs

Joint Venture A/c

Dr. Cr.

Particulars	Rs.	Particulars		Rs.
To X (goods supplied)	50,000	By Bank (by sales)		30,000
To X (expenses)	2,500	By Drawing of goods		10,000
To Bank (expenses)	6,500	By (Balance stock taken by X)		11,000
		By X	4000	
		P & LA/c	4000	
		(Loss)		8,000
	59,000			59,000

X's A/c

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To Joint Venture A/c	11,000	By Joint Venture A/c (Good and expenses)	52,500
To Joint Venture A/c (Loss)	4,000		
To Bank	32,500		
	52,500		52,500

B) Memorandum Joint Venture Account Method

In the method discussed above each co-venturer records all transactions relating to the joint venture in the Joint Venture Account opened in his books. But, under the Memorandum Joint Venture Account Method each co-venturer will record only those transactions relating to the joint venture which are directly concerned with him and not those of others.

a) Under this method each co-venturer opens a Joint Venture Account including the name of the other co-venturer. The heading of the account is 'Joint Venture with (name of coventurer) Account'. The Joint Venturer with (name of co-venturer) Account is a personal account and it does not show any profit or loss. The following entries will be made in this account :

i) Joint Venture with..........................Account Dr. To

cash/Bank/Creditors Account

(Being payments by cheque or cash or liabilities incurred on Joint Venture)

ii) Cash/Debtors Accounts Dr.

To Joint Venture............Account

(Being sale Cash/Credit made on account of Joint Venture)

b) A separate 'Joint Venture Memorandum Account' is prepared to ascertain profit or loss in Joint Venture. It is just like profit and loss account, all the expenses and losses are debited to it and all incomes and gains are credited to it. All the items of personal accounts will also appear on the same side of 'Joint Venture Memorandum Account'. The balance of Joint Venture Memorandum Account shows profits or loss on joint venture and each party makes an entry for his share of profits or losses. The journal entry is as under :

Joint Venture with................Account Dr.

To Profit and Loss Account

(Being profit earned on Joint Ventures)

Or

Profit and Loss Account Dr.

To Joint Venture with................Account

(Being loss effected on Joint Venture)

Illustration - 2

A and B entered into a Joint venture involving the buying and selling of old railway material with an agreement to share profit or loss equally. (*The amount is in Rs. Hundreds*). The cost of the material purchased was Rs. 30,000 which was paid by A, who drew bill of Rs. 20,000 on B at three months' period.

The bill was discounted by A at cost of Rs. 160. The transactions relating to the ventures were:

1) A paid Rs. 200 for carriage, Rs. 600 for commission on sales and Rs. 100 for travelling expenses (ii) B paid Rs. 80 for travelling expenses and Rs. 120 for sundry expenses (iii) Sales made by A amounted to Rs. 21,400 less allowance for faulty goods Rs. 400 and (iv) Sales made by B were Rs. 15,000.

The remaining goods were retained by A and B for their private use and these were charged to them as Rs. 1600 and Rs. 2400 respectively. A was credited with sum of Rs. 300 to cover the cost for warehousing and insurance. The expenses in connection with the discounting to the bill were to be treated as a charge against the venture. Prepare the ledger accounts in the books of both the parties and also the memorandum joint venture account.

Solution

Dr. Memorandum Joint Venture A/c Cr.

(Rs. In 000)

Particulars	Rs.	Particulars	Rs.
To Materials	30,000	By Sales	36,000
To discount on Bill	160	(21000 + 15000)	
To carriage	200	By stock taken by	
To Commission	600	A 1600	4,000
To Travelling (100+8)	180	B 2400	
To Sundry expenses	120		
To Warehousing expenses	300		
To Profit A : 4220			
B : 4220	8,440		
	40,000		40,000

In the Books of A

Joint Venture with B A/c

(Rs. in 000)

Dr. Cr.

Particulars		Rs.	Particulars	Rs.
To Bank (material)		30,000	By Bank (sales)	21,000
To discount on bill		160	By Stock taken	1,600
To Bank			By Balance c/d	12,980
Carriage	200			
Commission	600			
Travelling exp.	100			
Warehousing	300	1,200		
By Profit & Loss A/c		4,220		
		35,580		35,580
To Balance b/d		12,980		

In the Books of B

Joint Venture with A A/c

Dr. Cr.

(Rs. in '000)

Particulars		Rs.	Particulars	Rs.
To Bank			By Bank (Sales)	15,000
Travelling Exp.	80		By Stock taken	2,400
Sundry Exp.	120	200		
To Profit & Loss A/c		4,220		
To Balance c/d		12,980		
		17,400		17400
			By Balance b/d	12980

Sometimes the co–venturers invest money in Joint venture business and receive back the amounts on different dates. It is quite usual for them to agree to calculate interest at a certain rate. Each co–venturers is entitled to receive interest on the amounts invested by him and pay interest on the amounts received by him. Only net interest receivable from or payable to the conventurer is recorded in the joint venture account. Thus, the net amount of interest is also taken into amount before ascertaining the profit or loss on joint venture.

Illustration 3

A and B enter into a joint venture sharing profits and losses equally. A purchased goods for Rs. 5,000 for cash on January 1, 1999. On the same day Bought goods for Rs. 10,000 on credit and spend Rs. 1,000 on freight etc. Further expenses were incurred as follows :

On 1.2.1999	Rs. 1,500 by B
On 12.3.1999	Rs. 500 by A

Sales were made by each one of them as follows :

15.1.1999	Rs. 3,000 by A
13.1.1999	Rs. 6,000 by B
15.2.1999	Rs. 3,000 by A
1.3.1999	Rs. 4,000 by B

Creditors for goods were paid as follows

1.2.1999	Rs. 5,000 by A
1.3.1999	Rs. 5,000 by B

On March 31, 1999 the balance of stock was taken over by B at Rs. 9,000. The accounts between the co–venturers were settled by cash payment on this date. The co–venturers are entitled to interest at 12% per annum. Prepare necessary ledger accounts in the books of venturers as per Memorandum Joint Venture Account Method.

Solution

Memorandum Joint Venture Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To A (cost of goods)	5,000	By A (sales)	6,000
To B (Cost of goods)	10,000	By B (sales)	10,000
To B (Freight etc.)	1,000	By B (interest)	50
To A (expenses)	500	By B (stock taken)	9,000
To B (expenses)	1,500		
To A (interest)	135		
Profit transferred			
A : 3457			
B : 3458	6,915		
	25,050		25050

Joint Venture with B Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1999			1999		
Jan. 1	To Bank A/c (Purchase)	5,000	Jan 15	By Bank A/c (Sales)	3,000

Feb. 1	To Bank A/c (Creditors)	5,000	Feb. 15	By Bank A/c (Sales)	3,000
Mar. 1	To Bank A/c (Expenses)	500	Mar. 15	By Bank A/c (Final settlement)	8,902
Mar. 31	To Interest a/c	135			
Mar. 31	To Profit & Loss A/c	3,457			
		14,092			14,902

B's Books

Joint Venture with A Account

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
1999			1999		
Jan 1	To Bank A/c (Freight)	1,000	Jan 31	By Bank (Sales)	6,000
Feb. 1	To Bank A/c (Exp)	1,500	Mar. 31	By Bank (sales)	4,000
Mar. 1	To Bank A/c (Crs)	5,000	Mar. 31	By Goods A/c Stock taken over	9,000
Mar. 31	To Profit & Loss A/c	3,458	Mar. 31	By Interest A/c	50
Mar. 31	To Bank A/c (Amt. Paid in Final Statement)	8,092			
		19,050			19,050

Calculation of Interest :

Payment by A

Date	Amount	Month	Product (Rs.)	
1.1.99	Rs. 5,000	3	15,000	(5,000 × 3)
1.3.99	Rs. 500	1	500	(500 × 1)
1.2.99	Rs. 5,000	2	10,000	(5,000 × 2)
			25,000	

$$\text{Interest} = 25{,}500 \times \frac{12}{100} \times \frac{1}{12} = \text{Rs. } 255$$

Receipts by A

15.1.99	Rs. 3,000	2.5	7,500	(3,000 × 2 ½)
15.2.99	Rs. 3,000	1.5	4,500	(3,000 × 1 ½)
			12,000	

Interest = 12,000 × 12/100 × 1/12 = 120

Net Interest due = 265 – 120 = Rs. 135

Payment by B

1.1.99	Rs. 1,000	3	3,000
1.2.99	Rs. 1,500	2	3,000
1.3.99	Rs. 5,000	1	5,000
			11,000

Interest = 11,000 × 12/100 × 1/12 = Rs. 110

Receipts by B

31.1.99	Rs. 6,000	2	12,000
1.3.99	Rs. 4,000	1	4,000
			16,000

Interest = 16,000 × 12/100 × 1/12 = Rs. 160

Net Interest due from B = 160 – 110 = Rs. 50

C) Separate Books

Recording of transactions is done not in books of parties but in a separate set of books. Co–venturer first contributes to a common bank account and then all payments are made through it. Accounts of parties are also opened. Profit or Loss on Joint Venture is transferred to the respective partner's accounts in due ratios. Finally, the books are closed with the close of the venture.

Three main accounts opened under separate set of accounts are:

1. Joint Venture Account
2. Joint Bank Account, and
3. Personal Capital Accounts of Joint Venturers.

The following entries will be passed under this system

1) When cash is invested by Joint Venturer

Joint Bank A/c Dr.

To Capital Accounts of Joint Venturers.

(Being cash invested by Joint Venturers and deposited into the Bank)

2) When purchases are made for joint venture out of bank A/c

Joint Venture A/c Dr.

To Joint Bank A/c

(Being Purchase made for Joint Venture)

3) When expenses are incurred for joint venture out of Bank A/c

Joint Venture A/c Dr.

To Joint Bank A/c

(Being expenses incurred for Joint Venture Account)

4) When sales are made

Joint Bank A/c Dr.

To Sales

(Being sales made and receipts from sales deposited into Bank)

5) When some products are left unsold and are taken away by Joint Venturers

Capital accounts of Joint Venturer A/c Dr.

To Joint Venture A/c

(Being unsold stock taken by Joint Venturers)

6 (a) For Profit on Joint Venture account

Joint Venture A/c Dr.

To capital accounts of Joint Venturers A/c

(Being profit earned on Joint Venturers)

6 (b) The reverse entry will be passed in cases of losses on Joint Venture.

Illustration 4

X and Y enter into joint venture to underwrite public issue of Reliance Ltd. They agree to guarantee the subscription at par on 1,00,000 shares of Rs. 10 each of Reliance Ltd. and sharing profits and losses in the ratio of 2:3. The terms with the company are 4.5 % commission payable in cash and 6,000 fully paid shares of the company. They agreed to pay expenses in connection with the issue of shares. The expenses incurred are advertisement Rs. 5,000; Printing and stationery Rs. 2,000 and postage Rs. 600. All expenses are paid by X. The public subscribed to 88,000 shares only. The remaining shares under the agreement were duly taken by X and Y who provided the necessary cash equally. The commission is received in cash and is shared by the co–venturers in the ratio of 4:5. The entire holding of the joint venture is then sold in the market through brokers as follows : 25% at a price of Rs. 9 per share, 50% at a price of Rs. 8.75 per share, 15% at a price of Rs. 8.50 per share and the remaining 10% is taken over by A and B equally at an agreed price of Rs. 8 per share. Prepare the Joint Venture Account, Joint Bank Account, Shares Account and the Accounts of X and Y showing the final statement.

Solution

Joint Venture Account

Dr. Cr.

Particulars		Rs.	Particulars	Rs.
To			By Joint A/c (commission)	45,000
Advertisement	5000			
Printing	2000		By shares a/c (commission)	60,000
Postage	600	7,600		
To Shares A/c (Loss on sale)		23,400		
To profit transferred to				
X:	29,600			
Y:	44,400	74,000		
		1,05,000		1,05,000

Joint Bank Account

Dr. Cr.

Particulars	Rs.	Particulars	Rs.
To X (contribution)	60,000	By Shares A/c	1,20,000
To Y (contribution)	60,000	By X (commission)	20,000
To Joint Venture	45,000	By Y (commission)	25,000

(Commission)				By X (final settlement)	70,000
To Shares A/c (sale for				By Y (final settlement)	72,000
cash)	25%	40,500			
	50%	78,750			
	15%	22,950	1,42,200		
			3,07,200		3,07,200

Share Account

Particulars	Rs.	Particulars	Rs.
To Joint Bank a/c	1,20,000	By Joint Bank A/c (Sale of Shares)	40,500
To Joint Venture (commission)	60,000	By Joint Bank A/c (sale of shares)	78,750
		By Joint Bank A/c (Sale of shares)	22,950
		By X (shares taken over)	7,200
		By Y (shares taken over)	7,200
		By Joint Venture A/c	23,400
	1,80,000		1,80,000

X's Account

Particulars	Rs.	Particulars	Rs.
To Joint Bank A/c (Commission)	20,000	By Joint Venture A/c (Expenses)	7,600
To Shares A/c	7,200	By Joint Bank A/c (Commission)	60,000
To Joint bank A/c (Final Settlement)	70,000	By Joint Venture A/c (Profit)	29,600
	97,200		97,200

Y's Account

Particulars	Rs.	Particulars	Rs.
To Joint Bank A/c (Commission)	25,000	By Joint Bank A/c (Commission)	60,000
To Shares A/c	7,200	By Joint Venture A/c (Profit)	44,400
To Joint Bank A/c (Final Settlement)	72,200		
	1,04,400		1,04,400

Working Notes

1. Distribution of commission received in cash 4.5 % of Rs. 10,00,000 = Rs. 45,000
   Xs shares 4/9 x 45,000 = Rs. 20,000 Y's shares 5/9 x 45,000 = Rs. 25,000

2. Treatment of shares received
   Shares received by way of commission 6,000
   Shares not subscribed by public 12,000
   Total Number of shares received 18,000

a) Sold for cash
   25% of 18,000 i.e. 4,500 shares sold @ Rs. 9 per share Rs. 40,500
   50% of 18,000 i.e. 9,000 shares sold @ Rs. 8.75 per share Rs. 78,750

15% of 18,000 i.e. 2,700 shares sold @ Rs. 8.50 per share Rs. 22,950.

b) Dividend amongst X and Y

10 % of the remaining shares i.e. 1,800 shares are taken over equally by X and Y at an agreed price of Rs. 8 per share.

X : 900 shares @ Rs. 8 per share = Rs. 7200

Y : 900 shares @ Rs. 8 per share = Rs. 7200

KEYWORDS

Joint Venture: When two or more persons joint together to carry out a specific business and share the profits or losses on predetermined basis, it is known as a joint venture.

Co-venturer Account: It is a personal account and debited with sales made by the co–venturer or goods taken by him and is credited with assets given by him for the venture and expenses paid by him.

Memorandum Joint Venture Account: The profit or loss of the venture is computed in an account which is not part of the double entry mechanism and is termed as Memorandum Joint Venture Account.

POSSIBLE QUESTIONS
PART B (2 MARKS)

1. Define 'Consignment'. What is the difference between a consignment and a sale of goods?

1. What is mean by consignor?
2. What is mean by consignee?
3. Give journal entries in respect of consignment transactions in the books of consignor and consignee.
4. Write short notes on Del Credere Commission
5. Valuation of Unsold Stock in Consignment
6. Define a joint venture and give its various features.
7. Distinguish joint venture from consignment and partnership.
8. Give the various journal entries to be passed in case where separate set of books are maintained for recording joint venture transactions.
9. What is a Memorandum Joint Venture Account? Give the various journal entries when accounts are maintained under this method.
10. Give the various journal entries to be passed in case where no separate set of books are maintained for recording joint venture transactions.

PART C (8 MARKS)

1. On 1st July, 2006 Radio House of Delhi consigned 200 Radios to Banerjee Bros. of the Calcutta. The cost of each radio was Rs. 400. Radio House paid Rs. 5,000 for freight and insurance. On 7 July, 2006 Banerjee Bros. accepted a 3 months bill

drawn upon them by Radio House for Rs. 50,000, Banerjee Bros. paid Rs. 2,200 as rent and Rs. 1,300 for advertisement and upto 31st December, 2006 (on which date Radio House close their books) they sold 180 radios at Rs. 500 each. Banerjee Bros. were entitled to a commission of 5% on sales.

i. Give Journal entries and prepare necessary accounts to record the above transactions in the books of the parties.

