KARPAGAM UNIVERSITY

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

I B.COM / I B.COM (BPS)

SUBJECT: FINANCIAL ACCOUTING **SEMSTER: I**

SUBJECT CODE: 17BPU101 / 17CMU101

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, (2010) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R1 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2010)

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, (2010) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R1 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2010)

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, (2010) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R1 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2010)

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, (2010) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R1 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2010)

W1 www.iasplus.com/en/standards

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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, (2010) T.S. Reddy, A. Murthy, Magham Publication

Reference Books

R1 - Vinayagam N, Mani.P.L. and Natarajan.K.L, Financial Accounting, Sultan Chand and sons, New Delhi(2010)

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PROGRAMME OUTCOME

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.

LEARNING OUTCOME

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.

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,

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	:	**17CMU101/17BPU101**
CLASS	:	**I B.Com/ I B.Com BPS**

UNIT-I

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. (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.
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	To (Name of			Year	By (Name of		

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

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.		8,000	_		

	To Sales A/c (Credit Sales)				8,000	–
7	Cash A/c Dr. To Robert A/c (Cash received)		6,000	–	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	By Balance c/d		44,000
3	To Gopi A/c		19,000	31			
			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

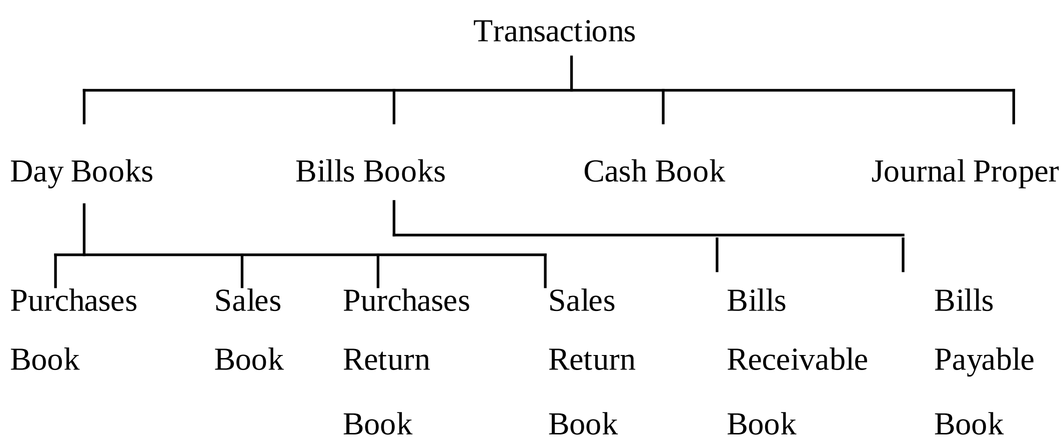
Moreover, transactions can be classified and grouped conveniently according to their nature, as some transactions are usually of repetitive in nature. Generally, transactions are of two types:

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, Invoice No....... dated			1,100	
					9,900
	Mohan & Co				
20	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					Not in

	12 Salwar sets @ Rs.200			2,400	7,900	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

T.N. Stores Account

Dr. 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
Single column cash book

II
Double column cash book
a) With discount and cash columns
b) With cash and bank columns

III
Triple column cash book with discount, cash and bank columns

IV
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.

<u>Year: 2016</u>

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

SUBJECT	:	**FINANCIAL ACCOUNTING**
SEMESTER	:	**I**
SUBJECT CODE	:	**17CMU101/17BPU101**
CLASS	:	**I B.Com/ I B.Com BPS**

UNIT-I

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. (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.
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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 – 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	To (Name of			Year	By (Name of		

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

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.		8,000	_		

	To Sales A/c (Credit Sales)				8,000	–
7	Cash A/c Dr. To Robert A/c (Cash received)		6,000	_	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

