Semester II

17PAU201	CORE- HIGHER FINANCIAL ACCOUNTING	L	T	P	C
		6	2	-	6

Course Objectives :

- Higher Financial Accounting represents the basic concepts of Accounting Practices in Depreciation, Hire Purchase and Installment, Departmental Account and Accounting Standards.
- This paper gives the Principles of Branch Accounting, and Accounting Standards.

Learning Out Comes:

- To make the students to understand the concept of depreciation.
- To enhance the students knowledge in departmental accounts
- To enlighten students knowledge in various accounting standards

UNIT I

Depreciation - Meaning - Importance - Causes of Depreciation - Methods of Depreciation - Straight Line Method - Written Down Value Method - Annuity Method - Valuation of Inventory.

UNIT II

Branch Accounts Excluding Foreign Branches - Hire purchase and Installment System including hire Purchase trading accounts - Royalty Accounts - Minimum Rent - Fixed Rent - Short Working - Recouping Short Workings.

UNIT III

Single Entry System - Meaning and Features - Statement of Affairs Method and Conversion Method -Departmental Accounts - Distribution of Expenses - Inter department Transfers.

UNIT IV

Partnership Accounts - Division of Profits - Fixed and Fluctuating Capital - Past Adjustments - Guarantee of Profits - Admission - Retirement - Death

UNIT V

Dissolution of Partnership - Insolvency of Partners - Rule in Garner Vs. Murray - Piecemeal Distribution - Sale to a company - Accounting Standards (Theory Only) - AS 2: Valuation of Inventory - AS 6: Depreciation Accounting - AS 7: Construction Contracts - AS 8: Revenue Reorganization, AS 13 Accounting for Investments.

Note: Distribution of marks for theory and problems shall be 20% and 80% respectively.

SUGGESTED READINGS:

TEXT BOOKS

1. Jain, S.P., & Narang. (2010). *Advanced Accounting*. Ludhiana: Kalyani Publishers.

REFERENCES

1. Shukla, M.C., Grewal, T.S., & Gupta, S.C. (2010). *Advanced Accounts*. New Delhi: Sultan Chand and Sons.
2. Gupta, R.L., & Radhaswamy, M. (2006). *Advanced Accountancy*. New Delhi: Sultan Chand and Sons.
3. Maheswari, S.N., & Maheswari, S.K. (2011). *Advanced Accounting*. New Delhi: Vikas Publishing House Pvt. Ltd.
4. Mukherjee, A., & Hanif, M. (2007). *Modern Accountancy*. New Delhi: Tata McGraw-Hill.
5. VinayahamCharumathi. (2008). *Financial Accounting*. New Delhi: Sultan Chand and Sons.
6. Arulanandam, M.A., & Raman, K.S. (2010). *Advanced Accounting*. New Delhi: Vikas Publishers.
7. Gupta, R.L., & Rathaswamy. (2009). *Advanced Accounting*. New Delhi: Sultan Chand & Sons.
8. Vinayagam, N., Mani, P.L., & Natarajan, K.L. (2010). *Financial Accounting*. New Delhi: Sultan Chand and sons.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(Deemed to be University)
(Established Under Section 3 of UGC Act 1956)
Coimbatore – 641 021.
LECTURE PLAN
DEPARTMENT OF COMMERCE

STAFF NAME: Dr. V.M.SENTHILKUMAR
SUBJECT NAME: HIGHER FINANCIAL ACCOUNTING SUB.CODE:17PAU201
SEMESTER: II CLASS: I B.Com - PA

S. No.	LECTURE DURATION (Periods)	TOPICS TO BE COVERED	SUPPORT MATERIALS
1.	1	Higher Financial Accounting – An Overview	T1 : 1-15
2.	1	Depreciation – Introduction	T1 : 227- 228
3.	1	Depreciation - Meaning	T1 : 227- 228
4.	1	Importance of Depreciation	T1 : 228
5.	1	Causes of Depreciation	T1 : 228- 230
6.	1	Methods of Depreciation	T1 : 231
7.	1	Types of Depreciation Calculation	T1 : 231
8.	1	Straight Line Method	T1 : 231-232
9.	1	Problems in Straight Line Method	T1 : 231-232
10.	1	Problems in Straight Line Method	T1 : 231-232
11.	1	Problems in Straight Line Method	T1 : 231-232
12.	1	Written Down Value Method	T1 : 232-237
13.	1	Problems in Written Down Value Method	T1 : 232-237
14.	1	Problems in Written Down Value Method	T1 : 232-237
15.	1	Problems in Written Down Value Method	T1 : 232-237
16.	1	Annuity Method	T1 : 237-238
17.	1	Problems in Annuity Method	T1 : 237-238
18.	1	Problems in Annuity Method	T1 : 237-238
19.	1	Problems in Annuity Method	T1 : 237-238
20.	1	Valuation of Inventory	T1 : 979-999
21.	1	Problems in Valuation of Inventory	T1 : 979-999
22.	1	Problems in Valuation of Inventory	T1 : 979-999
23.	1	Problems in Valuation of Inventory	T1 : 979-999

24.	1	Recapitulation and discussion of important questions	
	Total no. of hours planned for unit-1		**24 Hours**
		UNIT-2	
1.	1	Branch Accounts – An Overview	T1 : 779-789
2.	1	Branch Accounts – Problem Discussion	T1 : 790-800
3.	1	Branch Accounts – Problem Discussion	T1 : 801-842
4.	1	Hire purchase	T1 : 712-720
5.	1	Hire purchase – Problem Discussion	T1 : 720-740
6.	1	Hire purchase – Problem Discussion	T1 : 741-760
7.	1	Installment System	T1 : 761-762
8.	1	Installment System – Problem Discussion	T1 : 763-764
9.	1	Installment System – Problem Discussion	T1 : 765-766
10.	1	Hire Purchase trading accounts	T1 : 742-745
11.	1	Problem in Hire Purchase trading accounts	T1 : 745-750
12.	1	Problem in Hire Purchase trading accounts	T1 : 751-760
13.	1	Royalty Accounts	T1 : 660-661
14.	1	Royalty Accounts – Problem Discussion	T1 : 662-663
15.	1	Royalty Accounts – Problem Discussion	T1 : 664-665
16.	1	Minimum Rent	T1 : 665-666
17.	1	Minimum Rent – Problem Discussion	T1 : 667-668
18.	1	Fixed Rent	T1 : 668
19.	1	Fixed Rent – Problem Discussion	T1 : 669
20.	1	Short Working	T1 : 670-672
21.	1	Short Working – Problem Discussion	T1 : 673-675
22.	1	Recouping Short Workings.	T1 : 675-685
23.	1	Recouping Short Workings – Problem Discussion	T1 : 685-695

24.	1	Recapitulation and discussion of important questions	
	Total no. of hours planned for unit-2		**24 Hours**
		Unit – III	
1.	1	Single Entry System – An Overview	T1 : 592
2.	1	Single Entry System	T1 : 592
3.	1	Single Entry System - Meaning	T1 : 593
4.	1	Single Entry System - Features	T1 : 593
5.	1	Statement of Affairs Method	T1 : 593-594
6.	1	Statement of Affairs Method – Problem Discussion	T1 : 595-597
7.	1	Statement of Affairs Method – Problem Discussion	T1 : 597-600
8.	1	Statement of Affairs Method – Problem Discussion	T1 : 601-602
9.	1	Conversion Method	T1 : 602 - 605
10.	1	Conversion Method – Problem Discussion	T1 : 605 - 617
11.	1	Conversion Method – Problem Discussion	T1 : 618 - 627
12.	1	Conversion Method – Problem Discussion	T1 : 628 - 647
13.	1	Departmental Accounts – An Overview	T1 : 843
14.	1	Departmental Accounts – Simple Problems	T1 : 844
15.	1	Departmental Accounts – Simple Problems	T1 : 845
16.	1	Distribution of Expenses	T1 : 845 - 846
17.	1	Distribution of Expenses – Problem Discussion	T1 : 845 - 847
18.	1	Distribution of Expenses – Problem Discussion	T1 : 850 - 852
19.	1	Distribution of Expenses – Problem Discussion	T1 : 853 - 854
20.	1	Inter department Transfers.	T1 : 847
21.	1	Inter department Transfers. – Problem Discussion	T1 : 848 - 850
22.	1	Inter department Transfers. – Problem Discussion	T1 : 851 - 855

23.	1	Inter department Transfers. – Problem Discussion	T1 : 856 - 860
24.	1	Recapitulation and discussion of important questions	
	Total no. of hours planned for unit-3		**24 Hours**
		Unit – IV	
1.	1	Partnership Accounts – An Overview	T1 : 347
2.	1	Division of Profits	T1 : 348
3.	1	Division of Profits – Problem Discussion	T1 : 420-425
4.	1	Fixed Capital	T1 : 348
5.	1	Fixed Capital – Problem Discussion	T1 : 420-425
6.	1	Fixed Capital – Problem Discussion	T1 : 420-425
7.	1	Fluctuating Capital	T1 : 349
8.	1	Fluctuating Capital – Problem Discussion	T1 : 350
9.	1	Fluctuating Capital – Problem Discussion	T1 : 351 - 352
10.	1	Past Adjustments	T1 : 352 - 353
11.	1	Past Adjustments – Problem Discussion	T1 : 354 - 355
12.	1	Guarantee of Profits	T1 : 356
13.	1	Guarantee of Profits – Problem Discussion	T1 : 357 -358
14.	1	Guarantee of Profits – Problem Discussion	T1 : 359 -360
15.	1	Admission of Partners	T1 : 361 - 365
16.	1	Admission of Partners – Problem Discussion	T1 : 366 - 375
17.	1	Admission of Partners – Problem Discussion	T1 : 376 - 385
18.	1	Retirement of Partners	T1 : 385 - 389
19.	1	Retirement of Partners – Problem Discussion	T1 : 390 - 400
20.	1	Retirement of Partners – Problem Discussion	T1 : 401 - 403
21.	1	Death of Partners	T1 : 404 - 408
22.	1	Death of Partners	T1 : 409 - 412
23.	1	Death of Partners	T1 : 413 - 418

24.	1	Recapitulation and discussion of important questions	
	Total no. of hours planned for unit-4		**24 Hours**
		Unit - V	
1.	1	Dissolution of Partnership	T1 : 443 - 461
2.	1	Insolvency of Partners	T1 : 462
3.	1	Rule in Garner Vs. Murray	T1 : 462 - 466
4.	1	Application of Garner Vs. Murray Rule in India	T1 : 467 - 476
5.	1	Piecemeal Distribution	T1 : 477 - 480
6.	1	Piecemeal Distribution - Problems	T1 : 481 - 490
7.	1	Sale to a Company	T1 : 491 - 500
8.	1	Sale to a Company – Problem Discussion	T1 : 501 - 507
9.	1	Accounting Standards - Overviews	T1 : 1197 -1200
10.	1	Accounting Standards – Different Sections	T1 : 2001 -1207
11.	1	AS 2: Valuation of Inventory	T1 : 1208 -1209
12.	1	AS 2: Valuation of Inventory – Real Time Discussion	W1
13.	1	AS 6: Depreciation Accounting	T1 : 1211-1212
14.	1	AS 6: Depreciation Accounting – Real Time Discussion	W1
15.	1	AS 7: Construction Contracts	T1 : 1212
16.	1	AS 7: Construction Contracts– Real Time Discussion	W1
17.	1	AS 8: Revenue Reorganization	T1 : 1212 - 1213
18.	1	AS 8: Revenue Reorganization – Real Time Discussion	W1
19.	1	AS 13 Accounting for Investments	T1 : 1215 - 1216
20.	1	AS 13 Accounting for Investments	W1
21.	1	Recapitulation and discussion of important questions	

22.	1	**Revision :** Discussion of ESE question papers	
23.	1	Discussion of ESE question papers	
24.	1	Discussion of ESE question papers	
		Total no. of hours planned for unit-5 & Question Paper Discussion	**24 hours**

SUPPORT MATERIALS

TEXT BOOKS

1. Jain, S.P., & Narang. (2010). *Advanced Accounting*. Ludhiana: Kalyani Publishers.

Reference Books:

1. Shukla, M.C., Grewal, T.S., & Gupta, S.C. (2010). *Advanced Accounts*. New Delhi: Sultan Chand and Sons.
2. Gupta, R.L., & Radhaswamy, M. (2006). *Advanced Accountancy*. New Delhi: Sultan Chand and Sons.
3. Maheswari, S.N., & Maheswari, S.K. (2011). *Advanced Accounting*. New Delhi: Vikas Publishing House Pvt. Ltd.
4. Mukherjee, A., & Hanif, M. (2007). *Modern Accountancy*. New Delhi: Tata McGraw-Hill.
5. VinayahamCharumathi. (2008). *Financial Accounting*. New Delhi: Sultan Chand and Sons.
6. Arulanandam, M.A., & Raman, K.S. (2010). *Advanced Accounting*. New Delhi: Vikas Publishers.
7. Gupta, R.L., & Rathaswamy. (2009). *Advanced Accounting*. New Delhi: Sultan Chand & Sons.
8. Vinayagam, N., Mani, P.L., & Natarajan, K.L. (2010). *Financial Accounting*. New Delhi: Sultan Chand and sons.

Website Reference :

1. https://www.accountingcoach.com/financial-accounting/explanation

UNIT – I

DEPRECIATION AND INVENTORY VALUATION

Depreciation - Meaning - Importance - Causes of Depreciation - Methods of Depreciation - Straight Line Method - Written Down Value Method - Annuity Method - Valuation of Inventory.

DEPRECIATION

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

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

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

DEFINITION

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

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

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

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

NEED FOR PROVIDING DEPRECIATION

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

1. To ascertain correct profit / loss

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

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

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

3. To ascertain the real cost of production

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

4. To comply with legal requirements

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

5. To replace assets

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

CAUSES OF DEPRECIATION

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

I. INTERNAL CAUSES

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

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

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

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

II. EXTERNAL CAUSES

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

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

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

TERMS USED FOR DEPRECIATION

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

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

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

FACTORS DETERMINING THE AMOUNT OF DEPRECIATION

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

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

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

METHODS OF CALCULATING DEPRECIATION

1. Straight line method or fixed instalment method.
2. Written down value method or diminishing balance method
3. Annuity method.
4. Depreciation Fund method.
5. Insurance Policy method.
6. Revaluation method

Straight Line Method or Fixed Instalment Method or Original Cost Method

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

1) Amount of depreciation

= Total cost - Scrap value / Estimated Life

2) Rate of depreciation

= Amount of Depreciation / Original Cost x100

Problem 1

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

Solution:

Total cost = Purchase Price + Installation Charges

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

= Rs. 1,10,000

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

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

= Rs.1,05,000 / 5

= Rs.21,000

Merits:

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

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

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

Demerits:

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

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

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

Depreciation for the 1st year = 10% on Rs.1,00,000, ie., Rs.10,000
Depreciation for the 2nd year = 10% on Rs.90,000
(Rs.1,00,000 – Rs.10,000)
= Rs. 9,000
Depreciation for the 3rd year = 10% on Rs.81,000
(Rs.90,000 - Rs.9,000)
= Rs.8,100

Merits:

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

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

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

Demerits:

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

Distinction between Straight Line Method and Diminishing Balance Method:

Points of distinction	**Straight line method**	**Diminishing balance method**
1. Charge of depreciation	Depreciation is charged on the original cost of the asset.	Depreciation is charged on the written down value of the asset.
2. Change in	Throughout the life of the asset,	Amount of depreciation is more

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

Annuity Method:

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

Depreciation Fund Method or Sinking Fund Method :

Under this method, funds are made available for the replacement of asset at the end of its useful life. The depreciation remains the same year after year and is charged to Profit and Loss account every year through the creation of depreciation fund. The amount of annual depreciation is invested in good securities bearing interest at a specified rate. The aggregate amount of interest and annual provision is invested every year. When the asset is completely written off or is to be replaced, the securities are sold and the amount so realised by selling securities is used to replace the old asset.

Insurance Policy Method:

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

Revaluation Method:

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

RECORDING DEPRECIATION

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

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

Depreciation A/c Dr.

To Asset A/c

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

Profit and Loss A/c Dr.

To Depreciation A/c

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

1. On 1-1-99, A ltd., purchased machinery for Rs. 1,20,000 and on 30th June 2000, it acquired additional machinery at a cost of Rs.20,000. On 31st March 2001, one of the original machines, which had cost Rs.5,000 was found obsolete and sold as scrap for Rs.500. It was replaced on that date by a new machine costing Rs.8,000. Depreciation is provided at the rate of 15% per annum on the written down value.

Show the ledger accounts for the first three years

(a) When depreciation is written off in the asset account; and

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

Solution:

Machinery Account

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

Depreciation account

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

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

Machinery Account:

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

Provision for Depreciation Account

Machinery Account

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

Depreciation Account

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

Workings:
Original cost of asset sold as on 1-1-99 Rs. 5,000
Less. Depreciation @ 15% for 1999 on 5,000 Rs. 750
Balance as on 1-1-2000 Rs. 4,250
Less: Depreciation @ 15% for 2000 on 4,250 Rs. 638
Balance as on 1-1-2001 Rs. 3,612
Less: Depreciation @ 15% for 3 months Rs. 135
(on 3,612) Rs. 3,477
Less: Sold as Scrap Rs. 500
Loss transferred to P&L a/c Rs. 2,977

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

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

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

Solution:

Machinery Account

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

Provision for Depreciation Account

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

Machinery Disposal Account

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

Working Notes:

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

2. Depreciation on Machinery in use:

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

INVENTORY VALUATION

Inventory is an important element of assets of an enterprise. In some enterprises, inventory constitute the bulk of working capital. In view of this inventory of this inventory valuation and inventory control assume a pivotal position for many concerns. However, inventory valuation is outside the purview of the present chapter.

According to IAS-2* and AS-2*inventories are tangible property held- (a) For sale in the ordinary course of business;

(b) in the process of production for such sale or

(c) to be consumed in the production of goods or services for sale, We can rename the aboive three components of inventory as-

(a) Finished Goods,

(b) Work in process; or

(c) raw materials and components.

Objecctives of Inventory Valurtion

What aaare the objecttivs of inveentory valuation?The two objectives to be achieved by proper valuation of inventoties are-

(1) Determinationof Income - We know that opening and closing stock affect the quantum of Gross Profit (and hence net profit) of any concern. Any improper valuation of closing stock(i.e. inventory) will lead to over and under statement of Gross profits of not only this year but also next year(as closing stock of this year becomes the opening stock of next year).

(2) Determination of Financial position-Inventory appears as current asset in the balance sheet.

Any improper valuation will lead to distortion in the balance sheet also.

Besides these, inventory is use for computing various ratios which are u sed by proper valuation cannt be over-emphasised.

Methods of taking Inventories

There are two methods of taking inventories

(1) Periodic Inventory Method, (2) Perpetual Inventory Method,

Peridic Inventory Method-It requires periodic (annual) stock taking by actual aounting weighting or measuring at each accounting date. This quantitative units are converted into financial unis by applying appopriate pricing method (discussed shortly inthis chapter). The cost of sales of the period is obtained as follows-

Cost of sales = op. inventory + current purchase – closing inventory.

*IAS = International Accounting Standards Committee's IAS-2

AS = Accounting Standards Boards AS-2

However, it will not be out of place to state here the effect of any abnormal loss should done away with. Perpetual Inventory Method-This method provides a running record of inventory hand Records of inventory can be compared by physical stock taking to find out are discrepancy of the two. Inventory control is possible only through continuous stock taking.

Methods of Valuation of Inventories

basically there are theree methods of caluation of inventory-

1. Cost Price

(a) Historical Cost

(i) FIFO (ii) LIFO (iii) HIFO

(iv) Specific identification price

(v) Base Stock price

(vi) Simple average method

(vii) Weighted Average Method

(b) Current replacement price

(c) Standard Cost

2. Sale price

(i) Discounted future cash receipts

(ii) Net Realisable value

(iii) Current selling price

3. Lower of cost or sale price

(i) Aggregation total Inventory Method

(ii) Group Mehtod

(iii) Item by item method

Historical ost means the cost of acquisition on cost of production. Cost of acquisition includes not only the price paid but also includes cost of transportation, insurance in transit, duties paid and other direct expenses. It further includes indirect cost (like depreciation, rent) aand normal wastage of material and labour. This method is very objective and personal bias is absent under this method. The man drawback of this method is that it does not demarcate a line between operational gains and holding gains. This becomes very pronounced in a rapid inflationary conditions (Holding gains are those gains which arise outof holding the inventory) e.g. an item purchased two years back at Rs. 15,000 may be purchased at Rs. 20,000 now. If this can be sold at Rs. 30,000 now, the holding profits will be Rs. 20,000 – 15,000 = Rs. 5,000 and operating profts will be Rs. 30,000 – Rs.20,000 = Rs. 10,000.

(i) FIFO (First in first out method): This method presumes that materials which are received first are issued first. Issues of materials are pried in order of their purchase. The ending inventory consists of most recently purchased goods. The closing stock is valued at latest purchase price.

Theoreticallly , it is presumed that inventory received first, will be issued first, but in practice this may not be so. But from the pricing of issue of materials, point of view , this rule is follllwed.

The main defect of this method is that on a rising market, it reports larger earnings. Thiis inventory gains arising out of holding inventory cannot be separated from the operating.

(ii) LIFo (last in first out) This method is the reverse of FIFO method. This method is based on the assumption that the materials received last is issued first. Thus oldest acquisitions are from part of closing stcok. This mwthod excludes the holding profits. But comparisons between similar jobs will be difficult.

(iii) HIFO (highest in first out)- This method is based on the assumption that highest priced materials are issued first. It results in closing inventory being kept at the lowest possible price. It leads to certaion of secret reserves in times of rising prices.

Illustration

From the following find out FIFO and LIFO inventory values under-

1. Perpetual inventory Mehtod
2. Periodic Inventory Method

						Rs.
Jan.	1	O.B.	100 Units	@	7	700,00
Jan.	15	Issue	80 units			
Jan.	25	Purchases	120 units	@	9	1080.00
Feb	20	Issue	129 units			
April	10	Purchases	160 units	@	8	1280.00
May	20	Issue	100 units			
Oct	15	Purchases	80 units	@	10	800.00
Dec.	31	Inventory (Closing)	160 units		Total	3860.00

Solution

FIFO

Perpetual				Periodic		
	Rs.		Rs.			
80 units	@ Rs. 7	=	560	100 units	@ Rs.7	= 700
20units	@ Rs. 7	=	140	120 units	@ Rs.9	= 1080
100 units	@ Rs. 9	=	900	80 units	@ Rs. 8	= 640
20 units	@ Rs. 9	=	180		Cost of Issue	2440
80 units	@ Rs. 8	= 640		Inventory value = Rs. 3860 – 2440 = Rs.l440		
	Cost of Issue	2420				= 1,440
	Inventroy value	= 3860 – 2440				

LIFO

Perpetual				Periodic			
80 units	@ Rs. 7	=	560	80 units	@ Rs. 10	=	800
120 units	@ Rs. 9	=	1080	160 units	@ Rs. 8	=	1280
100 units	@ Rs. 8	=	800	60 units	@ Rs. 9	=	540
Cost of issue	2440			Cost of issue	2620		

Inventoy value = Rs. 3860 – 2420 Inventory value =

= Rs. 1440 Rs. 3860-2620 = Rs.l240

(iv) Specific Identification price - This method is used where materials are purchased specially for a particular order or job. Its application is confined to high cost items like cars computers, videos, antiques etvc. The question of precise determination of costs may again arise in case of joint costs like transportation.

(v) Base Stock price-This method is based widely accepted view that a minimum quantity of inventory must be held at all items in order to carry on the business. This minimum quantity is costed at the earliest acquisition price. Quantity over and above the base stock evaluated by some other method say FIFO or LIFO.

(vi) Simple Average Mthod-is average is average of prices without any regard to quantities purchased.

Here, the issue price is calculated as-

Issue Pr ice = Total of

different prices Number of Purchases
The simple average gives equal importance to large and small purchases.

(vii) Weighted Average-Weighted average price is calculated by dividing the total cost of materila in stock by total quantity of material in hand. Thus weighted average discriminates between small and large quantity purchases.

(b) Current replacement price-This means the price at which the stock could have acquired at the date of its issue. Under this method, all the inventories are valued at replacement price. The historical cost does enable distinction between operational gains and holdig gains. So it is suggested that taking of replacement costs in place of historical cost is better. This method suffers one serious drawback. The closing stock, when valued on this basis, will be including unrealised gains.

(c) Standard Cost - Under this method, the standard price of each material is fixed and all issues are made out the standard price. The fixation of standard cost depends on a number of factors like-quantity of material to be purchased which results in bulk discount, market conditions regarding prices etc. This method is easy to operate. It can warn management about the efficiency or otherwise of the ourchase department. The fixation of standard cost is subjective and hence it is its greatest shortcoming.

Sale Price

(i) Disconted furture cas receipts- This method is used where goods are produced under long-term contrcts. In such cases, the timing of receipts are known. They can be discounted at a suitable interest rate arrived at their present value. Such a discounted value can be taken as value of inventory.

(ii) Net Realisable value-As per IAS-2, net realisable value is the selling price in the ordinary course of business. From this selling price, cost of completion and cost incurred for making sale is deducted, it should be noted here that temporary fluctuations in prices should be ignored. Where there are firm sale contracts, the net realisable value should be taken into account. Any inventory in excess of sale contracts should be valued on the basis of arket prices.

(iii) Current Selling Price - This method is followed in those cases where there are a government controlled market. It is because of this the sugar industry in India has shifted over to the caluation of stock on the current selling price basis. The closing inventory of sugar is split into two parts- levy sugar and non-levy sugar. The levy sugar is vlaued at levy price and non levy sugar is valued at current selling price.

3 Lower of Cost or Sale price - Having determined the cost (whatever method is used), such cost should be reduced to selling price: This is done because of the principle of conservatism. By this principle, likely profits are to be ignored and likely losses are to be taken into account. Now which market price is to be considered? Is it not realisable value or replacement cost?

Net realisable value may mean-

(i) The selling price less estimated costs of completion and disposal. This is ceiling of this value. (ii) Net realisable value as reduced by gross proft, marging. This provides the floor of this value.

The AICPA has suggested for the application of the rule' lower of cash or market value* the following- (a) The ceiling figure to be taken when the replacement cost is more that ceiling.

(b) The floor figure is to be taken when replacement cost is less than the floor.

(c) The replacement cost when it lies between the floor and ceilding

Application of principle of cost or market value can be applied in any one of the following three ways- (1) Aggregate or Total Inventory Method-Under this method total cost and total of net realisable

value is compared and lower of the two is considered for valuation.