2. Arun sends goods on consignment to Seemu. The terms are that Seemu will receive 10% commission on the price (which is cost plus 25%) and 20% of any price realised above the invoice price. Seemu will meet his expenses himself, goods to be sent freight paid.

   i. Arun sent goods whose cost was Rs. 16,000 and spent Rs. 1,500 on freight, forwarding, etc. Seemu accepted a bill for Rs. 16,000 immediately on receiving the consignment. His expenses were Rs. 200 as rent and Rs. 100 as insurance. Seemu sold ¾ of the goods for Rs. 19,500. Part of the sales were on credit and one customer failed to pay Rs. 400. Give Consignment Account and Seemu's Account in the books of Arun and Arun's Account in the books of Seemu.

3. Dutt of Delhi makes sewing machines at a cost of Rs. 120. On 1st January, 1994 he consigned 200 of them, invoice price Rs. 150 to Khan at Madras to be sold on behalf of Dutt, Khan receiving a commission of 8% on

   i. sales plus 2% del credere and 10% of any profit that may remain on the basis of invoice price. Khan was to bear all expenses after the machines reach his godown. Dutt incurred Rs. 500 as forwarding expenses and insurance.

ii. 10 machines were damaged during transit for which Dutt received Rs. 1,050 from insurers. Khan took delivery of remaining machines paying Rs. 1,140 as freight, octroi duty, cartage, etc. (Subsequently he also paid Rs. 500 as storage and other charges).

iii. 4Khan sold 160 machines @ Rs. 180; 100 of them on credit out of which the proceeds of 5 machines could not be received because of the disappearance of the customer. Khan remitted the amount due to Dutt.

iv. You are required to prepare the Consignment to Madras A/c and Khan's A/c in Dutt's Books.

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 sales 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 should receive Rs. 2,500 as interest.
   i. 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).
   ii. Give journal entries in the books of Ramesh and Suresh and also prepare the necessary ledger accounts in their books.
5. Vikas and Vishal entered into a joint venture of underwriting 1,00,000 shares of

Rs. 10 each at par issued by a joint stock company. The consideration for underwriting the shares was 2,500 other shares of Rs. 10 each fully paid to be issued to them.

i. The public took up 90,000 shares and the remaining 10,000 shares of the guaranteed issued were taken up by Vikas and Vishal who provide cash equally for the purchase of remaining shares. The entire share holding of the joint venture was then sold through other brokers: 50% at a price of Rs. 10 less brokerage 50 paise per share; 20% at Rs. 9.50 less brokerage 50 paise per share and the balance were taken up by Vikas and Vishal equally at Rs. 9 per share. Expenses on account of joint venture were: advertisement Rs. 750 and other expenses Rs. 250. You are required to prepare; (a) Joint Venture Account; (b) Joint Bank Account; and (c) Accounts of Vikas and Vishal.

6. A and B entered into a joint venture for the purchase and sale of materials auctioned by the Government. A agreed to provide funds for the purchase of materials, and B to devote his time. The profit and loss was to be shared equally, subject to a credit of Rs. 500 to A by way of interest on his capital. A purchased materials worth Rs. 50,000; and drew a bill at two months for Rs. 20,000 on B which was duly accepted by the latter. The bill was discounted at a cost of Rs. 260. The various expenses relating to the venture were:

   a) A paid Rs. 250 for carriage, Rs. 100 for brokerage, and Rs. 50 for miscellaneous expenses.

   b) B paid Rs. 300 for commission, Rs. 200 for insurance, and Rs. 100 for miscellaneous expenses.

   The total sales amounted to Rs. 72,000 (cash). There was, however, some stock of unsold goods which was taken over by both the parties, at Rs. 200 by A and at Rs. 300 by B. B paid the amount due to A. The expenses in connection with the discounting of the bill were to be treated as a charge against the venture. Prepare Joint Venture Account in the books of A and B separately and a Memorandum Joint Venture Account.

7. C of Calcutta and D of Delhi entered into a joint venture for the purpose of buying and selling second–hand motor cars, C to make purchases and D to effect sales. The profit or loss was to be shared as to C two–fifths and D three–fifths. A sum of Rs. 10,000 was remitted by D to C towards the venture.

   C purchased 10 cars for Rs. 8,000, paid Rs. 4,350 for their reconditioning and sent them to Delhi. His other expenses were –Buying Commission 2½ per cent and Sundry Expenses Rs. 350.

   D took delivery of the cars by paying Rs. 750 for railway freight and Rs. 375 for octroi. He sold four cars at Rs. 1,600 each, two at Rs. 1,800 each and three at Rs. 2,250 each. He retained the remaining car for himself at an agreed value of Rs. 2,100. His expenses were–Insurance Rs. 150; Garage Rent Rs. 250; Brokerage Rs. 685; Sundries Rs. 450.Each party's ledger contains a record of his own transactions on joint account. Prepare a statement showing the result of the venture and the account of the venture in each party's ledger as it will finally appear, assuming that the matter was finally settled between the parties.

Unit V : Accounting for Partnership - Valuation of Goodwill – Calculation of Profit Sharing Ratio – Admission – Retirement of a Partner.

PARTNERSHIP ACCOUNTS

INTRODUCTION

The Indian Partnership Act of 1932 contains the main provisions which are applicable to partnership firms working in India. According to this Act "Partnership is the relation between persons who have agreed to share the profit of the business carried on by all or any of them acting for all". Individually the persons who work in the firm are called partners and the name with which all partners work collectively is called the firm's name. For example, A, B and C working in a firm will be called partners and 'ABC & Co.', the name with which these partners work collectively will be called firm's name.

ESSENTIAL FEATURES OF A PARTNERSHIP

The following are the essential features of a partnership firm:

i) Persons: In order to constitute a partnership firm, there must be at least two persons. The maximum number in partnership is 20 in case the firm is doing ordinary business and 10 in case the firm is engaged in banking business. This is as per Section 11 of the Companies Act, 1956.

ii) Agreement: In order to have a partnership, it is necessary that there must be an agreement between partners.

iii) Sharing of profits: It is one of the important terms to constitute a partnership firm. Generally sharing of profits (or losses) is one of the important element to constitute a firm.

iv) Business: It includes trade, covation and profession. The firm must be engaged in a lawful business.

v) Management: The management of the partnership firm will be done either by all the partners or any one of them on behalf of all other partners. There is mutual agency among the partners.

Following are the characteristics of partnership :

1. It is a contract between two or more than two persons.
2. A contract is necessary for division of profits/losses.
3. The business may be carried on by all or any of them acting for all.

PARTNERSHIP DEED

A document in which the terms and conditions of partnership are given is called Partnership Deed. In a partnership deed, the rights and duties of partners are given. If there is no partnership deed of a firm, all the provisions of Partnership Act, 1932 will be applicable with regard to duties, rights and liabilities of partners. A partnership deed should contain the following points :

1. Date of agreement.
2. Name and address of the partnership firm.
3. Name and address of the partners.
4. Nature and place of business.
5. Period of partnership, if any.
6. Capital of partners.
7. Profit sharing ratio.
8. Drawings of partners.
9. Interest on capital and on drawings.
10. Salary and commission of partners, if any.
11. Rights, duties and functions of partners.
12. Method of valuation of goodwill.
13. Accounting method at the time of retirement or death of a partner.
14. Arbitration clause to settle disputes among the partners.
15. Method of distribution of assets on the dissolution of the firm.
16. Accounting treatment or procedure at the time of dissolution.
17. Accounting procedures.
18. Any other provision.

PECULIAR ASPECTS OF ACCOUNTING FOR PARTNERSHIP FIRMS

In sole trading, there is only one owner who invests the capital. The Capital and Drawing accounts are opened in his name. But in partnership, Capital Account, Current Account and Drawings account of each partner are opened separately.

In a partnership contract, all terms and conditions on the basis of which partnership is started are defined. This contract may be oral or written. To avoid future disputes, the contract should be in writing, which is called the partnership deed. In the absence of a written contract, the following rules apply :

1. Distribution of profit and loss among the partners will be equal.
2. No interest on capital will be allowed.
3. No interest will be charged on drawings.
4. No salary is allowable to any partner for doing work in the capacity of a partner.
5. Interest on loan other than capital is allowed @ 6% per annum.
6. Every partner can equally share the assets of firm at the time of dissolution.

Profit and Loss Appropriation Account

In partnership, the method of preparing final accounts is the same as for sole trading. However, in a partnership firm, Profit and Loss Appropriation Account is required to be prepared to distribute the profits among the partners. The format of the Profit and Loss Appropriation Account is as under :

Profit and Loss Appropriation Account

	Rs.		Rs.
To Profit and Loss A/c, if any ———		By Profit and Loss A/c———	
(current year loss)		(Profit for current year)———	
To Interest on Capital———		By Interest on Drawings———	
To Salary to Partners———		By Capital Accounts or———	

To Commission to Partners ———	Current Account of Partners
To Interest on Partner's Loan ———	(Division of Loss)
To Capital or Current——— Accounts of Partners (Division of Profit)	

Fixed and Fluctuational Capitals

Capital Accounts of partners may be fixed or fluctuating. If Capital Accounts are fixed, two accounts are prepared for each partner: (i) partner's Capital Account and (ii) partner's Current Account.

In case of fixed capital, partners' Capital Account are credited only with that amount of capital at which business is started. Later on, if additional capital is invested, the capital account is credited and it is debited with the amount withdrawn permanently. No other adjustment is made in this account.

In partners' Current Accounts, all adjustments regarding interest on capital, salaries, share of profit and drawings are shown. The balance of this account always varies and that of Capital Account remains the same.

In case of fluctuating capital, only one account is prepared, which is called Capital Account. In this account, all items relating to additional capital, interest, drawings, share of profit and salaries, etc. are shown. The balance of this type of Capital Account in the beginning and in the end will be different and, as such, it is called Fluctuating Capital Account.

Interest on Capital and Drawings

Interest on capital is allowed only if it is allowed and interest on drawings is charged only if there is an agreement in this regard. Interest is calculated by considering the interest rate and time. Interest on capital is written on the Debit side of Profit and Loss Adjustment Account and Credit side of partners' Capital Account or Current Account. On the other hand, interest on drawings is written on the Credit side of Profit and Loss Adjustment Account and again on Debit side or Capital Account of Current Account.

Illustration 1: A and B are partners and they had Rs. 1,50,000 and Rs. 2,50,000 in their Capital Accounts as on 1st January, 1993. A paid a further sum of Rs. 50,000 on 1st July, 1993 and another Rs. 25,000 on November 1, 1993. B paid Rs. 1,00,000 on April 1, 1993 and another Rs. 25,000 on August 1, 1993.

A withdrew Rs. 1,000 per month at the beginning of every month and B Rs. 1,000 at the end of every month. 5% per annum interest on capital and on drawings is to be considered. Calculate the interest payable and chargeable.

Solution

Interest on Capital :

A Interest on Rs. 1,50,000 of one year = 1,50,000 · 5/100 = Rs. 7,500 Interest on Rs. 50,000 for 6 months = 50,000 ·1/2·5100= Rs. 1,250 Interest on Rs. 25,000 of 2 months = 25,000·2/12·5/100= Rs. 208.33

8958.33

Alternative Method

Product Method:

Under this method the product of capital invested and the number of months for which it remained in business are determined first and then interest is calculated for one month on the product. In the above case during first 6 months capital was Rs. 1,50,000, for next four months it was Rs. 2,00,000 and for the last two months it was Rs. 2,25,000. Hence, calculation of interest by product method are as under : Interest (Rs. 150000 · 6 + 200000 · 4 + 225000 · 2) for one month at 5% per annum.

=(900000 + 800000 + 450000) 5/100 ·1/12 = Rs. 8958.33 B

Interest on Rs. 1,00,000 for 9 months = Rs. 100000·5/100·9/12	= Rs. 3,750.00
Interest on Rs.2,50,000 for one year = Rs. 250000·5/100	= Rs. 12,500.00
Interest on Rs.25000 for 5 months = Rs. 25000·5/100·5/12	= Rs. 520.83
	16,770.83

Alternative Method

Product Method :

(250000·3 + 350000·4 + 375000·5) for 1 month at 5% per annum.

= (750000 + 1400000 + 1875000) 5/100 · 1/12 = Rs. 16770.83

Interest on Drawings

Because the same amount either at the beginning or at the end or each month is withdrawn by a partner, the interest can be calculated by the following simple formula :

A. The number of months for which interest is to be calculated = $\frac{n(n+1)}{2}$ Where, n = the number of months for which interest is payable for the first installment, here, n = 12

$$=\frac{12(12+1)}{2} = 78 \text{ months}$$

Interest = Rs. 1000 · 78/12 · 5/100 = Rs. 325

or = (Rs. 1000 · 12) $\frac{6\frac{1}{2}}{12}$ · 5/100 = Rs. 325

B Number of months = $\frac{n(n+1)}{2}$ where n = 11, because the amount is withdrawn at the end of every months.

= 11 · 12/2 = 66 months

Interest = Rs. 1000 · 66/12· 5/100 = Rs. 275

or = (Rs. 1000 · 12) · 5½ · 5/100 = Rs. 275 12

Notes

1. If the same amount is withdrawn at the beginning of every month, then 6½ month's interest will be calculated on total drawings.
2. If the amount is withdrawn at the end of every month, the interest is calculated on total drawings for 5½ months.
3. If the amount is withdrawn in the middle of every months, 6 months'

interest is calculated on total drawings.

4. If interest on drawings is being calculated but dates of withdrawal are not given, then 6 months interest will be calculated on total drawings.

Minor Partner

A partner who has not attained the age of majority is called a minor partner. Asno agreement can be entered into with a minor, he can only be admitted to the benefits of an existing partnership with the consent of all the partners. A minor partner is not personally liable for the debts of the partnership firm but his share in the partnership property and profits of the firm will be liable for firm's debts and obligations. He will not be personally liable for any debt of the firm until he attains the age of majority. He is not liable to share the loss if there is any. Within six months of his attaining majority or when he comes to know that the enjoys the benefits of partnership (whichever date is later), he has to elect whether or not he wants to continue as a partner. He must give public notice if he dos not want to continue as a partner otherwise he will be deemed to have elected to be a partner. He will become liable for the debts of the firm since he was admitted to the benefits of the partnership firm on his election as a partner.

Illustration 2: Since 1st January, 1996 A, B and minor C are equal partners.

Their Balance Sheet as on 31–12–1999 is as follows:

Liabilities		Rs.	Assets	Rs.
Sundry Creditors		40,000	Cash in hand	15,000
Accumulated Balance in		60,000	Cash at Bank	25,000
Profit & Loss A/c				
Capital Accounts:			Sundry Debtors	40,500
A	40,000		Stock in Trade	24,500
B	40,000		Plant & Machinery	35,000
C	20,000		Land & Building	60,000
		1,00,000		
		2,00,000		2,00,000

(i) Accumulated balance in Profit and Loss Account as given in the Balance Sheet consists of the following:

Profit of 1997 Rs. 36,000, Loss of 1998 Rs. 18,000, and Profit of 1999 Rs. 42,000.

(ii) Analysis of the books of accounts disclosed the following errors:

(a) A machinery costing Rs. 12,000 purchased in 1998 was debited to Repairs Account. 10% depreciation on reducing balance method is provided on plant and machinery.

(b) Rs. 1,080 being the fixed deposit interest due to the firm used by A for his personal expenses in 1999.

(c) Goods costing Rs. 12,000 sent on sale or return basis have been recorded as credit sale. The firm's gross profit ratio is 20% on sales.

Prepare Partners' Capital Accounts and Balance Sheet of the firm as on 31–12–1999 giving effect to the above adjustments.

Solution

Calculation of correct profit for various years

	1997	1998	1999
	Rs.	Rs.	Rs.
Profit (Loss) as given	36,000	(18,000)	42,000
Add: Machinery wrongly debited to Repairs A/c		12,000	
Add: Fixed deposit interest of the firm used by A for personal expenses			1,080
	36,000	(6,000	43,080
Less: 10% Depreciation on WDV of Machinery	–	(1,200)	1,080
	36,000	(7,200)	42,000
Less: Gross Profit on Rs. 12,000 (Goods on sale or return basis wrongly treated as sale) not yet realised @ 25% on cost	–	–	3,000
Correct Profit (Loss)	36,000	(7,200)	39,000
Share of: A	12,000	(3,600)	13,000
B	12,000	(3,600)	13,000
C (Minor Partner)	12,000	–	13,000

C being minor partner will not share the loss of 1998 as a minor partner can be admitted to the benefits of the firm.