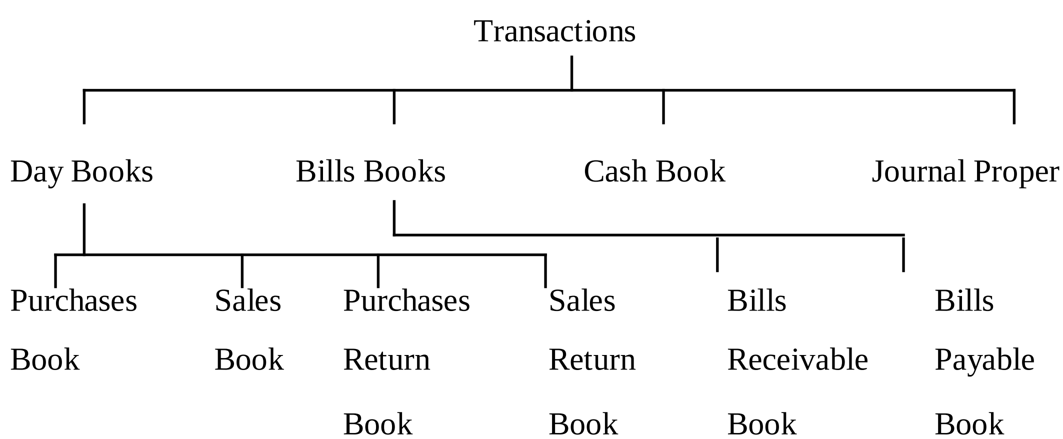
Moreover, transactions can be classified and grouped conveniently according to their nature, as some transactions are usually of repetitive in nature. Generally, transactions are of two types:

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

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, Invoice No....... dated			1,100	
					9,900
	Mohan & Co				
20	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		Remarks
				Details Rs.	Total Rs.	
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					Not in

	12 Salwar sets @ Rs.200			2,400	7,900	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

T.N. Stores Account

Dr. 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.

<u>Year: 2016</u>

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

UNIT 111

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 instalments.
- every installment will be treated to be the hire charges of the goods which is being used by the purchaser.
- If all instalments 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-purchase 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 installment 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-purchase 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

(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	Machinery A/c …………….Dr.		15,000	

April 1	To Bank A/c (Being down payment made at the time of delivery)			15,000
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.		5,585	5,585

	To Machinery A/c (Being the depreciation charged)			
"	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. Interest A/c ....Dr. To Y Machine Ltd. (Being the second instalment due).		13,605 1,395	 15,000
"	Y Machines Ltd. …………………Dr. To Bank		15,000	 15,000

	(Being the amount paid in second instalment)			
"	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.		14,288 712	15,000

	(Being the third instalment due).			
"	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 instalments of 22,000 each. The cash price of machine was Rs. 90,000. Find out the amount of interest included in each instalment.

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 instalments i.e. 4th, 3rd, 2nd and 1st instalment in the ratio of 1:2:3:4 (i.e. among 1st, 2nd, 3rd and 4th instalment 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 (5 X 2 = 10 Marks)

1. What is meant by Installment System?
2. Define Hire Purchase.
3. List out any two advantages of Hire Purchase System.
4. What is mean by down payment?
5. Write any two differences between Hire purchase and installment system ?

PART – C (5 X 6 = 30 Marks)

1. Mr. X purchased a machine on hire purchase system. As per terms, he is required to pay Rs.800 down, Rs.400 at the end of the first year, Rs.300 at the end of the second year and Rs.700 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 instalment.

2. 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 instalment.

3. Raja ram Purchased 5 bike for Rs.9,000 each 1.1.13 under the hire purchase system. The hire purchase price for all the 5 bikes Rs.50,000 to be paid as Rs. 10,000 down payment and 4 equal instalments of Rs.10,000 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.

4. Mr. X purchased a machine on hire purchase system. As per terms, he is required to pay Rs.800 down, Rs.400 at the end of the first year, Rs.300 at the end of the second year and Rs.700 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 instlment.
5. 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

Lesson :4
4.1 CONSIGNMENT ACCOUNTS

OBJECTIVE

After reading this lesson, you should be able to

a) Understand the meaning of consignment and explain the difference between consignment and sale

b) Explain the accounting treatment of consignment transactions

c) Account for normal and abnormal losses in consignment

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’.

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.

(b) **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.

(c) **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.

(i) 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.

(ii) 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.