(2) Group Method-Under this method, various types of inventories are grouped together on the bases of theor sismilarities. After this, lower of cost or net realisable price principle is applied for each category (not of individual item in the category.

(3) Item by Item Method - The cost and net realisable prices are compared by each item and lower of the two is used for valuation of inventory.

According to AS-2 comparison of the historical cost with net realisable value van be made separately for each item of inventory, or for groups of similar items. However comparison of the net realisable value of all dissimilar items ion a class of business, or all inventories of an enterprises on an overall bais, with the aggregate of the cost of all those items is not advisable because it amounts to setting off loss against unrealised profi.

Illustration

Bed Sheet

Carpets	Qty.	Cost	Mkt.	Qty.	Cash	<kt.
Rs.	Rs.	Rs.	Rs.	Rs.		
Coarse	50	60	50	100	20	18
Fine	100	100	125	200	30	28

How will value the inventory at lower of cost of market under- (a) Total Inventory Method

(b) Group Method

(c) Item by Item Method

Solution

(a) Total Inventory Method

				Price X Qty.	
	Qty.	Cost	Market	Cost	Market
		Rs.	Rs.	Rs.	Rs
Carpets					

Coarse	50	60	50	3,000	2,500
Fine	100	100	125	10,000	12,500
Bed-Sheets					
Coarse	100	20	18	2,000	1,800
Fine	200	30	28	6,000	5,600
				21,000	22,400

	Qty.	Cost	Market	Price X Qty Cost	Price X Qty Market	Lower of cost or market
		Rs.	Rs.	Rs.	Rs.	Rs.
Carpets						
Coarse	50	60	50	3,000	2,500	
Fine	100	100	125	10,000	12,500	
				13,000	15,000	13,000

Value of inventory = Rs. 21,000 (b) Group Method

Bed Sheets						
Coarse	100	20	18	2,000	1,800	
Fine	200	30	28	6,000	5,600	7,400
				8,000	7,400	20,400

Value of invento ry = Rs. 2 ,400

(c) Item by Item Method

	Quty.	Cost	Market	Price X Qty. Cost	Price X Qty. Market	Lower of Cost or market

Carpets						
Coarse	50	60	50	3000	2,500	2,500
Fine	100	100	125	10,000	12,500	10,000
Bed Sheets						
Coarse	100	20	18	2,000	1,800	1,800
Fine	200	30	28	6,000	5,600	5,600
						19,900

Value of Inventory = Rs. 19,900

POSSIBLE QUESTIONS
PART – A
Online Examinations

PART - B

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

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

2. Define Depreciation.
3. What is Fixed Asset?
4. What is residual value?
5. What is obsolescence?
6. Define inventory.
7. What is meant by FIFO?
8. What is meant by LIFO?
9. What is meant by weighted average method of inventory valuation?
10. What is simple average method of inventory valuation?

PART - C

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

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

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

4. The following transactions took place in respect of an item of material :
Jan 1 Opening Balance 500 Units @ Rs. 4.00

Jan 4 Issued 200 Units :
Jan 5 Received 200 Units @ Rs. 4.25
Jan 6 Received 300 Units @ Rs. 3.00
Jan 10 Issued 100 Units :
Jan 11 Issued 150 Units
Jan 12 Received 150 Units @ Rs. 4.10
Jan 13 Received 300 Units @ Rs. 3.00
Jan 15 Issued 100 Units :
Jan 19 Issued 100 Units :
Jan 20 Received 300 Units @ Rs. 4.50
Jan 25 Received 400 Units @ Rs. 4.00
Jan 26 Received 300 Units @ Rs. 3.00
Jan 27 Issued 200 Units:
Jan 30 Issued 250 Units:

Issues are to be priced on the principle of ‘ First in First Out ‘. Write out the stores ledger Account in respect of the materials for the month of January.

5. Prepare the stores ledger account showing how issues and closing stock balance will be recorded under standard price method. The standard price of a material is Rs. 10. The following are the purchases and issues made during November 2010.

Date	Particulars	Quantity	Rate
01.11.2010	Opening Balance	1,000 units	11
04.11.2010	Purchased	500 units	12
05.11.2010	Purchased	400 units	13
06.11.2010	Issued	800 units	
07.11.2010	Issued	400 units	
10.11.2010	Purchased	1,000 units	14
18.11.2010	Issued	700 units	
20.11.2010	Issued	200 units	
25.11.2010	Purchased	400 units	11
25.11.2010	Issued	300its	

6. The following are the details regarding of a certain item during the month of March, 2015.

March 1st Opening Balance 200 Units @ Rs. 5 each
March 1st Purchases 200 Units @ Rs. 7 each
March 8th Issue 300 Units
March 10th Purchases 300 Units @ Rs. 6 each
March 15th Issues 200 Units
March 18th Purchases 200 Units @ Rs. 5 each
March 21st Purchases 300 Units @ Rs. 10 each
March 25th Issues 250 Units
March 28th Purchases 100 Units @ Rs. 4 each
March 31st Issues 200 Units

Enter the above transactions in Stores Ledger Account under Simple Average Method.

7. The following transactions took place in respect of an item of material :

Jan 1	Opening Balance	600 Units @ Rs. 4.00
Jan 4	Issued	300 Units :
Jan 5	Received	200 Units @ Rs. 3.25
Jan 10	Issued	300 Units :
Jan 12	Received	350 Units @ Rs. 4.10
Jan15	Issued	200 Units :
Jan19	Issued	200 Units :
Jan20	Received	400 Units @ Rs. 4.50
Jan25	Received	400 Units @ Rs. 4.00
Jan26	Issued	250 Units:
Jan30	Issued	250 Units:

Issues are to be priced on the principle of 'Last in First Out '. Write out the stores ledger Account in respect of the materials for the month of January.

8. A firm maintains its stores ledger on the Weighted Average Method. During the month of July 2014 the following receipts and issues of materials were made. Record these transactions

Receipts

July 1st	Balance 50 units @ Rs. 4 per unit
July 5th	Purchase Order No. 10, 40 units @ Rs. 3 per unit
July 8th	Purchase Order No. 12, 30 units @ Rs. 4 per unit
July 15th	Purchase Order No. 11, 20 units @ Rs. 5 per unit
July 26th	Purchase Order No. 13, 40 units @ Rs. 3 per unit

Issues

July 10th	Material Requisition No. 4, 70 units
July 12th	Material Requisition No. 5, 10 units
July 20th	Material Requisition No. 6, 20 units
July 24th	Material Requisition No. 7, 10 units
July 27th	Shortage 5 units

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DEPARTMENT OF COMMERCE
I B.COM PA - Higher Financial Accounting (17PAU201)
Unit - I (Depreciation and Inventory Valuation)

S.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
1	Depreciation deducted from the concerned __________	Liability	Asset	Expenses	Incomes	Asset
2	Depreciation is a process of _____________	Valuation	Allocation	Reduction	Appreciation	Allocation
3	The main objective of providing depreciation is ___________	To calculate true profit	To calculate financial	To reduce tax burden	To reduce profit	To calculate true profit
4	Depreciation arises because of _____________	Fall in the market value of	Physical wear and tear	Fall in the value of money	Rise in the value of money	Physical wear and tear
5	Under the straight line method of charging depreciation, depreciation _______________	increases every year.	decreases every year	Is constant	Fluctuate every year.	Is constant
6	Under the diminishing balance method depreciation is calculated on _______________	Original value	Written down value	Scrap value	Market value	Written down value
7	The amount of depreciation charged on machinery will be debited to ________	Machinery account	Depreciation account	Cash account	Bank account	Depreciation account
8	Loss on the sale of machinery should be written off against ____________	Share premium account	Sales account	Depreciation fund account	General reserve account	Depreciation fund account
9	Depreciation is provided on ____________	Current asset	Fixed assets	Fictitious assets	Investment	Fixed assets
10						
11	The permanent, continuing and gradual shrinkage in the book value of a fixed asset is called______	Depreciation	Appreciation	Reduction	Computation	Depreciation
12	Depreciation is charged on the _____________	Market value	Book value	Purchase value	Sale value	Book value

S.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
13	Loss of usefulness occasioned by improved production methods is known as _________	Physical deterioration	Obsolescenc e	Disuse	Inadequacy	Obsolescence
14	The value of asset can be reduced to zero under this method ______	Straight line method	Written down value	Annuity method	Depreciation fund method	Straight line method
15	The balance in the asset account will not be reduced to zero under this method _____________	Straight line method	Written down value	Annuity method	Depreciation fund method	Written down value method
16	Income tax authorities recognize this method _____	Straight line method	Written down value	Annuity method	Depreciation fund method	Written down value method
17	Straight line method is also called ______	Written down value method	Annuity method	Depreciation fund method	Fixed installment method	Fixed installment method
18	Diminishing balance method is also called ______________	Written down value method	Annuity method	Depreciation fund method	Fixed installment method	Written down value method
19	Written down value method is also called _______	Annuity method	Diminishing balance	Depreciation fund method	Fixed installment method	Diminishing balance method
20	Straight line method is also called ____________	Annuity method	Diminishing balance	Original cost method	Depreciation fund method	Original cost method
21	Original cost method of depreciation is also called __________	Annuity method	Diminishing balance	Fixed installment	Depreciation fund method	Fixed installment method
22	Under annuity method the amount of depreciation is found out from _________	Log tables	Sinking fund tables	Annuity tables	Present value tables	Annuity tables
23	Annuity factor can be obtained from __________	Log tables	Sinking fund tables	Annuity tables	Present value tables	Annuity tables
24	Depreciation fund is also called ____________	Reserve fund	Compensatio n fund	Workers fund	Sinking fund	Sinking fund
25	Under depreciation fund method, the amount of depreciation is calculated with reference __________	Log tables	Sinking fund tables	Annuity tables	Present value tables	Sinking fund tables
26	Under which method, a policy is taken for amount of the asset to be replaced ______	Annuity method	Insurance policy	Fixed installment	Reducing balance method.	Insurance policy method
27	Under insurance policy method the premium is paid in the ______	Beginning of each year	End of each year	Beginning of each month	End of each month	Beginning of each year

S.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
28	Depreciation is the process of _______	Valuation of assets	Apportionment of the cost	Maintenance of assets	Purchasing the assets	Apportionment of the cost of the asset
29 30	Under annuity method, the amount of depreciation is __________	Increasing every year	Decreasing every year	Fixed for all the years	Change every year	Fixed for all the years
32	Profit from depreciation policy is transferred to ________________	Depreciation fund a/c	Asset a/c	P&L a/c	Liability side	Depreciation fund a/c
33	Interest is debited to asset a/c in ________	Annuity method	Sinking fund method	Insurance policy method	Straight line method	Annuity method
34	Depreciation applies to ____________	Current assets	Wasting assets	Intangible assets	Fixed assets	Fixed assets
35	Amortization applies to _________	Current assets	Wasting assets	Intangible assets	Fixed assets	Intangible assets
36	The asset account appears in the books at original cost when a _________	P & L account is maintained	Balance sheet is	Provision for depreciation	Provision for depreciation	Provision for depreciation
37	Depreciation is a ___________	Cash expenditure	Non cash expenditure	Deferred revenue	Capital expenditure	Non cash expenditure
38	Depreciation means _________________ value of an asset	Residual	Increased	Actual	Net	Residual
39	All fixed asset should be shown at cost less ____________ in the balance sheet	Reserve	Current balance	Depreciation	Floating value	Depreciation
40	Which of the following asset is not depreciable __________	Land	Plant	Building	Furniture	Land
41	The amount of depreciation is ___________ under straight line method	Semi-variable	Vary	Fixed	Semi-fixed	Fixed
42	Depreciation fund method is otherwise calles as ___________	Annuity method	Sinking fund method	Revaluation method	Straight line method	Sinking fund method
43	Under annuity method, the amount spent on the purcahase of an asset is regarded as an __________	Income	Expenditure	Investment	Depreciation fund	Investment
44	All assets whose benefit is derived for a ___________ period of time are called fixed assets	Long	Short	Middle	Not for a period	Long

S.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
45	If selling prices is less than the book value of the asset it denotes________________	Loss	Capital profit	Expenditure	Revenue profit	Loss
46 47 48	Under machine hour rate method of depreciation, the working of a machine is estimated in terms of ____________	Hours	Days	Months	Years	Hours
53	Under diminishing balance method the first year amount of depreciation is____________	Small	Heavy	Uniform	Less	Heavy
54	Depreciation arises because of ______________	Fall in market value of asset	Physical wear and tear	Fall in value of money	Increase in money value	Physical wear and tear
55	At the end of year the depreciation is charged to___________ account	Profit and Loss account	Balance sheet	Trading	Trail Balance	Profit and Loss account
56	Decrease in value of fixed assets is called__________	Less	Depreciation	Decrese	Increase	Depreciation
57	Fixed asset have ______________	Short life	Long Life	No life	Non cash	Long Life
58	A person to whom the business owes money is a ___________	Debtor	Creditor	Cashier	Supervisor	Creditor
59	While charging depreciation of an asset _______ A/c is debited in the books of buyer.	Depreciation	Asset	Cash	Interest	Depreciation
60	An example of provision is provision for__________	Depreciation	Share premium	Debenture redemption	Investment	Depreciation
61	For transfer of balance of sinking fund account to asset account at the end of the year___________	Asset	Sinking fund	Annuity	Liability	Sinking fund
62	Wasting asset includes_________	Mine	Quarries	Oil wells	Mine, Quarries and Oil wells	Mine, Quarries and Oil wells
63	Provision for depreciation account may appear in the______________ side of the balance sheet	Asset	Liability	Non account	Credit	Asset
64	An a important cause of depreciation is__________	Wear and tear	Lapse of time	Inadequacy	Disuse	Wear and tear

S.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
65	If selling price is more than the book value of the asset on the date of sale, it is _________	A loss	An income	A profit	No profit no loss	A profit
66	___________is a fixed asset	Machine	Wages	Insurance	Freight	Machine
67	Depreciation is charged on ___________	All asset	Current asset	All asset including good	Fixed asset excluding land	Fixed asset excluding land and
68	Under annuity method the amount of depreciation ________ every year.	Increases	Decreases	Constant	No depreciation	Decreases
69	Fixed asset have _____________	Short life	Long Life	No life	Non cash	Long Life

Unit - II

Branch Accounts Excluding Foreign Branches - Hire purchase and Installment System including hire Purchase trading accounts - Royalty Accounts - Minimum Rent - Fixed Rent - Short Working - Recouping Short Workings.

BRANCH ACCOUNTS

Branch and Department

Generally a business is split into many parts for the purpose to capture the market at different places or to have better management. If the different parts, usually, selling the same products or rendering the same services, are located at different places in the same town or in different towns, they are known as branches and when the various parts are located under the same roof, they are known as departments. A firm which has branches naturally wants to know the profit earned and loss suffered at each branch,, the system of accounting will naturally depended on the type of branch. Branches may be divided as under:-

(a) Branches which receive goods only from head office, selling goods only for cash, remitting all cash received to the head office, expenses being met out of remittance from the head office.

(b) Branches similar to the above except that goods are sold for cash and credit.(c) Branches similar to above (b) with the difference that head office invoices goods to the branch at selling price or at a price which is higher than Cost price and the office passes entries with the invoice price.

(d) Branches making their own purchases and manufacturing goods and functioning more or less cases as an autonomous units.

(e) Foreign branches, i.e. branches located in a foreign country. We will not study the accounting for such branches it is not in the syllabus.

Usually, account for the first three types branches are kept by the head office, The fourth and fifth type of branches generally maintain an independent of books of accounts.

The simplest case of branch is one where branch receives goods only from H. O, sells goods only for cash depositing the same with the bank in the name of H.O., and H.O., itself pays all branches' expenses and record goods sent to branch at cost.

H.O. maintains a Branch Account to ascertain profits and loss made at the branch. Here 'Branch Account' is in the nature of Trading and Profit and Loss Account. All investment in the form of goods and expenses incurred in respect of branch are recorded on the debit side of the 'Branch Account' - Whereas sale proceeds, closing stock and other items of income are recorded on the credit side of this account, if credits exceed debits, it means a profit at the branch which is transferred to profit & Loss Account where as id debit exceeds credits, it means a loss at branch which, like the profit a branch, is transferred to Profit & Loss Account. The entries to be made in the Head office books are :-

(a) When goods are sent to Branch

*Branch Account Dr.

To Goods sent to Branch Account

(For Cost Price of goods sent to Branch)

* If the branch returns some goods to H.O., a reverse entry will be passed with the Cost price of Goods returned.

(b) When branch expenses are met

Branch Account Dr.

To Cash/Bank Account

(For payment for branch expenses)

(c) When sale proceeds deposited by Branch with the bank in the name of Head Office :-

Bank Account Dr.

To Branch Account

(For sale proceeds deposited with the Bank)

(d) When at the end of the year some goods are lying with the Branch unsold.

Branch Stock Account Dr.

To Branch Account

(For cost Price of goods lying at the branch at the end of the year)

(e) When Branch Account reveals a profit

** Branch Account Dr.

To Profit and Loss Account

(For transfer of branch profit from Branch Account to profit & Loss Account)

(f) Branch Stock account will appear in the Balance Sheet of Head Office. In the beginning of the next year, this account is transferred t Branch Account by means of the following en try:-

Branch Account Dr.

To Branch Stock Account

(For Cost of Branch Stock as at the beginning of the year)

(g) Goods sent to Branch Account must be transferred at the end of the year to Purchase Account in case of trading concern and to Trading Account in the case of manufacturing concern. The entry will be :-

Goods Sent to Branch Account Dr.

To Purchase Account/Trading Account

(Transfer of Balance in Goods sent to Branch Account to Purchase/Trading Account)

(h) If the branch sells goods on credit also, a few additional entries will have to be made. For cash received from branch debtors during the year, following entry will be passed :-

Bank Account Dr.

To Branch Account

(For cash received from Branch debtors)

** If Branch Account reveals a loss, a reverse entry will be passed with the amount of loss.

(i) At the end of the year, the following entry will be passed with the total amount due from the Branch

Account debtors as at the date:-

Branch Debtors Account Dr.

To Branch Account

(For closing branch debtors)

Branch Debtors will appear in the Balance Sheet of the H.O. and will be transferred to Branch Account in the beginning of the next account period.

Note:- Sometime H.O. may send cash to the branch to meet petty cash expenses at the branch. At the end of the year, some cash may be lying with the branch. The amount should be treated in the same way as stock at branch is treated.

Illustration 1

From the following particulars relating to Bangalore Branch for the ending 31st December, 1994 prepare the accounts in the head office books:-

	Rs.
Stock at Branch on 1st January, 1994	17,800
Branch Debtors on 1st January, 1994	9,400
Petty Cash at Branch on 1st January 1994	40
Goods sent to Branch during the year	56,800
Cash Sales during the year	31,600
Credit Sales during the year	80,800
Cash received from the debtors	75,800
Cash sent to Branch for expenses :-	
Rent	4,000
Salaries	12,000
Petty Cash	2,000
Stock at Branch on 31st December 1994	10,800
Petty Cash at Branch on 31st December, 1994	60
Goods returned by the Branch	1,600

Solution:

Bangalore Branch Account

Dr. Cr.

Date	Particulars		Amount Rs.	Date	Particulars		Amount Rs.
1994				1994			
Jan., 1	To Balance b/d			Jan.l to Dec.,31	By Cash Sales Received from Debtors	75,800	
	Stock Debtors Petty Cash	17,800 9,400					31,600
					Goods sent to Brach Account		
Jan.l to Dec.,31	To Goods sent to Branch Account	40	27,240		Branch Stock A/c Branch Debtors A/c Petty Cash at Branch Account		1,07,400
" "	To Cash for Expenses: Rent Salary Petty	4,000 12,000 2,000	56,800				1,600 10,800
	To Profit transferred to Profit & Loss Account		18,000				14,400 60
		32,220	1,34,260				1,34,260

Memorandum Branch Debtors Account

Dr. Cr.

To Balance b/d	9,400	By Cash	75,800
To Credit Sales	80,800	By Balance c/d	14,400
	90,200		90,200

Goods sent to Branch Account

		Rs.			Rs.
1994			1994		
Jan.l to Dec. 31	To Bangalore Branch A/c returns	1,600	Jan. 1 to Dec. 31	By Bangalore Branch Account	56,800
Dec.31	To Purchase Account Transfer	55,200			
		56,800			56,800

Branch Stock Account

		Rs.			Rs.
1994			1994		
Jan.l	To Balance b/d	17,800	Jan.l	To Transfer to Bangalore Branch A/c	17,800
Dec.31	To Bangalore Branch A/c	10,800	Dec. 31	By balance c/d	10,800
		28,600			28,600
1995 Jan.l	To Balance b/d	10,800			

Branch Debtors Account

		Rs.			Rs.
1994			1994		
Jan. 1	To Balance b/d	9,400	Jan.1	To Transfer to Bangalore A/c	9,400
Dec. 31	To Bang lore Branch A/c	14,400	Dec. 31	By Balance c/d	14,400
1995	To Balance b/d	14,400			
		23,800			23,800
Jan.1					

Petty Cash at Branch Account

		Rs.			Rs.
1994			1994		
Jan.1	To Balance b/d	40	Jan.1	By Bangalore Branch A/c	40
Dec.	To Bangalore Branch A/c	60	Dec.31	By Balance b/d	60
		100			100
1995		60			
	To Balance b/d				
Jan.1					

Note: No entry is made for credit sales at branch in the H.O. books. The cash received from the debtors will be remitted to the H.O. along with Cash received for Cash Sales. The H.O. makes no entry for cash received by it. It will debit cash, credit branch. By the same token, the H.O. makes no entry for discounts allowed, bad debt written off or returns by the Branch debtors. It the branch has received to bill of exchange, it will be sent to the H.O.

The entry then will be to debit Bills Receivable Account and Credit Branch Account.

Type (c)

In this case, goods are invoiced to the Branch at selling price. In order to ascertain the profit, just entries will have to be made for the difference between the invoice value of goods sent in branch and their cost. Similarly stock at branch will be valued at invoice value but, again suitable adjustment will be necessary to ensure that stock does not appear in the Balance Sheet at more than the cost.

The entries in respect of goods sent to Branch and Stock will be as follows:-

(a) When goods are sent to branch Account Dr.

(For invoice price of the goods sent to branch)

(b) For stock lying at branch at the end of the Trading period

Dr.

Stock at Branch Account

To Goods sent to Branch Account

To Branch Account

(For invoice price of the goods lying at the branch at the end of the year)

(c) For adjustment in the Value of goods sent

Goods sent to Branch Account Dr. To Branch Account

(For loading invoice price of goods sent to branch)

If some goods have been returned by the branch to Head Office the above mentioned entry will be passed only for the loading in invoice price f goods sent to branch less invoice price of the goods returned by branch.

4. For adjustment in the value of Closing Stock

Branch Account Dr.

To Stock Reserve Account

(Loading in the amount of closing stock at branch

Credited to Branch Stock Reserve Account and debited to Branch A/c)

In the beginning of the next year, Branch Stock Reserve Account will be transferred to Branch Account by means of the following entry:

Branch Stock Reserve Account Dr.

To Branch Account

(Transfer of Branch Stock Reserve Account to Branch Account)

Illustration 2

Mohan Stores of Delhi has a branch at Kanpur, goods are sent by the head office at invoice price which is at a profit of 20% on invoice price. All expenses of the branch are paid by the head office. From the following particulars prepare branch account in the Head Office books:-

Opening balance		
Rs.		
Stock at invoice price		22,000
Debtors		3,400
Petty Cash		200
Goods sent to branch at invoice price		40,000
Expenses paid by H.O.		
Rent	1,200	
Wages	400	
Sales and other expenses	1,800	3,400
Remittances made to Head Office		
Cash Sales	5,300	

Cash collected from Debtors	42,000	47,300
Goods returned by branch at invocie price	800	
Balance at the end:		
Stock at Invoice price		26,000
Debtors at the end		4,000
Petty Cash		250

Solution:

Branch Account

Dr.
Cr.

To Opening balances: Stock			By Stock reserve (loading) of		
Debtors			stock in the beginning		
	22,000		By Goods sent to branch		4,400
Petty Cash			(loading) By Cash Sales		
	3,400		ByCash Collected from		8,000
To Good sent to branch			Customers		
Account	200	25,600		5,300	
To Bank Rent Wages		40,000		42,000	47,300
Salary & other Expenses			By Goods returned to H.O. By		
			Balance:		
To Stock reserve (loading) on	1,200		Stock		
					800
Closing Stock	400		Debtors		
To Goods returned (loading)	1,800	3,400	Petty Cash	26,000	
To Net Profit					
				4,000	
		5,200		250	30,250
		160			
		16,390			
		90,750			90,750

Illustration:

Naresh Stores Ltd. operate a retail branch at Madras All purchases are made by the Head Office in Calcutta, goods being charged out to the branch at selling price which is cost plus 50%. All cash received by the branch in remitted to Calcutta. Branch expenses are paid out of an imprest account which is reimbursed by Calcutta monthly Branch helps a sales ledger and subsidiary books but otherwise all branch transactions are recorded in the books of the Calcutta Office. On April 1,1990 Stock in trade at Madras, at selling price, amounted to Rs. 2,76,900 and debtors to Rs. 54,800.

During 1990-91 the following transactions took be place at the branch.

	Rs.
Goods received from Calcutta at selling price	9,37,200
Cash Sales	5,21,000
Credit Sales les returns	4,23,700
Goods returned to Calcutta at selling price	14,400
Agreed Allownces to customers off selling price	
(already taken into account while involing)	8,200
Cash receiving from debtors	3,98,600
Discount allowed to debtors	97,000
Bad debts written off	4,800
Expenses	1,43,800

On 31 March, 1991 Stock in trade at Madras was found to amount to Rs 2,45,100

You are required to (a) write up the Branch Stock Account, and (b) prepare the Trading and Profit and Loss Account at the Branch for the year 1990-91

Solution:

Madras Branch Stock Account

	Rs.			Rs.
To Balance b/d To Goods sent to Branch Account	2,76,900	By Sales- Cash	5,21,000	
		Credit	4,23,700	9,44,700
	9,37,200	By Allowance to Customers		8,200
		By Goods Sent & Branches		14,400
		By Shortages (Balancing figure) By Balances c/d		1,700
				2,45,100
	12,14,100			12,14,100

Branch & Trading and Profit & Loss Account

	Rs.			Rs.
To Opening Stock (Cost) (2,76,900-92,300)	1,84,600	By Sales: Cash Credit By Closing Stock		
To Goods Sent to Branch (Cost)			5,21,000	
(9,37,200 - 14,400 - 3,07,600) Gross Profit		(2,45,700-81,700) By Gross Profit	4,23,700	9,44,700
	6,15,200			
To Discount To Bad debts To Expenses To Nel Profit	3,08,300			1,63,400
	11,98,100			11,08,100
	9,700			3,08,300
	4,800			
	1,43,800			
	1,50,000			
	3,08,300			30,800

Stock and Debtors System

Account of balance of type (c) can also be prepared in another manner known as the Stock and Debtors system a Branch Stock Account is maintained whose balance at any time shows the selling price of goods lying at the branch, a Branch Debtors Account is maintained whose balance at any time reveals the amount recoverable by the branch from its debtor at that particular time a Branch Expenses Account to show total expenses incurred in connection with the branch by the branch and H.O. a Branch Adjustment Account to reveal gross profit or gross loss at the branch and a Branch Profit and Loss Account to reveal net profit, or net loss made at the branch. Sometimes Branch Profit and Loss A/c merged into Branch Adjustment Account which is then made to reveal net profit or net loss instead of gross profit or gross loss. Under the method the entries are made as follows:

1. Where goods are sent to a Branch

Branch Stock Account Dr.