Partners' Capital Accounts

	A	B	C		A	B	C
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Fixed Deposit				By Balance b/d	40,000	40,000	20,000

Interest	1,080	–	–	(Opening Capital)			
To Balance c/d	60,320	61,400	45,000	By Profit/Loss			
				(Transfer)			
				(for 3 years)	21,400	21,400	25,000
	61,400	61,400	45,000		61,400	61,400	45,000

Balance Sheet of A, B and C as at 31-12-1999

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	40,000	Cash in hand	15,000
Capital Accounts:		Cash at Bank	25,000
A	60,320	Sundry Debtors (1)	25,500
B	61,400	Stock in Trade (2)	36,500
C	45,000	Plant & Machinery	44,720
		(35,000+12,000–1,200–1,080)	
		Land & Building	60,000
	2,06,720		2,06,720

(1)	Sundry Debtors as given	40,500
	Less: Goods on approval basis wrongly treated as credit sale	
	(Cost Rs. 12,000+Rs. 3,000 Profit = Rs. 15,000 sale)	15,000
	Debtors	25,500
(2)	Stocks as given	24,500
	Add: Cost of goods sent on approval basis	12,000
	Closing Stock	36,500

Past Adjustments

Sometimes after closing the accounts of a partnership firm, it is discovered that there was some error or omission in those accounts. For example, interest o capitals or drawings may have been omitted at all, charged or allowed at high or too low a rate, profits and losses may have been distributed among the partners in a wrong proportion and so on. In order to correct these errors and omissions, adjustment entries are to be passed in the usual way.

Illustration 3: A and B had been in partnership for many years as valuers, sharing profits equally, it had been their custom to ignore fee, earned on uncompleted matters, when preparing annual accounts. On 1st January, 1996 they entered into a new partnership agreement under which the profits earned in any year were to be distributed as follows: Up to Rs. 8,000 – equally.

Excess over Rs. 8,000 – one-third to A and two-third to B.

Although they shared profits in accordance with new agreement, they continued to prepare their accounts upon the old basis, i.e., ignoring fees earned on uncompleted work. At the end of 1998, it was pointed out to them that they were not following the terms of their agreement, and it was agreed that such

correcting entries as might be necessary should be put through as on 31st December, 1998. The profits already dealt with were as follows:

1996 – Rs. 7,500, 1997– Rs. 8,2010; 1998– Rs. 9,350.

The outstanding fees not brought into accounts were:

	Rs.
On 31st December 1995	960
On 31st December 1996	1,280
On 31st December 1997	1,550
On 31st December 1998	920

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

Solution

As the fees outstanding had not been brought into accounts, the profit already dealt with the wrong. The correct profits after taking these fees into account would be as follows:

Year (1)	Profit as given (2)	Add Fees outstanding at the end of the year (3)	Less Fees outstanding at the beginning of the year (4)	Correct Profit (5)=(2)+(3)–(4)
	Rs.	Rs.	Rs.	Rs.
1995	–	960	–	960
1996	7,500	1,280	960	7,820
1997	8,210	1,550	1,280	8,480
1998	9,350	920	1,550	8,720

The profit already distributed and the profit as should have been distributed are given in the following Table:

Year	Profits as already distributed			Profit as should have been distributed		
	Profit as given Rs.	A's share Rs.	B's share Rs.	Correct Profits Rs.	A's share Rs.	B's share Rs.
1995	–	–	–	960	480	480
1996	7,500	3,750	3,750	7,820	3,910	3,910
1997	8,210	4,070	4,140	8,480	4,160	4,320
1998	9,350	4,450	4,900	8,720	4,240	4,480
Total	25,060	12,270	12,790	25,980	12,790	13,190

A has been credited with Rs. 12,270 while he ought to have been credited with Rs. 12,790. Thus he should be credited with Rs. 520 (Rs. 12,790 – Rs. 12,270) more.

B has been credited with Rs. 12,790 while he ought to have been credited with Rs. 13,190. Thus he should be credited with Rs. 400 (Rs. 13,190 – Rs. 12,790) more.

The following entry is required to correct the Partners' Accounts.

		Rs.	Rs.
Fee outstanding account	Dr.	920	
To A's Capital Account			520
To B's Capital Account			400
(Being outstanding fee brought into account)			

Guarantee

Sometimes, a partner is taken into the firm on the guarantee that he shall be given a minimum amount of the profits of the firm oven if there are no profits or his share of profit falls short of the guaranteed amount. This guarantee to the new partner can be given by one of the existing partners or all the existing partners. For accounting purposes, the guaranteed amount due to the new partner should be deducted out of the total profits. Then profits of the remaining partners should be ascertained from the residue (i.e. total profit minus the guaranteed amount payable to the new partner) and divide the same in the new profit sharing ratio of the existing partners. This will be more clear from the following illustrations.

Illustration 4: Red, White and his son Blue were partners in the firm of M/s Red and White. On 1st April, 1998 Green the Manager was admitted as a partner. Profits and losses in the new partnership were to be shared as follows:

Red 4/10, White 3/10, Blue 2/10 and a salary of Rs. 600 per annum, and Green 1/10.

Green has previously been paid a salary of Rs. 1,000 per annum and a commission of 3 per cent of the profits, after changing his salary and commission, but before charging any partner's salary.

It was agreed that for the first year of the new partnership, any excess of his share of the profit over the sum he would have earned had he remained Manager increased by Rs. 700, should be charged to Red's share of profit.

On considering the draft accounts for the year ended 31st March, 1999, the partners agreed to the following adjustments:

(a) to provide for a staff bonus of Rs. 5,500.

(b) That Red's son Grey, an employee of the partnership, should receive an additional bonus of Rs. 250 chargeable against his father's share of profit.

(c) that Rs. 500 of White's share of profit should be credited to his son Blue.

The profits for the year, before making the above adjustments and before charging Blue's salary amounted to Rs. 32,000.

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

Solution

Profit and Loss Adjustment Account

for the year ended 31st March, 1999

	Rs.		Rs.
To Green's Capital A/c	2,590	By Net Profit (i)	25,900
To Balance c/d	23,310		
	25,900		25,900
To Red's Capital A/c (4/9)	10,425	By Balance b/d	23,310
To White's Capital A/c (3/9)	7,819	By Red's Capital A/c	
To Blue's Capital A/c (2/9)	5,213	(Amount of Guarantee) (iii)	147
	23,457		23,457

Statement showing the final summary of division of profit

	Red	White	Blue	Green
	Rs.	Rs.	Rs.	Rs.
Salary	-	–	600	–
Profits	10,425	7,819	5,213	2,590
Transfer from White to Blue	-	(–) 500	(+) 500	–
Bonus payable to Grey	(–) 250	–	-	–
Excess amount debited for the guarantee given	(–) 147	–	-	–

	10,028	7,319	6,313	2,590

Working Notes

(i)	*Distributable Profit:*	Rs.
	Profit as disclosed by accounts	32,000
	Less: Staff Bonus	5,500
		26,500
	Salary to Blue	600
	Profit to be distributed among partners	600
		25,900
(ii)	*Remuneration which Green would have received as Manager:*	
	Salary	1,000
	Commission: (26,500 – 1,000) 3/103	743
		1,743
(iii)	*Amount now being paid to Green:*	
	1/10 of Profits (Rs. 25,900)	2,590
	Excess amount [2,590 – (1,743 + 7000)] debited to Red	147

ADMISSION OF A PARTNER

Sometimes a running business may require new partner for the following reasons :

1. Need of more capital for expansion of business.
2. Need of expertise in managerial or technical field for running the business.
3. For growth of the business by admitting a reputed person as partner.
4. To admit a new partner in place of an old retiring partner.

When a new partner is admitted in business, he gets two types of rights.

1. Right to Share Future Profit-Loss of the Business

When a new partner is admitted in the business, he gets the right to receive profit in an agreed ratio. This share in profit is sacrificed by the old partners. To compensate the old partners for this sacrifice, the new partner pays a price in the form of goodwill adjustment. The method of valuation of goodwill is usually given in the partnership contract. When new partner comes into partnership, the profit sharing ratio of old partners is changed.

2. Right to Share in Assets of the firm

When a new partner is admitted in the firm, he also becomes the owner of firm's assets as per his share, for which he brings in the required capital. Hence, at the admission of a new partner, revaluation of assets and liabilities becomes necessary so that there should be no loss to the old partners or the new partner. At the time of admission of a new partner, the following are the main considerations which must be settled between the old and the new partners:

1. Determination of new profit sharing ratio.
2. Determination of the value of goodwill and its allocation among old partners.
3. Revaluation of assets and liabilities of the existing business.
4. Distribution of accumulated profits, reserves and losses.
5. Determination of the capital to be brought in by the new Partner. Each point is discussed in detail in the following pages :

Determination of New Profit Sharing Ratio

When a new partner joins the firm, the share of old partners is reduced because they sacrifice some part of their share to the new partner.

The determination of new profit–sharing ratio depends upon the agreement among the old and new partners. In what ratio the new partner gets his share from the old partners depends upon their agreement. Thus on admission of a new partner, what the new ratio of all the partners will be is an important question. In various circumstances, the calculation of new profit–sharing ratio is made as follows :

If Share of New Partner is Given :

When the share of new partner is given and in the absence of any direction, the old partners will continue to share the remaining share in their old profit sharing ratio after deducting the share of the new partner.

Illustration 5

Yogu and Ankit are partners sharing profits and losses in the ratio of 3:2. They admit Atul as a partner for one fourth share in the future profits. Calculate the new profit–sharing ratio of partners.

Solution

Atul's share is 1/4

Thus remaining share = 1 – ¼ = ¾

Hence Yogu's share = ¾ · 3/5 = 9/20

Now Ankit's share = ¾ · 2/5 = 6/20 and

Atul's share = ¼ or 5/20

= 9/20 : 6/20 : 5/20

Hence, the new profit sharing ratio will be = 9 : 6 : 5.

When the New Partner Purchases His Share From Old Partners in a Certain Ratio

In this case, the share of old partners will be calculated by deducting that portion which they have sacrificed in favour of a new partner. The remaining share will be treated as the share of old partners. This will be clear from the following example :

Illustration 6

A and B are partners in a firm sharing profits and losses in the ratio of 3: 2. A new partner C is admitted. A surrenders 1/5 share of his profit in favour of C, and B surrenders 2/5 of his share in favour of C. Calculate the new profit–sharing ratio of the partners.

Solution

Sacrifice by A to C

Sacrifice by B to C

Share of C A's new share B's new share Share of A, B and C

= 3/5 · 1/5 = 3/25

= 2/5 · 2/5 = 4/25

= 3/25 + 4/25 = 7/25

= 3/5 – 3/25 = (15–3)/25 = 12/25

= 2/5 – 4/25 = (10–4)/25 = 6/25

= 12/25 : 6/25 : 7/25

= 12 : 6 : 7

When Sacrificing Ratio is given

In this case, the sacrifice made by old partners towards the new partner is given. This is clear from the following example :

Illustration 7

A and B are partners sharing profit or loss in the ratio of 7:5. They admit their manager C into partnership who is to get one sixth share in the profits. He acquires his share as 1/24 from A and 1/8 from B. Calculate the new profit sharing ratio

Solution

(Old Ratio – Share given to new partner)

A = 7/12 – 1/24 = (14–1)/24 = 13/24

B = 5/12 – 1/8 = (10–3)/24 = 7/24

C = 1/6

New ratio = 13/24 : 7/24 : 1/6

= 13 : 7 : 4

Sacrificing Ratio When Old and New Ratios are Given

In case, when old and new ratios of partners after admission of a partner are given, it is necessary to calculate the sacrificing ratio of the old partners by the formula:

Sacrificing Ratio = Old Ratio – New Ratio.

Illustration 8

X and Y are partners sharing profits or losses in the ratio of 4:3. Z is admitted and the new ratios are X–7, Y–4 and Z–3 (7:4:3:). Calculate the sacrificing ratio.

Solution

Sacrificing Ratio = (Old Ratio – New Ratio)

X's sacrifice = 4/7–7/14 = (8–7)/14 = 1/14

Y's sacrifice = 3/7 – 4/14 = (6–4)/14 = 2/14

Thus, sacrificing ratio is 1:2 for X and Y.

Goodwill

Goodwill is the value of the reputation of a firm. When a new partner is admitted in the partnership, he starts getting share in the profits of the firm immediately on his entrance. He gets the benefit of the firm's reputation which has been developed by old partners through their hard work and efforts. Hence, the old partners want some compensation for their previous labour or efforts made by them to build the firm's reputation. The amount of compensation given by the new partner to old partners is called goodwill. It is an intangible asset which is not visible and touchable, but it is subject to fluctuations.

In the words of Lord Macnaugten, "Goodwill is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation and connection of a business. It is the attractive force which brings in customers. It is the thing which distinguishes an old established business from a new business at first start.....Goodwill is composed of a variety of elements. It differs in its composition in different trades and in different business in the same trade."

"The probability that the old customers will report to the old place" is called goodwill – Lord Alden.

When a new partner gives money for goodwill, he hopes that he would receive some extra profit from this amount,. If a new partner starts a new business, he will have to put in a lot of hard work and face difficulties to create and maintain customers. But when he becomes partner in an old established business, he does not face any such problem, and is therefore, wiling to pay for the effort and money spent on establishing the business and providing credibility to the firm. Thus, we can say that goodwill is the value of the reputation of a firm which is concerned with the earning capacity of the business.

Element of Goodwill

Goodwill means the capacity of the business to earn more than normal profit. In other words, it is the value of reputation of the business. It attracts more customers. It is an intangible asset of the business. When the reputation of business gets established, its earning capacity becomes automatic. It takes time to develop goodwill which depends on many factors, mentioned as under:

1. Personal reputation of the owners and manager.
2. Speciality of goods or services provided.
3. Favourable location or site.
4. Patents, Copyrights or Trade Marks.
5. Advantage of an important license with the firm.
6. Advantage of selling a special type of product or raw material

For the above reasons, the firm gets or earns more profit and the one who purchases the goodwill of firm also purchases the name of the firm. It is important to note that goodwill exist only when the business is running in profit. In a business which is running at a loss, there will be no goodwill because the value of goodwill arises from the future possibility of the firm to earn profit.

Need for valuation of goodwill of a firm :

1. On Admission of a New Partner : When a new partner comes into the firm, he gets a share in the future profits. The share of the old partners is consequently reduced. So, the new partner has to pay for the goodwill besides his capital. The amount paid for goodwill is distributed among old partners in their sacrificing ratio. Valuation of goodwill depends on the agreement among old and new partners.
2. On Retirement or Death of a partner : As a new partner brings in the amount of goodwill, in the same way, at the time of retirement, a partner receives his share of goodwill of the firm. At the time of death, the deceased partner's share of goodwill is to be given to his legal representatives. For this, the need for valuation of goodwill arises. On the Amalgamation of firms : When two or more than two firms are merged and a new firm is formed, it is called amalgamation. At the time of amalgamation, like other assets and liabilities, goodwill is also value and becomes the part of purchase consideration like other assets.
3. On Sale of firm's business to another firm or company, it is very important to value the firm's goodwill.
4. When profit sharing ratio of the partners is changed, there is a need to evaluate the goodwill so that the losing partners could be compensated.

Methods of Evaluating Goodwill

The following are the important methods of valuation of goodwill :

(A) Average Profits Method

Under this method, the average of the profits of last three or four years is calculated. The average profits is multiplied by number of years in which the anticipated profits will be available. If the goodwill is twice the average profits of last three years, it is to be valued at two years's purchase of the last three years average profit.

Value of Goodwill = Average profit · Number of year's purchased.

$$\text{Formula} = \frac{\text{Total profits}}{\text{No. of years}} \cdot \text{No. of years purchased}$$

The following points need to be considered for valuation of average profit:

1. Abnormal Profit : If in any year, a firm earns abnormal profits, then it is to be deducted from the firm's profits because it is not or usual or recurring nature. For example, profit due to rise in prices at the time of war of after Floods, etc.

2. Abnormal Loss : If in any year, a firm incurred any abnormal losses, them it is added back to the profits. These abnormal losses include loss of stock due to fire, theft or floods, etc.

3. Normal Expenses : If there are any normal expenses which are of recurring nature and are not deducted from the firm's profit, these should be deducted, such as insurance premium, etc.

(B) Super Profit Method

In this method, super profit is calculated and it is multiplied with a specific number to find out the goodwill. Super profit is the profit above the normal profit being earned by other firms engaged in the same business.

If any old firm is earning equal to the profits being earned by other new firms engaged in the same type of business, there will be no value of the goodwill of the old firm. If the old firm is earning more profits than the new firm, there will be value of the goodwill of the old firm. The greater the difference in such profits, the higher will be the value of goodwill.

For example, if the investment in the business is of Rs. 5,00,000 and the rate of profit considered appropriate in similar business is 15%, the normal profit will be Rs. 75,000 (5,00,000 ·15/100). This normal profit is compared with the actual profit earned. If the actual profit is more than the normal profit, it will be called super profit. Suppose further that the actual profit is Rs. 1,00,000, then (1,00,000 –75,000) Rs. 25,000 is super profit.

Goodwill = Super profit · No. of years purchased.