(d) Proforma Invoice : Since the goods sent on consignment can not be treated as sales, the consignor does not prepare proper invoice. He simply prepares a Proforma invoice and sends it to the consignee, alongwith the goods despatched. 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.

(e) Expenses : Expenses relating to consignment of goods are divided into two categories vis. (i) Non-recurring expenses and (ii) Recurring expenses.

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			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 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 consignment)		3,000	3,000
Sep 10	Bills receivable A/c Dr. To Alok (Being an acceptance for 2 months bill from Alok as an Advance)		20,000	20,000
Sep 13	Bank Account Dr. To Bills Receivable A/c (Being the acceptance of Alok on the due date)		20,000	20,000
Sep 30	Consignment A/c Dr. To Alok (Being unloading expenses Rs. 600 and selling expenses Rs. 900/- incurred by Alok)		1,500	1,500

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

Bills 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.

SUMMARY

Consignment is a specialised kind of transaction between consignor and consignee, whereby consignor sends goods to consignee to be sold by the latter on behalf of the former for a mutually agreed commission. The goods consigned to the agent cannot be treated as sales at the time of the consignment, they are treated as sales only when those are sold by the consignee. In a consignment transaction, the consignor sends goods to the consignee and makes a bill called Proforma Invoice. The value recorded in the proforma invoice may be the actual cost to the consignor or actual cost to the consignor plus mark-up. The objective of consignor in making accounts relating to consignment are to ascertain the results of consignment and to make final settlement with the consignee. To achieve this, he prepares consignment account and consignee account. The consignee makes accounts relating to consignment relating to consignment to effect the settlement with the consignor and to recognise his commission entitlement as consignee.

KEYWORDS

Consignment: A shipment of goods by a manufacturer or wholesale dealer to an agent to be sold by him on commission basis, on the risk and account of the former, is known as consignment.

Consignor: The person who sends the goods to the agent to be sold by him as commission basis is called the consignor.

Del Credere Commission: It is a commission which is paid by the consignor to the consignee for taking additional risk of recovery of debts on account of sales made on credit by the consignee on behalf of the consignor.

Account Sales: It is a statement which contains the details of sales, expenses incurred and commission entitlement and balance due to the consignor.

Normal Loss: The normal loss is one which cannot be avoided because of the basic nature of the goods/processes involved.

POSSIBLE QUESTIONS

PART B (2 MARKS)

ANSWER ALL THE QUESTIONS

1. Define 'Consignment'. What is the difference between a consignment and a sale of goods?
2. What is mean by consignor?
3. What is mean by consignee?
4. Give journal entries in respect of consignment transactions in the books of consignor and consignee.
5. Write short notes on Del Credere Commission
6. Valuation of Unsold Stock in Consignment

PART C (8 MARKS)

7. 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.

   Give Journal entries and prepare necessary accounts to record the above transactions in the books of the parties.

8. 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.

   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.

9. 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

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.

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).

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.

You are required to prepare the Consignment to Madras A/c and Khan's A/c in Dutt's Books.

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SUGGESTED READINGS

1. Fundamentals of Accounting by R.L. Gupta and V.K. Gupta, Sultan Chand and Sons, New Delhi.
2. Advanced Accounting by R.L. Gupta and M. Radhaswamy, Sultan Chand and Sons, New Delhi.
3. Advanced Accounting by Ashok Sehgal and Deepak Sehgal, Taxmann Allied Services Pvt. Ltd., New Delhi.
4. Advanced Accounts by M.C. Shukla, T.S.

Karpagam Academy of Higher Education
(Deemed University Established Under Section 3 of UGC Act, 1956)
Coimbatore - 641 021.

LESSON : 5

ACCOUNTING FOR PARTNERSHIP : BASIC CONCEPTS AND COMPUTATIONS, ADMISSION OF NEW PARTNER

STRUCTURE

5.0 Objective

5.1 Introduction

5.2 Essential Features of a Partnership

5.3 Partnership Deed

5.4 Peculiar Aspects of Accounting for Partnership Firms

5.5 Admission of a Partner

5.0 OBJECTIVE

After reading this lesson, you should be able to

a) Explain the important clauses in a partnership deed.

b) Understand the peculiar points relating to accounting for partnership firms.

c) Compute the value of goodwill of the firm.