To Goods sent to Branch Account

(For invoice price of goods sent to Branch Account)

Note : The above entry is reversed if goods are returned by branch t Head Office.

2. When expenses are incurred for the Branch

Branch Expenses Account Dr.

To Cash/Bank Account

(For payment made by H.O. for tranch expenses)

3. When sales are made at the branch

(a) Cash/Bank Account Dr.

To Branch Stock Account

(For cash sales made at the branch)

(b) Branch Debtors Account Dr.

To Branch Stock Account

(For credit sales made at the branch)

4. When Cash is received n account of

Branch Debtors Cash/Bank Account Dr.

To Branch Debtors Account

(For cash received from branch debtors)

5. When goods are returned by the Branch Debtors to Branch

Branch Stock Account Dr.

To Branch Debtors Account

(For goods returned by Debtors to Branch)

6. When any allowance is made to branch debtors, say discount.

Branch Expenses Account Dr.

To Branch Debtors Account

7. When there is any leakage, loss or wastage at the Branch

Branch Stock Adjustment Account Dr. (with loading) Branch Profit and Loss Account Dr. (with Cost price)

To Branch Stock Account (With invoice price)

Note : To above entry is reversed if there is surplus in any stock. For the excess of selling price over charged on goods sent ot branch;

8. Goods sent to Branch Account Dr.

To Branch Stock Adjustment Account

9. For the Adjustment of the invoice price of the closing stock.

Branch Adjustment Account Dr. With the difference in the invoice

To Stock Reserve Account price of the stock and the Cost value of stock.

(The Stock Reserve Account, will be carried to the next accounting year and then transferred to the credit Branch Adjustment Account)

10. For transfer of Branch Expenses Account to Branch Profit & Loss Account

Branch Profit & Loss Account Dr.

To Branch Expenses Account

11. For transfer of Gross profit revealed by branch adjustment account to Branch profit & Loss Account

Branch Adjustment Account Dr.

To Branch Profit & Loss Account

The above entry will be reversed if there is a Gross loss.

12. For transfer of Net Profit revealed by Branch profit & Loss Account to General profit & Loss Account

Branch profit & Loss Account Dr.

To (General) profit & Loss Account

The entry will be reversed in case of Net Loss.

13. For transfer of balance in Goods sent to Branch Account to Trading Account or Purchase Account

Goods sent to Branch Account Dr.

To Trading Account/Purchases Accounts

Illustration 3

Oils Ltd. opened a branch at Kanpur in 1993. Goods are invoked to the branch at cost plus 25%. The following figures are given to you for 1993 and 1994 ascertain the profit or Loss made in two years by stock and debtors system:

	Rs.	Rs.
To Goods sent to Branch (Inv. Value)	1,40,400	2,65,200
Sales -Cash	50,000	80,000
Credit	70,000	1,60,000
Cash received from Debtors	62,400	1,51,400
Discount allowed to Customers	1,600	2,600
Goods returned by customers	2,000	1,500
Cash remitted to Branch for:		
Rent	1,200	1,500
Salaries	6,000	8,000
Sundry Expenses	960	1,000
Stock at Branch as on 31st December		47,800

Solution:

Branch Stock Account

		Rs.			Rs.
1993			1993		
Jan.l	To Goods sent to Branch Account (l)	1,40,400	Jan,l	By Cash Sales (2)	50,000
Dec., 31	To Branch Debtors A/c Returns	2,000	Dec. 31	By Branch Debtors A/c Credit Sales (3) By Balance C/d	70,000 22,400
		1,42,400			1,42,400
1994					
Jan.l	To Balance b/d 22,400				

Goods sent to Branch Account

		Rs.			Rs.
1993			1993		
Dec.31	Branch Adjustment A/c (8)	28,080	Jan.l to Dec.31	By Branch Stock A/c (1)	1,40,400
	To Purchase Account (11)	1,12,320			
		1,40,400			1,40,400

Branch Debtors Account

		Rs.			Rs.
1993			1993		
Jan.l	To Branch Stock A/c To Credit Sales (3)	70,000	Jan. l to Dec., 31	By Cash (4)	62,400

"

Dec. 31				By Branch Stock A/c Returns (5)	2,000
				By Branch Exp. A/c Discount (7)	
				By Balance c/d	1,600
					4,000
		70,000			70,000
1994					
		4,000			
Jan. 1	To Balance b/d				

Branch Expenses Account

		Rs.			Rs.
1993			1993		
Jan. 1	To Cash-Rent (6)	1,200	Dec.31	By Branch Adjustment	
	Salaries				9,760
	S. Exp.	6,000		A/c Transferred (10)	
	To Branch Debtors A/c	960			
	Discount (7)				
Dec. 31					
		1,600			
		9,760			9,760

Branch Adjustment Account

		Rs.			Rs.
1993			1993		
Dec.31	To Stock Reserve A/c		Dec.31	By Goods sent to Branch A/c	28,080
		4,480			
	20% as Rs, 22400 (9) To				
	Branch Exp. A/c General	9,760			
	profit & Loss A/c				
	transfer				
		13,840			
		28,080			28,080

Stock Reserve Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1993 Dec. 31	To Balance c/d	4,480	1993 Dec.31	By Branch Adjustment A/c (4)	4,480
		4,480			4,480
			1994 Jan. 1	By Balance b/d	

Note : Figure in Backers show the steps and entries to be completed.

Branch Stock Account

Date	Particulars	Rs.	Date	Particulars	Rs.
1993 Jan.l	To Balance b/d	22,400	1993 Jan. 1 to Dec. 31	By Cash Sales	80,000
to Dec. 31	To Goods sent to Branches "A/c	2,65,200	Dec. 31	By Branches Deb. A/c Credit Sales	1,60,000
	To Branch Debtors A/c Returns	1,500		By Branch Adj . A/c - Wastage*	1,300
				By Balance c/d	47,800
		2,89,100			2,89,100
1994 Jan.l	To Balance b/d	47,800			

Goods sent to Branch Account

		Rs.			Rs.
1993			1993		
Dec. 31	To Branch Adj. A/c	53,040	Jan 1 to	By Branch Stock A/c	2,65,200
" "	To Purchases A/c	2,12,160	Dec. 31		
		2,65,200			2,65,200

Branch Debtor Account

		Rs.			Rs.
1993			1993		
Jan.l	To Balance b/d	4,000	Jan.l	By Cash	1,51,400
Jan.l to	To Branch Stock A/c	1,60,000	Dec.31	By Branch Stock A/c	
Dec. 31	Credit sales			Returns	1,500
				By Branch Exp. A/c Discount	2,600
				By Balance c/d	8,500
		1,64,000			1,64,000
1994					
Jan.l	To Balance b/d	8,500			

* The wastage is found as a balancing figure after putting the figure of closing stock on the credit side.

Branch Expenses Account

		Rs.			Rs.
1993			1993		
Jan. l	To Cash-Rent	1,500	Dec.31	By Branch Adj. A/c	13,100
	Salaries	8,000		Transfer	
	Sun Exp.	1,000	1994		

Dec. 31					
	To Branch Debtors A/c		Jan.l		
	Discount	2,600			
		13,100			13,100

Stock Reserve Accounts

		Rs.			Rs.
1993			1993		
Dec.31	To Branch Adj. A/c	4,480	Jan.l	By Balance b/d	4,480
	Transfer	9,560	Dec.31	By Branch Adj. c/d	
Dec. 31	To Balance c/d			(reserve required closing stock)	9,560
		14,040			14,040
			1994		9,560
			Jan., l	By balance b/d	

Branch Adjustment Account

		Rs.			Rs.
1993			1993 ec., 31		
Dec., 31	To Branch Adj., A/c		D	By Stock Reserve A/c transfer	4,480
	Reserve required on closing stock To Branch Stock A/c	9,560			
				By Goods sent to	
	Wastage			Branch A/c	53,040
	To Branch Exp. A/c To	1,300			
	profit & loss A/c (transfer of Net Profit)	13,100			
		33,560			
		57,520			57,520

Distinction between whole-sale and retail profit at branch

Sometimes, the manufacturers of goods sell their goods on retail basis also. In such cases they supply the goods to these retail branches at a price at which it is supplied to the wholesalers the us keeping them at par with the wholesalers. Since goods are sold by branches at retail price which is more than wholesale price, therefore, the difference between their sale price and whole sale price only will be taken to be profit earned by the branch. For example the cost of an article may be Rs. 100, the wholesale price is Rs. 130 If the articles are sent to branch and sold there, the profit revealed according to the above method will be Rs. 30 (retail Price minus the cost.) It is apparent, however, that by selling goods through branch Profit is only Rs. 10 Rs. 20 could have been earned by selling the goods on whole-sale basis to others. For knowing the true profit at retail branches, the practice adopted sometimes is to charge the branch with wholesale price and then to ascertain the profit. The Head Office Trading Account will then be credited with goods sent to branches at wholesale price and not at cost.

It must be remembered however, that the stock at the end of the year at the branch will be valued at wholesale price. Therefore, the Head Office must create a proper reserve by debiting its own profit & Loss account in order to show the branch stock at cost in the Balance Sheet.

Illustration 4

A Ltd. has a retail branch at Nagpur and goods are sold to customers at cost plus 100%. The wholesale price is cost plus 80 %. Goods are invoiced to Nagpur at wholesale price. From the following particulars find out the profit made at Head office and Nagpur for the year 1993-9

H.O. Nagpur

Stock on July 1,1993 25,000

Purchases 1,50,000 —
Goods sent to Branch (Invoice Price)
54,000 — Sales
1,53,000 50,000

Stock on 30th, June 60,000 1,000

Sales at H.O. are made only on whole-sale basis and that at Branch only to customers. Stock at branch is valued at Invoice Price.

Trading Account for 1993-94

Particulars	H.O. Rs.	Nagpur Rs.	Particulars	H.O. Rs.	Nagpur Rs.
To Opening Stock	25,000	—	By Sales	1,53,000	50,000
To Purchases	1,50,000	—			
To Goods received from H.O.		54,000	By Goods sent to Branch	54,000	—
To profit & Loss A/c Gross profit	92,000	5,000	By Closing Stock	60,000	9,000
	2,67,000	59,000		2,67,000	59,000

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Profit & Loss Account 1993-94

Particulars	H.O. Rs.	Nagpur Rs.	Particulars	H.O. Rs.	Nagpur Rs.
To Stock Reserve against for $\left(80,000\times\frac{160}{200}\right)$	4,000	—	By Gross profit	92,000	5,000
To Net Profit (Subject to exp.)	88,000	5,000			
	92,000	5,000		92,000	5,000

Had the solution been attempted on the usual lines it would have been as follows:-

Trading and Profit & Loss Account for 1993-94

Particulars	Head Office	Nagpur	Particulars	Head Office	Nagpur
	Rs.	Rs.		Rs.	Rs.
To Opening Stock	25,000		By Sales	1,53,000	50,000
To Purchase	150,000		By goods Sent to		
To goods setn to			(at cost)-	30,000	
54,000 × 100					
			By Closing Stock		
			(at cost)	60,000	5,000
		30,000			
	68,000	25,000			
	243,000	55,000		243,000	55,000

Branch at cost 180

Illustration:

A head office sends goods to its Branch at 20% less than its lisepitce. Goods are sold to customers at cost plus 100% from the following particulars ascertain the profit made at the head office and the branch in case of branch on the wholesale basis.

Opening show of cost

	Head Office	Branch
	Rs.	Rs.
(at invoice price in case of Branch)	40,000	32,000
Purchases	200,000	
Goods Sent to Branch (at invoice price)	96,000	

Sales	1,70,000	80,000
Expenses	14,000	8,000

Solution

	H.O	Branch	By Sales	No.	Branch
	Rs.	Rs.		Rs.	Rs.
To Opening stock	40,000	32,000	By goods sent to	170,000	80,000
To Purchases	2,00,000		Branch A/c	96,000	
To Goods From. H.O To Gross Profit c/d		96,000	By closing Stock		64,000
	1,21,000	16,000		95,000	
	3,61,000	144,000		3,61,000	1,44,000
To Expenses	14,000	8,000		1,21,000	16,000
			By Gross Profit b/d		
To Stock Reserve against Branch stock $64,000 \times \frac{60}{160}$	24,000		By Stock Reserve against branch opening stick $32,000 \times \frac{60}{160}$		
To Net Profit	95,000	8,000		12,000	
	1,33,00	16,000		133,000	16,000

Calculation of closing stock

	Head office	Branch	
	Rs.	Rs.	
Opening stock	40,000	32,000	(at invoice price)
Purchases	2,00,000		
Goods from (HO)		96,000	(at invoice price)
	2,40,000	1,28,000	

Independent Branch

So far we have studied branches which did not keep books of account. Now we s shall deal with branches keeping their own accounts.

The Head Office will open its own books an account called "Branch account to which goods or cash sent will be debited. When cash is received from the branch, the branch account will be credited. This account is maintained more or less /like personal accounts so that any expenses incurred on behalf of the branch will also be debited the account. The balance of this account shows how much money the branch owes to Head Office.

Similarly the branch will have "Head Office Account" in its books "goods" or Cash received from Head office be credited and goods and cash sent to Head Office debited.

The balance in the account is usually credit and indicates the amount owed by branch to the Head Office.

The balance in the branch account (Head Office books) should agree with the balance in the Head

Office account ((branch books). But due to goods or cash in transit this may, not be so. IT goods are sent by the Head Office it will pass an entry immediately but the branch will record the receipt of goods only on their receipt. There will surely be some cash to Head Office, it will record it immediately but the Head Office will wait till actual receipt. On the date of closing of accounts, goods or cash in transit, the Head Office will have to pass the following entry:

Goods in Transit Dr.

To Branch Account

Similarly, for cash sent by the branch but still in transit the branch will pass the entry; Cash in Transit Account Dr.

To Head Office Account

Both Goods and Cash in transit are assets and should be shown in the balance sheet:

Note: If in examination problems, there is a difference in the balance shown by the Head Office and Branch Accounts; the difference should be assumed to be due to either gods in transit or cash-in transit. Suppose in the Head Office books, branch account shows debit balance to Rs. 26,000/- and in the branch books. Head Office account shows a credit balance of Rs. 21,000/ - worth of goods or cash is in transit.

Now we shall take up certain other are peculiar to an independent branch. Account of fixed assets at the Branch is usually maintained in Head Office books and not in branch books even if the asset is originally paid by the branch.

When such an asset is acquired and branch pays for it, the branch passes the following entry: Head Office Account Dr.

To Cash/Bank Account

The Head Office will pass the following entry on receipt of advice from Branch: Branch Fixed Asset (by name) Dr.

To Branch Account

If Head Office pay s for it, it will debit Branch Fixed Asset Account and will credit cash. Branch passes no entry. Regarding depreciation there is no peculiarity if the accounts of fixed assets are maintained in the branch books. But if accounts of such assets are maintained in Head Office books, the entry in respect of depreciation will be:

Branch Account Dr.

To Branch Fixed Assets Account

In the branch books the entry will be:

Depreciation Account Dr.

To Head Office Account

Head Office always does some work on behalf of the branch and thus Head Office Charges a reasonable amount from the branch. For that the Branch passes the following entry:

Head Office Expenses Account Dr. To Head Office Account

Head Office will pass the following entry:

Branch Account Dr.

To Salaries Account (Or Profit & Loss Account)

There may be inter branch transactions. Suppose A Branch sends goods to B branch, the various entries to be passed are as follows:

In A's books:

Head Office Account Dr.

To Goods sent to Branch Account

In B's books :

Goods received from Head Office Account Dr.

To Head Office Account

The Head Office will, of course, keep accounts of all the branches and will also record inter branch transactions.

If, therefore , goods are supplied by A Branch to B Branch the Head Office will Pass the following entry :

A Branch Account Dr.

To B Branch Account

Illustration 5

Nagrik Cloth Ltd., had a branch at Rohtak. Preliminary account prepared by Rohtak Branch for 1994 showed a profit of Rs. 11,400 without considering the following:

Cash remitted to the Head Office not yet received	3,600
Goods sent by the H.O. not yet received at Rohtak	4,400
H.O. expenses charged to Branch	3,200
Depreciation on Branch assets (account kept in H.O. Books	900

Record the above in the books of both the Head Office and Branch. Also state how much profit has the branch made.

Solution:

Books of Head office

Date 1994	Particulars		L.F.	Dr.	Cr.
	Goods in transit Account	Dr.		4,400	
	To Rohtak Branch Account				4,400
	(Being goods sent to Rohtak Branch not received there)				
	Rohtak Branch Account	Dr.		3,200	
	To Salaries Account (or P&L A/c)				3,200
	(being H.O. expenses to be received from the branch)				
	Rothak Branch Account	Dr.		900	
	To Branch Assets Account				900

Depreciation on branch assets (account kept in H.O. Books charged to Branch A/c)			
Cash in Transit Account	Dr.	3,600	
To Head Office Account			3,600
(Cash sent to HO not yet received there)			
Head Office Expenses Account	Dr.	3,200	
To Head Office Account			3,200
(Expenses Charged by Head Office)			
Depreciation Account	Dr.	900	
To Head Office Account			900
(Depreciation in respect of branch assets account in Head Office)			

After making the above entries the profit at the branch will be reduced to Rs. 7,300 i.e. Rs, 11,400 being H.O. expenses depreciation.

Illustration 6

A & Co. Ltd, having their H.O. at Delhi with branches at Lucknow and Allahabad close their annual account on 31st December, when the following transactions have taken place:

(a) Remittances of Rs. 4,500 made by Lucknow branch to its H.O. on 30th December, received by the

H.O. on 5th January.

(b) Goods valuing Rs. 2,200 dispatched by the Allahabad on 27th December, under instructions from the H.O. and received by the Lucknow on 30th December.

(c) Depreciation amounting to Rs, 1,100 on Lucknow branch fixed assets when accounts of such assets are maintained at the H.O.

(d) Goods worth Rs. 9,000 dispatched by the H.O. to Allahabad branch on 30th December received by that branch on 7th January.

Show these entries in the books of the (i) H.O. and (ii) Lucknow branch as at the close of the year.

Solution:

H.O. JOURNAL

			Rs.	Rs.
(a)	No Entry			
*(b)	Lucknow Branch A/c	Dr.	2,200	
	To Allahabad Branch A/c			2,200
	(Goods sent by Allahabad Branch to Lucknow Branch as per our instalment)			
(c)	Lucknow Branch A/c	Dr.	1,100	
	To Lucknow Assets A/c			1,100
	(Dep, on assets as Lucknow Branch)			
(d)	Goods-in-Transit A/c)	Dr.	9,000	
	To Allahabad Branch A/c			9,000
	(Goods sent by us not yet received by Allahabad Branch)			

* Strictly entry (b) is not required as the question requires entries only at the close of the year.

Lucknow Branch Journal

			Rs.	Rs.
(a)	Cash-in-transit A/c	Dr.	4,500	
	To Head Office A/c			4,500
	(Entry for remittances still on transit)			
(b)	Goods from H.O. A/c	Dr.	2,200	
	To Head Office A/c			2,200
	(Goods received from Allahabad oon Head Office instructions)			
(c)	Depreciation A/c	Dr.	1,100	
	To Head Office			1,100
	(depreciation on assets)			

Incorporation of branch trial balance in Head Office books

On the receipt of trial balance from the branch, the H.O. will take steps to incorporate branch figures with its own figures with a view to present a common trading and profit and loss account and Balance sheets. This process is known as Incorporation'. Before starting to pass entries, the Trading and Profit & Loss Account of the branch will have to be prepared and after that the combined balance sheet of the branch and the Head Office. There are two methods for doing this:

Under first method, the Trading and Profit and Loss Account of the Branch is prepared in the regular way in the books of the Head Office. The entries to be passed are as follows:

1. Branch Trading Account Dr.

To Branch Account

(With the items of opening stock, purchases and other items appearing on the debit side of Trading Account of the branch but excluding gross profit).

2. Branch Account Dr.

To Branch Trading Account

(With Sales; Closing Stock and other items appearing on credit side of Trading Account of the branch but excluding loss).

2. Branch Trading Account Dr.

To Branch Profit and Loss Account

(For Gross profit revealed by Trading Account).

If there is a gross loss, the entry will be reversed:

Note:

4. Branch Profit & Loss Account Dr.

To Branch Account

(Fro amounts appearing on the debit side a Profit & Loss account of the branch but excluding net Profit and Gross Loss)

5. Branch Account Dr.

To Branch Profit & Loss Account

(With items appearing on the credit side of P&L A/c of

Branch but excluding gross profit and net loss).

6. Branch Profit and Loss Account Dr.

To Profit & Loss Account

(With net profit revealed by Profit & Loss Account of the Branch). The above entry will be reversed if there is a net loss:

It should be noted that Branch Trading Account and Branch Profit and Loss Account will set off.

It is desired to close the books of the branch completely and to record branch assets and liabilities in the Head office books for the purpose of repairing common Balance Sheet, the following two further entries should be passed:

Branch Assets (individually) To Branch Account (Incorporation of branch assets as shown in the balance sheet at the branch) Branch Account
Dr.

To Branch Liabilities (individually)

(Incorporation of branch liabilities so outsiders shown in the Balance Sheet of the branch).

Illustration 6

You are required to prepare the Trading and Profit & Loss Account and consolidated balance sheet of Eve Ltd., in Calcutta and its branch at Delhi. Give Journal entries incorporation of Delhi branch accounts in the Head Office and show the branch account in Head Office book after incorporating these in the assets and liabilities.

The trial balance as on 31st December, 1993 are as under.

	H.O. Dr.	Branch Dr.	H.O. Cr.	Branch Cr.
Manufacturing expenses		30,00010,000	–	–
Salaries		30,00010,000	–	–
Wages	1,00,000	40,000	–	–
Cash in Hand		10,0002,000	–	–
Purchases	1,50,000	8,000	–	–
Capital		–	–2,00,000	–
Goods received from H.O.		–15,000	–	–
Rent	8,000	4,000	–	–
General expenses	20,000	5,000	–	–

Sales		–	–4,50,000	1,50,000	
Goods sent to Branch		–	–15,000		–
Purchase returns		–	–5,000	1,000	
Opening Stock	50,000	30,000		–	–
Discount earned		–	–2,000	1,000	
Machinery H.O.	1,50,000		–	–	–
Machinery, branch	50,000		–	–	
Furniture H.O.	7,000		–	–	–
Furniture, Branch	3,000		–	–	–
Debtors	40,000	15,000		–	–
Creditors		–	–30,000	5,000	
H.O. Accounts		–	–	–45,000	
Branch Accounts	54,000		–	–	–
Total	7,02,000	2,11,000	7,02,000	1,11,000	

Closing stock H.O. was Rs. 40,000 and at branch Rs. 30,000. Depreciation is to be chargeable or machinery

@ 20% and furniture @ 15%. Rent outstanding is Rs. 500 (for branch).

Solution:

H.O..Books

Journal

1993

		Rs.	Rs.
Delhi Branch Account	Dr.	10,450	10,000
To Branch machinery account			
To Branch furniture account			450
(Being the depreciation on branch fixed assets charged to branch)			
Branch trading account	Dr.	1,75,000	
To Delhi Branch account			1,75,000
(Cueing the total of the following items in branch debited to branch trading account)			

Branch stock account	Dr.	30,000	
To Delhi Branch account			47,000
(being the transfer of various assets to branch to H.O. books)			
Delhi Branch account	Dr.	5,500	
To Branch creditors account			5,000
To Branch expenses/s account			500
(Being the transfer of liabilities at branch to H.O. books)			

Delhi Branch Account

Date	Particulars	Amount	Date	Particulars	Amount
1993		Rs.	1978		Rs.
Dec.31	To Balance b/d	54,000	Dec.31	By Delhi Trading A/c	
	To Branch assets depreciation	10,450		-opening stock purchases etc.	1,75,000
	To Delhi trading account sales and stock	1,81,000		By Delhi P&L A/c expenses,	
				Sundry assets	29,950
	To Delhi Profit & loss account -discount				47,000
		1,000			
	To S. Liabilities				

	5,500			
	2,51,950			2,51,950

Trading and profit and Loss Account of Eve Ltd.

Fr the year ended 31st December, 1993

	H.O. Rs.	Delhi Rs.		H.O. Rs.	Delhi Rs.
To Opening Stock	50,000	30,000	BY Goods sent to branch	15,000	—
To Purchases less returns	1,45,000	79,000	By Sales	4,50,000	1, 50,000
To Goods received from H.O.	—	15,000	By Closing Stock	40,000	30,000
To Wages	1,00,000	40,000			
To Manufacturing ex.	30,000	10,000			
To Gross profit carried down	1,80,000	6,000			
	5,05,000	1,80,000		5,05,000	1,80,000
To Rent (paid and o/c) To Salaries	8,000	4,500	By Cross Profit b/d	1,80,000	6,000
	30,000	10,000	By Discount	2,000	1,000
To General expenses To Depreciation: Machinery 20% FURNITURE 15% TO NET PROFIT	20,000	5,000	By Net Loss		22,950
	30,000	10,000			
	1,050	450			
	92,950	—			
	1,82,000	29,950		1,82,000	29,950

(b) Lighting and heating expenses are distributed on the basis of units of power consumed by each department, and so on,

(iii) Common expenses whose benefit is not capable of accurate measurement are dealt with as follows:

(a) Selling expenses, e.g, discounts, bad debts, selling Commission, etc., are apportioned on the basis of sales or Cost of production plus Administrative expenses.