If the super profit will be available for three years, the value of goodwill will be :

Rs. 25,000 · 3 = Rs. 75,000

Goodwill = Super profit · No. of years purchased Super Profit =

Actual or Average Profit – Normal Profit Normal Profit =

Capital Invested · Normal Rate of Return/100

(C) Capitalisation Method

Under this method, it is assumed that if capital invested by the firm earns a normal profit, there is no goodwill, but if firm earns more than normal profit, excess capital which might be invested to earn that excess profit is called goodwill. There are two ways of finding out goodwill under this method:

1. Capitalisation of Average Profit

Under this method goodwill is calculated as :

Goodwill = Normal Capital Employed – Actual Capital Employed

$$\text{Normal Capital Employed} = \frac{\text{Profit or Average Profit}}{\text{Normal Rate of Return}} \times 100$$

Suppose the normal rate of profit is 10 per cent and the firm earns Rs. 10,000. If the actual capital employed is Rs. 80,000, then normal capital employed is calculated as under:

$$\text{Normal Capital Employed} = \frac{10{,}000\ (\text{Profit}) \cdot 100}{10\ (\text{Normal rate of return})}$$

$$= \text{Rs. } 1{,}00{,}0000$$

Goodwill = Normal Capital Employed – Actual Capital Employed

= 1,00,000 – 80,000 = Rs. 20,000

Thus, the excess of normal capital employed over actual capital is the value of goodwill.

2. Capitalisation of Super Profit

Under this method, first the super profit is capitalized and on that basis the value of goodwill is determined. Here, super profit is :

= Actual Profit – Normal Profit

After this goodwill is ascertained with the help of following formula :

$$\text{Goodwill} = \frac{\text{Super Profit} \cdot 100}{\text{Normal rate of return}}$$

Methods of Recording Goodwill on the Admission of a New Partner

Various methods of recording goodwill at the time of admission in a firm are as under :

1. The amount of goodwill is paid by new partner to old partners outside the business.
2. Amount of goodwill is brought in cash by new partners in the firm and is withdrawn by the old partners. In this way, it does not affect the capitals of partners.
3. When amount of goodwill is bought in cash and retained in the business, it will increase the capital of the firm.
4. The new partners does not bring in the goodwill in cash but the goodwill account is raised in the books. Under this method Goodwill Account is debited and old partners' Capital Accounts are credited in their old profit–loss sharing ratio. In this case, Goodwill Account will be shown in the Balance Sheet. If Goodwill Account is written off among all partners in new ratio, it will not be shown in Balance Sheet.

Treatment of Goodwill in Account

1. When goodwill is paid by new partner to old partners outside the business: When the amount of goodwill is received by old partners privately or outside the business in case, no entry will be made in the books of firm.

2. When goodwill is brought by new partner and is withdrawn by old partners: In such a cash, the receipt of goodwill money is recorded in the books of firm and is transferred to Capital Accounts of old partners in their sacrificing ratio. The amount, thus, transferred is immediately withdrawn by old partners.

The following entries are recorded in firm's books in the above case :

i) When goodwill is brought in cash

Cash Account Dr.

To Goodwill Account

(Being amount of goodwill brought in cash)

ii) Transferring Goodwill old partners in their sacrificing ratio :

Goodwill Account Dr.

To Old Partners' Capital Account

(Being amount of goodwill transferred to Capital Account)

iii) On withdrawn of goodwill by old partners :

Old Partners' Capital Account Dr.

To Cash Account

(Being goodwill withdrawn)

Alternative Method

Under this method, Cash Account is debited with the amount of goodwill and new partner's Capital Account is credited. Then new partner's Capital Account is debited and old partner's Capital Accounts are credited in the sacrificing ratio.

On bringing the goodwill in cash :

i) Cash Account Dr.

To New Partner's Capital Account

(Being brought by new partner for goodwill)

ii) On transferring the goodwill to old partner's Capital Accounts :

New Partner's Capital Account Dr.

iii) To old partners' Capital Accounts

(Being amount of goodwill distributed by old partner' in their sacrificing ratio).

Old Partners' Capital Account Dr.

To Cash Account

(Being amount of goodwill withdrawn by old partners)

Now the question arises as to the ratio in which goodwill is to be distributed among old partners when a new a new partner is admitted. Goodwill will be distributed to old partners in their sacrificing ratio. For example, X and Y are partners sharing profits and losses in the ratio of 3:2. After admission of Z as a partner, their new ratio is 2:2:1. Here, the scarifying ratio of X and Y will be calculated. The scarifying ratio will be calculated as under :

X sacrifices = 3/5 –2/5 =1/5

Y sacrifices= 2/5 = 2/5= 0

In the above case, the amount of goodwill will be given only to X because he has sacrificed it to Z and Y will not get any amount of goodwill as he did not sacrifice any share. If new ratio is not given in the question and it is said that the new partner will be given 1/5 share, it is assumed that old partners sacrifice in their old ratio.

3. Amount of Goodwill retained in the Business : In this method the amount of goodwill is retained in the business. For this, the following entries will be made :

i) When amount of goodwill is brought in :

Cash Account Dr.

To Goodwill Account OR

To New partner's Capital Account

(Being amount of goodwill received)

ii) Amount of goodwill transferred to old partners' Capital Accounts:

New partner's Capital Account Dr.

OR

Goodwill Account Dr.

To Old Partners' Capital Account

(Being amount of goodwill transferred to old partners

Accounts in sacrificing ratio)

4. Raising Goodwill Accounts : Sometimes, the amount of goodwill is not brought in cash by the new partner. Hence, goodwill account is raised with full

value of firm's goodwill and capital account of old partners are credited in the old profit sharing ratio.

a) When goodwill is raised :

Goodwill Account Dr.

To Old Partners' Capital Account

(Being Goodwill Account raised in the books of the firm in old ratio)

b) When goodwill is written off :

All partners' (including new partner)

Capital Accounts Dr.

To Goodwill Account

(Being Goodwill Account transferred to all partners' Capital Account in the new profit sharing ratio)

When goodwill already appears in the books : If goodwill already appears in the books, it is transferred to old partner's Capital Accounts in their old ratio at the time of admission of a new partner. The only entry will be :

Old Partners Capital Accounts Dr.

To Goodwill Account

(Being goodwill appeared in B/S is written-off in old ratio)

After this, the entries for goodwill brought in by the new partner will be passed.

When Goodwill is not brought in Cash and Goodwill Account is raised : When new partner does not bring goodwill in cash and goodwill already appears in the Balance Sheet, goodwill will be dealt with as under :

Change in Profit Sharing

Sometimes, partners change their profit-loss sharing ratio. In such a case to treat the amount of goodwill, the following entries will be made :

1. Raising Goodwill Account : First of all, goodwill is to raised by debiting the Goodwill Account with full value and crediting all partner's capital accounts in their old ratio :

Goodwill Account Dr.

To All Partners' Capital Account

(Being Goodwill Account raised in old ratio)

2. Writing off the Goodwill Accounts : After having raised the goodwill, Goodwill Account will be written off by debiting all partners' Capital Accounts in the new ratio.

All Partners' Capital Accounts Dr.

To Goodwill Account

(For Goodwill written off in the new ratio)

Revaluation of Assets and Liabilities

Revaluation Account is prepared to revalue various assets and liabilities of the firm. When a new partner is admitted into a partnership concern, he acquires the ownership rights in the assets of the firm and is also responsible for the liabilities of the firm. It is, therefore, desirable from the point of view of the incoming partner as well as the existing partners that the assets and liabilities as appearing in the Balance Sheet on the date of admission of the new partner should be properly valued.

It is possible that some of the assets might have appreciated in value or some of the assets have been shown more than their realizable values. Hence, these assets must be shown at lower values. Some of the liabilities may not have been shown in the books, though they will be paid. Thus, if the values of assets and liabilities as shown in the books of accounts are different than their actual values, adjustments will have to be made.

For the adjustment of various assets and liabilities, a Profit and Loss Adjustment or Revaluation Account is prepared. On its debit side is shown decrease in assets, outstanding expenses and increases in liabilities, and on the credit side, increase in assets, prepaid expenses and decrease in liabilities are shown. The balance of this account is transferred to Capital Accounts of old partners in their old ratio.

Adjustment for Undistributed Profits or Losses and Reserves

i) When a new partner is admitted in the firm, reserves, undistributed profits and credit or debit balance of Profit and Loss Account are transferred to old partners' Capital Accounts in their old ratio. For this purpose, the following journal entries are passed.

Profit and Loss Account (if Profit) Dr.
General Reserve Account Dr.
To old partners' Capital Accounts
(Being profits & reserve distributed in old partners in old ratio)

ii) If the debit balance of Profit and Loss Account is shown in the Balance Sheet, then it will also be transferred to old partners' Capital Accounts in old ratio.

Old Partners' Capital Accounts Dr.
To Profit and Loss Account

Preparation of Memorandum Revaluation Account

Sometimes, the partners agree that the value of assets and liabilities are not to be altered and these are to be shown in the books at their old values. In such a case, increase or decrease in the amount of assets and liabilities will be recorded in a special account known as Memorandum Revaluation Account. No corresponding entry is made in assets and liabilities to record changes in their values. This Memorandum Account is divided into two parts :

i) In the first part, Revaluation Account is prepared in the usual way as explained earlier and profit or loss is distributed to old partners in old ratio.

ii) In the second part, all the entries which were shown in the Revaluation Account will be reversed. It means those items which were shown on the Debit side of Revaluation Account will now be placed in the credit side of Memorandum Revaluation Account, and all credit items of Revaluation Account will be shown in the Debit side of Memorandum Revaluation Account. Thus, whatever the result (profit or loss) may be, it will be distributed among all the partners (including the new partner) in new profit sharing ratio.

It is important to keep in mind that, after preparation of Memorandum Revaluation Account, the result (Profit or Loss) will be reversed as shown by

Revaluation Account. If Revaluation Account show profit, the Memorandum Revaluation Account will show loss and vice–versa. Secondly, while preparing the Balance Sheet, all the fixed assets and liabilities (expect cash in hand and bank) are to be shown at original figures. But in capital accounts of partners, adjustments will be made for profit/loss of both the parts of Memorandum Revaluation Account.

RETIREMENT AND DEATH OF A PARTNER

INTRODUCTION

A new partner is admitted in the firm when such a need arises, the same way, a partner may like to retire after giving due notice. His accounts are settled upto the date on which he retires. He will have his share of profit (or loss) upto that date, a share in the old reserves and the Goodwill of the firm. A balance sheet is prepared on the day of his retirement and his capital account is completed upto the date. Either he is paid cash in full for his capital account or partly he is paid with a promise to pay the balance at a future date. In such a case his capital account is transferred to the Loan A/c and shown as a liability in the balance sheet. It may be paid in instalments afterwards.

Usually, the manner, in which a partner shall retire is mentioned in the partnership deed. When a partner retires he is entitled to his share in the following accounts:

1. The retiring partner is entitled to his share out of the past accumulated profits and reserves in his profit–sharing ratio.
2. He is also entitled to his share of profit upto the date of his retirement. Suppose the books of accounts of the firm are closed on 31st March every year and the partner is retiring on 30th June. He is entitled to his share of profit for this 3 months' period i.e., from 1st April to 30th June.
3. When a partner retires he is paid for his share of goodwill in the firm.
4. According to the terms of the Partnership Deed the value of all assets and liabilities are revalued on the retirement of a partner. For this purpose, a

Revaluation Account is prepared. He is entitled to his share of profit (or loss) on the revaluation of assets and liabilities.

In the absence of any agreement to the contrary, the profit sharing ratio between the remaining partners remains unchanged after his retirement.

ACCOUNTING PROCEDURE AT THE TIME OF RETIREMENT OF A PARTNER

The following problems arise when a partner retires from the firm and remaining partners continue with the business :

1. Treatment of goodwill
2. Revaluation of assets and liabilities
3. Adjustments of accumulated reserve and losses
4. Calculating the amount due to the retiring partner and its payment.

Treatment of Goodwill

When a partner retires from the firm remaining partners are benefitted because future profit is shared only by them. For example, if A, B and C are partners and their profit sharing ratio is 2 : 2: 1. If B retires from the firm, A and C will distribute the profits in 2:1 ratio or a new ratio.

A and C will get share of B. Hence, A and C will compensate the retiring partner B in the gaining ratio. When a new partner is admitted in the firm, he pays the amount of goodwill and if a partner retires from the firm, the remaining partners compensate the retiring partner by paying for the goodwill.

Gaining ratio is the difference of new ratio and old ratio. If there is no other agreement, remaining partners will share the profits in the same ratio in which they shared earlier before the retirement of a partner. In such a situation, the gaining ratio of the remaining partners would be their old ratio.

For example, A B and C are sharing profits in the ratio 3:2:1. C retires from the firm. In this case, new ratio of A and B will be 3:2.

Illustration 1

i) A, B and C were sharing profit and loss in the ratio of 2:3:1. Calculate the new ratio and the gaining ratio when (a) A retires, (b) B retires and (c) C retires.

ii) A, B and C were partners sharing profit and loss in the ratio of 2:3:1. C retires and A and B decide to share future profit and loss in the ratio of 3:4. Calculate the gaining ratio.

iii) A, B and C were partners sharing profit and loss in the ratio of 2:3:1. C retires and his share is taken by A and B in the ratio of 2:1. Find the new ratio.

Solution

i) (a) When A retires, the new ratio of B and C will be 3:1.
This will also be their gaining ratio.

(b) When B retires, the new ratio of A and C will be 2:1. This will also be their gaining ratio.

(c) When C retires, the new ratio of A and B will be 2:3 This will also be their gaining ratio.

ii) Gaining Ratio = New Ratio —Old Ratio

Gain of A = 3/7 –2/6 = 4/42

Gain of B = 4/7 –3/6 = 3/42

Thus, the gaining ratio of A and B is 4/42 : 3/42 or 4:3

iii) Share got by A from C = 1/6 × 2/3 = 2/18

Share got by B from C = 1/6 × 1/3 = 1/18

New ratio of A = 2/6 + 2/18 = 8/18 New ratio of B = 3/6 + 1/18 = 10/18

Hence, new ratio of A and B = 8/18 : 10/18 or 8 : 10 or 4 : 5

Adjustment of Goodwill

Having understood the gaining ratio of new partners, let us discuss how the goodwill will be adjusted in accounts. The following are the methods of treating goodwill in books in case of retirement :

1. When Goodwill account is raised with full value

Under this method, Goodwill Account is debited with full value of Goodwill and the partners' Capital Accounts, including retiring partner's Capital Account are credited in the old ratio. Goodwill will be show in the Balance Sheet at full value.

2. When goodwill account is raised with full value and written off by remaining partners

Under this method, first of all Goodwill Account is debited with full value and all partners (including retiring partner) Capital Accounts are credited in the old ratio. Secondly, remaining partners' Capital Accounts are debited in new ratio and Goodwill Account is credited. Hence, the Goodwill Account is closed. It will be shown in Balance Sheet.

3. When goodwill is raised only with the share of the retiring partner and then written off by remaining partners

In this case, firstly Goodwill Account is debited and retiring partner's Capital Account is credited with his share of goodwill. Secondly, Capital Accounts of remaining partners are debited in their gaining ratio and Goodwill Account is credited. Hence, Goodwill Account will be closed.

4. **When retiring partner's share of Goodwill is to be adjusted in the Capital** Accounts of remaining partners without raising Goodwill Account

In this case, the retiring partner's share of goodwill is calculated and debited to continuing partners Capital Accounts in their gaining ratio with corresponding credit being given to retiring partner's Capital Account.

Note : From the above explanation, it is clear that when we deal with the total value of goodwill (Opening Goodwill Account or Closing Goodwill Account), we should use either the old ratio or the new ratio. If we adjust the share of goodwill of the retiring partner only we should use only the gaining ratio.

Illustration 2

A, B and C are partners sharing profits and losses in the ratio of 4:3:2. B retires and on retirement the goodwill of the firm is valued at Rs. 43,200, No goodwill appears in the books. A and C agree to share future profits in the ratio of 5:3. Find the gaining ratio and pass the journal entries for goodwill in each of above cases.

Solution

Old ratio between A, B and C = 4:3:2

New Ratio between A and C = 5:3

Gaining ratio = New ratio — old ratio

A = 5/8 –4/9 = (45 –32)/72 = 13/72

C = 3/8 –2/9 = (27 –16)/72 = 11/72

Hence, A and C will compensate B in the ratio of 13 : 11

(a) When the full value of goodwill is raised in the books :

		Rs.	Rs.
Goodwill A/c	Dr.	43,200	
To A's Capital A/c			19,200
To B's Capital A/c			14,400
To C's Capital A/c			9,600
(Goodwill raised and credited to partners capital accounts in old ratio)			

Note : Goodwil will appear in the Balance Sheet as an asset until it is written off.