5.1 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.

5.2 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.

5.3 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.

5.4 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 = $n\frac{(n+1)}{2}$ 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) · $\frac{5\frac{1}{2}}{12}$ · 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. As no 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 Profit & Loss A/c		60,000	Cash at Bank	25,000
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

5.5 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	=	3/5 · 1/5 = 3/25
Sacrifice by B to C	=	2/5 · 2/5 = 4/25
Share of C A's new	=	3/25 + 4/25 = 7/25
share B's new share	=	3/5 - 3/25 = (15-3)/25 = 12/25
Share of A, B and C	=	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.

3. 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.

4. On Sale of firm's business to another firm or company, it is very important to value the firm's goodwill.

5. 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.

Formula = $\frac{\text{Total profits}}{\text{of years}} \cdot$ No. of years purchased No.

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.

5.2 RETIREMENT AND DEATH OF A PARTNER

STRUCTURE

5.2.0 OBJECTIVE

After reading this lesson, you should be able to

a) Discuss the accounting procedure at the time of retirement of a partner.

b) Explain the procedure of calculation of profit and treatment of life policy at the time of death of a partner.

5.2.1 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.

5.2.2 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.

5.2.2.1 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.

5.2.2.2 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.

5.2.2.3 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

5.2.2.4 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

	Rs.		Rs.
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			

5.2.4 SUMMARY

The only difference between admission and retirement of a partner is that in case of the former, the new partner joins the firm whereas in case of retirement, an old partner leaves the firm because of certain reasons. The main points which require attention in case of retirement of partner are treatment of goodwill, revaluation of assets and liabilities, adjustment of accumulated reserves and losses, and calculation of total amount due to the retiring partner. The problems which arise in case of death of a partner are similar to those of a retiring partner except that the death of a partner may occur at any time whereas the retirement of a partner is planned. The points which require special attention at the time of death of a partner are calculation of deceased partner's share of profit and treatment of life policy or policies

5.2.5 KEYWORDS

Partnership: It is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

Partnership Deed: A document which contains details of an express written agreement between the partners is called partnership deed.

Minor Partner: A parties who has not attained the age of majority is called a minor partner.

Sacrificing Ratio: It means the forgoing a fraction of share in favour of a new partner by the old over.

Goodwill: Goodwill is the value of the reputation of a firm in respect of profits expected in future over and above the normal rate of profits.

Gaining Ratio: The ratio in which the continuing partners acquire the outgoing partner's share is called as gaining ratio. Surrender value: It is the value which is payable immediately to the insured on surrendering all rights of the policy (policies) to the insurer.

Memorandum Revaluation Account: Sometimes it may be derived not to alter the value of assets and liabilities in the books, a Memorandum Revaluation Account will be opened.

5.2.6 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)

6. 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.

7. 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.

Shanker died on 1st April, 1995 and his legal representatives are entitled to :

His capital as appearing in the last Balance Sheet.

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.

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.

Prepare Shanker's Capital Account

8. Explain goodwill and describe various methods of valuing goodwill.
9. Explain the treatment of goodwill in case of admission of a new partner with journal entries.
10. What is Revaluation Account ? How is it prepared ? How is it different from Memorandum Revaluation Account.

5.2.7 SUGGESTED READINGS

1. Fundamentals of Accounting by R.L. Gupta and V.K. Gupta, Sultan Chand and Sons, New Delhi.
2. Advanced Accounts by M.C. Shukla, T.S. Grewal and S.C. Gupta, S. Chand and Co. Ltd., New Delhi.
3. Fundamentals of Advanced Accounting by R.S.N. Pillai and V. Bagavathi, S. Chand and Co. Ltd., New Delhi.
4. Studies in Advanced Accounting by S.N. Maheshwari, Sultan Chand and Sons, New Delhi.
5. Financial Accounting by Shashi K. Gupta, Nisha Aggarwal and Neeti Gupta, Kalyani Publishers, Ludhiana.
6. Financial Accounting by P.C. Tulsian, Pearson Education, New Delhi.