Balance Sheet of Eve Ltd. At a 31st December, 1993

Liabilities Amount Assets Amount

Rs. Rs.

Share Capital 2,00,000 Fixed Assets

H.O. profit 2,950 Machinery H.O. 1,50,000

Less profit & Loss at branch (Loss) 22,950 70,000 Branch 50,000

Sundry Creditors 2,00,000

H.O. 30,000 35,000 Less Dep. 40,000
1,60,000

Branch 5,000 Furniture

Rent outstanding at branch 500 H.O. 7,000

Branch 3,000

10,000

Less Dep. 1,500 8,500

Current Assets

Stock Head Office 40,000

Branch 30,000 70,000

Debtors H.O. 40,000

Branch 15,000 55,000

Cash in hand

H.O. 10,000

Branch 2,000 12,000

3,05,500 3,05,500

Alternatively, instead of passing entries regarding Trading and profit and Loss Account, only one entry of the profit made or loss suffered at the branch may be passed:

Brach Account Dr.

To H.O. Profit & Loss Account. For loss the above entry is reversed.

Accounting for Hire-Purchase and Installment System

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

- The goods will be delivered to the purchaser at the time of agreement.
- The purchaser has a right to use the goods delivered.
- The price of the goods will be paid in installments.
- Every installment will be treated to be the hire charges of the goods which is being used by the purchaser.
- If all installments are paid as per the terms of agreement, the title of the goods is transferred by vendor to the purchaser.
- If there is a default in the payment of any of the instalments, the vendor will take away the goods from the possession of the purchaser without refunding him any amount received earlier in the form of various installments.

Characteristics of Hire-purchase system

Before discussing the characteristics of hire-purchase system, we must know what a hire purchase agreement is and what the contents of a hire-purchase agreement are. 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-purchase at the commencement of the agreement.
- The number of instalments to be paid by the hire-purchase along with the amount of each instalment and the date of payment of each instalment.
- The down payment if any, the down payment means the amount which is required to be paid by hire-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.

Worked out 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 journal of hire – vendor the following accounts will be opened in the ledger of hire – vendor and the postings will be made accordingly.

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

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

Worked out examples-3:

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

Give journal entries in the books of X Company Ltd. whose accounting year ends on 31st March each year, under Asset Accrual Method.

Solution:

(a) under Asset Accrual Method

Journal Entries in the Books of X Co. Ltd.

Date	Particulars	LF	Dr.(Rs.)	Cr.(Rs.)
2005 April 1	Machinery A/c ……………Dr. To Bank A/c (Being down payment made at the time of delivery)		15,000	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. To Machinery A/c (Being the depreciation charged)		5,585	5,585

"	Profit & Loss A/c …………………Dr. To Interest A/c ToDepreciation A/c (Being the amount transferred)		7,628	2,043 5,585
2007 March 31	Machinery A/c ……………………………………...Dr. 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 (Being the amount paid in second instalment)		15,000	15,000
"	Depreciation A/c …………………Dr. To Machinery A/c (Being the depreciation charged)		5,027	5,027
"	Profit & Loss A/c …………………Dr. To Interest A/c ToDepreciation A/c (Being the amount transferred)		6,422	1,395 5,027
2008 March 31	Machinery A/c ……………………………………...Dr. Interest A/c ....Dr. To Y Machine Ltd.		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 installments of 22,000 each. The cash price of machine was Rs. 90,000. Find out the amount of interest included in each installment.

Soluton:

Hire-purchase Price = 10,000 + (22,000 x 4) = Rs.98,000 Less: Cash Price Rs.90,000 Total Interest= Rs.8,000

The total Interest of Rs 8,000 is to be apportioned among the various installments i.e. 4th, 3rd, 2nd and 1st instalment in the ratio of 1:2:3:4 (i.e. among 1st, 2nd, 3rd and 4th installment in the ratio of 4:3:2:1)

(1)Share of 1st instalment in the Interest= 8,000x4/10 = Rs.3,200

(2)Share of 2nd instalment in the Interest= 8,000x3/10 = Rs.2,400

(3)Share of 3rd instalment in the interest= 8,000x2/10 = Rs.1,600

(4)Share of 2nd instalment in the interest= 8,000x1/10 = Rs. 800

(b) When cash price and amounts of instalments are given but the amount of each instalment is not equal: The following worked out example will clear the doubts.

Rate of Interest not known and Instalments of different amounts

Worked out Example-7

Cash price of a machine is Rs. 37,400 on 1st January,2003. Its hire-purchase price is Rs. 50,000. This hire-purchase price is paid in five annual instalments in the following manner: Rs. 15,000 at the end of the first year Rs. 12,000 at the end of second year; Rs. 10,000 at the end of third year, Rs. 8,000 at the end of fourth year, Rs. 5,000 at the end of fifth year. Calculate interest and cash price included in each instalment.

Solution:

Calculation of Interest Included in each Instalment

Total Interest= Hire-purchase price-Cash Price

Total Interest=Rs.50,000-37,400=12600

Total Interest of Rs12,600 is to be apportioned among the five instalments in the following manner:

Instalment No	Unpaid Amount(Rs.)	Calculation of Int.(Rs.)
First	50000	(12600x50000)/126000=5000
Second	50000-15000=35000	(12600x35000)/126000=3500
Third	35000-12000=23000	(12600x23000)/126000=2300
Fourth	23000-10000=13000	(12600x13000)/126000=1300
Fifth	13000-8000=5000	(12600x5000)/126000=500
Total	126000	

Calculation of Cash Price included in each instalment

Instalment No.	Instalment(Rs.)	Interest(Rs.)	Cash Price(Rs.)
First	15000	5000	10000
Second	12000	3500	8500
Third	10000	2300	7700
Fourth	8000	1300	6700
Fifth	5000	500	4500
Total	50000	12600	37400

ROYALTIES

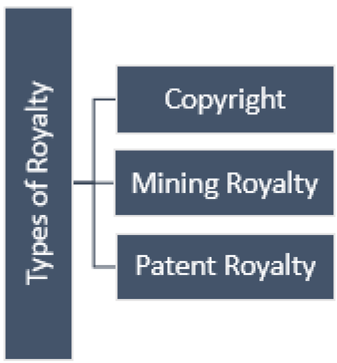
Royalty is payable by a user to the owner of the property or something on which an owner has some special rights. A royalty agreement is prepared between the owner and the user of such property or rights. If payment is made to purchase the right or property that will be treated as capital expenditure instead of a Royalty.

Payment made by the lessee on account of a royalty is normal business expenditure and will be debited to the Royalty account. It is a nominal account and at the end of the accounting year, balance of Royalty account need to be transferred to the normal Trading and Profit & Loss account. Royalty, based on the production or output, will strictly go to the Manufacturing or Production account. In case, where the Royalty is payable on sale basis, it will be part of the selling expenses.

Types of Royalties

There are following types of Royalties −

- **Copyright** − Copyright provides a legal right to the author (of his book/s), the photographer (on his photographs), or any such kind of intellectual works. Copyright royalty is payable by the publisher (lessee) of a book to the author (lessor) of that book or to the photographer, based on the sale made by the publisher.
- **Mining Royalty** − Lessee of a mine or quarry pays royalty to lessor of the mine or quarry, which is generally based on the output basis.



- **Patent Royalty** − Patent royalty is paid by the lessee to lessor on the basis of output or production of the respective goods.

Basis of Royalty

In case of the patent, publisher of the book pays royalty to the author of the book on the basis of number of books sold. So, holder of patent gets royalty on the basis of output and the mine owner gets royalty on the basis of production.

Important Terms

Following are the important terms, which are used in Royalty agreements −

Royalty

A periodic payment, which may be based on a sale or output is called Royalty. Royalty is payable by the lessee of a mine to the lessor, by publisher of the book to the author of the book, by the manufacturer to the patentee, etc.

Landlord

Landlords are the persons who have the legal rights on mine or quarry or patent right or copybook rights.

Tenet

An Author or publisher; lessee or patent or who takes out rights (usually commercial or personal rights) from the owner on lease against the consideration is called tenet..

Minimum Rent

According to the lease agreement, minimum rent, fixed rent, or dead rent is a type of guarantee made by the lessee to the lessor, in case of shortage of output or production or sale. It means, lessor will receive a minimum fix rent irrespective of the reason/s of the shortage of production.

Payment of royalty will be minimum rent or actual royalty, whichever is higher for example −

M/s Hyderabad publication printed a book on Java on the minimum rent of Rs. 1,000,000/- per annum royalty being payable @ Rs. 20 per book sold. In the first year of publication, Hyderabad publication sold 75,000 copy of the books and in the second year, number of sold books fell down to 45,000 only. Amount of royalty will be payable as under −

	Minimum Rent	**Royalty Payable**
Ist Year 75,000 Books X Rs. 20 per book = Rs. 1,5,00,000	1,0,00,000	Rs. 1,5,00,000
IInd Year 45,000 Books X Rs. 20 per book = Rs. 9,00,000	1,0,00,000	Rs. 1,0,00,000

Short workings

Difference of minimum rent and actual royalty is known as short workings where payment of Royalty is payable on the basis of minimum rent due to shortage in the production or sale. For example, if calculated royalty is Rs. 900,000/- as per sale of books based on the above example, but royalty payable is Rs. 1000,000 as per minimum rent, short working will be Rs. 100,000 (Rs. 1,000,000 – Rs. 9,00,000).

Ground Rent

The rent, paid to the landlord for the use of land or surface on the yearly or half yearly basis is known as **Ground Rent** or **Surface Rent**.

Right of Recouping

It may contain in the royalty agreement that excess of minimum rent paid over the actual royalty (i.e. short workings), may be recoverable in the subsequent years. So, when the royalty is in excess of the minimum rent is called the right of recoupment (of short workings).

Right of recoupment will be decided for the fixed period or for the floating period. When the right of recoupment is fixed for the certain starting years from the date of royalty agreement, it is said to be fixed or restricted. On the other hand, when the lessee is eligible to recoup the short workings in next 2 or 3 years from the year of its commencement, it is said to be floating.

Short working will be shown on the asset side of Balance sheet up to allowable year of recouping after that it will be transferred to profit & loss account (after expiry of allowable period).

Lease Premium

An **Extra payment** in addition to royalty, if any, paid by lessee to lessor is called Lease premium and will be treated as capital expenditure and it will be written off on yearly basis through profit and loss account as per the suitable method.

TDS (Tax Deducted at Source)

If there is an applicability of TDS (Tax deducted at source) as per Income Tax Act, lessee will make the payment to lessor after deducting TDS as per applicable rate and lessee is liable to deposit it to the credit of Central Government. Amount of royalty will be gross amount of royalty (inclusive of TDS), that will be charged to profit and loss account.

For example, if royalty amount is 1,000,000/-& rate of TDS is 10%, then lessee will pay Rs. 900,000/- to lessor. Amount of royalty charge to profit and loss account will be Rs. 1,000,000/- and balance amount of Rs. 100,000/- will be deposited in the credit of central Government account.

Stoppage of Work

Sometime, there may be stoppage of work due to conditions beyond control like strike, flood, etc. in this case, minimum rent is required to be revised as provided in the agreement.

Revision of the minimum rent will be −

- Reduction of minimum rent in the proportion of the stoppage of work;
- On the basis of fixed percentage; or
- By a fixed amount in the year of stoppage.

Sub Lease

Sometime, landlord or lessor allows lessee to sublet some part of the mine or land as a sub-lessee. In this case, lessee will become lessor for sub lessee and lessee for main landlord.

In such a case, as Lessee, he will maintain the following books of accounts −

As a Lessee

- Landlord Account
- Minimum Rent Account
- Royalty Account
- Short workings Recoupable Accounts

As a Sub Lessor

- Royalties Receivable Account
- Sub lessee Account
- Short workings allowable Account

Accounting Entries

When there is no royalty in the year	(a) Minimum Rent A/c Dr To Landlord A/c (b) Short working A/c Dr To Minimum Rent A/c
Where Royalties are less than minimum rent and short workings are recoverable in next years.	(c) Minimum Rent A/c Dr To Landlord A/c (d) Royalties A/c Dr Short workings A/c Dr To Minimum Rent A/c (e) Landlord A/c Dr To Bank A/c (f) Profit & Loss A/c Dr To Royalty A/c
When Short workings are recouped	(g) Royalties A/c Dr To short workings A/c To Landlord A/c (h) Landlord A/c Dr

	To Bank A/c
Transfer of irrecoverable Short workings	(i) Profit & Loss A/c Dr To Short workings A/c

Illustration

From the below given information's, please open prepare the necessary accounts in the books of M/s Black Diamond Limited.

- Company leased a colliery on 01-01-2010 at a minimum rent of Rs. 75,000.
- Royalty Rate@ Rs. 1/- per ton.
- Right of recouping of shortworkings is restricted to first 3 years.
- Output for the first four years of the lease was 40,000, 65,000, 1,05,000, and 90,000 tons respectively.

Solution −

Analytical Table

Year	Output (Tons)	Royalties @ Rs. 1 Per ton	Shortworkings	Surplus	Recoupment	Unrecoupable Short workings	Payable to Landlord
2010	40,000	40,000	35,000		--		75,000
2011	65,000	65,000	10,000	30,000	--	15,000	75,000
2012	105,000	105,000	--	15,000	30,000		75,000
2013	90,000	90,000					90,000
	300,000	300,000	45,000	45,000	30,000	15,000	315,000

In the Books of M/s Black Diamonds Ltd

Royalties Account

Date	Particulars	Amount	Date	Particulars	Amount
31-12-2010	To Landlord A/c	40,000	31-12-2010	By Production A/c	40,000
31-12-2011	To Landlord A/c	=======	31-12-2011	By Production A/c	=======

31-12-2012	To Landlord A/c	65,000	31-12-2012	By Production A/c	65,000
31-12-2013	To Landlord A/c	=======	31-12-2013	By Production A/c	=======
		105,000			105,000
		=======			=======
		90,000			90,000
		=======			=======

Landlord Account

Date	**Particulars**	**Amount**	**Date**	**Particulars**	**Amount**
					40,000
		75,000			35,000
		----------			----------
		75,000		By Royalties A/c	**75,000**
31-12-2010	To Bank A/c	----------	31-12-2010	By Shortworkings A/c	----------
31-12-2011	To Bank A/c	75,000	31-12-2011	By Royalties A/c	65,000
		----------		By Shortworkings A/c	10,000
		75,000			----------
		----------			**75,000**

		30,000			
		75,000			105,000
		----------			----------
					105,000
31-12-2012	To Shortworkings A/c	**105,000**	31-12-2012	By Royalties A/c	----------
31-12-2012	To Bank A/c	----------	31-12-2013	By Royalties A/c	90,000
31-12-2013	To Bank A/c	90,000			----------
		----------			**90,000**
		90,000			----------

Shortworkings Account

Date	Particulars	Amount	Date	Particulars	Amount
		35,000			35,000
		----------			----------
		35,000			**35,000**
		----------			----------
		35,000			45,000
	To Landlord A/c		31-12-2010	By Balance C/d	
31-12-2010		10,000			----------
	To Balance b/d		31-12-2011	By Balance C/d	
01-01-2011		----------			**45,000**
	To Landlord A/c		31-12-2012	By Landlord A/c	
01-01-2012		**45,000**			----------
	To Balance b/d		31-12-2010	By Profit & Loss A/c	
		----------			30,000
		45,000			15,000
		----------			----------
		45,000			**45,000**
		----------			----------

POSSIBLE QUESTIONS

PART – A

Online Examination

PART – B (2 MARKS)

1. From the following particulars, calculate closing branch debtors balance:

Branch Debtors(1.1.2014)	Rs. 6,300
Credit Sales	Rs. 39,000
Cash received from debtors	Rs. 41,200

2. Compute Opening branch debtors balance from the following transactions:

Credit Sales	Rs. 51,000
Cash Received from debtors by the branch	Rs. 42,500
Branch Debtors (Closing)	Rs. 7,700
Discount allowed to customers by branch	Rs. 1,800

3. Journalise the following under stock and Debtors system :

Goods sent to branch		Rs. 80,000
Sales at branch	- For Cash	Rs. 65,000
	For Credit	Rs. 36,000

4. X purchased a typewriter 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 the third year. Interest is charged at 5% p.a. Calculate the total cash price of the typewriter and the amount of interest payable on each instalment.
5. X purchased a typewriter 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 the third year. Interest is charged at 5% p.a. Calculate the total cash price of the typewriter and the amount of interest payable on each instalment.
6. What is meant by Minimum Rent or Dead Rent?
7. What is meant by Installment System?
8. What is meant by Default?
9. What do meant by repossession?
10. Define down payment.
11. Define Hire purchase.

12. Define Hire Vendor.

POSSIBLE QUESTIONS

PART – C (8 MARKS)

13. From the following details, prepare Kolkata branch A/c in the books of head office and also journalise for the year 2006.

Particulars	Amount (Rs.)
Opening Stock	10,000
Closing Stock	20,000
Opening Petty Cash	1,500
Closing Petty Cash	1,000
Opening Debtors	25,000
Closing Debtors	15,000
Goods sent to branch at cost	50,000
Expenses of branch met by Head Office	
Rent	2,500
Salaries	4,500
Cash Sales	30,000
Collection from debtors	80,000

14. On 1st January, 2012 Pavia bought a machine from Jai & Co on hire purchase system Rs. 1,20,000 was the cash price, Rs. 30,000 down payment and at the end of I year Rs. 34,500, II year Rs. 33,000 and III year Rs. 31,500 was payable. The vendor charged interest @ 5% and depreciation is provided @ 10% annually. Journalize the entries in the books of both the parties.
15. . The Calcutta Commercial Company invoiced goods to its Jamshedpur Branch at cost. The Head office paid all the branch expenses from its bank except petty cash expenses which were paid by the branch. From the following details relating to the Branch, prepare,
    (a) Branch Stock Account
    (b) Branch Expenses Account
    (c) Branch Debtors Account and
    (d) Branch Profit and Loss Account

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Stock (Opening)	21,000	Allowances to customers	600
Debtors (Opening)	37,800	Discount to customers	4,200
Petty Cash (Opening)	600	Bad debts	1,800

Goods sent from H.O	78,000	Goods returned by customers to branch	1,500
Goods returned to H.O	3,000	Salaries and Wages	18,600
Cash Sales	52,500	Rent and Rates	3,600
Advertisement	2,400	Debtors (Closing)	29,400
Cash received from debtors	85,500	Petty Cash (Closing)	300
Stock (Closing)	19,500	Credit Sales	85,200

16. . A Company leased a colliery on 1.1.2012 at a minimum rent of Rs. 20,000 merging into a royalty of Rs. 1.50 per tone with power to recoup shortworkings over the first four years of the lease. The output of the colliery for the first four years was 9,000 tonnes, 12,000 tonnes, 16,000 tonnes and 20,000 tonnes respectively. Give journal entries and for the four years in the books of lessee and lessor.

17. Define the term branch account and explain the various kinds of branches.

18. Ram purchased a Van for Rs. 42,000 payment is made as Rs. 10,000 down and four installments of Rs. 10,000 each at the end of each year. Interest is charged at 10% p.a. Buyer depreciates the Van at 10% p.a. on Written Down Value Method. Ram after having paid the down payment and first installment at the end of first year, could not pay the second installment and the hire vendor took possession of the van. The hire vendor after spending Rs. 1,280 on repairs of the van sold it for Rs. 31,000. Show the ledger in the books of Ram and hire vendor.
19. Mr. Ramu purchased a machine on installment system from Mr. Somu on 1.1.2004 for a sum of Rs. 64,000. Rs. 16,000 is paid as down payment and the balance in three installment of Rs. 16,000 each. The cash price is Rs. 59,600 and interest is @ 5% p.a. Mr. Ramu charges depreciation @ 10% p.a. on the written down value method. Pass Journal and ledger in the books of both the parties.
20. Explain the accounting treatment when Royalties are more than, less than or equal to Minimum Rent?
21. Saran purchased a machine on hire purchased system on 01.04.2014. The cash price of machine was Rs. 2,10,000. According to the agreement Rs. 60,000 is to be paid on delivery. The balance to be paid in four instalments of Rs. 37,500 each annually with interest. Interest is charged at 20 % p.a. Calculate the interest. Journalise the entries in the books of both the parties
22. Explain the different methods of recovery of shortworkings usually found in royalty agreements?
23. 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.

24. Sundar sells goods on H.P system at cost plus 60%. From the following prepare Hire purchase Trading a/c.

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

The following transactions took place during the year:-

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

(Instalment due Rs.4,000)

25. Mr. P Purchased 4 Cars for Rs.14,000 each 1.1.13 under the hire purchase system. The hire purchase price for all the 4 cares Rs.60,000 to be paid as Rs. 15,000 down payment and 3 equal instalments of Rs.15,000 each at the end of each year. Interest is charged at 5% p.a. The buyer depreciates the car at 10% p.a on straight line method.

From the above particulars give journal entries in both the parties.

26. i. On 1-1-2008 Mr. Joel purchased machinery on hire purchase system. The payment is to be made Rs.40, 000 down(on signing of the contract) and Rs.40,000 annually for three years. The cash price of the machinery is Rs.1,49,000 and rate of interest is 6%. Calculate the interest in each year's installment.

ii.Mr. Nakul purchased a machine on hire purchase system. As per terms, he is required to pay Rs.4000 down, Rs.2000 at the end of the first year, Rs.1500 at the end of the second year and Rs.2800 at the end of third year. Interest is charged at 5% p.a. Calculate the total cash price of the machine and the amount of interest payable on each instilment.

27. Marimuthu Brought 10 Cars for Rs.4,50,000 each 1.1.15 under the hire purchase system. The hire purchase price for all the 10 Cars Rs.5,00,000 to be paid as Rs. 1,00,000 down payment and 4 equal installments of Rs.1,00,000 each at the end of each year. Interest is charged at 5% p.a. The buyer depreciates the car at 10% p.a on straight line method. From the above particulars give journal entries in both the parties.

28. On 1-1-98 Z purchased machinery on hire purchase system. The payment is to be made Rs.4,000 down(on signing of the contract) and Rs.4,000 annually for three years. The

cash price of the machinery is Rs.14,900 and rate of interest is 5%. Calculate the interest in each year's installment.

29. Mr. P purchased 4 cars for Rs 14,000 each on 1.1.92 under the hire purchase system. The hire purchase price for all 4 cars was Rs. 60,000 to be paid as Rs. 15,00 down payment and 3 equal installments of Rs. 15,000 each at the end of each year. Interest is charged at 5% p.a. the buyer depreciates the car at 10% p.a. on straight line method. From the above particulars give journal entries and relevant accounts in the books of Mr. P and in the books of Hire Vendor.
30. Revathi & co sells goods on H.P system at cost plus 60. From the following information prepare Hire Purchase Trading account to ascertain the profit and loss Account.

    1.1.2016 Goods with H.P customer(at H.P Price) Rs. 16,000

    31.12.2016 Goods sold on H.P during the year at H.P price Rs. 80,000

    Cash received during the year from customer Rs. 56,000

    Goods repossessed from customer (installments due Rs. 2,000) valued at Rs 300

    Goods with the H.P customer at H.P Price 36,000
31. VSS sells goods on Hire purchase system at cost plus 50%. From the following prepare Hire purchase Trading a/c.

Jan 1 Goods out on hire purchase system at hire purchase Price	Rs.64,000
Dec 31 Installments not due and unpaid	Rs.1,44,000
Installments due and unpaid	Rs. 8,000
The following transactions took place during the year:-	
a)Goods sold on H.P price	Rs.3,20,000
b) Cash received from customers at H.P price	Rs.2,24,000
c) Goods received back on default valued at	Rs. 1600
(Installment due Rs.4,000)	

32. The Chennai Super King Trading Co. purchased a motor van from Mumbai Indians Motor Co. on hire purchase agreement on 1.1.2000, paying cash Rs.10,000 and agreeing to pay further three installments of Rs.10,000 each on 31st December each year. The cash price of the car is Rs.37,250 and the Mumbai Indian Motor co charges interest at 5% p.a.