(b) When the full value of goodwill is raised in the books and written off :

		Rs.	Rs.
Goodwill A/c	Dr.	43,200	
To A's Capital A/c			19,200
To B's Capital A/c			14,400
To C's Capital A/c			9,600
(Being the Goodwill credited to all partners in old ratio)			
A's Capital A/c	Dr.	27,000	

C's Capital A/c	Dr.	16,200	
To Goodwill A/c			43,200
(Being the Goodwill written off in the new ratio)			

(c) **When the retiring partner's share of goodwill is raised and written off :**

		Rs.	Rs.
Goodwill A/c	Dr.	14,400	
To B's Capital A/c			14,400
(Being B's share of Goodwill)			
A's Capital A/c	Dr.	7,800	
C's Capital A/c	Dr.	6,600	
To Goodwill A/c			14,400
(Goodwill written off in the gaining ratio of 13:11)			

(d) When the goodwill is adjusted in Capital Account without opening a Goodwill Account :

		Rs.	Rs.
A's Capital A/c	Dr.	7,800	
C's Capital A/c	Dr.	6,600	
To B's Capital A/c			14,400
(Being due to B adjusted between A and C in their gaining ratio)			

Note : In all the above cases, B gets a credit for Rs.14,400 being his share of goodwill of the firm which comes from A and C in their gaining ratio of 13:11.

When goodwill already exists in the books at the time of retirement, the need for its revaluation arises to find out increase or decrease in its value. If the value has increased, Goodwill Account will be debited and Capital Accounts of all partners will be credited in their old ratio with the amount of increase. On decrease in its value, a reverse entry will be made.

Revaluation of Assets and Liabilities

Revaluation of assets and labilities is also required at the time of retirement of a partner in the same way as it is done in case of admission of a partner. The profit or loss which results from revaluation will be transferred to all partners' Capital Accounts in their old profit sharing ratio. For this purpose, a "Revaluation Account" or "Profit and Loss Adjustment Account" is prepared. If the remaining partners wish to show assets and liabilities at their old values Memorandum Revaluation Account will be prepared.

Adjustment of Accumulated Reserves and Losses

At the time of retirement, if general reserve, credit balance of Profit and Loss Account or other undistributed profits are given in the Balance Sheet, they are credited in the old partners' Capital Accounts in old profit sharing ratio. For this, the following journal entry is made:

Reserve or Profit and Loss A/c Dr.

To Partners' Capital A/c

(Old ratio)

If the partners want that only retiring partner's Capital Account be credited with his share in undistributed profits, then the following entry will be made.

Reserves or Profit and Loss A/c Dr.

To Retiring Partner's Capital A/c

(With the share of retiring partner)

Remaining undistributed profits will be shown in the Balance Sheet after retirement.

If the remaining partners want that, without changing the amount of reserves or profit, share be given to retiring partner, the following entry will be made :

Continuing Partner's Capital A/c Dr.

(In their gaining ratio)

To Retiring Partner's Capital A/c

Calculating the amount due to the retiring partner and its payment

The retiring partner's Capital Account is credited with his share of capital, share of goodwill, share of profit on account of revaluation and undistributed profits and reserves of last years. This account will be debited with his drawings, share in revaluation loss and other losses. If payment is no made to the retiring partner, the amount due is transferred to his loan account. According to Section 37 of Partnership Act, the retiring partner can have either interest @ 6% per annum on this amount due or the profit earned by remaining partners with the help of this amount from the date of retirement. For this, the journal entry will be :

Retiring Partner's Capital A/c Dr.

To **Retiring Partner's Loan A/c**

If remaining partners bring cash to pay off the retiring partner then, journal entry will be :

Bank A/c Dr.

To Continuing Partner's Capital A/c

(For cash brought in by partners in the

agreed ratio to pay off the retiring partner)

Payment in Instalments

Capital Account of the retiring partner is settled as per agreement. It may be settled in two ways :

1) Payment in instalments with interest

2) Payment in a fixed number of instalments of equal amount (including interest).

Amount of instalment can be calculated with the help of Annuity Table.

Note : **In the absence of any information, balance of retiring partner's Capital** Account will be transferred to his Loan Account.

Illustration 3

A, B and C were carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1, respectively. On 31st December, 1985, the Balance Sheet of the firm stood as follows :

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	13,590	Cash	5,900
Capital Accounts :		Debtors	8,000
A : 15,000		Stock	11,690
B : 10,000		Building	23,000
C : 10,000	35,000		
	48,590		48,590

B retires on the above mentioned date on the following terms :

(i) Building be appreciated by Rs. 7,000.

(ii) Provision for bad debts be made @ 5% on Debtors.

(iii) Goodwill of the firm be valued at Rs. 9,000 and adjustment in respect be made without raising a Goodwill Account.

(iv) Rs. 5,000 be paid to B immediately and the balance due to him be treated as loan carrying interest @ 6% per annum. Such loan is to be paid in three equal annual instalments together with interest.

Pass the journal entries to record the above mentioned transactions and **show the Balance Sheet of the firm as it would appear immediately after B's retirement. Prepare B's Loan Account** till it is finally closed.

Solution

Journal

Particulars	Dr. Rs.	Cr. Rs.
Building A/c Dr.	7,000	
To Revaluation A/c		7,000
(Being appreciation in the value of Building)		
Revaluation A/c Dr.	400	
To Provision for Bad Debts		400
(Being provision for bad debts created on debtors)		
Revaluation A/c Dr.	6,600	
To A's Capital A/c		3,300
To B's Capital A/c		2,200
To C's Capital A/c		1,100
(Being profit on revaluation credited to old partners)		
A's Capital A/c Dr.	2,250	
C's Capital A/c Dr.	750	
To B's Capital A/c		3,000
(Being B's share of goodwill adjusted in gaining ratio of 3:1 in A and C)		
B's Capital A/c Dr.	5,000	
To Bank A/c		5,000
(Being the amount paid to B on retirement)		
B's Capital A/c Dr.	10,200	
To B's Loan A/c		10,200
(Balance of amount due to B transferred to his loan account)		

Balance Sheet

as on 1st January, 1986

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	13,590	Cash	900
B's Loan A/c	10,200	Debtors 8,000	
Capital Accounts :		Less : Prov. for bad debts 400	7,600
A : 16,050		Stock	11,690
B : 10,350	26,400	Building 23,000	
		Add : Appreciation 7,000	30,000
	50,190		50,190

B's Loan Account

1986	Rs.	1986	Rs.
Dec.31 To Bank	3,816	Jan. 1 By Balance b/d	10,200
To Balance c/d	6,996	Dec. 31 By Interest A/c	612
	10812		10,812
1987		1987	
Dec. 31 To Bank	3,816	Jan. 1 By Balance b/d	6,996
To Balance c/d	3,600	Dec.31 By Interest A/c	420
	7,416		7,416
1988		1988	
Dec.31 To Bank	3,816	Jan. 1 By Balance b/d	3,600
		Dec. 31 By Interest A/c	216
	3,816		3,816

Working Notes

(i) New Profit-Loss sharing Ratio :

Old Profit-sharing Ratio of A, B and C = 3/6 : 2/6 : 1/6, After B's retirement the ratio between A & C will be = 3 : 1 or 3/4 : 1/4

(ii) Gaining Ratio of A and C :

Gain to A = 3/4 – 3/6 = (18–12)/24 = 6/24

Gain to C = 1/4 – 1/6 = (6–4)24 = 2/24 Hence

the gaining ratio is 6/24 : 2/24 or 3 : 1

(iii) According to Annuity Table .37410981 should paid every your to repay rupee one with 6 per cent interest in 3 years. The annual instalment for payment of Rs. 10,200 comes to Rs. 10,200 × .37410981 = Rs. 3,816

Illustration 4

P and Q were working in partnership profits and losses equally. On 31 December, 1996, P decided to retire and in his place his son R was admitted as partner from 1 January, 1997, with 1/3 share of profit.

Balance Sheet

as on December 31, 1996

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	14,700	Goodwill	15,000
Capital Accounts :		Land & Building	40,050
P : 54,300		Motor Car	12,000
Q : 48,000	1,02,300	Furniture	9,300
		Sundry Debtors	24,150
		Cash at Bank	16,500
	1,17,000		1,17,000

It was decided that:

a) The goodwill would be raised to Rs. 20,000.

b) The car would be taken over by P at its book value.

c) The value of land and buildings would be increased by Rs. 8,280.

d) Q and R would introduce sufficient capital to pay off P and to leave thereafter a sum of Rs. 7,350 as bank balance, so as to make their capital proportionate to their share of profits.

e) The Capital payable by R was to be gifted to him by his father.

f) The new partners decided not to show goodwill as an asset.

The new arrangements were duly complied with. Show the partners Capital Account and the Bank Account.

Solution

Capital to be brought in by the partners :

Total Capital of the new firm :

	Rs.
Goodwill	20,000
Land and Buildings	48,330
Furniture	9,300
Sundry Debtors	24,150
Cash at Bank	7,350
Total Assets	1,09,130
Less : Creditors	14,700
Total Capital of Q and R	94,430
Q's Capital = 94,430 × 2/3	62,953
R's Capital = 94,430 × 1/3	31,477

Amount payable to P :

		Rs.
P's Capital		54,300
His share of profit on revaluation :		
Goodwil	5,000	
Land & Buildings	8,280	
13,280 ×1/2 =		6,640

		60,940
Less : Capital of R to be gifted by P		31,477
		29,463
Less : Car taken over	12,000	
Balance payable in cash		17,463

Amount to be brought in by Q :

	Rs.
Q's Capital	48,000
His share, 1/2 of profit on revaluation	6,640
Existing Capital	54,640
Q's share in the new firm	62,953

Cash to be brought in by Q = Rs. 62,953 –Rs. 54,640 = Rs. 8,313

Capital Accounts

	P	Q	R		P	Q	R
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To R's Capital A/c	31477	–	–	By Balance b/d	54300	48000	–
To Motor Car A/c	12000	–	–	By Revaluation A/c	6640	6640	–
To Bank A/c	17463	–	–	By Bank A/c	–	8313	–
To Goodwill A/c	–	13333	6667	**By P's Capital A/c**	–	–	31477
To balance c/d	–	49620	24810				
	60940	62953	31477		60940	62953	31477

Bank Account

	Rs.		Rs.
To Balance b/d	16500	**By P's Capital A/c**	17463
To Q's Capital A/c	8313	By Balance c/d	7350
	24813		24813

Illustration 5

A, B and C share profits and Losses as 1 : 2 : 2. On 31 st December, 1989 when A decided to retire, their capitals were Rs. 27,000; Rs. 54,000 and Rs. 54,000 respectively. A agreed to keep his capital in the firm as a loan subject to 6% per annum interest. However, he was to receive a share in the profits after charging interest on capital and loan of new firm for the year 1990, of only an amount equal to 1/3 of his share in the old firm. On 1st January, 1990 D was admitted who paid Rs. 18,000 for his capital and Rs. 12,000 for his 1/7 share of goodwill. The goodwill was shared by B and C in their respective ratios.

In 1990, the firm earned a profit of Rs. 67,020, before charging interest on loan of A and on capital @ 5 percent. Show the profit sharing ratios for the year 1990. Also show the Capital of the partners on 31st December. 1990.

Solution

Profit and Loss Account
for the year ended 31st December, 1990

Particulars	Rs.	Particulars	Rs.
To interest on A's Loan (6% on Rs. 27,000)	1620	By Net profit	67020
To Interest on Capital : (@ 5%)			
B on Rs. 60000 3000			
C on Rs. 60000 3000			
D on Rs. 18000 900	6900		
To A's Loan A/c (1/15 of Rs. 58,500)	3900		
To Profit Transferred to Capital Accounts			
B : 3/7 23400			
C : 3/7 23400			
D : 1/7 7800	54600		
	67020		67020

Capital Accounts

	P	Q	R		P	Q	R
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
1990				1990			
Dec. 31				Jan. 1			
To Balance c/d	86400	86400	26700	By Balance b/d	54000	54000	–
				By Goodwill A/c	6000	6000	–
				By Cash	–	–	18000
				Dec. 31			
				By Interest A/c	3000	3000	900
				By P & L A/c	23400	23400	7800
	86400	86400	26700		86400	86400	26700

Working Notes

(1) A is entitled to 1/3 of his previous share = 1/5 × 1/3 = 1/15

(2) Profit sharing ratio among B, C and D for 1990 and 1991 and 1991 will be 3/7, 3/7 and 1/7 respectively, calculated as :

B + C = 1 – 1/7 = 6/7

B's Share = 6/7 × 1/2 = 3/7

C's Share = 6/7 ×1/2 = 3/7

(3) **A's share in firm's profit = Rs. (Rs. 67,020** – Rs. 1,620 – Rs. 6,900) × 1/15 = Rs. 3,900

5.2.3 DEATH OF A PARTNER

The accounting treatment at the time of death of a partner is same as at the time of retirement. Main difference between the two is that of closing of the account of business. **Deceased partner's capital account is credited with his opening capital, interest on capital** up to his death**, his share in undistributed profits, revaluation profits, firm's**

Profits from the date of the last balance sheet up to his death and with his share of goodwill. Drawings, interest on drawings and losses are debited in the deceased partner's Capital Account and the remaining amount is transferred to his legal representative's account. Legal representative can receive either interest at 6 per cent per annum, on the amount due from the date of death to the date of settlement or the profit earned with the help of that amount.

Most of the points have already been discussed in the retirement of a partner but the following two points require special attention:

i) Calculation of deceased partner's share of profit.

ii) Treatment of life policy or policies.

These will be discussed one by one.

5.2.3.1 Calculation of Deceased Partner's Share of Profit

The deceased partner's share of profit is to be determined either on the basis of time or turnover.

(a) On the basis of time: In this case, it is assumed that the profit during the previous year has been earned uniformly in all months during the year, provided previous year is taken as the base for calculation of profit. Sometimes average profits of the past three or four years is taken as base rather than the previous year. Whatever base may be taken, it is to be multiplied by the period for which the deceased partner remained in the firm and also his profit sharing ratio at the time of his death. For example A, B, and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. B dies on 14th March, 1996. The average of the last three years is Rs. 30,000. B's share of profit on the basis of time is calculated as under:

Average yearly profit = Rs. 30,000

Profit for 73 days i.e., Jan. 1 to March 14, 1996 = $\frac{\text{Rs. } 30{,}000 \cdot 73}{365}$ = Rs. 6,000

B's share = 2/6 × 6,000 = Rs. 2,000

(b) On the basis of turnover: In this method, average past profit is divided into two portions i.e., before the death and after the death on the basis of ratio of turnover to the date of death to average turnover and then deceased partner's share is calculated and credited to his capital account. For example, A, B and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1. B dies on 14th March, 1996. Turnover from 1st January, to 14th March, 1996 is Rs. 42,000. Average turnover of the last three years is Rs. 60,000 and profit is Rs. 30,000. B's share of profit on this basis will be calculated as under:

Average turnover = Rs. 60,000

Sales to the date of death = Rs. 42,000.

Profit to the date of death = Rs. 42,000 × ……. = Rs. 21,000

B's share of profit = × 21,000 = Rs. 7,000.

5.3.2.2 Treatment of Life Policies

To make an arrangement for the paym1ent of amount belonging to deceased partner
3
to his legal representative, the firm can get insured the life of all the partners jointly or **individually. Premiums on life policies are paid out of firm's funds and this is debited to firm's Profit and Loss A**ccount. Amount received in the form of claim from the life insurance company is credited to all the partners in their profit/loss sharing ratio. In the case of individual policies also, the deceased partner is entitled to his share in the surrender value of policies of all the partners. Other partners are also entitled to their respective share in the amount of policy of the deceased partner.

Illustration 6

Brown and Smith are partners. The partnership deed provides inter alia:

i) That the Account be balanced on 31st December each year.

ii) That the profits be divided as follows : Brown 1/2; Smith 1/3 and carried to a Reserve account 1/6.

iii) That in the event of the death of a partner, his executors be entitled to be paid :

(a) The capital to his credit at the date of death.

(b) His proportion of reserve at the date of last balance sheet.

(c) His proportion of profit to date of death based on the average profits of the last three completed years.

(d) By way of goodwill his proportion of the total profits for the three preceding years.