The Chennai Super King Trading Co. writes off 10% p.a as depreciation on the reducing balance method. Journalize the above in the books of both the parties.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(DEEMED TO BE UNIVERSITY)
(ESTABLISHED UNDER SECTION 3 OF UGC ACT 1956)
DEPARTMENT OF COMMERCE
I B.COM PA - Higher Financial Accounting (17PAU201)
Unit - II (BRANCH, HIGHER PURSHASE, ROYALTY)

S.NO.	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
1	Down Payment is otherwise called as____________	Initial amount	Amount	Cash	Finance	Initial amount
2	Hire vendor is the _________of the goods on the	seller	Purchaser	Hire Purchaser	Debtor	seller
3	Hire Purchase Price = Cash Price + _______	Cash	Interest	Market Price	Cost Price	Interest
4	Hirer is otherwise called as __________	Hire Purchaser	Vendor	Purchaser	Hire vendor	Hire Purchaser
5	_________means the sum payable periodically by the	Purchase	Business	Hire	Sales	Hire
6	___________ means the amount which is paid at the	Bills Payment	Down Payment	Payment	Cash Payment	Down Payment
7	Cash price means the cash price of goods at which the	Cash and Credit	Market	Cash	Credit	Cash
8	Hire Purchaser is the _________ of the goods	buyer	Seller	vendor	Hire vendor	buyer
9	__________ is otherwise called as initial amount	Bills Payment	Down Payment	Payment	Cash Payment	Down Payment
10 11	__________ is the seller of the goods on the hire purchase system	Hire Purchaser	Vendor	Purchaser	Hire vendor	Hire vendor
12	Hire Purchaser is otherwise called as__________	Vendor	Purchaser	Hire vendor	Hirer	Hirer

S.NO.	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
13	The excess of hire purchase price over cash price is called	cost	price	rate	interest	interest
14	____________ is the aggregate of cash price and	cash price	Market Price	Invoice Price	Hire purchase price	Hire purchase price
15	Hire Purchase Price - Cash Price = __________	Total Interest	Total Cash	Total	Total Price	Total Interest
16	Depreciation on fixed assets purchased on hire purchase	Seller	purchaser	cashier	inventor	purchaser
17	Investment account Is ___________ account	Nominal	Real	Personal	Real and Nominal	Real
18	Sale of right is a ____________ receipt in case	Capital	Liability	Asset	Investment	Capital
19	Brokerage is ________ in the cost of investment in the	reduced	added	rectified	decreased	added
20	Interest accrued upto the date of sale of investment added	Ex-interest	Interest	Rate	Cash	Ex-interest
21	The average clause in a clause in a loss of stock policy	Under insurance of stock	stock	insurance charge	insurance	Under insurance of stock
22	The difference between standard turnover and actual	short purchases	Short sales	Purchases	Sales	Short sales
23	Loss of profit insurance is also known as ____________	Consequential loss	insurance	loss	Consequential loss insurance	Consequential loss insurance
24	Under hire purchase system depreciation is	on cash price	hire purchase price	market price	on factor price	on cash price
25	Hirer charges depreciation on	hire purchase price	cash price	lower of the two	on factor price	cash price
26	What is transferred to hirer under hire purchase	ownership of asset	possession of assets	ownership and possession of asset	Possession of Liability	possession of assets
27	Hire purchase act is__________	1932	1956	1972	1872	1972
28	The sale of goods act is applicable in___________	Credit purchase	Cash purchases	Cash sales	credit purchases	Cash purchases

S.NO.	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
29 30	What is transferred to hire under installment payment system?	Ownership of assets	Possession of assets	ownership and possession of asset	ownership of liabilities	ownership and possession of asset
32	ownership and possession of asset is transferred to hire	Ownership of assets	Possession of assets	ownership and possession of asset	ownership only	ownership and possession of asset
33	Excess of asset over liability is called____	creditors	profit	capital	goodwill	capital
34	Which records are made in single entry system?	only in cashbook	in ledger, posting of	records in cashbook and posting of only	Nominal account	records in cashbook and posting of only
35	In which book the transactions are recorded originally?	cashbook	balance sheet	journal	subsidiary book	journal
36	Floating asset is known as_____	fixed asset	current assets	noncurrent assets	long term asset	current assets
37	Excess of ____ over liability is called capital	creditors	profit	capital	asset	asset
38	In which book the work classification is done?	trial balance	ledger	balance sheet	Journal	ledger
39	A person who owes money to the firm is called______	Debtors	Creditors	Owners	Bankers	Debtors
40	Debit the losses and expenses and credit the gain and income	Personal account	Real account	Nominal account	Owners account	Nominal account
41	Trade mark account is___________	Real account	Personal account	Nominal account	Non personal account	Real account
42	Goodwill is a__________	Personal account	Nominal account	Real account	Non personal account	Real account
43	Purchase goods from ram this is a______	Cash purchase	Credit purchase	Partly cash purchase	Bulk purchase	Credit purchase
44	Sold machinery worth Rs 10000 to Ramesh. It is entered	Sales account	Cash account	Sales return account	Machinery account	Machinery account
45	Return outwards book is known as________	Purchase return journal	Sales return book	Purchase from outsiders	Return inwards	Purchase return journal

S.NO.	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
46						
47	Debt notice prepared by the purchase of goods when ____	He return the goods	He purchases the goods	He purchases For credit	He purchases for cash	He return the goods
48						
53	Direct expenses are debited in the_______	Balance sheet	Trial balance	Profit and loss account	Trading account	Trial balance
54	The stock is valued at ___________	Cost price	Market price	Cost price or market price	Cost price or market price	Cost price or market price
55	Adjusted purchase means___________	Purchase	Purchase + opening stock	Purchase - closing stock	Closing stock + opening stock	Closing stock + opening stock
56	The main purpose of accounting is to provide	Shareholder	Sellers	Buyers	Customers	Shareholder
57	Adjusted purchase means___________	Purchase	Purchase + opening stock	Purchase - closing stock	Closing stock + opening stock	Closing stock + opening stock
58	The main purpose of accounting is to provide	Shareholder	Sellers	Buyers	Customers	Shareholder
59	Which of the following is an operating expense?	Bad debt	Salary to manager	Depreciation	Expired insurance	Salary to manager
60	Branch stock is always prepared at _______ price	Cost	Invoice	Market price	Cost or market price whichever	Invoice

UNIT - III

Single Entry System - Meaning and Features - Statement of Affairs Method and Conversion Method -Departmental Accounts - Distribution of Expenses - Inter department Transfers.

SINGLE ENTRY SYSTEM

Definition:

Single entry system of book-keeping is not a system at all. It means recording transactions not according to well defined rules but according to mere convenience. Under the Double Entry System a transaction must be recorded with both the aspects. If there is a debit, there must be a credit and vice-versa. It is not so under the single entry system. Debit and credit may be completed in some transactions, while no record at all may be there in respect of a number of transactions. Most transactions are recorded only once without completing double entry. It is all a matter of convenience. Accounts are not maintained. While there is no hard and fast rule; usually only the cash account, bank account (sometimes the pass book is treated as sufficient for this purpose) and personal account (that is, account of customers and creditors) are kept. Generally, there will be no accounts to show purchases, sales, assets, incomes and losses and expenses. There can be no trial balance.

This Single Entry System has the following disadvantages:

(1) Since there is no trial balance, there is no proof of accuracy.

(2) Profit or losses cannot be ascertained properly because of lack of information about purchases, sales, expenses, etc.

(3) Since accounts relating to assets (furniture, office equipment, etc.) are not maintained, there is no control over such assets. This may result in wastages and misappropriation.

(4) The Balance Sheet (called Statement of Affairs here) can be prepared only with difficulty and that too without sufficient accuracy.

(5) Useful comparison for the guidance of management cannot be made because relevant information will generally be missing.

Joint stock companies cannot keep books on the Single Entry System under law, but sole proprietorships and partnerships may, if they so wish, adopt this system. But unless the firm is very small, it is not desirable to do so.

How to ascertain profit? Ascertainment of profit or loss under this system is really simple. "Suppose I start a business on 1st January, 1993 with Rs. 20,000. On 31st December 1993 I find that may capital is Rs.25,000 (for finding out capital see below). This surely means that I have made a profit of Rs.5,000, the capital could not have grown otherwise. But suppose I brought an additional Rs.4,000 as capital during the year. This explains the increase in capital to this extent This brings down the profit to Rs.1,000. One thing more I must have drawn some money for private use. Suppose the figure is Rs.500 per month or Rs.6,000 for the year. Had this money not been drawn, the capital would have been Rs. 31,000 and the profit earned would have been Rs.7,000. The formula to find out profit, therefore, is:

Rs.

Capital at the end of the year		25,000
Add Drawings during the year		6,000
		31,000
Less : Fresh Capital introduced		4,000
Capital in the beginning of the year	20,000	24,000
Profit during the year		7,000

How to ascertain capital? Capital is really assets minus liabilities. Under the Single Entry System also, capital is ascertained in this manner. Statement of Affairs (not at all different from balance sheet) is prepared and assets and liabilities put on the proper sides. The difference between assets and liabilities is capital. Personal account and cash accounts are usually maintained and hence the amount of sundry debtors, cash balance, bank balance and sundty creditors will be readil) available. The amount of other assets can be ascertained only by physical inspection.

The amount of capital at the beginning and at the end of the year can be ascertained by preparing statement of affairs. Now we have to find out the profit or loss. For this purpose a ‘statement of profit or loss is prepared in the following manner:—

Statement of Profit for the year ending on..........

Capital at the end —

Add: Drawings during the year —

Less: Additional Capital introduced during the year— (A) Adjusted Capital at the end of the year —

(B) Less: Capital at the beginning —

Profit or loss —Rs.

Illustration-1

A keeps his books by single entry system. From the following information find out the profit earned by him during 1988.

	1st. Jan. 1993 Rs.	31st Dec. 1993 Rs.
Bank Balance	740 (Cr.)	400 (Dr.)
Cash in hand	—	10
Debtors	5,300	8,800
Creditors	1,500	1,950
Stock	1,700	1,900
Plant	2,000	2,000
Furniture	140	140

On 30th, June, A bought in Rs.600 as additional capital and withdrew Rs.300 for private use. A provision for doubtful debts@5% is necessary. Plant and Furniture are subject to depreciation @5%. Interest on capital is to be charged at 5%.

Solution

Statement of Affairs as at 1st January, 1993

Liabilities	Rs.	Assets	Rs.
Bank Overdraft	740	Sundry Debtors	5,300
Sundry Creditors	1,500	Stock Plant FurnitureTotal	1,700
Capital (Balancing figure)	6,900		2,000
			140
	9,140		9,146
Total			

Statement of Affairs as at 31st December, 1988

Liabilities	Rs.	Assets		Rs.
Sundry Creditors	1,950	Cash in Hand Cash at Bank		10
		Sundry Debtors Less		
Capital (Balancing figure)	10,753	Provision for Doubtful		400
		Debts Stock Plant		
		Less Depreciation	8,800	
		Furniture		
		Less Depreciation		
			440	8,360
		Total		
				1,900
			2,000	

			100	
			140	1,900
			7	
				133
Total	12,703			12,703

		Rs.
Profit: Capital as at Dec. 31, 1988		
		10,753
Add Drawings		300
		11,053
Less Fresh Capita	1600	
Capital on 1-1-88	6,900	
Interest	360*	
		7,860
Profit earned		3,1193

* Interest on Rs. 6,900 for one year and on Rs. 600 for 6 months.

Illustration: 2

The following is the Balance Sheet of X, Y, and Z an on December 31, 1993

Balance Sheet

Liabilities	Rs.	Assets	RS.
Sundry Creditors	42,000	Cash in Hand Cash at Bank Sundry Debtors Stock	4,000
Bills Payable	28,000	Furniture & Fittings Machinery and Plant Z's Current Account	38,000
X's Fixed Capital Y's Fixed Capital Z's Fixed Capital	1,50,000		84,000
X's Current Account	1,00,000		67,000
Y's Current Account	50,000		20,000
	4,800		1,60,000
	3,400		5,200
	3,78,200		3,78,200

The partners share profits in the ratio of 3:2:1 after charging interest 10% interest on Capitals. During 1994, the drawings were : X at Rs. 4000 per month, Y at Rs. 3000 per month and Z at Rs. 25,00 per month.

On 31st December, 1994 the various assets were- Cash in Hand Rs. 3,000, Standry Debtors Rs 86,000 Stock Rs. 1,27,500 at selling price which was fixed at cost plus 25%, Furniture and Fittings Rs. 18,000 and Machinery and Plant, Rs. 2,50,000. Liabilities were- Sundry Creditors, Rs. 34,000, Bills Payable Rs. 24,000 and Bank Overdraft Rs. 60,000 as per Pass Book which showed that a cheque for Rs. 10,000 deposited had been returned dishonoured. Ascertain this Profit a Loss made by the firm in 1994 and show the Balance Sheet as on 31st December, 1994.

Solution :

Statement of Affairs-as on December 31, 1993

Liabilities	Rs.	Assets	Rs.
Sundry Creditors Bills Payable Bank Overdraft	34,000	Cash in Hand	3,000
Fixed Capital of X, Y and Z Combined	24,000	Sundry Debtors	
Current Accounts of X, Y, and Z (Balancing figure)	60,000	(Rs. 86,000 + Rs. 10,000)	96,000
	3,00,000	100 Stock (1,27,500 × 100/125)	1,02,000
		Furniture & Fittings	
		Machinery and Plant	18,000
	51,000		2,0,000
	4,69,000		4,69,000

Statement of Profit and Loss

Rs. Rs.

Combined Credit Account of X, Y and Z as Dec. 31,1994 51,000

Add: Drawings

X	48,000		
Y	36,000		
Z	36,000	1,14,000	
			1,65,000

Less.: Combined Current Account X, Y and Z as 31st December, 1993
(4800 + 3400-5200) 3,000

1,62,000

Proffit suljeed to interest

Less-: Interest an Capital as 10%		
X		15000
Y		10,000
Z	5,000	30,000
		132,000
Profit divided among X,Y, and Z		
X 1/2		66,000
Y 1/3		44,000
Z 1/6		22,000

Balance Sheet of Z, X, and Y, as on December 31, 1994

	Rs.		Rs.
Sundry Creditors Bills Payable	34,000	Cash in Hand Sundry Debtors Stock	3,000
Bank Overdraft Capital (Fixed)		Furniture & Fittings	
X 1,50,000	24,000		96,000
		Machinery and Plant	
Y 1,00,000	60,000		1,02,000
Z 50,000			18,000
		Z's Current Account	
Current Accounts			2,50,000
		Balance on Jan., 1 5,200	
P Balance on Jan. 1 4,800			
		Add : Drawings 30,000	
Add : Interest 15,000	3,00,000		
		35,200	
Profit 66,000			

85,800			Less : Interest	5,000	
			Profit 22,000	27,000	
Less : Drawings	48,000				
X Balance on Jan. 1	34,000				
Add : Interest	10,000				8,200
Profit	44,000	37,800			
57,400					
Less : Drawings	36,000	21,400			
		4,77,200			4,77,200

Conversion into Double Entry. If the books arc maintained on Single Entry basis, they can be converted into double entry basis but with good deal of effort Assuming that accounts of cash, bank, customers and suppliers have been maintained, the following steps will be necessary:—

(1) Take die statement of affairs at the end of the previous year. Open all accounts (except those already opened) with proper balances.

(2) Go through the cash book (or cash and bank accounts). Excepting transactions with customers and suppliers (these transactions must have been posted already) other? should be posted to proper accounts.

(3) Analyze all personal accounts (a) Analysis of accounts of customers will reveal the following:—

Entry Now

Credit Sales Credit Sales A/c Bills

Dishonoured Credit B/R A/c Charges debited to them Credit Charges A/c Cash

received —

Discount allowed to them Debit Discount A/c Sales

Returns Debit Sales Returns A/c Bad Debts written

off Debit Bad Debts A/c

Bills Receivable received Debit Bills Receivable A/c

(b) Analysis of accounts of suppliers will reveal the following :

Entry Now

Credit Purchases	Debit Purchases A/c
Bills Payable Dishonored	Debit Bills Receivable A/c
Cash Paid	—
Purchases Returns	Credit Returns Outwards A/c
Discount Received	Credit Discount A/c
Bills Payable Issued	Credit Bills Payable A/c

(4) Go through the waste book and see if any transaction still remains to be recorded.

For instance, interest may be due on loan. The entry to be passed is: Interest A/c ... ... Dr.

To Loan Creditor

Preparation of Trading and Profit and Loss A/c from Single Entry Records. If Single Entry books have been converted into Double Entry books, a trial balance can then be taken out. From the trial balance final accounts can be easily prepared. However, a short cut is also possible. This short cut will be available only if the summary of cash transactions is prepared.

Students will remember that for preparing the Trading Account the following information is necessary: Opening Stock (available from previous statement of affairs.) Purchases (always ascertained by making an inventory.) Wages, etc.

Sales

Closing Stock

Purchases and sales are ascertained on commonsense basis. If I owe Rs.50/- to the grocer on 1st April, pay him Rs.90 during the month and still owe him Rs.40 at the end of the month. I must have purchased from him goods for Rs.80, i,e., Rs.(90 + 40)—50. Similarly, the grocer can calculate the sale to me.

In business firms credit purchases and credit sales are found by preparing accounts of total Creditors and total Debtors. Consider the following:

Total Creditors A/c

Dr. Cr.

	Rs.		Rs.
To Cash			
(as per Cash Book) To Discounts			
(as per analysis) To Returns	43,000	By Balance c/d	
To Balance c/d		(given as per previous statement of	
		affairs)	
(as per schedule of Creditors)		By Credit Purchases	
	800	(balancing figure)	9,000
	1,100		
	8,500		44,400
	53,400		53,400

Items on the debit side total Rs.53,400, of this Rs.9,000 is the opening balance. Therefore, the balancing figure of Rs.44,400 must be the credit purchases. Cash purchases, must have been recorded on the credit side of the Cash Book and will be taken from there. Thus total purchases can be found out.

Can you find out the credit sales from the following?

Rs.

Total Debtors on 1st Jan. 1988	15,600
Cash received during 1988 from Drs.	68,200
Discount allowed to them	1,800
Bad Debts written off	600
Returns Inwards	2,500
Bills Receivable received from them	11,000
Bills Dishonored	1,500
Total Debtors on 1st Dec., 1988	14,300

Thus—

Make the total debtors A/c. The debit side will be short: The balancing figure will be credit sales.

Total Debtors Account

Dr. Cr.

	Rs.		Rs.
To Balance b/d	15,600	By Cash	68,200
To B/R (Dishonored) To Credit Sales (Balancing figure)	1,500	By Discount	1,800
		By Bad Debts	600
	81,300	By Return Inwards	2,500

		By B/R	11,000
To Balance b/d		By Balance c/d	14,300
	98,400		98,400
	14,300		

Net credit sales will be (Rs. 81,300 less Rs.2,500 (Returns)) Rs.78,800.

Cash sales will be on the debit side of the Cash Bode. Credit Sales plus Cash Sales give you total sales. Examination of the credit side of the Cash Book will also reveal wages, carriage inwards, etc., which will be debited to the Trading Account.

Thus all information to prepare Trading Account becomes available and gross profit will be ascertained. This is put on the credit side of the Profit and Loss Account Credit side of the Cash Book reveals expenses. These expenses after proper adjustments (for expenses prepaid or outstanding) will be debited to the Profit and Loss A/c. Debit side of the Cash Book will reveal incomes (such as sale of old newspapers.) These will be put on the credit side of the Profit and Loss A/c. The Profit and Loss A/c should also be debited with any depreciation which has to be written off. Thus net profit or net loss can be ascertained. This will be transferred to the Capital Account

Balance Sheet—Preparation of Balance Sheet is easy. The previous Statement of Affairs will reveal the various assets. The assets adjusted for depreciation and disposal (see debit side of Cash Book) and new acquisition (see credit side of Cash Book) will be put in the Balance Sheet at the end of the year. The balances for cash, debtors, stock and creditors will be given as at the end of the year.

These will put down in the Balance Sheet. Capital will be as per previous Statement of Affairs adjusted for net profit or net loss and drawings (see credit side of Cash Book).

Illustration: 4

A and B share profits and losses in the ratio of 3 :2. Prepare Trading A/c: Profit and Loss A/c and Balance Sheet from the following:

1. **Cash Book :** Bank Balance on 1st Jan., 1993 Rs.8000; A's drawings 9,000; B's drawing, Rs.6,000 paid to trade creditors. Rs.60,000, paid against B/P Rs. 16,000; Wages Rs.22,000; Salaries Rs. 10,000; Other trade expenses, Rs.26,510; Received from trade debtors, Rs.91,200; Received against B/P 16,090; Receipts from cash sales 31,620; cash in hand, Rs.400, (On 31st December, 1993.). There was no cash in hand on 1st Jan., 1993

2. **Particulars of Assets and Liabilities**

	1.1.1993 Rs.	31.12.1993 Rs.
A's Capital	180,000	?
B's Capital	20,000	?
Stock	39,600	50,000
Creditors	50,000	38,710
Debtors	44,000	14,000
B/R	10,000	14,000
B/P	6,000	Nil
Premises	40,000	40,000
Furniture	2,400	2,400

3. **Other Information:** A and B will pay interest on drawing as Rs.120 and Rs.60. A and B are entitled to 5% interest on capital. B will get 6% Commission on the net profits remaining after such commission.

Allow 5% depreciation in premises and furniture and create a reserve for bad debts amounting Rs.2,650.

Trading and Profit and Loss A/c for the year ending Dec. 31.1993

	Rs.	Rs.		Rs.	Rs.
			By Sales:		
To Stock		39,600	Credit	1,00,000	
To Purchases		40,000	Cash	31,620	1,31,620
To Wages		22,000			
To G.P.c/d		80,020	By Closing Stock		50,000
		1,81,620			1,81,620
		10,000			80,020
To Salaries		26,510	By G.P.b/d		
” Trade Exp.			” Int. on Drawings:		
					180
Premises	2,000	2,120	” Dcp: A	120	
Furniture	120	2,650	B	60	
To Res. for bad debts					
” Int. On Cap:					80,200

		5,000		
A	4,000			
B	1,000	1,920		
To B's Commission $\frac{33920 \times 6}{106}$				
To Net profit		32,000		
A	19,200	80,200		
B	12,800			

Balance Sheet of

A & B, As on Dec. 31,1988

Liabilities			Rs.	Assets		Rs.
				Rs. Stock		
				Debtors	38,710	
Creditors			14,000			50,000
				Less provision		
Bank overdraft			3,000	2,650		
A Cap. A/c		B		B/R Cash		36,060
	80,000			Premises	40,000	
+Int.	4,000	20,000				14,000
				Less dep.	2,000	

+Net Profit		1,000				400
	19,200			Furniture	2,400	
		12,800				
	1,03,200	33,800		Less dep.	120	
						38,000
+Commission		1,920				
	—					
		35,720				
	1,03,200					2,280
		6,000				
Less Drawings						
	9,000	29,720	94,080			
	94,200	60	29,660			
		29,660	1,40,740			1,40,740
Less in on Draw.	120					
	94,080					

Working notes:

Cash A/c

	Rs.		Rs.
To Balance To Debtors To B/R	8,000	By A's Drawings By B's	9,000
To Cash sales		Drawings By Trade Crs.	
	91,200	By B/P	6,000
To Bank Overdraft			
	16,090	By Wages	60,000
(bal figure)			
	31,620	By Salaries	16,000
	3,000	By Trade Exp.	22,000
		By Balance (Cash)	10,000
			26,510
			400
	1,49,910		1,49,910

Total Debtors A/c

	Rs.		Rs.
To Balance b/d	50,000	By Cash	91,200
To Sales (bal. fig.)	1,00,000	By B/R	20,090
		By Balance c/d	38,710
	1,50,000		1,50,000

B/R

	Rs.		Rs.
To Balance b/d	10,000	By Cash	16,090
To S. Eta. (bal. fig.)	20,090	By Balance c/d	14,000
	30,090		30,090

B/P

	Rs.		Rs.
To Cash	16,000	By Balance b/d	6,000
		By S. Crs. (bal. fig.)	10,000
	16,000		16,000

Trade Crs.

	Rs.		Rs.
To B/P To Cash	10,000	By Balance b/d	44,000
To Bal. c/d			
	60,000	By Purchases (bal. fig.)	40,000
	14,000		
	84,000		84,000

Illustration : 5

The following information in sappl from which you are required to prepare Trading and Profit and Loss Account for the year ended and Balance Sheet an on 31st December, 1993.

Assets and Liabilities	**Jan 1, 1993**	**Dec., 31, 1993**
Rs. Rs. Creditons		
1,577,00 1,24,000		
General expenses owings	6,000	3,300
Sundry Assets	11,61,00	1,20,400
Stock	80,400	1,11,200
Cash in hand and at Banh	69,600	80,800
Debtors	?	1,78,700

Other Transactions:

Cash and discount credited to Debtors	6,40,000
Returns from Debtors	14,500
Bad Debtors	4200
Sales-Cash and Credit	71,8,100
Discount allowed for creditons	70,00
Returns to Creditons	40,00
Calnilal introduced (paid into Bank)	85,000
Returns from Debtors (Paid into Bank)	62,500
Cash Purehase	10,300
Expanses paid by cash	95,700
Purchase of Machinery by cheque	4300
Drawings by chegue	31,800
Cash Payment into Bank	50,000
with drawn from Bank into Cash	92,400
Payments to creditors by chegue	60,270
Cash in hand at end	12,000

Solution:

It will the holed there since the Conical in the regaining in the given, the opening balance sheet will the necessary for illus the same to the found out. This regained information regarding credit sales. But the question given information regaling cash and credit sales Combined. How it in necessary to prepare the Cash Book ledgers Total Debtors and Total Creditors Accounts.

Cash Book

Dr.

Cr.

	Cash Rs.	Bank Rs.		Cash Rs.	Bank Rs.
To Balance b/d (2) To Capital	29,600	40,000	By Purchases By	10300	
Account To Sundry Debtors			Expenses By		
To Cash		85,000	Machinery By	95,700	
To Balance			Drawings By Bank		4,300
		6,25,000	By Cash		
To Cash Sales (Balancing					31,800
figure) To Balance b/d		50,000	By Sundry Creditors		
	92,400			50,000	—
			By Balance c/d (1)		
	46,000				42,400
					6,02,700
				12,000	
					68,800
	1,68,000	8,00,000		1,68,000	8,00,000
	12,000	68,800			

Note : (1) Cash in hand in given to Rs. 12,000 was a balance bank cash on 68,800 ie, 80,800-12,000

(2) These are balancing of same find out opening balance at bank in found out by deducting the debtors from credits in the banks columns cash balance, in found.

Sundry Creditors

		Rs.			Rs.
1993 Jan., 1	To Balance b/d (Balancing figure)	1,65,300	1993 Jan., 1 to	By Cash	6,25,000
			Dec., 31	By Discount	15,000
Jan.,1 to Dec., 31	To Credit Sales (7,18,100 – 46,000)	6,72,100		By Returns	14,500
				By Bad Debts	4,200
				By Balance c/d	1,78,700
		8,37,400			8,37,400
1994 Jan., 1	To Balance b/d	1,78,700			

Capital on 1st January , 1993 :

Total Assets : Sundry Assets		1,16,100
Stock		80,400
Cash in hand and at Bank		69,600
Debtors		1,65,300
		4,31,400
Less : Sundry Creditors	1,57,700	
Expenses Owings	6,000	1,63,700
Capital on 1st Jan., 1993		2,67,700

Trading and Profit and Loss Account for two yr. ended December 31, 1993

		Rs.			Rs.
To Opening Stock		80,400	By Sales: Credit Cash		
				6,72,100	
To Purchases			Less : Returns	46,000	
				7,18,100	
Credit	5,80,000				
				14,500	
Cash	10,300		By Closing Stock		7,03,600
	5,90,300				
Less : Returns	4,000	5,86,300			1,12,200
					8,14,800
To Gross Profit c/d		1,48,100			
		8,14,100	By Gross Profit b/d		

		By Discount Receive	
To General Expense	93,000		1,48,100
		d	
(95,700 + 3,300 – 6,000) To Discount allowed	15,000		7,000
To Bad debts	4,200		
To Net Profit	42,900		
	1,55,100		1,55,100

Balance Sheet

An on December 31, 1993

Liabilities		Rs.	Assets		Rs.
Sundry Creditors		1,24,000	Sundry Assets		
			Balance	1,16,100	
Expenses Owing		3,300	Additions	4,300	1,20,400
Capital : Balance on			Stock		1,11,200
Jan. 1, 1993	2,67,700				
Addition	85,000		Sundry Debtors Cash in hand Cash at Branch		1,78,700
Profit	42,900				

	3,95,600		12,000
		3,63,800	
Less : Drawings	31,800		
			68,800
		4,91,100	4,91,100

Departmental Accounts: Procedure, Expenses and Inter Departmental Transfers

Introduction:

Departmental Accounts are accounts relating to the several departments or sections of a business drawn up with a view to ascertaining their individual performances. A business may have a number of departments each dealing in a different type of goods. For instance, Departmental Store is an example of large scale trading by a retail trader. In order to carryout business more efficiently, a businessman divides his store into many sections, each section is called a Department. In order to ascertain the profit or loss made by each department, it is desirable to prepare separate Trading and Profit and Loss Account for each department.