On 31st December, 1989, the Ledger balance were :

	Rs.	Rs.
Brown's Capital		9,000
Smith's Capital		6,000
Reserve		3,000
Creditors		3,000
Bills Receivable	2,000	
Investments	5,000	
Cash	14,000	
	21,000	21,000

The profit for three years were :

1987 Rs. 4200, 1988 Rs. 3900, 1989 Rs. 4500. Smith died on 1st May, 1990

Show the accounts as between the firm and Smith's died on 1st May, 1990

Solution

Effective profit sharing ratio between Brown and Smith is 3 : 2 Smith's share in the profits to the date of death :

	Rs.
Profit for 1987	4,200
Profit for 1988	3,900
Profit for 1989	4,500
Total Profits	12,600

Average = Rs. 12,600/3 = Rs. 4,200

Profit for 4 months upto May 1, 1990 = 4,200 × 1/3 = Rs. 1,400

Smith's share therein = Rs. 1,400 × 2/5 = 560

Smith's share in Goodwill :

Goodwill = Rs. 12,600

Smith's share = Rs. 12,600 × 2/5 = Rs. 5,040

Smith's Capital Account

	Rs.		Rs.
1990		1990	
May, 1		May 1	
To Smith's Executors' A/c	12,800	By Balance b/d	6,000
		By Reserve A/c	1,200
		By P & L suspense A/c	560
		(Profit upto death)	
		By Goodwill A/c	5,040
	12,800		12,800

Smith's Executors' Account

		Rs.
	1990	
	May 1	
	By Smith's Capital A/c	12,800
		12,800

Joint Life Policy

Accounting treatment of Joint Life Policy may be done by any of following methods:

1. First Method: When payment of premium is considered as a business expenditure

Under this method, the amount of premium is charged to Profit and Loss Account of each year and the amount received from insurance company on the death of any partner is treated as income. Bank Account will be debited and Joint Life Policy Account will be credited with the amount received from the insurance company on the death of a partner. Then Joint Life Policy Account is closed by transferring it to all the partners Capital Accounts (including the deceased partner) in their profit sharing ratio. The main problem in this method is that no surrender value of policy is shown in the books.

2. Second Method : When surrender value is treated as an asset

In this method at the time of payment of premium, the Joint Life Policy Account is debited and Bank Account is credited. That amount of premium which is more than surrender value at the end of year, it is assumed as loss with which Profit and Loss Account is debited and Joint Life Policy Account is credited. Joint Life Policy Account (Surrender Value) is shown as asset in the Balance Sheet.

At the time of death of any partner, Bank Account is debited and Joint Life Policy Account is credited with the amount received. Credit balance of Joint Life Policy Account **is considered as profit and transferred to all partners' capital** accounts in their profit-loss sharing ratio.

The main advantage of this method is that surrender value is considered as an asset and disadvantage is that the premium is not shown fully as an expense in Profit and Loss Account.

3. Third Method : When premium is considered as an asset

With the amount of premium paid, Joint Life Policy Account is debited and Bank Account is credited. Joint Life Policy Account is shown as an asset in the Balance Sheet. At the time of death of any partner, Bank Account is debited and Joint Life Policy Account is credited. After his, if there is any credit balance in Joint Life Policy Account, it is distributed among all partners in their profit sharing ratio.

4. Fourth Method : When payment of premium is treated as an investment and a Reserve Account is opened -

   1. Premium is debited to Joint Life Policy Account.
   2. Every year amount equal to the premium is debited to Profit and Loss Appropriation Account and credited to Joint Life Policy Reserve Account.
   3. Joint Life Policy Account and Joint Life Policy Reserve Account are adjusted in such a way that the balance in each account is equal to surrender value of the policy.
   4. At the death of a partner Joint Policy Account is credited with the amount received. Credit balance of Joint Policy Reserve Account is transferred to Joint Life Policy Account and Joint Life Policy Account is closed by transferring to Capital Accounts of all the partners in their profit sharing ratio.

Under this method, surrender value is shown on the assets side and Joint Life Policy Reserve Account on liabilities side of Balance Sheet.

Main advantage of this method is that surrender value is shown in Balance Sheet and all premium is charged from Profit and Loss Appropriation Account.

Illustration 7: (a) A and B are partners in a firm. On April 1, 1997 they took out a Joint Life Policy without profits for Rs. 30,000 upon which an annual premium of Rs. 1,400 is payable. A and B share profits in the ratio of 2 : 1. On March 31, 1998

B died and Rs. 30,000 is received from the Insurance Company.

Journalise the above transactions. Premium is to be adjusted through Profit and Loss Account.

(b) A and B who shared profits in the ratio of 3 : 2 took a joint life policy on May 1, 1995 for Rs. 30,000. The annual premium was Rs. 1,300. The surrender value of the policy was:

1995 Nil; 1996 Rs. 400; 1997 Rs. 900; 1998 Rs. 1,450

B died on September 15, 1995 and the amount of the policy was received on Dec. 341, 1998. The books are closed on Dec. 31, each year.

Show Joint Life Policy Account and Joint Life Policy Reserve Account assum–ing that premiums were written off through Joint life Policy Reserve Account.

Solution

Journal Entries

1997		Rs.	Rs.
April 1 Joint Life Policy Premium A/c	Dr.	1,400	
To Bank A/c			1,400
(Being the payment of annual premium)			
1998			
Mar. 31 Profit and Loss Account	Dr.	1,400	
To Joint Life Policy Premium A/c			1,400
(Being Premium charged to P & L A/c)			
Mar. 31 Insurance Company A/c	Dr.	30,000	
To Joint Life Policy A/c			30,000
(Being the amount of J.L.P. due for receipt)			

Mar. 31	Bank Account	Dr.	30,000	
	To Insurance Company A/c			30,000
	(Being the receipt of claim from Insurance Company)			
Mar. 31	Joint Life Policy A/c	Dr.	30,000	
	To A's Capital A/c			20,000
	To B's Capital A/c			10,000
	(Being the amount of policy distributed between partners in the ratio of 2 : 1)			

(b) Joint Life Policy Account

1995		Rs.	1995		Rs.
May 1	To Bank A/c	1,300	Dec. 31	By J.L.P. Reserve A/c	1,300
1996			1996		
May 1	To Bank A/c	1,300	Dec. 31	By J.L.P. Reserve A/c	900
				By Balance c/d	400
		1,300			1,300
1997			1997		
Jan. 1	To Balance b/d	400	Dec. 31	By J.L.P. Reserve A/c	800
May 1	To Bank A/c	1,300		By Balance c/d	900
		1,700			1,700
1998			1998		
Jan. 1	To Balance b/d	900	Sept. 15	By Bank A/c	30,000
May 1	To Bank A/c	1,300		By J.L.P. Reserve A/c	900
Dec. 31	To Capital A/c:				
	A	17,220			
	B	11,480			
		30,900			30,900

Joint Life Policy Reserve Account

1995		Rs.	1995		Rs.
Dec. 31	To Joint Life		Dec. 31	By P & L	
	Policy A/c	1,300		Approp. A/c	1,300
1996			1996		
Dec. 31	To Joint Life		Dec. 31	By P. & L	
	Policy A/c	900		Approp. A/c	1,300
	To Balance c/d	400			
		1,300			1,300
1997			1997		
Dec. 31	To Joint Life		Dec. 31	By Balance b/d	400
	Policy A/c	800		By P & L Approp. A/c	1,300
	To Balance c/d	900			
	1,700			1,700	
1998		1998			
Sept. 15	To Joint Life		Sept. 15	By Balance b/d	900
	Policy A/c	900			

POSSIBLE QUESTIONS

PART B (2 MARKS)

1. What is partnership?
2. What is partnership deed?
3. What do you mean by retirement of a partner?
4. What is mean by admission of a partner?
5. What is the difference between gaining ratio and sacrificing ratio?

PART C (8 MARKS)

1. P, Q and R are in the partnership and on 1st January, 1995 their respective capitals were Rs. 20,000, Rs, 12,000 and Rs, 10,000. Q is entitled to a salary of Rs. 2,500 and R Rs. 2,000 per annum, payable before division of profits. Interest is allowed on capital @ 5% per annum but is not charged on drawings. Of the net divisible profits of first Rs. 10,000; P is entitled to 40%, Q to 35% and R to 25% and over that amount profits are shared equally. The profit for the year ended 31st December, 1995 after debiting partnership salaries, but before charging interest on capitals, was Rs. 18,000 and partners had withdrawn Rs. 800 each. Prepare partners' accounts for the year.
2. Ravi, Shanker and Sastry are partners sharing profits and losses as 6:5:4. They have a Joint Life Policy for Rs. 2,00,000 on which they pay Rs. 7,500 per annum as premium and debit the same to Profit and Loss Account as premium. Accounts are closed annually on 31 December.
    a. Shanker died on 1st April, 1995 and his legal representatives are entitled to :
        i. His capital as appearing in the last Balance Sheet.
        ii. Interest on capital at 6 per cent per annum to the date of death.
    b. His share of profit calculated till date of his death on the basis of the previous years profit; and
    c. His share of goodwill calculated as two years purchase on the average of

the last three years' profit before inclusion of the policy premium as business expense.

d. Shanker's drawing in 1995 amounted to Rs. 3000. His capital shown in 1994 Balance Sheet was Rs. 80000. The profit for the three years 1992, 1993 and 1994 after inclusion of the policy premium as business expense amounted to Rs. 65000, Rs. 64000 and Rs. 69000 respectively.

e. Prepare Shanker's Capital Account

3. Explain goodwill and describe various methods of valuing goodwill.

4. Explain the treatment of goodwill in case of admission of a new partner with journal entries.

5. What is Revaluation Account ? How is it prepared ? How is it different from Memorandum Revaluation Account.

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UNIT I

QUESTION	OPTION A	OPTION B	OPTION C	OPTION D	ANSWER
called as	single entry	accounting	journalising	ledger	accouning
Accounting begins ----------------- ends.	book keeping	voucher	business transactions	overdraft as per pass book	book keeping
The statement containing various ledger balances on a date is known as ---------------	trial balance	balance sheet	profit/loss a/c	net profit	trial balance
Ledger is a set of -------------	accounts	journal	transactions	overdraft as per pass book	accounts
Journal records transactions in a ----------- order.	chronological	analytical	sequence	capital account	chronological
Ledger records in an -------- order	Alphabetical	analytical	chronological	cash	analytical
When the goods are returned to the supplier a ---------- is sent to him	debit note	credit note	journal proper	ledger	debit note
In doubel entry system, every business transaction records ------------ aspect	one	two	three	four	two
Impersonal account are classified in to	three	two	four	five	two
ledger is termed as -----------------	posting	recording	both (a) and (b)	net profit	posting
An asset worth Rs. 1,00,000 is sold for Rs.85,000 the capital loss amounts to	Rs.85,000	Rs.1,00,000	Rs.15,000	Rs.1,85,000	Rs.15,000
Amount spent on acquiring a copy right is an example for	capital expenditure	revenue expenditure	expenditure	Profit and loss	capital expenditure
One of the current assets is	Stock	Machinery	land	Sales	Stock
cost means ---------	price	expenses	production	building .	price
An account which receives the benefit from a transaction is called --------	credit	debit	both debit and credit	not a transaction	debit
If investments having an original cost of Rs. 20,000 are sold for Rs.16,000,so what is the capital loss?	Rs. 20,000	16,000	Rs.4000	Rs.36,000	Rs.4000
Bank account is a	Personal account	Real account	nominal account	capital account	Personal account
A written document in support of a transaction is called --------------	Receipt	credit note	Debit note	total cost of asset	Receipt
Business transaction may classified in to ---------------- transactions	Three	Two	One	invoice book	two
Rent paid to land lord. Rent account is a	Personal account	Real account	nominal account	not an account	nominal account
Purchase return means goods return to the supplier due to -----------	good quality	defective quality	super quality	overdraft as per pass book	defective quality
Amount spent in order to produce and sell the goods and services is called	expense	income	revenue	total cost of asset	expense
Amount owned by the proprietor is ------------	assets	liabilities	capital	overdraft as per pass book	capital
The accounting equation is connected with -------------------	assets only	liabilities only	assets, liabilities, and capita	invoice book	assets, liabilities, and cap
Goods sold to 'X' should be debited to	cash a/c	X a/c	sales a/c	total cost of asset	X a/c
Purchased goods from ' Y' for cash should be credited to	Y a/c	Cash a/c	purchases a/c	overdraft as per pass book	Cash a/c
Withdrawals of cash from bank by the proprietor for office use should be credited to	drawings a/c	bank a/c	cash a/c	total cost of asset	bank a/c
Purchased goods from X on credit should be credited to	X a/c	Cash a/c	Purchases a/c	total cost of asset	X a/c
An entry is passed in the beginning of each current year is called	original entry	final entry	opening entry	invoice book	opening entry
As per business entity assumption the business is different from the	owners	banker	Government	total cost of asset	owners
Going concern assumption tells us the life of the business is	very short	very long	long	capital account	very long
Cost incurred should be matched with the revenues of the particular period is based on	matching concept	historical concept	full disclosure concept	invoice book	matching concept
As per dual aspect concept, every business transaction has	three aspects	one aspect	two aspects	total cost of asset	two aspects
Ledger is a book of	original entry	final entry	all cash transactions	invoice book	final entry
brackets.	journal	ledger	narration	account	narration
The column of ledger which links the entry with journal is	L.F column	J.F column	particulars column	overdraft as per pass book	J.F column
amount of each transactions.	journal	ledger	narration	account	journal
Nominal account having credit balance represents	income / gain	expenses/losses	assets	capital account	income gain
Nominal account having debit balances represents	income/gain	expenses/losses	liability	invoice book	expenses/losses
Real account always shows	debit balances	credit balances	nil balances	invoice book	debit balances
An account which contains details about expenses, losses, incomes and gains.	real account	nominal account	personal account	impersonal account	nominal account
When the total of debits and credits are equal, it represents	debit balance	credit balance	nil balance	total cost of asset	nil balance
Debit what comes in and credit what goesout is related to	real account	nominal account	personal account	impersonal account	real account
equal amount and vice versa".	double entry system	single entry system	triple entry system	four entry system	double entry system
Purchase book is kept to record --------------	all purchases	cash purchases only	only credit purchases	total cost of asset	only credit purchases
Credit sales are recorded in ------------	sales book	sales return book	purchase return book	cash book	sales book
Goods returned by customers are recorded in	sales book	sales return book	purchase return book	cash book	sales return book
The cash book records -------------------	all cash payments	all cash receipts	payments	overdraft as per pass book	payments
Cash book is one of the ----------- books.	purchase book	subsidiary book	sales book	invoice book	subsidiary book
The balance of cash book indicates	net income	cash in a hand	debtors and creditors	Sales	cash in a hand
Purchase journal records only ---------- purchase of goods	credit purchases	cash purchases	credit sales	cash sales	credit purchases
Sales journal records all ----------- sales of goods	credit purchases	cash purchases	credit sales	cash sales	credit sales
Purchases Book, Sales Book, Purchase Return Book and Sales Return Book are	day books.	Cash book	Subsidiary book	debit book	Subsidiary book
Which is given to a customer who buys goods regularly or buys goods in large quantity?	Trade discount	Cash discount	Commission	Percentage	Trade discount
actual receipt.	Business entity	cost	matching	accrual	accrual
As per accounting procedure, Investment account is a	Personal account	Real account	nominal account	not an account	real account
Sales book other wise known as ----------	purchase book	sales return book	day book	purchases return book	day book
A ---------------- is a special journal which is used for recording all cash receipts and cash payments.	day books.	Cash book	Subsidiary book	debit book	cash book
In a business , very small expenses like postage, telegram are recored in ------	cash book	day book	Subsidiary book	petty cash book	petty cash book
To find the arithmetical accuracy of all accounts , --------------- is prepared.	subsidiary	journal	ledger	trial balance	trial balance