The preparation of such Trading and Profit and Loss Account separately for each department enables to compare the results of trading activities; in brief:

1. It enables to compare the performance of one department with that of another and to measure the progress of the department itself by comparing year-wise performance.

2. It enables to measure the profitability of each department. In the absence of departmental accounting, if there is a loss, the businessman thinks that the whole business is at loss. Thus he may stop the business and may start a new business, because he is unable to understand the performance of each department. But, by preparing departmental accounts separately, the contribution of profit made by each department can be known.

Thus a good profit- making department can be developed and the department which gives small margin of profit or no profit can be closed down. It is also possible to check the profit of a department, not to be eaten away by the department which makes no profit.

3. It helps in formulating new policies and to adopt new and latest techniques in the departments, thereby further profitability of the department can be expected.

4. Departmental Managers of the profit-making department can be encouraged by adopting a method of commission on the basis of departmental profit. This step will further boost the profit-making department.

Accounting Procedure:

There are two methods of keeping departmental accounts:

1. Independent Basis:

In this method, accounts of each department are maintained separately. Each department prepares Trading and Profit and Loss Account. Finally, the profit or loss of each department is transferred to the (General) Profit and Loss Account for all the departments. The independent departmental book-keeping is an expensive one.

2. Columnar Basis:

In this method, there is a single set of books. All accounts of all the departments are maintained together, but in a columnar or tabular form. In order to enable the preparation of departmental trading and profit and loss accounts, various subsidiary books, such as purchases, sales, returns books, are prepared in a columnar form and this shows the record, in detail, for each department.

The following is the specimen of a purchase book and a sales book:

Departmental Purchase Book

Date	Particulars	L.F.	Total	Dept. 1	Dept. 2	Dept. 3

Departmental Sales Book

Date	Particulars	L.F.	Total	Dept. 1	Dept. 2	Dept. 3

The same pattern of rulings may be followed in case of other subsidiary books.

Departmental Trading and Profit and Loss Account:

When the books and accounts are maintained on a columnar basis, Trading and Profit and Loss Account can also be prepared on columnar basis. There arises no difficulty in finding out gross profit and net profit for each department separately. From the analytical ledger accounts and subsidiary books department-wise figures are readily available. If an item of expenses definitely identified with a particular department, it can be termed as direct expenses with reference to the department.

For instance, salary of Manager and salesman of a particular department, special advertising, separately metered electricity etc. are expenses and exclusively meant for and identified with particular departments. Apart from this, there are some expenses termed as indirect expenses.

Certain types of expenses are not readily identifiable departmentally and the benefit of such type of expenses goes to all departments. And such types of expenses, called joint expenses, are incurred for the business as a whole.

For instance, rent, depreciation, selling expenses, welfare expenses, advertising etc. Allocation of such expenses among the various departments becomes indispensable on an equitable basis at the date of account. The important point in such cases is to fix the basis on which the different revenue items are to be split up. It is neither possible nor desirable to sub-divide all items on equal basis.

Allocation of Common Expenses:

Normally, all direct expenses are charged to the respective departments, in case of indirect or general expenses, proper allocation among the departments must be made in order to ascertain the profit and loss made by each department. Each department is charged with proper business expenses. If the basis for such allocation is not specially mentioned, then the following procedure may be followed.

Indirect Expenses	*Basis of Allocation*
1. Expenses on Purchases, for instance, Carriage, Freight, Duty, Octroi, etc.	In the ratio of departmental Net Purchases. (But ignore inter-departmental purchases)
2. Expenses on Selling, for instance, Selling Commission, Bad Debts, Discount Allowed, Advertisements, Carriage out etc.	In the ratio of Net Sales of various departments. (Ignore inter-departmental sales)

3. Expenses on Land and Building, for instance, Rent, Rates, Depreciation, Repairs.	On the basis of space occupied by each department.
4. Expenses on Machinery, for instance, Depreciation, Repairs etc.	On the basis of value of machineries of each department.
5. Expenses on Electricity, for instance, Lighting, Heating etc.	On the basis of Meter reading or points or space occupied by each department.
6. Expenses on Insurance	On the basis of Stock value or/and cost of machineries or actual premiums.
7. Expenses on Welfare, Canteen, Recreation etc.	On the basis of number of employees of each department.
8. Expenses on workmen's compensation.	On the basis of wages of each department.
9. Salary of Factory Manager.	On the basis of time devoted by him for each department.
10. Non-departmental expenses	When allocation of some expenses is impossible, they can be charged to General Profit and Loss Account.

Some expenses cannot be apportioned and no basis of apportionment is practicable. For instance, interest on Loan, Income Tax, Salary to General Manager, Share Transfer expenses, Bank charges, Audit fees etc. Here these expenses can safely be transferred to General Profit and Loss Account.

Similarly, income of general nature such as Interest on Calls-in-arrears, Interest on Investment, fees on share transfer etc. credited to General Profit and Loss Account. The Departmental Trading Account shows the Gross Profit or Loss and Departmental Profit and Loss Account shows the Net Profit or Loss earned or suffered by each department.

Illustration 1:

The proprietor of a large retail store wished to ascertain approximately the net profit of the X, Y and Z departments separately for the three months ended 31st March 2006. It is found impracticable actually to take stock on that date, but an adequate system of departmental accounting is in use, and the normal rates of gross profit for the three departments concerned are respectively 40%, 30% and 20% on turnover before charging the direct expenses. The indirect expenses are charged in proportion to departmental turnover.

The following are the figures for the departments:

	X Rs.	Y Rs.	Z Rs.
Opening stock (1-1-2006)	10,000	14,000	7,000
Purchases	12,000	13,500	9,700
Sales	20,000	18,000	16,000
Direct expenses	2,000	1,500	700

The total indirect expenses for the period (including those relating to other departments) were Rs. 5,400 on the total turnover of Rs. 1, 08,000. Prepare a statement showing the approximate net profit, making a stock reserve of 10% for each department on the estimated value on 31-3-2006

SOLUTION

Departmental Trading & Profit & Loss A/c for three months ended 31st March 2006

	X Rs.	Y Rs.	Z Rs.		X Rs.	Y Rs.	Z Rs.
To Opening stock	10,000	14,000	7,000	By Sales	20,000	18,000	16,000
To Purchases	12,000	13,500	9,700	By Closing			
To Gross profit c/d	8,000	5,400	3,200	stock (bal. fig)	10,000	14,900	3,900
	30,000	32,900	19,900		30,000	32,900	19,900
To Direct expenses	2,000	1,500	700	By Gross profit	8,000	5,400	3,200
To Indirect expenses	1,000	900	800				
To Stock reserve @ 10%	1,000	1,490	390				
To Net profit (bal. fig)	4,000	1,510	1,310				
	8,000	5,400	3,200		8,000	5,400	3,200

Note (1) Indirect expenses applicable to the three departments.

$\frac{54,000}{1,08,000} \times 5,400 =$ Rs. 2,700 to be apportioned in the ratio of 10 : 9 : 8 (Rs. 1,000 ; 900 : 800)

(2) Direct expenses are not shown in Trading A/c because rates of gross profit given are before charging the direct expenses.

Illustration 2:

From the following particulars you are required to prepare Trading and Profit and Loss Accounts for the year ended 31st December 2005, showing the gross and net profits of each department. Apportion the general expenses of the business on the basis of turnover. Also prepare the Balance Sheet.

Trial Balance (31-12-2005)

		Rs	Rs
Capital			65,000
Plant *less* Depreciation		15,000	–
Stock (1.1.2005)	Dept. A	25,000	–
	Dept. B	19,000	–
Purchases	Dept. A	46,480	–
	Dept. B	22,050	–
Wages	Dept. A	11,600	–
	Dept. B	5,360	–
Departmental charges	Dept. A	7,530	–
	Dept. B	3,230	–
Returns out	Dept. A	–	1,160
	Dept. B	–	700
Sales	Dept. A	–	80,000
	Dept. B	–	40,000
Rent, Rates etc.		3,750	–
Salaries and Commission		9,450	–
Advertising		3,750	–
Discount & Interest		2,040	–
Sundry Expenses		1,530	–
Depreciation		750	–
Sundry Debtors		12,530	–
Sundry Creditors		–	6,570
Cash at Bank		4,380	–
		1,93,430	1,93,430

Stock in hand Dec. 31, 2005 Dept. A Rs 30.000 and B Rs 20,500.

Total sales are Rs 1.20.000 i.e., Dept. A Rs 80.000 and B Rs 40.000. Proportion of general or indirect expenses chargeable to A 2/3 and B 1/3. (B.Com. Madurai. MS. Bharathiar)

Solution:

Trading and Profit and Loss Account
for the year ended 31st Dec. 2005

Dr. Cr.

	Dept. A Rs	Dept. B Rs	Total Rs		Dept. A Rs	Dept. B Rs	Total Rs
To Stock: Opening	25,000	19,000	44,000	By Sales	80,000	40,000	1,20,000
To Purchase (net)	45,320	21,350	66,670	By Stock: Closing	30,000	20,500	50,500
To Wages	11,600	5,360	16,960				
To Dept. Expenses	7,530	3,230	10,760				
To Gross Profit	20,550	11,560	32,110				
	1,10,000	60,500	1,70,500		1,10,000	60,500	1,70,500
To Rent, Rates	2,500	1,250	3,750	By Gross Profit	20,550	11,560	32,110
To Salaries & Commission	6,300	3,150	9,450				
To Advertising	2,500	1,250	3,750				
To Dis. & Interest	1,360	680	2,040				
To Sundry Expenses	1,020	510	1,530				
To Depreciation	500	250	750				
To Net profit	6,370	4,470	10,840				
	20,550	11,560	32,110		20,550	11,560	32,110

Balance Sheet as on 31st December 2005

Liabilities		Rs	*Assets*		Rs
Sundry Creditors		6,570	Cash at Bank		4,380
Capital	65,000		Sundry Debtors		12,530
Add: Profit	10,840	75,840	Stock:		
			Dept. A.	30,000	
			Dept. B.	20,500	50,500
			Plant	15,750	
			Less: Depre.	750	15,000
		82,410			82,410

Illustration 3:

The following purchases were made by a business house having three Departments:

Department A – 1,000 units
Department B – 2,000 units } at a total cost of Rs 1,00,000
Department C – 2,400 units

Stocks on 1st January were:

Department A – 120 units
Department B – 80 units
Department C – 152 units

The Sales were:

Department A – 1,020 units @ Rs 20 each
Department B – 1,920 units @ Rs 22.50 each

Department C – 2,496 units @ Rs 25 each

The rate of Gross Profit is the same in each case. Prepare Departmental Trading Account.

Solution:

Departmental Trading Account
for the year ended...

Dr. Cr.

	Dept. A	Dept. B	Dept. C		Dept. A	Dept. B	Dept. C
	Rs	Rs	Rs		Rs	Rs	Rs
To Stock	1,920	1,440	3,040	By Sales	20,400	43,200	62,400
To Purchases	16,000	36,000	48,000	By Stock	1,600	2,880	1,120
To Gross Profit c/d	4,080	8,640	12,480				
	22,000	46,080	63,520		22,000	46,080	63,520

Workings:

Closing Stock (in units)

	Dept. A	Dept. B	Dept. C
	Units	Units	Units
Opening Stock	120	80	152
Add: Purchases	1,000	2,000	2,400
	1,120	2,080	2,552
Less: Sales	1,020	1,920	2,496
Closing Stock	100	160	56

We know that the total purchase price of the following units:

Department A – 1,000 units
Department B – 2,000 units Cost comes to Rs 1,00,000
Department C – 2,400 units

If the purchased units would have been sold at a given rate, then the total selling price of the above (complete) units:

Department A – 1,000 units @ Rs 20	=	Rs 20,000
Department B – 2,000 units @ Rs 22.50	=	Rs 45,000
Department C – 2,400 units @ Rs 25	=	Rs 60,000
		1,25,000

Thus, the total profit is 25% of cost price or 20% of selling price.
Rate of Gross Profit is the same in each case. So, we can find out the cost price:

	Selling Price	Profit	Cost Price
	Rs	Rs	Rs
Department A 20% of	20.00	4.00	16.00
Department B 20% of	22.50	4.50	18.00
Department C 20% of	25.00	5.00	20.00

Proof:

Department A – 1,000 units @ Rs 16	=	16,000
Department B – 2,000 units @ Rs 18	=	36,000
Department C – 2,400 units @ Rs 20	=	48,000
		1,00,000

Inter-Departmental Transfers:

Goods are often supplied from one Department to another – Inter-Departmental transfer. Such transfer must be credited to Supplying Department and debited to Receiving Department. If the transfers are made at cost price, then it can be treated as mere transfer. No further adjustment is needed.

However, if the transfers of goods are made at selling price, then a profit is earned by the supplying department of the same organization. When the goods, transferred from one department to another, still remain unsold with the transferee department, at the end of the accounting period, there arises a necessity to eliminate the unrealized profit on such stock on hand. This is because, so much of issuing department's profit (notional) remain unrealized from the viewpoint of the firm as a whole. The reserve will be equal to the profit included in respect of unsold goods at the end of closing.

The entry is:

General Profit and Loss Account Dr.

To Stock Reserve

In certain cases, the transferee department may have some stock in the beginning of the accounting period, against which stock reserve was already created in the previous year, will also be transferred to General Profit and Loss Account by means of Journal entry:

Stock Reserve Account Dr.

To General Profit and Loss Account

Alternatively, a single journal entry can be passed for the unrealized profit on the basis of the difference between unrealized profit included in opening and closing stock.

Illustration 1:

A firm has two departments — Piece goods and readymade dresses. All goods purchased by the readymade department from Piece goods department are charged at the usual selling price.

From the following particulars prepare departmental trading and profit and loss accounts for the year ended Dec. 31, 2005:

	Piecegoods Rs	Readymade Rs
Stock 1.1.2005	1,00,000	25,000
Purchases	10,00,000	7,500
Sales	11,00,000	2,25,000
Transfer to Readymade	1,50,000	
Expenses:		
Manufacturing		30,000
Selling	10,000	3,000
Stock on 31.12.2005	1,00,000	30,000

The stocks in the readymade department are considered as consisting of 75% cloth supplied from Piece goods dept. and 25% expenses and cloths from outside. The Piece goods department earned gross profit in 2004 at the same rate as in 2005. General expenses of the business as a whole in 2005 amounted to Rs 45,000.

Solution:

Departmental Trading and Profit and Loss Account
for the year ended 31st Dec. 2005

Dr. Cr.

	Piece-goods	Ready-made	Total		Piece-goods	Ready-made	Total
	Rs	Rs	Rs		Rs	Rs	Rs
Stock Opening	1,00,000	25,000	1,25,000	Sales	11,00,000	2,25,000	13,25,000
Purchases	10,00,000	7,500	10,07,500	Transfer to Readymade	1,50,000	–	1,50,000
Transfer from Piece-goods	–	1,50,000	1,50,000	Stock: Closing	1,00,000	30,000	1,30,000

Manufacturing Expenses	–	30,000	30,000				
Gross Profit c/d	2,50,000	42,500	2,92,500				
	13,50,000	2,55,000	16,05,000		13,50,000	2,55,000	16,05,000
Selling Expenses	10,000	3,000	13,000	Gross Profit b/d	2,50,000	42,500	2,92,500
Net Profit	2,40,000	39,500	2,79,500				
	2,50,000	42,500	2,92,500		2,50,000	42,500	2,92,500

Rate of Gross Profit on Sale (Piecegoods) $= \dfrac{\text{Gross Profit} \times 100}{(\text{Sales} + \text{Transfer})}$

$= \dfrac{25{,}000 \times 100}{(12{,}50{,}000)} = 20\%$

75% of Rs 30,000 (closing) is from Piecegoods= Rs 22,500

Therefore unrealised profit $= \dfrac{22{,}500 \times 20}{100} =$ Rs 4,500

Less: Existing Provision on Opening Stock:

(Piecegoods) $= \dfrac{25{,}000 \times 75}{100} \times \dfrac{20}{100} =$ Rs 3,750

750*

Illustration 2:

From the following balances extracted from the books of a firm, prepare Departmental Trading and General Profit and Loss Account for the year ended 31st December 2005 and a Balance Sheet as on that date after adjusting the unrealized departmental profits, if any.

		Rs			Rs
Land and Buildings		12,500	Capital		30,000
Furniture		2,500	Sales:	Dept. A	2,00,000
Opening Stock:	Dept. A	3,000		Dept. B	3,20,000
	Dept. B	4,000	Creditors		10,000
Purchases:	Dept. A	1,00,000			
	Dept. B	1,50,000			
General Expenses		1,40,000			
Debtors		20,000			
Drawings		28,000			
Cash at Bank		1,00,000			
		5,60,000			5,60,000

Additional information:

1. Closing stock of Dept. A – Rs 13,000 including goods from Dept. B Rs 4,000 at cost to Dept. A.

2. Closing stock of Dept. B – Rs 26,000-including goods from Dept. ARs 9,000 at cost to Dept. B.

3. Sales Dept. A includes transfer of goods to Dept. B of the value of Rs 20,000 and sales of Dept. B includes transfer of goods to Dept. A of the value of Rs 30,000 both at market price to transferor departments.

4. Opening stock of Dept. A and Dept. B includes goods to the value of Rs 1,000 and Rs 1,500 taken from Dept. B and Dept. A respectively at cost price to transferor departments.

5. Depreciate land and buildings by 5% and furniture by 10% p.a.

Departmental Trading Account
for the year ended 31st December 2005

Dr. Cr.

	Dept. A Rs	Dept. B Rs	Total Rs		Dept. A Rs	Dept. B Rs	Total Rs
To Opening Stock	3,000	4,000	7,000	By Sales	1,80,000	2,90,000	4,70,000
To Purchases	70,000	1,30,000	2,00,000	By Transfers	20,000	30,000	50,000
To Transfers	30,000	20,000	50,000	By Closing Stock	13,000	26,000	39,000
To Gross Profit	1,10,000	1,92,000	3,02,000				
	2,13,000	3,46,000	5,59,000		2,13,000	3,46,000	5,59,000

General Profit and Loss Account
for the year ended 31st Dec. 2005

Dr. Cr.

		Rs		Rs
To General Expenses		1,40,000	By Gross Profit:	
To Depreciation:			Dept. A	1,10,000
Land & Building	625		Dept. B	1,92,000
Furniture	250	875		
To Provision for unrealised Profit:				
Dept. A	2,400			
Dept. B	4,950	7,350		
To Net Profit		1,53,775		
		3,02,000		3,02,000

Workings:

Calculation of provision for unrealised profit on stock:

Dept. A: Rate of Gross Profit = $\frac{1,10,000}{2,00,000} \times 100 = 55\%$

Dept. B: Rate of Gross Profit = $\frac{1,92,000}{3,20,000} \times 100 = 60\%$

Provision required on closing stock:

Dept. A: 60% of Rs 4,000 = Rs 2,400

Dept. B: 55% of Rs 9,000 = Rs 4,950

Solution:

N.B. There is no need for any adjustment for opening stock which includes inter-departmental transfers. This is because goods have been valued at cost to the transferor department and not to transferee departments.

Balance Sheet as on 31st December 2005

Liabilities		*Rs*	*Assets*		*Rs*
Capital:	Rs 30,000		Fixed Assets:		
Add: Profit	1,53,775		Land and Buildings	12,500	
	1,83,775		*Less*: Depreciation	625	11,875
Less: Drawings	28,000	1,55,775	Furniture	2,500	
Sundry Creditors		10,000	*Less*: Depreciation	250	2,250
			Stock: Dept. A:	13,000	
			Dept. B:	26,000	
			Less: Provision for	39,000	
			unrealised profit	7,350	31,650
			Sundry Debtors		20,000
			Cash at Bank		1,00,000
		1,65,775			1,65,775

Illustration 3:

A company has two departments viz. Piece goods and Tailoring. All goods purchased by the Tailoring Department from Piece goods Department are sold at normal market prices, same as prices charged to outside customers.

From the following particulars prepare Departmental Trading and Profit and Loss Account and a Balance Sheet as on 31st March 2005.

	Piecegoods Dept.	Tailoring Dept.
	Rs	Rs
Opening Stock	20,000	Nil
Purchases	2,20,000	10,000
Goods from Piecegoods dept.	–	60,000
Wages	600	6,400
Salaries (Departmental)	4,800	1,200
Closing Stock (at cost to the Dept.)	38,600	14,000
Sales	2,43,000	1,36,000
Printing and Stationery	1,000	600
Machinery	–	12,000

Further information:

	Rs
Advertisement	10,000
Salaries (General)	18,000
Capital	1,20,000
Debtors	54,000
Creditors	7,000
Drawings	1,00,000
Cash at Bank	41,000
Cash in Hand	6,400

Depreciate Machinery by 10%. The general unallocated expenses are to be apportioned in the ratio of Piece goods -3 and Tailoring -2.

Solution:

Departmental Trading and Profit and Loss Account
for the year ended 31st March 2005

Dr. Cr.

	Piecegoods Dept.	*Tailoring Dept.*	*Total*		*Piecegoods Dept.*	*Tailoring Dept.*	*Total*
	Rs	*Rs*	*Rs*		*Rs*	*Rs*	*Rs*
To Opening Stock	20,000	–	20,000	By Sales	2,43,000	1,36,000	3,79,000
To Purchases	2,20,000	10,000	2,30,000	By Goods to Tailoring	60,000	–	60,000
To Goods from Piecegoods	–	60,000	60,000	By Closing Stock	38,600	14,000	52,600
To Wages	600	6,400	7,000				
To Gross Profit	1,01,000	73,600	1,74,600				
	3,41,600	1,50,000	4,91,600		3,41,600	1,50,000	4,91,600
To Salaries (Departmental)	4,800	1,200	6,000	By Gross Profit	1,01,000	73,600	1,74,600
To Salaries (General) (3 : 2)	10,800	7,200	18,000				
To Printing & Stationery	1,000	600	1,600				
To Advertisement (3 : 2)	6,000	4,000	10,000				
To Depreciation	–	1,200	1,200				
To Net Profit	78,400	59,400	1,37,800				
	1,01,000	73,600	1,74,600		1,01,000	73,600	1,74,600
To Provision for unrealised profit			4,000	By Net Profit:			
To Net Profit transferred to capital			1,33,800	Piecegoods	78,400		
				Tailoring	59,400		1,37,800
			1,37,800				1,37,800

Note: The rate of Gross Profit of Piecegoods Department is calculated as follows:

$$\frac{\text{Gross Profit} \times 100}{\text{Sales to Outsiders} + \text{Sales to Tailoring Dept.}}$$

$$= \frac{\text{Rs } 1,01,000 \times 100}{\text{Rs } 2,43,000 + 60,000} = 33\ 1/3\%$$

Calculation of Provision for Unrealized Profit:

The composition of the Closing Stock of Tailoring Department is not given The Tailoring Department possesses stock of Rs 14,000. There is no doubt that the stock consists of goods from Piece goods and Outside It can be assumed that the stock consist of both types of goods i.e. from Piece goods and Outside in the ratio of their purchases.

Therefore, the value of goods of Piece goods Department included in the closing stock of Tailoring Department can be calculated as under:

$$\frac{\text{Value of Purchases from Piece goods Dept.}}{\text{Value of Total Purchases}} \times \text{Total Closing Stock of Tailoring Dept.}$$

$$= \frac{\text{Rs } 60{,}000}{\text{Rs } 70{,}000} \times 14{,}000 = \text{Rs } 12{,}000$$

So, unrealised profit thereof = 33 1/3% of Rs 12,000 = Rs 4,000

Balance Sheet as on 31st March 2005

Liabilities		Rs	*Assets*		Rs
Capital:	1,20,000		Machinery	12,000	
Add: Profit	1,33,800		*Less*: Depreciation	1,200	10,800
	2,53,800		Closing Stock		
Less: Drawings	1,00,000	1,53,800	Piecegoods	38,600	
			Tailoring	14,000	
Creditors		7,000		52,600	
			Less: Provision for unrealised Profit	4,000	48,600
			Sundry Debtors		54,000
			Cash at Bank		41,000
			Cash in hand		6,400
		1,60,800			1,60,800

Illustration 5 :

From the under-mentioned information and instructions, prepare Departmental Trading and Profit and Loss Account in columnar form of the three Departments of the Outfitters Ltd.

	Tailoring	Ladies Wear	Outfitting
	Rs	Rs	Rs
Stock on 1st January 2005	41,280	33,975	93,721
Stock on 31st December 2005	32,840	13,828	81,626
Purchases	2,10,342	75,296	1,39,109
Purchase Returns	14,382	5,629	1,823
Sales for the year	4,00,173	1,54,085	3,62,189
Sales Returns	Nil	3,259	11,217
Wages	72,823	30,084	24,613

Goods were transferred as follows (all at cost):

Tailoring to Ladies wear Rs 389 and Outfitting Rs 6.679; Ladies wear to Tailoring Rs 5,315; Outfitting to Tailoring Rs 4,271 and to Ladies Wear Rs 5,801. Apportion equally: Stationery Rs 921; Postage Rs663; General charges Rs39.627. Insurance Rs 1,785 and Depreciation Rs 5.460.

Allocate the following further expenditure as you think best and append notes stating the basis selected for each item. Establishment Rs 63,395; Bad Debts Rs 19,823; Advertising Rs 7,293 and

Income Tax Rs 11,028. Rent and taxes Rs 45,437 is to be split up in proportion to space occupied i.e. Tailoring 4; Ladies Wear 2; Outfitting 3 and others 2. Approximate apportionment is all that is necessary: charge any odd balance to Outfitting Department.

SOLUTION

Departmental Trading and Profit and Loss Account

Dr. **for the year ended 31st December 2005** Cr.

	Tailoring	*Ladies* Wear	*Outfitting*		*Tailoring*	*Ladies* Wear	*Outfitting*
	Rs	Rs	Rs		Rs	Rs	Rs
To Opening Stock	41,280	33,975	93,721	By Sales	4,00,173	1,54,085	3,62,189
To Purchases	2,10,342	75,296	1,39,109	By Transfer to			
To Transfer from				Ladies Wear	389	–	5,801
Tailoring	–	389	6,679	By Transfer to			
To Transfer from				Outfitting	6,679	–	–
Ladies Wear	5,315	–	–	By Transfer to Tailoring	–	–	4,271
To Transfer from						5,315	
Outfitting	4,271	5,801	–				
	2,61,208	1,15,461	2,39,509		4,07,241	1,59,400	3,72,261
Less: Returns	14,382	5,629	1,823	Less: Returns	–	3,259	11,217
	2,46,826	1,09,832	2,37,686		4,07,241	1,56,141	3,61,044
To Wages	72,823	30,084	24,613	By Closing Stock	32,840	43,828	81,626
To Gross Profit	1,20,432	60,053	1,80,371				
	4,40,081	1,99,969	4,42,670		4,40,081	1,99,969	4,42,670
To Stationery	307	307	307	By Gross Profit b/d	1,20,432	60,053	1,80,371
To Postage	221	221	221				
To General Charges	13,209	13,209	13,209				
To Insurance	595	595	595				
To Depreciation	1,820	1,820	1,820				
To Establishment (Sales Ratio)	28,176	10,565	24,654				
To Bad Debts (Sales Ratio)	8,810	3,304	7,709				
To Advertising (Sales Ratio)	3,242	1,216	2,835				
To Rent and Taxes (given Ratio 4 : 2 : 3)	16,523	8,261	12,392				
To Rent and Taxes– other space: equality	2,754	2,754	2,753				
To Income tax	2,804	1,122	7,102				
To Net Profit	41,971	16,679	1,06,774				
	1,20,432	60,053	1,80,371		1,20,432	60,053	1,80,371

POSSIBLE QUESTIONS

PART – A

Online Examination

PART – B (2 MARKS)

1. What is single entry system?
2. Define Statement of Affairs Method.
3. Define conventional method.
4. What is meant by departmental accounting?
5. Apportion the following expenses on the basis of cost of goods sold ratio among the four departments, A,B, C & D :
   Sales (Rs.) : A: 2,00,000 : B : 1,50,000 : C : 1,00,000 : D : 50,000
   G.P. Ratio : 20 % on Sales.
   Expenses : Salaries Rs. 6,000 ; Rent & Rates Rs. 1,500; Insurance Rs. 1,300.
6. What do you understand by 'Inter-departmental transfers'?
7. What should be the basis of allocation for the following expenses under Departmental Accounts?
   (a)Salaries ; (b) Lighting ; (c) Discount allowed ; (d) Rent and Taxes
8. Sales Rs. 1,60,000 ; Rate of Gross Profit is 25 % on sales ; Purchases Rs. 1,40,000 ; and closing stock Rs. 30,000. Find out the opening stock.
9. Calculate the value of purchases : Cost of goods sold Rs. 4,00,000 ; Opening stock Rs. 50,000 ; Closing stock Rs. 60,000.

Part – C (6 Marks)

10. Saran keeps his books on single entry system. From the following particulars, prepare a statement showing profit or loss made by his for the year ended March 31, 2014.

Particulars	March 31, 2013 (Rs.)	March 31, 2014 (Rs.)
Debtors	16,000	19,000
Stock	12,000	15,000
Furniture	2,000	4,000
Cash in hand	1,000	1,500
Creditors	1,200	1,800
Bank overdraft	__	2,000

During the year Saran introduced Rs. 10,000 as further capital in the business and withdrew Rs. 6000.

11. Company carries on its business through five department's viz., A, B, C, D and E. The Trial Balance as on 31-12-08 is as follows:

Particulars	A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)	E (Rs.)
Opening Stock	5,000	3,000	2,500	4,000	4,500
Purchases	50,000	30,000	10,000	26,000	30,000
Sales	48,000	21,000	9,500	23,000	30,000
Closing Stock	6,000	4,000	3,500	3,500	5,500

The Opening and closing stocks have been valued at cost. The expenses, which are to be in proportion to the cost of goods sold in the respective departments are as follows :

Particulars	Amount (Rs.)
Salaries and Commission	5,510
Rent and Rates	1,450
Miscellaneous Expenses	1,305
Insurance	580

Show the final result and the percentage on sales in each department and also the combined result with percentage on sales.

12. Gopal keeps his books on single entry system. From the following particulars, prepare a statement showing profit or loss made by her for the year ended March 31, 2014.

Particulars	March 31, 2013 (Rs.)	March 31, 2014 (Rs.)
Debtors	25,000	20,000
Stock	12,000	15,000
Furniture	8,000	7,000
Cash in hand	4,000	5,500
Creditors	2,200	1,800
Bank overdraft	1,000	2,000

Adjustments:

- During the year Gopal introduced Rs. 25,000 as further capital in the business and
- He withdrew Rs. 10,000.

13. Elaborate the important basis of apportionment of expenses among different departments?

14. Following is the Trial Balance of Mr. Rajan as on 31.12.2009

Particulars	Debit (Rs.)	Credit(Rs.)
Capital Account	-	40,000
Drawing Account	1,500	-
Opening Stock :		-
Dept A	8,500	-
Dept B	5,700	-
Dept C	1,200	
Purchases		-
Dept A	22,000	-
Dept B	17,000	-
Dept C	8,000	
Sales :	-	
Dept A	-	54,000
Dept B	-	33,000
Dept C		21,000
Sales Returns :		-
Dept A	4,000	-
Dept B	3,000	-
Dept C	1,000	
Freight and Carriage		-
Dept A	1,400	-
Dept B	800	-
Dept C	200	
Wages :		-
Dept A	800	-
Dept B	550	-
Dept C	150	
Furniture & Fixtures	4,600	-
Plant & Machinery	20,000	-
Bills Receivable	4,200	-
Bills Payable	-	8,000
Motor Vehicles	40,000	-
Sundry Debtors	8,000	-
Sundry Creditors	-	7,000
Salaries	4,500	-
Power and Water	1,200	-
Telephone Charges	2,100	-
Bad Debts	750	-
Rent and Taxes	6,000	-
Insurance	1,500	-
Printing and Stationery	2,000	-

Advertising	3,500	-
Bank Overdraft	-	12,000
Cash in hand	550	-
Total	**1,75,000**	**1,75,000**

Prepare Department Trading and Profit and Loss Account and the Balance Sheet after bring into account the following adjustments:

(a) Outstanding wages Dept . B – Rs. 150; Dept. C – Rs. 50
(b) Salaries payable Rs. 500
(c) Depreciate Plant & Machinery and motor vehicle @ 10%.
(d) Create a reserve of 5% for bad and doubtful debts.
(e) Each department share the expenses in proportion to their sales.
(f) Closing stock Dept A – Rs. 3,500: Dept B – Rs. 2,000: Dept C – Rs. 1,500.

15. Describe the points of distinction between a statement of affairs and a balance sheet?

16. Mr. Mano keeps his books of accounts under single entry system. His financial position on 31.12.2000 and 31.12.2001 was as follows :

Particulars	2000 Rs.	2001 Rs.
Cash	9,860	800
Stock in trade	38,520	57,020
Plant and Machinery	54,420	61,000
Bills Receivable	-	16,480
Sundry Debtors	24,840	43,940
Sundry Creditors	72,040	80,000
Furniture	4,960	5,220
Drawings	-	5,000

During the year he introduced additional capital of Rs. 20,000. From the above particulars prepare a statement of Profit and Loss of Mr. Mano for the year ended 31.12.2001.

17. Explain the procedure for the preparation of departmental accounts?

18. A retail trader keeps his books under single entry. The assets and liabilities as on date were:

Particulars	31.12.2008 (Rs.)	31.12.2009 (Rs.)
Furniture	5,000	8,000
Stock	15,000	20,000
Machinery	25,000	28,000
Debtors	24,000	40,000
Creditors	38,000	45,000
Cash	18,000	7,000
Drawings	-	6,000

Additional capital introduced during the year Rs. 25,000. Provision for Bad debts @ 5% on debtors is to be provided. Depreciation on Machinery @ 10% to be provided. Prepare a statement of profit or loss for the trader for the year 2009.

19. Suma Departmental stores has two departments-provisions and Fancy mart. From the following, prepare departmental Trading Account.

Purchase:

Provisions Department – 1,000 units
Cosmetics Department - 2,000 units (at a total cost of Rs. 1,10,000)

Opening Stock:

Provisions Department – 400 units
Cosmetics Department - 600 units

Sales :

Provisions Department – 900 units @ R. 75 per unit
Cosmetics Department - 2,100 units @ Rs. 45 per unit
Assume that Gross Profit rate is uniform for both the departments.

KARPAGAM ACADEMY OF HIGHER EDUCATION
(DEEMED TO BE UNIVERSITY)
(ESTABLISHED UNDER SECTION 3 OF UGC ACT 1956)
DEPARTMENT OF COMMERCE
I B.COM PA - Higher Financial Accounting (17PAU201)
Unit - III (SINGLE ENTRY SYSTEM AND DEPARTMENTAL ACCOUNTING)

S.NO.	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
1	As per the cost of concept an asset is recorded at	market cost	actual cost	normal cost	purchase cost	actual cost
2	The system of operating at several places through one’s	Department	Division	Office	Branch Organization	Branch Organization
3	The main establishment located at the main place of	Head Office	Office	Division	Branch	Head office
4	Branches may be divided into __________ categories,	2	3	4	5	3
5	Goods supplied to Dependent _________ by the	Head Office	Office	Branches	Department	Branches
6	The One Account System or Debtors System is generally	Real Account	Current Account	50	Nominal Account	Nominal Account
7	Branch Account is a in nature and is prepared in the	Not Involve	not taken	not see	taken	Not taken
8	Under Debtors System, bad debts and discounts	Credit side	Debit side	Income side	credit or debit	Credit side
9	Under the X_______________ System					
10	the debtors (at close) are shown on the of the Branch	Decreasing	Increasing	Reducing	Deducting	Deducting
11	Under the __________ System, the Head Office will	Debtors	Purchasers	Sellers	Vendos	Debtors
12	Under the Debtors System, the Reserve for Doubtful	deducted	recorded	accumulated	renewed	recorded

S.NO.	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
13	Actual petty expenses incurred by the branch	received	accounted	recorded	not be recorded	not be recorded
14	The and the subsidiary establishment located at	Head Office	Office	Division	Debtors	Debtors
15	Under Debtors System, the Debtors at close are	On the credit side of the Head Office	On the debit side of the	On the credit side of the	Are not shown in the Branch	On the credit side of the Branch
16	Under Debtors System, the Branch Account	Real Account	Nominal Account	Personal Accunt	Real and Nominal	Nominal Account
17	The cash and credit sales of the branch are Rs.5,000 and	Rs.20,000	Rs.15,000	Rs.10,000	Rs.25,000	Rs. 15,000
18	The__________ can be recorded completely in a	Accounts	Transactions	Bills	Sales	Accounts
19	The parties to the joint venture deposit their	Sales	Purchase	Joint bank	Bank	Bank
20	The___________ of the parties can also be opened in	Personal accounts	Commission account	Sales	Bills	Sales
21	__________balances are settled before the clousure of	Prepaid	Bills payable	Bills receivable	Outstanding balances	Bills receivable
22	A joint bank account can be opened in	Own	Separate	Joint	Own separate and Joint	Own separate and Joint
23	The expenses incurred on joint venture by the other	Accepted	Thrown	Ignored	None	Thrown
24	The joint venture account is debited with the value of the	Sold	Bought	Exempted	Purchased	sold
25	The amount of__________will also be	Purchase	Expenses	Sales	Purchase, expenses sales	Purchase, expenses sales
26	The resultant profit or loss may be ___________-by all	Shared	Ignored	Exempted	Shared ignored and exempted	Shared ignored and exempted
27	Joint ventures must be distinguished from_______	Private ownership	Single ownership	Partnership	Joint ownership	Single ownership
28	The parties to thejoint venture will have					

S.NO.	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
29	an____________status	High	Low	Normal	Equal	Normal
31	In . joint venture the___________of profit is an	Earning	Loss	Gain	Getting	Gain
32	________________is a principal as well as agent	Consignor	Co –venturer	Consignee	joint venture	Consignor
33	A . joint venture is usually of___________-duration	Long	High	Small	Short	Small
34	Each party opens a joint venture account and the	Other	All	Single	Double	Other
35	____________ is a non trading concern	hospitals	profit	gain	loss	hospitals
36	_____________and expenditure is a revenue	profit	gain	loss	income	income
37	a___________ cash transactions will be entered.	plan	actual	loss	actual and loss	actual
38	a___________ will appear on the credit side.	receipts	profit	income	loss	income
39	A _________appears on the debit side	excess	expenditure	cash	credit	Expenditure
40	one type of depreciation is___________	bad debts	sold	purchase	receipts	bad debts
41	payments are entered in _______side	debit and credit	debit	journal	credit	credit
42	A_________ Of cash enters in debit side.	debit	receipts	payment	credit	Receipts
43	A _________ will receive in advance.	Profit	loss	income	gain	income
44	income earned during the ________are not received.	period	year	day	month	period
45	The ___________ will be made for expenditure.	gain	loss	gain and loss	provision	provision

S.NO.	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
46	income and ________ is accompanied.	gain	expenditure	loss	gain and loss	Expenditure
47	for ________ income.	paid	credit	accrued	prepaid	accrued
52	Valuation of unsold stock remaining with the consignee	Sales	Market	Selling	Purchasing.	Market
53	Entry of an unsold stock will be passed on the books	Seller	Consignee	Consignor	Purchaser	Consignor
54	In valuing the unsold stock, due consideration should be	Abnormal loss	Normal loss	Quantity	Quality	Normal loss
55	______________on consignment account is an	Stock	Purchase	Sales	Opening stock	Stock
56	If the consignee is not the owner for the goods then no	Buyer	Consignee	Seller	seller and buyers	Consignee
57	_________Loss is a loss which arises due to mischief.	More	Normal	Low	Abnormal	Abnormal
58	.__________loss of goods should also be considered	Actual	Normal	Expensive	Damaged	Normal
59	It is a __________principle that stock must not be shown	Fixed	Basic	High	Actual	Fixed
60	Entries are passed in the books of the consignor on	Purchase	Sales	Cost	Price	cost

UNIT IV

Partnership Accounts - Division of Profits - Fixed and Fluctuating Capital - Past Adjustments - Guarantee of Profits - Admission - Retirement - Death

PARTNERSHIP ACCOUNTS

INTRODUCTION

The Indian Partnership Act of 1932 contains the main provisions which are applicable to partnership firms working in India. According to this Act "Partnership is the relation between persons who have agreed to share the profit of the business carried on by all or any of them acting for all". Individually the persons who work in the firm are called partners and the name with which all partners work collectively is called the firm's name. For example, A, B and C working in a firm will be called partners and 'ABC & Co.', the name with which these partners work collectively will be called firm's name.

ESSENTIAL FEATURES OF A PARTNERSHIP

The following are the essential features of a partnership firm:

i) **Persons**: In order to constitute a partnership firm, there must be at least two persons. The maximum number in partnership is 20 in case the firm is doing ordinary business and 10 in case the firm is engaged in banking business. This is as per Section 11 of the Companies Act, 1956.

ii) **Agreement**: In order to have a partnership, it is necessary that there must be an agreement between partners.

iii) **Sharing of profits**: It is one of the important terms to constitute a partnership firm. Generally sharing of profits (or losses) is one of the important element to constitute a firm.

iv) **Business**: It includes trade, covation and profession. The firm must be engaged in a lawful business.

v) **Management**: The management of the partnership firm will be done either by all the partners or any one of them on behalf of all other partners. There is mutual agency among the partners.

Following are the characteristics of partnership :

1. It is a contract between two or more than two persons.
2. A contract is necessary for division of profits/losses.
3. The business may be carried on by all or any of them acting for all.

PARTNERSHIP DEED

A document in which the terms and conditions of partnership are given is called Partnership Deed. In a partnership deed, the rights and duties of partners are given. If there is no partnership deed of a firm, all the provisions of Partnership Act, 1932 will be applicable with regard to duties, rights and liabilities of partners. A partnership deed should contain the following points :

1. Date of agreement.
2. Name and address of the partnership firm.
3. Name and address of the partners.
4. Nature and place of business.
5. Period of partnership, if any.
6. Capital of partners.
7. Profit sharing ratio.
8. Drawings of partners.
9. Interest on capital and on drawings.
10. Salary and commission of partners, if any.
11. Rights, duties and functions of partners.
12. Method of valuation of goodwill.
13. Accounting method at the time of retirement or death of a partner.
14. Arbitration clause to settle disputes among the partners.
15. Method of distribution of assets on the dissolution of the firm.
16. Accounting treatment or procedure at the time of dissolution.
17. Accounting procedures.
18. Any other provision.

PECULIAR ASPECTS OF ACCOUNTING FOR PARTNERSHIP FIRMS

In sole trading, there is only one owner who invests the capital. The Capital and Drawing accounts are opened in his name. But in partnership, Capital Account, Current Account and Drawings account of each partner are opened separately.

In a partnership contract, all terms and conditions on the basis of which partnership is started are defined. This contract may be oral or written. To avoid future disputes, the contract should be in writing, which is called the partnership deed. In the absence of a written contract, the following rules apply :

1. Distribution of profit and loss among the partners will be equal.
2. No interest on capital will be allowed.
3. No interest will be charged on drawings.
4. No salary is allowable to any partner for doing work in the capacity of a partner.
5. Interest on loan other than capital is allowed @ 6% per annum.
6. Every partner can equally share the assets of firm at the time of dissolution.

Profit and Loss Appropriation Account

In partnership, the method of preparing final accounts is the same as for sole trading. However, in a partnership firm, Profit and Loss Appropriation Account is required to be prepared to distribute the profits among the partners. The format of the Profit and Loss Appropriation Account is as under :

Profit and Loss Appropriation Account

	Rs.	Rs.
--	To Profit and Loss A/c, if any -----	By Profit and Loss A/c-------
	(current year loss)	(Profit for current year)-------
	To Interest on Capital-------	By Interest on Drawings-------
	To Salary to Partners-------	By Capital Accounts or-------
	To Commission to Partners -------	Current Account of Partners

To Interest on Partner's Loan ------
- (Division of Loss)

To Capital or Current-------

Accounts of Partners

(Division of Profit)

Fixed and Fluctuational Capitals

Capital Accounts of partners may be fixed or fluctuating. If Capital Accounts are fixed, two accounts are prepared for each partner: (i) partner's Capital Account and (ii) partner's Current Account.

In case of fixed capital, partners' Capital Account are credited only with that amount of capital at which business is started. Later on, if additional capital is invested, the capital account is credited and it is debited with the amount withdrawn permanently. No other adjustment is made in this account.

In partners' Current Accounts, all adjustments regarding interest on capital, salaries, share of profit and drawings are shown. The balance of this account always varies and that of Capital Account remains the same.

In case of fluctuating capital, only one account is prepared, which is called Capital Account. In this account, all items relating to additional capital,

interest, drawings, share of profit and salaries, etc. are shown. The balance of this type of Capital Account in the beginning and in the end will be different and, as such, it is called Fluctuating Capital Account.

Interest on Capital and Drawings

Interest on capital is allowed only if it is allowed and interest on drawings is charged only if there is an agreement in this regard. Interest is calculated by considering the interest rate and time. Interest on capital is written on the Debit side of Profit and Loss Adjustment Account and Credit side of partners' Capital Account or Current Account. On the other hand, interest on drawings is written on the Credit side of Profit and Loss Adjustment Account and again on Debit side or Capital Account of Current Account.

Illustration 1: A and B are partners and they had Rs. 1,50,000 and Rs. 2,50,000 in their Capital Accounts as on 1st January, 1993. A paid a further sum of Rs. 50,000 on 1st July, 1993 and another Rs. 25,000 on November 1, 1993. B paid Rs. 1,00,000 on April 1, 1993 and another Rs. 25,000 on August 1, 1993.

A withdrew Rs. 1,000 per month at the beginning of every month and B Rs. 1,000 at the end of every month. 5% per annum interest on capital and on drawings is to be considered. Calculate the interest payable and chargeable.

Solution

Interest on Capital :

A Interest on Rs. 1,50,000 of one year = 1,50,000 · 5/100 = Rs. 7,500

Interest on Rs. 50,000 for 6 months = 50,000 ·1/2·5100= Rs. 1,250 Interest on Rs. 25,000 of 2 months = 25,000·2/12·5/100= Rs. 208.33

8958.33

Alternative Method

Product Method:

Under this method the product of capital invested and the number of months for which it remained in business are determined first and then interest is calculated for one month on the product. In the above case during first 6 months capital was Rs. 1,50,000, for next four months it was Rs. 2,00,000 and for the last two months it was Rs. 2,25,000. Hence, calculation of interest by product method are as under : Interest (Rs. 150000 · 6 + 200000 · 4 + 225000 · 2) for one month at 5% per annum.

=(900000 + 800000 + 450000) 5/100 ·1/12 = Rs. 8958.33 **B**

Interest on Rs. 1,00,000 for 9 months = Rs. 100000·5/100·9/12	= Rs. 3,750.00
Interest on Rs.2,50,000 for one year = Rs. 250000·5/100	= Rs. 12,500.00
Interest on Rs.25000 for 5 months = Rs. 25000·5/100·5/12	= Rs.

	520.83

16,770.83

Alternative Method

Product Method :

(250000·3 + 350000·4 + 375000·5) for 1 month at 5% per annum.

= (750000 + 1400000 + 1875000) 5/100 · 1/12 = Rs. 16770.83

Interest on Drawings

Because the same amount either at the beginning or at the end or each month is withdrawn by a partner, the interest can be calculated by the following simple formula :

A. The number of months for which interest is to be calculated = $\frac{n(n+1)}{2}$ Where, n = the number of months for which interest is payable for the first installment, here, n = 12

$$=\frac{12(12+1)}{2} = 78 \text{ months}$$

Interest = Rs. 1000 · 78/12 · 5/100 = Rs. 325

or = (Rs. 1000 · 12) $\frac{6½}{12}$ · 5/100 = Rs. 325

Number of months = $\frac{n(n+1)}{2}$ where n = 11, because the amount is withdrawn at the end of every months.

= 11 · 12/2 = 66 months

Interest = Rs. 1000 · 66/12· 5/100 = Rs. 275

or = (Rs. 1000 · 12) · $\frac{5½}{12}$ · 5/100 = Rs. 275

Notes

1. If the same amount is withdrawn at the beginning of every month, then 6½ month's interest will be calculated on total drawings.
2. If the amount is withdrawn at the end of every month, the interest is calculated on total drawings for 5½ months.
3. If the amount is withdrawn in the middle of every months, 6 months' interest is calculated on total drawings.
4. If interest on drawings is being calculated but dates of withdrawal are not given, then 6 months interest will be calculated on total drawings.

Minor Partner

A partner who has not attained the age of majority is called a minor partner. Asno agreement can be entered into with a minor, he can only be admitted to the benefits of an existing partnership with the consent of all the partners. A minor partner is not personally liable for the debts of the partnership firm but his share in the partnership property and profits of the firm will be liable for firm's debts and obligations. He will not be personally liable for any debt of the firm until he attains the age of majority. He is not liable to share the loss if there is any. Within six months of his attaining majority or when he comes to know that the enjoys the benefits of partnership (whichever date is later), he has to elect whether or not he wants to continue as a partner. He must give public notice if he dos not want to continue as a partner otherwise he will be deemed to have elected to be a partner. He will become liable for the debts of the firm since he was admitted to the benefits of the partnership firm on his election as a partner.

Illustration 2: Since 1st January, 1996 A, B and minor C are equal partners.

Their Balance Sheet as on 31-12-1999 is as follows:

Liabilities		Rs.	Assets	Rs.
Sundry Creditors		40,000	Cash in hand	15,000
Accumulated Balance in 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 Interest	1,080	-	-	By Balance b/d (Opening Capital)	40,000	40,000	20,000
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 (35,000+12,000–1,200–1,080)	44,720
		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 values, 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

	ed	White	Blue	Green
	s.	Rs.	Rs.	Rs.

Salary		-	600	-
Profits	10,425	7,819	5,213	2,590
Transfer from White to Blue		(-) 500	(+) 500	-
Bonus payable to Grey	(-) 250	-	-	-
Excess amount debited for the guarantee given	(-) 147	-	-	-
	10,028	7,319	6,313	2,590

Working Notes		
i)	*Distributable Profit:*	Rs.
	Profit as disclosed by accounts	32,000
	Less: Staff Bonus	5,500
		26,500
	Salary to Blue	600
	Profit to be distributed among partners	600
		25,900

(ii) Remuneration which Green would have received as Manager:

	Salary	1,000
	Commission: (26,500 – 1,000) 3/103	743
		1,743
iii)	*Amount now being paid to Green:*	
	1/10 of Profits (Rs. 25,900)	2,590
	Excess amount [2,590 – (1,743 + 7000)] debited to Red	147
	ADMISSION OF A PARTNER	
	Sometimes a running business may require new partner for the	
	following reasons :	

	1.	Need of more capital for expansion of business.	
	2.	Need of expertise in managerial or technical field for running	
		the business.	
	3.	For growth of the business by admitting a reputed person as partner.	
	4.	To admit a new partner in place of an old retiring partner.	

When a new partner is admitted in business, he gets two types of rights.

1. Right to Share Future Profit-Loss of the Business

When a new partner is admitted in the business, he gets the right to receive profit in an agreed ratio. This share in profit is sacrificed by the old partners. To compensate the old partners for this sacrifice, the new partner pays a price in the form of goodwill adjustment. The method of valuation of goodwill is usually given in the partnership contract. When new partner comes into partnership, the profit sharing ratio of old partners is changed.

2. Right to Share in Assets of the firm

When a new partner is admitted in the firm, he also becomes the owner

of firm's assets as per his share, for which he brings in the required capital. Hence, at the admission of a new partner, revaluation of assets and liabilities becomes necessary so that there should be no loss to the old partners or the new partner. At the time of admission of a new partner, the following are the main considerations which must be settled between the old and the new partners:

1. Determination of new profit sharing ratio.
2. Determination of the value of goodwill and its allocation among old partners.
3. Revaluation of assets and liabilities of the existing business.
4. Distribution of accumulated profits, reserves and losses.
5. Determination of the capital to be brought in by the new

Partner. Each point is discussed in detail in the following pages :

Determination of New Profit Sharing Ratio

When a new partner joins the firm, the share of old partners is reduced because they sacrifice some part of their share to the new partner.

The determination of new profit-sharing ratio depends upon the agreement among the old and new partners. In what ratio the new partner gets his share from the old partners depends upon their agreement. Thus on admission of a new partner, what the new ratio of all the partners will be is an important question. In various circumstances, the calculation of new profit-sharing ratio is made as follows :

If Share of New Partner is Given :

When the share of new partner is given and in the absence of any direction, the old partners will continue to share the remaining share in their old profit sharing ratio after deducting the share of the new partner.