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UNIT I

QUESTION	OPTION A	OPTION B	OPTION C	OPTION D	ANSWER
UNIT II					
The main object of providing depreciation is:	To calculate true profit.	To show true financial p	To reduce tax.	To provide funds for replaceme	**To calculate true profit.**
Depreciation arises because of:	Fall in the market value of an ass	Physical wear and tear.	Fall in the value of money	Tax reduction	**Physical wear and tear.**
Depreciation is a process of:	Valuation	Allocation	Segregation	Both valuation and allocation	**Valuation**
Under the straight line method of providing depreciation it:	Increase every year.	Remain constant every y	Floating every year	Decreases every year	**Remain constant every y**
Under the diminishing balance method depreciation it:	Increase every year.	Remain constant every y	Floating every year	Decreases every year	**Decreases every year**
Under the fixed installment method of providing depreciation it is calculated on:	Original cost	on balance amount	On scrap value	Installment value	**Original cost**
Under the diminishing balance method, depreciation is calculated on:	Scrap value	On original value	On book value	Cost value	**On book value**
The amount of depreciation charged on machinery will be debited	Machinery a/c	Depreciation account	Cash account	Repair account	**Depreciation account**
Loss on sale of plant and machinery should be written off against:	Share premium	Depreciation fund accou	Sale account	Profit & loss account	**Depreciation fund accou**
Loss on sale of machinery will be:	Debited on machinery A/c	Credited to machinery A	Credited to profit and loss A/c	Profit & loss account	**Credited to machinery A**
Asset which have a limited useful life are termed as:	Limited assets	Depreciation assets	Unlimited asset	Dummy assets	**Depreciation assets**
Process of becoming out of date or obsolete is termed as:	Physical deterioration	Depletion	Obsolescence	Amortization	**Obsolescence**
Which of the term is used to write off in reference to tangible fixed assets.	Depreciation	Depletion	Amortization	Both (b) and (c)	**Depreciation**
The economic factors causing depreciation:	Time factor	Obsolescence and inade	Wear and tear	Money valuation	**Obsolescence and inade**
Profit prior to incorporation is an example of:	Capital reserve	Revenue reserve	Secret reserve	Redemption	**Capital reserve**
Total depreciation cannot exceeds its:	Scrap value	Cost value	Market value	Depreciable value	**Depreciable value**
Depreciation value of an asset is equal to:	Cost + Scrap value	Cost + Market price	Cost – Scrap value	Cost + Market price– Scrap val	**Cost – Scrap value**
Depreciation does not depend on fluctuations as:	Market value of asset	Cost of price of asset	Scrap value of asset	Depreciable value	**Market value of asset**
Depreciation is:	An income	An asset	A loss	A liability	**A loss**
The book value of an asset is obtained by deducting depreciation from its:	Market value	Scrap value	Market + Cost price	Cost	**Cost**
Depreciation fund method is also known as:	Sinking fund method	Annuity method	Sum of years digits method	Depletion Method	**Sinking fund method**
In the provision method of depreciation the asset always appears at:	Cost price	Market Price	Scrap Value	Market value	**Cost price**
three years will be	Rs. 1400	Rs. 1,458	Rs. 542	No answer	**No answer**
The amount of depreciation charged on a machinery will be debited to	Machinery a/c	Depreciation account	Cash account	Repair account	**Depreciation account**
Loss on the sale of machinery should be written off against	Share premium account	Sales account	Depreciation fund account	Machinery a/c	**Depreciation fund accou**
The main objective of providing depreciation is	To allocate true profit	financial position in the	To reduce tax burden	replacement of fixed assets	**To allocate true profit**
In the accounting records, the fixed assets are normally recorded	At cost	At book value	At scrap value	At replacement value	**At cost**
Salvage value means	disposed off	estimated disposal value	definite sale price of the asset	Cost – Scrap value	**estimated disposal value**
Depreciation follows which accounting concept	Historical cost concept	Matching concept	Money measurement concept	Going concern concept	**Matching concept**
What method do we use for depreciating tools,crates	Diminishing balance method	Reducing balance metho	Straight line method	Reducing balance method	**Reducing balance metho**
The Profit and Loss account shows	Financial position of the	Net profit or Net loss	an asset	Gross profit or Gross Loss	**Financial position of**
Returns inwards are deducted from	Purchases	Sales	Returns outward	Cost price	**Sales**
Rent outstanding is	a liability	an asset	an income	Receivable	**a liability**
Closing stock is shown in	Profit and loss account	Trading account and	Purchases	Net profit or Net loss account	**Trading account and**
Opening stock is shown in	Balance sheet	Profit and Loss	Trading account	Sales	**Trading account**
Gross Profit is transferred to	Capital account	Profit and loss account	Balance sheet	Trading account	**Profit and loss account**
Interest on capital is added to	Expense A/c	Income A/c	Capital A/c	Asset Account	**Capital A/c**
Interest on drawings is deducted from	Income A/c	Capital A/c	Expense A/c	Profit and Loss account	**Capital A/c**
Outstanding interest on loan borrowed is to be added to	Asset A/c	Income A/c	Loan A/c	Capital A/c	**Loan A/c**
All the items given in the adjustment will appear at _________	Three places	Two places	One Place	Four Place	**Two places**
_____________is the original form of accounting	Financial accounting	Cost accounting	Management accounting	Business Accounting	**Management accounting**
A person who owes money to the business is a __________	Debtor	Creditor	Investor	Agent	**Debtor**
A _________ is a person to whom business owes money	Creditor	Debtor	proprietor	Investor	**Creditor**
Asset acquired for long period of time in the business is known as	Fixed asset	Current asset	Fictitious asset	Dummy assets	**Fixed asset**
______________ is the major source of revenue of any business	Purchase	Sale	Interest	Commission	**Sale**
Excess of current asset over current liabilities is known as _________ capital	Fixed	Working	Current	Variable	**Working**
long time	Accounting entity	Going concern	Accounting period	Matching Concept	**Going concern**
Bank account is a _________	Personal accounting	personal accounting	Nominal account	Asset Account	**Personal accounting**
Capital expenditure are recorded in the __________	Balance sheet	Profit & loss account	Asset Account	Trading account	**Balance sheet**
Nominal accounts are related to	Assets& liability	Expenses & losses	Debtors & creditors	Profit and Loss account	**Assets& liability**
Trading account is a ____________account	Real	Nominal	Personal	Capital A/c	**Nominal**
Income tax is debited to ________________	Profit and loss account	Cash accounting	Drawings account	Asset Account	**Drawings account**
Debit is the asset means	Increase	Decrease	No charge	Fixed	**Increase**
Credit in the liability means	Increase	Decrease	No charge	Fixed	**Increase**
Capital always have a __________balance	Debit	Credit	Payable	Receivable	**Credit**
description of every transaction made in the journal is called	Summary	Description	Narration	Information	**Narration**
Capital expenditure are recorded in the __________	Trading account	Profit & loss account	Asset Account	Balance sheet	**Balance sheet**
Tangible asset Bills receivable is a ___________	Trading account	Profit & loss account	Asset Account	Balance sheet	**Trading account**
Carriage outward is debited to___________	Trading account	Profit & loss account	Asset Account	Balance sheet	**Profit & loss account**
Sales return appearing in the trail balance are deducted from	Capital	Sales	Purchase	Asset	**Sales**

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DEPARTMENT OF COMMERCE

FINANCIAL ACCOUNTING (17CMU101)

UNIT I

QUESTION
Unit-III
Hire purchase act was force to came from-------------
Hire purchase price = -------------+interest outstanding
The possession or goods will be passed by the owner to the -------------
Initial payment is known as ------------------
.-------------price includes cash price and interest
Hire purchase price includes cash price and----------------
.For closing interest a/c ----------------------a/c is credited
The additional amount apart from the cash price payable by the buyer as compensation for postponed
The buyer of the goods on hire purchase basis is termed as ________.
The seller of the goods on hire purchase basis is termed as ________.
Under _______ system ownership is transferred on payment of final instalment.
The parties involved in instalment system are called _______.
In hire purchase system the relationship between the hirer and hire vendor is that of ________.
.In instalment purchases system, the relationship between the buyer and seller is that of --
.Instalment purchase is governed by _________ Act.
Hire purchase act was passed in the year _______.
In hire purchase system, for paying down payment ________ A/c is debited.
Hire purchase price – cash price = ________.
If the hire purchaser fails to make payment of any instalment, it is called _______payment.
The hire vendor has the right to take array the goods sold on hire purchase in the event of default is
The hire vendor may take away all the goods on which there is default of instalment is known as
The hire vendor may take away only a portion of the goods on which there is default of instalments is
When sales of small value are made in addition to normal sale, the hire vendor follows _______ method
Under debtors method, the profit or loss made on goods sold on hire purchase made on goods sold on
Under _______ system, the property in goods passes to the buyer immediately on signing the contract.
Under hire purchase system ownership of goods is passed to the buyer on payment of _______.
Hire purchase price = _______ + interest outstaning
The possession or goods will be passed by the owner to the _______.
The main objective of providing depreciation is
depreciation arises because of
.under straight line method of depreciation , depreciation

under diminishing balancing method, depreciation is calculated on
The transactions, which involve consumer’s approval or rejections of goods after physical delivery, are
When the goods are sent on sale or return basis _______ A/c is debited.
In sale or return basis, when customers return the goods _______ A/c is debited.
In sale or return basis of accounting if market price of goods is less than cost, stock must be shown at
A ________ is opened on memorandum basis to show the goods sent, approved, rejected and balance
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An agreement of hiring with option to buy is ____________.

An agreement of sale is made under ________.

Under which system, ownership is transferred on payment of final installment

Under which system ownership is transferred on signing of the agreement

Under hire purchase system the buyer is called _________.

Under hire purchase system the seller is called _________.

Under hire purchase system the relationship of hirer and hire vendor is ______.

Under hire purchase system, the risk of loss is borne by ____________.

Under installment system the risk of loss is borne by ________.

Under hire purchase system who has the right of sell __________.

Under hire purchase system, if installment is not paid the hire vendor has right to ___________.

Under hire purchase system, the agreement can be _________.

Hire purchase system is governed by ___________.

Installment system is governed by _______

Cash price plus interest is _________.

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COIMBATORE- 64

(For the candidates admitted from 2

OPTION A	OPTION B	OPTION C
1973	1974	1971
Cash price	Purchase price	Interest price
Seller	Owner	Hirer
Up payment	Down payment	Non cash payment
Cash price	Non cash price	Sale price
Interest	Cash	Purchase
P&L	Interest	Trading
hire purchase price	interest	cash price
owner	vendor	hirer
hire vendor	owner	both
hire purchase system	instalment system	single entry system
vendor and hirer	buyer and seller	debtor and creditor
debtor and creditor	bailor and bailee	owner and hirer
debtor and creditor	bailor and bailee	owner and hirer
sale of goods	hire purchase act	instalment purchase
1980	1978	1975
hire vendor	hirer	cash
total interest	first balance	total amount
instalment price	hire price	default
default	repossession	both
complete repossession	partial repossession	repossession
complete repossession	partial repossession	forfeiture
debtors	creditors	stock
trading A/c	profit and loss A/c	hire purchase trading
hire purchase	instalments purchase	both
initial payments	final payments	both down & initial
cash price	purchase price	interest price
Seller	owner	hirer
to calculate true profit .	To calculate loss	To find out the
fall in market value of	. Physical wear and tear	fall in value of money
.increases every year	.decreases every	remains constant

original cost	written down value	scrap value
purchases	purchase returns	sale or return on sale
sale	customer	both
sale	customer	goods
cost	invoice	market
Sale or return day book	sales or return ledger	rough ledger
sale/returns	customer	purchases
instalment price	hire price	default
default	repossession	both
complete repossession	partial repossession	repossession
complete repossession	partial repossession	forfeiture
debtors	creditors	stock
trading A/c	profit and loss A/c	hire purchase trading
hire purchase	instalments purchase	both
installment system.	credit system	Hire purchase system
installment system.	credit system	Hire purchase system
installment system.	credit system	Hire purchase system
installment system.	credit system	Hire purchase system
buyer.	Hirer	hire vendor
buyer.	Hirer	hire vendor
Buyer and seller	bailer and bailee	Pawner and Pawnee
buyer.	Hirer	hire vendor
buyer.	Hirer	hire vendor
buyer.	Hirer	hire vendor
sell the goods	repossession of goods.	repair of goods
Renewed	Terminated	Registered
1972	1973	1974
Hire Purchase Act.	Sale of goods Act	Properties Act
installment price.	hire purchase price	maximum retail price.

[TY

;C Act 1956)

41 021

016 onwards)

OPTION D		ANSWER
1975		**1975**
Balance price		**Purchase price**
None		**Hirer**
Last payment		**Down payment**
Hirer purchase		**Sale price**
Sale		**Interest**
Real		**Interest**
invoice price		**hire purchase price**
seller		**hirer**
none		**hire vendor**
all of these		**instalment system**
owner and buyer		**buyer and seller**
buyer and seller		**owner and hirer**
buyer and seller		**debtor and creditor**
contract		**instalment purchase**
1972		**1980**
assets		**hirer**
cash balance		**total interest**
cash price		**default**
none		**repossession**
get back		**repossession**
repossession		**repossession**
trading		**stock**
memorandum trading		**memorandum trading**
none		**hire purchase**
none		**final payments**
balance price		**purchase price**
seller and hirer		**hirer**
None		**to calculate true profit**
Increase in money value		**. Physical wear and tear**
None		**remains constant**

book value		**scrap value**
both a & b		**sale or return on sale**
none		**customer**
all		**sale**
selling		**cost**
none		**Sale or return day book**
trading		**sale/returns**
cash price		**default**
none		**repossession**
get back		**repossession**
repossession		**repossession**
trading		**stock**
memorandum trading		**memorandum trading**
none		**hire purchase**
Cash system		**Hire purchase system**
Cash system		**installment system.**
Cash system		**Hire purchase system**
Cash system		**installment system.**
Debtor		**Hirer**
Debtor		**hire vendor**
Debtor and Creditor		**bailer and bailee**
Debtor		**hire vendor**
Debtor		**buyer.**
Debtor		**hire vendor**
purchase of goods		**repossession of goods.**
Endorsed		**Terminated**
1975		**1972**
Contract Act		**Sale of goods Act**
retail price.		**hire purchase price**

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DEPARTMENT OF COMMERCE

FINANCIAL ACCOUNTING (17CMU101)

UNIT I

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Under hire purchase system, the agreement can be _________.

Hire purchase system is governed by ___________.

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Cash price plus interest is _________.

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COIMBATORE- 6

(For the candidates admitted from 2

OPTION A	**OPTION B**	**OPTION C**
1973	1974	1971
Cash price	Purchase price	Interest price
Seller	Owner	Hirer
Up payment	Down payment	Non cash payment
Cash price	Non cash price	Sale price
Interest	Cash	Purchase
P&L	Interest	Trading
hire purchase price	interest	cash price
owner	vendor	hirer
hire vendor	owner	both
hire purchase system	instalment system	single entry system
vendor and hirer	buyer and seller	debtor and creditor
debtor and creditor	bailor and bailee	owner and hirer
debtor and creditor	bailor and bailee	owner and hirer
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1980	1978	1975
hire vendor	hirer	cash
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debtors	creditors	stock
trading A/c	profit and loss A/c	hire purchase trading
hire purchase	instalments purchase	both
initial payments	final payments	both down & initial
cash price	purchase price	interest price
Seller	owner	hirer
to calculate true profit .	To calculate loss	To find out the
fall in market value of	. Physical wear and tear	fall in value of money
.increases every year	.decreases every	remains constant

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purchases	purchase returns	sale or return on sale
sale	customer	both
sale	customer	goods
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Sale or return day book	sales or return ledger	rough ledger
sale/returns	customer	purchases
instalment price	hire price	default
default	repossession	both
complete repossession	partial repossession	repossession
complete repossession	partial repossession	forfeiture
debtors	creditors	stock
trading A/c	profit and loss A/c	hire purchase trading
hire purchase	instalments purchase	both
installment system.	credit system	Hire purchase system
installment system.	credit system	Hire purchase system
installment system.	credit system	Hire purchase system
installment system.	credit system	Hire purchase system
buyer.	Hirer	hire vendor
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Buyer and seller	bailer and bailee	Pawner and Pawnee
buyer.	Hirer	hire vendor
buyer.	Hirer	hire vendor
buyer.	Hirer	hire vendor
sell the goods	repossession of goods.	repair of goods
Renewed	Terminated	Registered
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Hire Purchase Act.	Sale of goods Act	Properties Act
installment price.	hire purchase price	maximum retail price.

[TY
;C Act 1956)
41 021
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OPTION D		ANSWER
1975		**1975**
Balance price		**Purchase price**
None		**Hirer**
Last payment		**Down payment**
Hirer purchase		**Sale price**
Sale		**Interest**
Real		**Interest**
invoice price		**hire purchase price**
seller		**hirer**
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all of these		**instalment system**
owner and buyer		**buyer and seller**
buyer and seller		**owner and hirer**
buyer and seller		**debtor and creditor**
contract		**instalment purchase**
1972		**1980**
assets		**hirer**
cash balance		**total interest**
cash price		**default**
none		**repossession**
get back		**repossession**
repossession		**repossession**
trading		**stock**
memorandum trading		**memorandum trading**
none		**hire purchase**
none		**final payments**
balance price		**purchase price**
seller and hirer		**hirer**
None		**to calculate true profit**
Increase in money value		**. Physical wear and tear**
None		**remains constant**

book value		**scrap value**
both a & b		**sale or return on sale**
none		**customer**
all		**sale**
selling		**cost**
none		**Sale or return day book**
trading		**sale/returns**
cash price		**default**
none		**repossession**
get back		**repossession**
repossession		**repossession**
trading		**stock**
memorandum trading		**memorandum trading**
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Cash system		**Hire purchase system**
Cash system		**installment system.**
Cash system		**Hire purchase system**
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Debtor		**Hirer**
Debtor		**hire vendor**
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Debtor		**hire vendor**
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1975		**1972**
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Coimbatore
DEPARTMENT OF COMMERCE
FINANCIAL ACCOUNTING (17CMU101)

KARPAGAM UNIVERSITY
(Established Under Section 3 of UGC Act 1956)
COIMBATORE- 641 021
(For the candidates admitted from 2016 onwards)

UNIT I

QUESTION	OPTION A	OPTION B	OPTION C	OPTION D	ANSWER
UNIT-IV					
A shipment of goods by a manufacturer to an agent to be sold by commission basis is known as--------	Accounting	Transaction	Consignment	Jointventure.	consignment
.------------- is a commission which is paid by the consignor to the consignee for taking additional	Del credere commission	Proforma invoice	Over riding commission	Account sales	Del credere commission
------------- is sent by a seller to a buyer.	Bills	Cash	Price	Invoice	invoice
The consignee is entitled to remuneration by way of---------------	Commission	Increment	Profit	All	commission
Valuation of unsold stock remaining with the consignee is done on the basis of ------------------	Sales	Market	distribution	Purchasing.	sales
Entry of an unsold stock will be passed on the books of------------------	Seller	Consignee	Consignor	Purchaser	consignor
In valuing the unsold stock,due consideration should be given to--------------	Abnormal loss	Normal loss	Quantity	Quality	normal loss
------------------ on consignment account is an asset and will be shown in the balancesheet of the	Stock	Purchase	Sales	Opening stock	Stock
If the consignee is not the owner for the goods then no entry will be made in the books of----------------	Buyer	Consignee	Seller	ALL	consignee
.------------- Loss is a losswhich arises due to mischief.	More	Normal	Low	Abnormal	abnormal
--------------loss of goods should also be considered while valuaing the stock.	Actual	Normal	Expensive	Damaged	normal loss
It is a ------------------- principle that stock must not be shown at more than the cost.	Fixed	Basic	High	Actual	Basic
Entries are passed in the books of the consignor on the basis of--------------- price	Purchase	Sales	Cost	value	cost
The coloumn which is provided to record the invoice value also is called-----------	Consignment account	Joint account	Memorandum column	Sales account	Memoramdum column
.------------------ is not merely the amount paid by the consignor to purchase the goods	Entry	Billing	Cost	Price	cost
Ownership in the goods does not pass to the-----------	Whole seller	Purchaser	Seller	Agent	Agent
.---------------makes no record of the transactions in his books when goods are sent	Agent	Principal	Buyer	Dealer	Agent
The valuation of stock lying with the consignee is done on the same basis as-----------stock	Ordinary	Valid	Invalid	Paid	Ordinary
The entry to record the consigning of goods will be on the basis of-------------price	Paid	Delievered	Actual	Invoice	Actual
.------------------can be calculated only by compairing the cost with the sale proceeds.	Loss	Normal loss	Abnormal loss	Profit	Profit
Goods sent on consignment account is transferred to the-----------account	Purchase	Sales	Profit	Trading	Trading
.-------------loss means inherent and unavoidable loss	Actual	Normal	Fulure	None	normal
------------- arise as a result of a contract entered into between two or more parties who agree to	Consignment	Joint venture	Profit & loss	Trading	joint Venture
The Joint venture account is-------------- with the value of goods purchased.	Added	Debited	Credited	Not included	Debited
Parties to the Joint venture may keep separate set of-------------	Books	Accounts	Sales	Purchase	Books
When the goods are sold the Joint venture accountis --------------- with the sale proceeds	Debited	Credited	Deducted	Closed	Credited
The difference between the two sides in Joint venture will be transferred to ---------------account	Purchase	Joint venture	Profit & loss	Trading	Profit and loss
Each party records the transactions in joint venture in their own--------------	Accounts	Ledger	Books	Journal	Accounts
The goods supplied or expenses incurred on-------------are debited to the account of the other party.	joint venture	Consignment	Bills of exchange	Profit & loss account	joint venture
The parties to the joint venturedeposit their contribution into the -----------account.	Sales	Purchase	Joint bank	Bank	joint bank
The---------- of the parties can also be opened in joint venture account	Personal accounts	Commission account	Sales	Bills	Personal accounts
----------------balances are settled before the clousure of the venture	Prepaid	Bills payable	Bills receivable	Outstanding balances	Outstanding balances
The expenses incurred on joint venture by the other party will be-----------	Accepted	Thrown	Ignored	None	Accepted
The joint venture account is debited with the value of the goods-------------	Sold	Bought	Exempted	Purchased	sold
The amount of----------------will be debited to the joint venture account.	Purchase	Expenses	Sales	All	expenses
The resultant profit or loss may be ----------------by all the concerned parties	Shared	Ignored	Exempted	All	Shared
The parties to thejoint venture will have an-----------status	High	Low	Normal	Equal	equal
The profit or loss in case of a joint venture belongs to---------------	One	All	No one	None of the above	all
.--------------------is a principal as well as agent	Consignor	Co –venturer	Consignee	joint venture	co -venturer
A . joint venture is usually of-------------duration	Long	High	life	Short	short
Each party opens a joint venture account and the accounts of --------parties	Other	All	Single	All	other
Account sales is prepared by the	Consignor	Consignee	both (a) and (b)	Principal	Consignee
Goods are sent on consignment account is a	real a/c	personal a/c	nominal a/c	representative	personal
When goods consigned are sold by the consignee, the account to be debited is	cash a/c	consignment a/c	consignor's personal a/c	none of the above	Consignors personal
Consignment account is of the nature of a	real a/c	personal a/c	nominal a/c	none of the above	Nominal account
Del-credere commission is allowed to the consignee to bear	normal loss	abnormal loss	loss on account of bad debts	none of the above	Loss on account of bad
The abnormal loss on consignment is credited to	profit/loss a/c	consignee's a/c	consignment a/c	none of the above	Consignment
Overriding commission is calculated on	total sales	credit sales	cash sales	none of the above	total sales
Del credire commission is paid to under	normal loss	abnormal loss	loss due to bad debts	total loss	Loss on account of bad
The unsold stock is valued at	cost price	invoive price	cost price +direct expenses	cost price + indirect	cost price +direct
Loss of stock is said to be normal only when ------	It is because of leakage	it is destroyed by fire	it is lost by theft	it is unavoidable	it is unavoidable
Normal loss is also known as ---------- loss	normal loss	abnormal loss	total loss	unaviodable	unavoidable
Joint venture is a --------------- partnership	personal	single	particular	consignment	particular
Joint venture is a nature of	Personal account	real account	nominal account	not an account	Nominal account
Parties involved in joint venture are called ----	venturers	co-venturers	partners	agent	co-venturers
The profit of joint venture is transferred to ---	profit and loss a/c	Tradind a/c	co-venturers a/c	joint Bank a/c	Profit and loss a/a
Capital accounts of the co-venturers are of the nature of	Personal account	real account	nominal account	not an account	Personal accounts
When purchaes are made for the joinjt venture out of joint bank account , the ---------- account is	consignment	Joint venture	co-venturers a/c	personal	joint venture
A temporary partnership agreement between two or more persons to undertake a particular business.	consignment	Joint venture	co-venturers a/c	personal	joint Venture
A accounting statement prepared by consignee for the submission to the consignor.	invoice	list of stock	account sales	value of goods	account sales

KARPAGAM ACADEMY OF HIGHER EDUCATION
Coimbatore
DEPARTMENT OF COMMERCE
FINANCIAL ACCOUNTING (17CMU101)

KARPAGAM UNIVERSITY
(Established Under Section 3 of UGC Act 1956)
COIMBATORE- 641 021
(For the candidates admitted from 2016 onwards)

UNIT I

QUESTION	OPTION A	OPTION B	OPTION C	OPTION D	ANSWER
UNIT- V					
An ordinary partnership business can have:	Not more than 50 partners	Not more than 20 partner	Any number of partners.	Any number than 2 partners.	Not more than 20 partners
A banking partnership business can have:	Not more than 10 partners	Not more than 20 partner	Not more than 50 partners	Any number of partners	Not more than 10 partners
In the absence of an agreement profit and loss are divided by partners in the ratio of:	Capital	Equally	Time devoted by each partners	On partners interest	Equally
In the absence of an agreement, Interest on loan advanced by the partner to the firm is allowed at the rate of:	6%	5%	12%	9%	6%
Current accounts of the partners should be opened when the capitals are:	Fluctuating	Fixed	Either fixed or fluctuating	Fixed and Fluctuating	Fixed
Investment in partnership is made by introducing	Cash	Non-Cash Assets	Cash or Non-cash assets	Cash and Non cash assets	Cash or Non-cash assets
Partnership is formed by the partners by	Written Agreement	Oral Agreement	Written Or Oral Agreement	Neither Written nor Oral Agreement	Written Or Oral Agreement
Any partner who investments in the business but does not take active part in the business is	Secret partner	Sleeping partner	Active partner	Nominal partner	Sleeping partner
The written agreement of partnership is called	Partnership deed	Articles of association	Memorandum of association	Certificate of incorporation	Partnership deed
Under fixed capital methods, profit will be credited to	Capital Account	Drawings	Current A/c	Profit & Loss	Current A/c
Partnership business in Pakistan is government by partnership Act of	1913	1932	1934	1928	1932
The members of partnership firm are individually called as	Director	Investor	Partner	Manager	Partner
The object of partnership is to	Earn profit	Not to earn profit	Welfare of members	Non welfare of members	Earn profit
Liability of partners in a partnership business is:	Limited	Un-limited	Limited & unlimited	Either Limited or Un-limited	Un-limited
Capital of the partners are maintained by	Fixed capital method.	Fluctuating capital method	By any two above methods.	Neither Fixed nor Fluctuating	By any two above methods.
Drawings of the partners are	Debited to profit & loss A/c	Credited to profit & loss A	Credited to capital A/c	Debited to capital A/c	Debited to capital A/c
A partners has to pay interest on drawings what is the entry in the personal A/c of the partner?	Credit partners capital A/c	Credit partners current A/	Debit the partners current A/c	Debit partners current A/c	Debit partners current A/c
Interest on capital Account	Debited to profit & loss A/c	Credit to profit & loss A/c	Debit to profit & loss and credited	Only credited to partners capital A/c.	Debit to profit & loss and cr
At the time of admission of a new partner the firm is:	Dissolved	Continued	Not effected	Re-organized	Dissolved
At the time of admission an incoming partner contributes as goodwill	In cash	Does not pay cash	May or may not pay cash for good	Reduces from his profit	May or may not pay cash fo
Good will is valued as two years purchase of the average profits of three previous years are Rs. 15000, the value of g	Rs. 15000	Rs. 30000	Rs. 20000	Rs. 50000	Rs. 30000
An incoming partner pays his share of good will in cash, and profit sharing ration of old partner is changed, Good – wi	As their old profit ratio	According to new ratio	According to sacrifice ratio	According to gaining ratio	According to sacrifice ratio
At the time of admission of a new partner, general reserve is	Debited to capital of old partners	Credited to capital of old	Debited to current account	Allowed to remain is balance sheet	Credited to capital of old pa
A new partner may be admitted to a partnership	With the consent of all partners	With the consent of two t	With the consent of any one of the	Without consent of old partners	With the consent of all partn
At the time of admission of a new partner Good will	Belongs to all partners, new and old	Belongs only to the new p	Belongs only to the old partner wh	Belong to none of the partners	Belongs only to the old partr
In the revaluation account a decrease in the value of plant and machinery	Appears on the debit side	Appears on the credit sid	Does not appear at all	Appears on the debit side of good will acc	Appears on the debit side
In the revaluation account an increase in the value of land and building	Appears on the debit side	Appears on the credit sid	Does not appear at all	Appears on the debit side of good will acc	Appears on the credit side
The partnership may come to an end due to the	Death of a partner	Insolvency of partner	By giving notice	Death or insolvency of a partners or by giv	Death or insolvency of a par
In case of retirement of a partner full good will is credited to the accounts of	All partners	Only retiring partner	Only remaining partner	New Partner	All partners
Revaluation account is operated to find out gain or loss at the time of	Admission of a partner	Retirement of a partner	Death of a partner	Admission or Retirement or Death of a pa	Admission or Retirement or
Partners equity is effected due to	Admission of a partner	Retirement of a partner	Death of a partner	Admission or Retirement or Death of a pa	Admission or Retirement or
The accounting procedure at the retirement of partner is valued	Revaluation of assets and liabilities	Ascertaining his share of	Finding the amount due to him	Revaluation of assets and liabilities,Ascerta	Revaluation of assets and lia
If the remaining partner want to continue the business, after the retirement of a partner, a new partnership agreement	Necessary	Not necessary	On the interest of the partners	Optioned	Necessary
An account operated to ascertain the loss or gain at the death of a partner is called	Realization account	Revaluation account	Execution account	Deceased partner A/c	Revaluation account
Amount due to out going partner is shown in the balance sheet as his	Liability	Asset	Capital	Loan	Loan
The loss or gain an account of revaluation at the time of retirement of a partner is shared by	Remaining partners	Retiring partner	All partners	New Partner	All partners
On the retirement of a partner any reserve being should be transferred to the capital account of	All partners in the old profit sharing ratio	Remaining partners in the	Neither the retiring partner, nor th	New Partner	All partners in the old profit
Old profit sharing ratio minus new profit sharing ratio is equal to	Sacirficing Ratio	Gaining Ratio	Capital Ratio	Profit sharing ratio	Sacrificing Ratio
For any decrease in the value of liability, revalutaion A/c is to be:	Debited	Credited	Both debited and Credited	Neither Debited nor Credited	Credited
Revaluation A/c is a:	Real A/c	Personal A/c	Cash A/c	Nominal A/c	Nominal A/c
When good will is brought in cash by new partner, method is known as	Premium method	Revaluation Method	Memorandum revaluation method	Initial Method	Premium Method
Section 37 of partnership act provided interest on the amount left by retiring or decreased partner at	5%	10%	6%	Bank rate	6%
When a partner dies, firm will receive the:	1/2 amount of policy	1/4 amount of policy	3/4 amount of policy	Full amount of policy	Full amount of policy
The profit or loss on revaluation of assets at the time of admission must be transferred to the partners in the _______	Capital Ratio	Old Profit Sharing Ratio	New Profit Sharing ratio	Sacrificing ratio	Old Profit Sharing Ratio
Any amount to be written off after admission of a partner is transferred to the capital accounts of the partners in	Old ratio	New Ratio	Capital Ratio	Sacrificing ratio	New Ratio
On admission of a new partner, decrease in the value of asset is debited to	Revaluation Account	Balance Sheet	Trading Account	Profit and Loss Account	Profit and Loss Adjustment
When a new partner is admitted the combined share of the old partners are	reduced	increased	Multiplied	Divided	reduced
A and B share in the ratio of 3:2. C is admitted as a partner and is given one fifth of the share. Then the ratio of sacrifi	3:2	4:2	5:2	6:2	3:2
The sum of shares sacrificed by the old partners is equal to the share given to the _______	Existing partner	Active partner	New Partner	Dormant Partner	New Partner
Profit on revaluation is to be credited to the old partners in the	Old ratio	New Ratio	Capital Ratio	Sacrificing ratio	Old ratio
All accumulated losses are transferred to the capital accounts of the partners in _____	Capital Ratio	Old Profit Sharing Ratio	New Profit Sharing ratio	Sacrificing ratio	Old Profit Sharing Ratio
Goodwill paid by a new partner must be shared by the old partners in their ______	Capital Ratio	Old Profit Sharing Ratio	New Profit Sharing ratio	Sacrificing ratio	Sacrificing ratio
Goodwill is a	Fixed Asset	Tangible Asset	Intangible Asset	Current Asset	Intangible Asset
It is necessary to value the goodwill at the admission of a new partner and credit should be given to	all partners	the old partners	new partner	retiring partner	the old partners
In the absence of specific agreement, the old partners contribute to the new partner's share of profit	equally	in proportion of their capi	in their profit sharing ratio	gaining ratio	in their profit sharing ratio
______ = old ratio - new ratio	Gaining Ratio	Old Profit Sharing Ratio	New Profit Sharing ratio	Sacrificing ratio	Sacrificing ratio
Normal Profit = Capital employed x __________	Average profit	Super profit	Normal rate of return	No of years of purchase	Normal rate of return
Super profit = Average profit -________	Average profit	Normal profit	Normal rate of return	No of years of purchase	Normal profit
_____ = Total profit/ No. of years	Average profit	Normal profit	Normal rate of return	No of years of purchase	Average profit
____ = Average profit - Normal profit	Super profit	Normal rate of return	No of years of purchase	Average profit	Super profit
_____ = Capital employed x normal rate of return	Super profit	No of years of purchase	Average profit	Normal profit	Normal profit