Illustration 5

Yogu and Ankit are partners sharing profits and losses in the ratio of

3:2. They admit Atul as a partner for one fourth share in the future profits. Calculate the new profit-sharing ratio of partners.

Solution

Atul's share is 1/4

Thus remaining share = 1 - ¼ = ¾ Hence

Yogu's share = ¾ · 3/5 = 9/20 Now Ankit's share

= ¾ · 2/5 = 6/20 and Atul's share = ¼ or 5/20

= 9/20 : 6/20 : 5/20

Hence, the new profit sharing ratio will be = 9 : 6 : 5.

When the New Partner Purchases His Share From Old Partners in a Certain Ratio

In this case, the share of old partners will be calculated by deducting that portion which they have sacrificed in favour of a new partner. The remaining share will be treated as the share of old partners. This will be clear from the following example :

Illustration 6

A and B are partners in a firm sharing profits and losses in the ratio of

3: 2. A new partner C is admitted. A surrenders 1/5 share of his profit in favour of C, and B surrenders 2/5 of his share in favour of C. Calculate the new profit-sharing ratio of the partners.

Solution

Sacrifice by A to C

Sacrifice by B to C

Share of C A's new share B's new share of A, B and C

3/5 · =
1/5 3/25
2/5 · =
2/5 4/25

=3/25 + 4/25 = 7/25

=3/5 - 3/25 = (15-3)/25 = 12/25

= 2/5 - 4/25 = (10-4)/25 = 6/25

=12/25 : 6/25 : 7/25

=12 : 6 : 7

When Sacrificing Ratio is given

In this case, the sacrifice made by old partners towards the new partner is given. This is clear from the following example:

Illustration 7

A and B are partners sharing profit or loss in the ratio of 7:5. They admit their manager C into partnership who is to get one sixth share in the profits. He acquires his share as 1/24 from A and 1/8 from B. Calculate the new profit sharing ratio

Solution

(Old Ratio - Share given to new partner)

A = 7/12 - 1/24 = (14-1)/24 = 13/24

B = 5/12 - 1/8 = (10-3)/24 = 7/24

C = 1/6

New ratio = 13/24 : 7/24 : 1/6

= 13 : 7 : 4

Sacrificing Ratio When Old and New Ratios are Given

In case, when old and new ratios of partners after admission of a partner are given, it is necessary to calculate the sacrificing ratio of the old partners by the formula:

Sacrificing Ratio = Old Ratio - New Ratio.

Illustration 8

X and Y are partners sharing profits or losses in the ratio of 4:3. Z is admitted and the new ratios are X-7, Y-4 and Z-3 (7:4:3:). Calculate the sacrificing ratio.

Solution

Sacrificing Ratio = (Old Ratio - New Ratio)

X's sacrifice = 4/7-7/14 = (8-7)/14 = 1/14

Y's sacrifice = 3/7 - 4/14 = (6-4)/14 = 2/14

Thus, sacrificing ratio is 1:2 for X and Y.

Goodwill

Goodwill is the value of the reputation of a firm. When a new partner is admitted in the partnership, he starts getting share in the profits of the firm immediately on his entrance. He gets the benefit of the firm's reputation which has been developed by old partners through their hard work and efforts. Hence, the old partners want some compensation for their previous labour or efforts made by them to build the firm's reputation. The amount of compensation given by the new partner to old partners is called goodwill. It is an intangible asset which is not visible and touchable, but it is subject to fluctuations.

In the words of Lord M, "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, willing 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. Specialty of goods or services provided.
3. Favorable location or site.
4. Patents, Copyrights or Trade Marks.
5. Advantage of an important license with the firm.
6. Advantage of selling a special type of product or raw material For the above reasons, the firm gets or earns more profit and the one

Who purchases the goodwill of firm also purchases the name of the firm. It is important to note that goodwill exist only when the business is running in profit. In a business which is running at a loss, there will be no goodwill because the value of goodwill arises from the future possibility of the firm to earn profit.

Need for valuation of goodwill of a firm:

1. On Admission of a New Partner: When a new partner comes into the firm, he gets a share in the future profits. The share of the old partners is consequently reduced. So, the new partner has to pay for the goodwill besides his capital. The amount paid for goodwill is distributed among old partners in their sacrificing ratio. Valuation of goodwill depends on the agreement among old and new partners.

2. On Retirement or Death of a partner: As a new partner brings in the amount of goodwill, in the same way, at the time of retirement, a partner receives his share of goodwill of the firm. At the time of death, the deceased partner's share of goodwill is to be given to his legal representatives. For this, the need for valuation of goodwill arises. On the Amalgamation of firms: When two or more than two firms are merged and a new firm is formed, it is called amalgamation. At the time of amalgamation, like other assets and liabilities, goodwill is also value and becomes the part of purchase consideration like other assets.

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

4. When profit sharing ratio of the partners is changed, there is a need to evaluate the goodwill so that the losing partners could be compensated.

Methods of Evaluating Goodwill

The following are the important methods of valuation of goodwill:

(A) Average Profits Method

Under this method, the average of the profits of last three or four years

is calculated. The average profits are 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' purchase of the last three years average profit.

Value of Goodwill = Average profit · Number of year's purchased.

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

The following points need to be considered for valuation of average profit:

1. Abnormal Profit : If in any year, a firm earns abnormal profits, then it is to be deducted from the firm's profits because it is not or usual or recurring nature. For example, profit due to rise in prices at the time of war of after Floods, etc.

2. Abnormal Loss : If in any year, a firm incurred any abnormal losses, them it is added back to the profits. These abnormal losses include loss of stock due to fire, theft or floods, etc.

3. Normal Expenses : If there are any normal expenses which are of recurring nature and are not deducted from the firm's profit, these should be deducted, such as insurance premium, etc.

(B) Super Profit Method

In this method, super profit is calculated and it is multiplied with a specific number to find out the goodwill. Super profit is the profit above the normal profit being earned by other firms engaged in the same business.

If any old firm is earning equal to the profits being earned by other new firms engaged in the same type of business, there will be no value of the goodwill of the old firm. If the old firm is earning more profits than the new firm, there will be value of the goodwill of the old firm. The greater the difference in such profits, the higher will be the value of goodwill.

For example, if the investment in the business is of Rs. 5,00,000 and the rate of profit considered appropriate in similar business is 15%, the normal profit will be Rs. 75,000 (5,00,000 ·15/100). This normal profit is compared with the actual profit earned. If the actual profit is more than the normal profit, it will be called super profit. Suppose further that the actual profit is Rs. 1,00,000, then (1,00,000 - 75,000) Rs. 25,000 is super profit.

Goodwill = Super profit · No. of years purchased.

If the super profit will be available for three years, the value of goodwill will be :

Rs. 25,000 · 3 = Rs. 75,000

Goodwill = Super profit · No. of years purchased Super Profit = Actual or Average Profit - Normal Profit Normal Profit = Capital Invested · Normal Rate of Return/100

(C) Capitalization 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. Capitalization 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:

$$\text{Normal Capital Employed} = \frac{10{,}000\ (\text{Profit}) \cdot 100}{10\ (\text{Normal rate of return})}$$

= 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. Capitalization 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 partner does not bring in the goodwill in cash but the goodwill account is raised in the books. Under this method Goodwill Account is debited and old partners' Capital Accounts are credited in their old profit-loss sharing ratio. In this case, Goodwill Account will be shown in the Balance Sheet. If Goodwill Account is written off among all partners in new ratio, it will not be shown in Balance Sheet.

Treatment of Goodwill in Account

1. When goodwill is paid by new partner to old partners outside the business: When the amount of goodwill is received by old partners privately or outside the business in case, no entry will be made in the books of firm.

2. When goodwill is brought by new partner and is withdrawn by old partners: In such a cash, the receipt of goodwill money is recorded in the books of firm and is transferred to Capital Accounts of old partners in their sacrificing ratio. The amount, thus, transferred is immediately withdrawn by old partners. The following entries are recorded in firm's books in the above case :

i) When goodwill is brought in cash

Cash Account Dr.

To Goodwill Account

(Being amount of goodwill brought in cash)

ii) Transferring Goodwill old partners in their sacrificing ratio :

Goodwill Account Dr.

To Old Partners' Capital Account

(Being amount of goodwill transferred to Capital Account)

iii) On withdrawn of goodwill by old partners :

Old Partners' Capital Account Dr.

To Cash Account

(Being goodwill withdrawn)

Alternative Method

Under this method, Cash Account is debited with the amount of goodwill and new partner's Capital Account is credited. Then new partner's Capital Account is debited and old partner's Capital Accounts are credited in the sacrificing ratio.

On bringing the goodwill in cash :

i) Cash Account Dr.

To New Partner's Capital Account

(Being brought by new partner for goodwill)

ii) On transferring the goodwill to old partner's Capital Accounts :

New Partner's Capital Account Dr.

iii) To old partners' Capital Accounts

(Being amount of goodwill distributed by old partner' in their sacrificing ratio).

Old Partners' Capital Account Dr.

To Cash Account

(Being amount of goodwill withdrawn by old partners)

Now the question arises as to the ratio in which goodwill is to be distributed among old partners when a new a new partner is admitted. Goodwill will be distributed to old partners in their sacrificing ratio. For example, X and Y are partners sharing profits and losses in the ratio of 3:2. After admission of Z as a partner, their new ratio is 2:2:1. Here, the scarifying ratio of X and Y will be calculated. The scarifying ratio will be calculated as under :

X sacrifices = 3/5 - 2/5 =1/5

Y sacrifices= 2/5 = 2/5= 0

In the above case, the amount of goodwill will be given only to X because he has sacrificed it to Z and Y will not get any amount of goodwill as he did not sacrifice any share. If new ratio is not given in the question and it is said that the new partner will be given 1/5 share, it is assumed that old partners sacrifice in their old ratio.

3. Amount of Goodwill retained in the Business : In this method the amount of goodwill is retained in the business. For this, the following entries will be made :

i) When amount of goodwill is brought in :

Cash Account Dr.

To Goodwill Account OR

To New partner's Capital Account

(Being amount of goodwill received)

ii) Amount of goodwill transferred to old partners' Capital Accounts:

New partner's Capital Account Dr.

OR

Goodwill Account Dr.

To Old Partners' Capital Account

(Being amount of goodwill transferred to old partners Accounts in sacrificing ratio)

4. Raising Goodwill Accounts : Sometimes, the amount of goodwill is not brought in cash by the new partner. Hence, goodwill account is raised with full value of firm's goodwill and capital account of old partners are credited in the old profit sharing ratio.

a) When goodwill is raised :

Goodwill Account Dr.

To Old Partners' Capital Account

(Being Goodwill Account raised in the books of the firm in old ratio)

b) When goodwill is written off :

All partners' (including new partner)

Capital Accounts Dr.

To Goodwill Account

(Being Goodwill Account transferred to all partners' Capital Account in the new profit sharing ratio)

When goodwill already appears in the books : If goodwill already appears in the books, it is transferred to old partner's Capital Accounts in their old ratio at the time of admission of a new partner. The only entry will be :

Old Partners Capital Accounts Dr.

To Goodwill Account

(Being goodwill appeared in B/S is written-off in old ratio)

After this, the entries for goodwill brought in by the new partner will be passed.

When Goodwill is not brought in Cash and Goodwill Account is raised : When new partner does not bring goodwill in cash and goodwill already appears in the Balance Sheet, goodwill will be dealt with as under :

Change in Profit Sharing

Sometimes, partners change their profit-loss sharing ratio. In such a case to treat the amount of goodwill, the following entries will be made :

1. Raising Goodwill Account : First of all, goodwill is to raised by debiting the Goodwill Account with full value and crediting all partner's capital accounts in their old ratio :

Goodwill Account Dr.

To All Partners' Capital Account

(Being Goodwill Account raised in old ratio)

2. Writing off the Goodwill Accounts : After having raised the goodwill, Goodwill Account will be written off by debiting all partners' Capital Accounts in the new ratio.

All Partners' Capital Accounts Dr.

To Goodwill Account

(For Goodwill written off in the new ratio)

Revaluation of Assets and Liabilities

Revaluation Account is prepared to revalue various assets and liabilities of the firm. When a new partner is admitted into a partnership concern, he acquires the ownership rights in the assets of the firm and is also responsible for the liabilities of the firm. It is, therefore, desirable from the point of view of the incoming partner as well as the existing partners that the assets and liabilities as appearing in the Balance Sheet on the date of admission of the new partner should be properly valued.

It is possible that some of the assets might have appreciated in value or some of the assets have been shown more than their realizable values. Hence, these assets must be shown at lower values. Some of the liabilities may not have been shown in the books, though they will be paid. Thus, if the values of assets and liabilities as shown in the books of accounts are different than their actual values, adjustments will have to be made.

For the adjustment of various assets and liabilities, a Profit and Loss Adjustment or Revaluation Account is prepared. On its debit side is shown decrease in assets, outstanding expenses and increases in liabilities, and on the credit side, increase in assets, prepaid expenses and decrease in liabilities are shown. The balance of this account is transferred to Capital Accounts of old partners in their old ratio.

Adjustment for Undistributed Profits or Losses and Reserves

i) When a new partner is admitted in the firm, reserves, undistributed profits and credit or debit balance of Profit and Loss Account are transferred to old partners' Capital Accounts in their old ratio. For this purpose, the following journal entries are passed.

Profit and Loss Account (if Profit) Dr.

General Reserve Account Dr.

To old partners' Capital Accounts

(Being profits & reserve distributed in old partners in old ratio)

ii) If the debit balance of Profit and Loss Account is shown in the Balance Sheet, then it will also be transferred to old partners' Capital Accounts in old ratio.

Old Partners' Capital Accounts Dr.

To Profit and Loss Account

Preparation of Memorandum Revaluation Account

Sometimes, the partners agree that the value of assets and liabilities are not to be altered and these are to be shown in the books at their old values. In such a case, increase or decrease in the amount of assets and liabilities will be recorded in a special account known as Memorandum Revaluation Account. No corresponding entry is made in assets and liabilities to record changes in their values. This Memorandum Account is divided into two parts:

i) In the first part, Revaluation Account is prepared in the usual way as explained earlier and profit or loss is distributed to old partners in old ratio.

ii) In the second part, all the entries which were shown in the Revaluation Account will be reversed. It means those items which were shown on the Debit side of Revaluation Account will now be placed in the credit side of Memorandum Revaluation Account, and all credit items of Revaluation Account will be shown in the Debit side of Memorandum Revaluation Account. Thus, whatever the result (profit or loss) may be, it will be distributed among all the partners (including the new partner) in new profit sharing ratio.

It is important to keep in mind that, after preparation of Memorandum Revaluation Account, the result (Profit or Loss) will be reversed as shown by Revaluation Account. If Revaluation Account show profit, the Memorandum Revaluation Account will show loss and vice-versa. Secondly, while preparing the Balance Sheet, all the fixed assets and liabilities (expect cash in hand and bank) are to be shown at original figures. But in capital accounts of partners, adjustments will be made for profit/loss of both the parts of Memorandum Revaluation Account.

RETIREMENT AND DEATH OF A PARTNER

INTRODUCTION

A new partner is admitted in the firm when such a need arises, the same way, a partner may like to retire after giving due notice. His accounts are settled upto the date on which he retires. He will have his share of profit (or loss) upto that date, a share in the old reserves and the Goodwill of the firm. A balance sheet is prepared on the day of his retirement and his capital account is completed upto the date. Either he is paid cash in full for his capital account or partly he is paid with a promise to pay the balance at a future date. In such a case his capital account is transferred to the Loan A/c and shown as a liability in the balance sheet. It may be paid in instalments afterwards.

Usually, the manner, in which a partner shall retire is mentioned in the partnership deed. When a partner retires he is entitled to his share in the following accounts:

1. The retiring partner is entitled to his share out of the past accumulated profits and reserves in his profit-sharing ratio.
2. He is also entitled to his share of profit upto the date of his retirement. Suppose the books of accounts of the firm are closed on 31st March every year and the partner is retiring on 30th June. He is entitled to his share of profit for this 3 months' period i.e., from 1st April to 30th June.
3. When a partner retires he is paid for his share of goodwill in the firm.
4. According to the terms of the Partnership Deed the value of all assets and liabilities are revalued on the retirement of a partner. For this purpose, a Revaluation Account is prepared. He is entitled to his share of profit (or loss) on the revaluation of assets and liabilities.

In the absence of any agreement to the contrary, the profit sharing ratio between the remaining partners remains unchanged after his retirement.

ACCOUNTING PROCEDURE AT THE TIME OF RETIREMENT OF A PARTNER

The following problems arise when a partner retires from the firm and remaining partners continue with the business :

1. Treatment of goodwill
2. Revaluation of assets and liabilities
3. Adjustments of accumulated reserve and losses
4. Calculating the amount due to the retiring partner and its payment.

Treatment of Goodwill

When a partner retires from the firm remaining partners are benefitted because future profit is shared only by them. For example, if A, B and C are partners and their profit sharing ratio is 2 : 2: 1. If B retires from the firm, A and C will distribute the profits in 2:1 ratio or a new ratio.

A and C will get share of B. Hence, A and C will compensate the retiring partner B in the gaining ratio. When a new partner is admitted in the firm, he pays the amount of goodwill and if a partner retires from the firm, the remaining partners compensate the retiring partner by paying for the goodwill.

Gaining ratio is the difference of new ratio and old ratio. If there is no other agreement, remaining partners will share the profits in the same ratio in which they shared earlier before the retirement of a partner. In such a situation, the gaining ratio of the remaining partners would be their old ratio.

For example, A B and C are sharing profits in the ratio 3:2:1. C retires from the firm. In this case, new ratio of A and B will be 3:2.

Illustration 1

i) A, B and C were sharing profit and loss in the ratio of 2:3:1. Calculate the new ratio and the gaining ratio when (a) A retires, (b) B retires and (c) C retires.

ii) A, B and C were partners sharing profit and loss in the ratio of 2:3:1. C retires and A and B decide to share future profit and loss in the ratio of 3:4. Calculate the gaining ratio.

iii) A, B and C were partners sharing profit and loss in the ratio of 2:3:1. C retires and his share is taken by A and B in the ratio of 2:1. Find the new ratio.

Solution

i) (a) When A retires, the new ratio of B and C will be 3:1.
This will also be their gaining ratio.
(b) When B retires, the new ratio of A and C will be 2:1. This will also be their gaining ratio.
(c) When C retires, the new ratio of A and B will be 2:3 This will also be their gaining ratio.

ii) Gaining Ratio = New Ratio —Old Ratio
Gain of A = 3/7 - 2/6 = 4/42
Gain of B = 4/7 - 3/6 = 3/42
Thus, the gaining ratio of A and B is 4/42 : 3/42 or 4:3

iii) Share got by A from C = 1/6 × 2/3 = 2/18
Share got by B from C = 1/6 × 1/3 = 1/18
New ratio of A = 2/6 + 2/18 = 8/18 New
ratio of B = 3/6 + 1/18 = 10/18
Hence, new ratio of A and B = 8/18 : 10/18 or 8 : 10 or 4 : 5

Adjustment of Goodwill

Having understood the gaining ratio of new partners, let us discuss how the goodwill will be adjusted in accounts. The following are the methods of treating goodwill in books in case of retirement:

1. **When Goodwill account is raised with full value**

Under this method, Goodwill Account is debited with full value of Goodwill and the partners' Capital Accounts, including retiring partner's Capital Account are credited in the old ratio. Goodwill will be show in the Balance Sheet at full value.

2. **When goodwill account is raised with full value and written off by remaining partners**

Under this method, first of all Goodwill Account is debited with full value and all partners (including retiring partner) Capital Accounts are credited in the old ratio. Secondly, remaining partners' Capital Accounts are debited in new ratio and Goodwill Account is credited. Hence, the Goodwill Account is closed. It will be shown in Balance Sheet.

3. **When goodwill is raised only with the share of the retiring partner and then written off by remaining partners**

In this case, firstly Goodwill Account is debited and retiring partner's Capital Account is credited with his share of goodwill. Secondly, Capital Accounts of remaining partners are debited in their gaining ratio and Goodwill Account is credited. Hence, Goodwill Account will be closed.

4. **When retiring partner's share of Goodwill is to be adjusted in the Capital Accounts of remaining partners without raising Goodwill Account**

In this case, the retiring partner's share of goodwill is calculated and debited to continuing partners Capital Accounts in their gaining ratio with corresponding credit being given to retiring partner's Capital Account.

Note : From the above explanation, it is clear that when we deal with the total value of goodwill (Opening Goodwill Account or Closing Goodwill Account), we should use either the old ratio or the new ratio. If we adjust the share of goodwill of the retiring partner only we should use only the gaining ratio.

Illustration 2

A, B and C are partners sharing profits and losses in the ratio of 4:3:2. B retires and on retirement the goodwill of the firm is valued at Rs. 43,200, No goodwill appears in the books. A and C agree to share future profits in the ratio of 5:3. Find the gaining ratio and pass the journal entries for goodwill in each of above cases.

Solution

Old ratio between A, B and C = 4:3:2

New Ratio between A and C = 5:3

Gaining ratio = New ratio — old ratio

A = 5/8 - 4/9 = (45 - 32)/72 = 13/72

C = 3/8 - 2/9 = (27 - 16)/72 = 11/72

Hence, A and C will compensate B in the ratio of 13 : 11

(a) When the full value of goodwill is raised in the books :

		Rs.	Rs.
Goodwill A/c	Dr.	43,200	
To A's Capital A/c			19,200
To B's Capital A/c			14,400
To C's Capital A/c			9,600
(Goodwill raised and credited to partners capital accounts in old ratio)			

Note : Goodwill will appear in the Balance Sheet as an asset until it is written off.

(b) When the full value of goodwill is raised in the books and written off :

	Rs.	Rs.

Goodwill A/c	Dr.	43,200	
To A's Capital A/c			19,200
To B's Capital A/c			14,400
To C's Capital A/c			9,600
(Being the Goodwill credited to all partners in old ratio)			
A's Capital A/c	Dr.	27,000	
C's Capital A/c	Dr.	16,200	
To Goodwill A/c			43,200
(Being the Goodwill written off in the new ratio)			

(c) When the retiring partner's share of goodwill is raised and written off :

		Rs.	Rs.
Goodwill A/c	Dr.	14,400	
To B's Capital A/c			14,400
(Being B's share of Goodwill)			
A's Capital A/c	Dr.	7,800	
C's Capital A/c	Dr.	6,600	
To Goodwill A/c			14,400
(Goodwill written off in the gaining ratio of 13:11)			

(d) When the goodwill is adjusted in Capital Account without opening a Goodwill Account :

		Rs.	Rs.
A's Capital A/c	Dr.	7,800	
C's Capital A/c	Dr.	6,600	
To B's Capital A/c			14,400
(Being due to B adjusted between A and C in their gaining ratio)			

Note : In all the above cases, B gets a credit for Rs.14,400 being his share of goodwill of the firm which comes from A and C in their gaining ratio of 13:11.

When goodwill already exists in the books at the time of retirement, the need for its revaluation arises to find out increase or decrease in its value. If the value has increased, Goodwill Account will be debited and Capital Accounts of all partners will be credited in their old ratio with the amount of increase. On decrease in its value, a reverse entry will be made.

Revaluation of Assets and Liabilities

Revaluation of assets and liabilities is also required at the time of retirement of a partner in the same way as it is done in case of admission of a partner. The profit or loss which results from revaluation will be transferred to all partners' Capital Accounts in their old profit sharing ratio. For this purpose, a "Revaluation Account" or "Profit and Loss Adjustment Account" is prepared. If the remaining partners wish to show assets and liabilities at their old values Memorandum Revaluation Account will be prepared.

Adjustment of Accumulated Reserves and Losses

At the time of retirement, if general reserve, credit balance of Profit and Loss Account or other undistributed profits are given in the Balance Sheet, they are credited in the old partners' Capital Accounts in old profit sharing ratio. For this, the following journal entry is made:

Reserve or Profit and Loss A/c Dr.
To Partners' Capital A/c
(Old ratio)

If the partners want that only retiring partner's Capital Account be credited with his share in undistributed profits, then the following entry will be made.

Reserves or Profit and Loss A/c Dr.
To Retiring Partner's Capital A/c

(With the share of retiring partner)

Remaining undistributed profits will be shown in the Balance Sheet after retirement.

If the remaining partners want that, without changing the amount of reserves or profit, share be given to retiring partner, the following entry will be made :

Continuing Partner's Capital A/c Dr.
(In their gaining ratio)
To Retiring Partner's Capital A/c

Calculating the amount due to the retiring partner and its payment

The retiring partner's Capital Account is credited with his share of capital, share of goodwill, share of profit on account of revaluation and undistributed profits and reserves of last years. This account will be debited with his drawings, share in revaluation loss and other losses. If payment is no made to the retiring partner, the amount due is transferred to his loan account. According to Section 37 of Partnership Act, the retiring partner can have either interest @ 6% per annum on this amount due or the profit earned by remaining partners with the help of this amount from the date of retirement. For this, the journal entry will be :

Retiring Partner's Capital A/c Dr.
To Retiring Partner's Loan A/c

If remaining partners bring cash to pay off the retiring partner then, journal entry will be :

Bank A/c Dr.
To Continuing Partner's Capital A/c
(For cash brought in by partners in the
agreed ratio to pay off the retiring partner)

Payment in Instalments

Capital Account of the retiring partner is settled as per agreement. It may be settled in two ways :

1) Payment in instalments with interest
2) Payment in a fixed number of instalments of equal amount (including interest).

Amount of instalment can be calculated with the help of Annuity Table.

Note : In the absence of any information, balance of retiring partner's Capital Account will be transferred to his Loan Account.

Illustration 3

A, B and C were carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1, respectively. On 31st December, 1985, the Balance Sheet of the firm stood as follows :

Liabilities	**Rs.**	**Assets**	**Rs.**
Sundry Creditors	13,590	Cash	5,900
Capital Accounts :		Debtors	8,000
A : 15,000		Stock	11,690
B : 10,000		Building	23,000
C : 10,000	35,000		
	48,590		**48,590**

B retires on the above mentioned date on the following terms :

(i) Building be appreciated by Rs. 7,000.

(ii) Provision for bad debts be made @ 5% on Debtors.

(iii) Goodwill of the firm be valued at Rs. 9,000 and adjustment in respect be made without raising a Goodwill Account.

(iv) Rs. 5,000 be paid to B immediately and the balance due to him be treated as loan carrying interest @ 6% per annum. Such loan is to be paid in three equal annual instalments together with interest.

Pass the journal entries to record the above mentioned transactions and show the Balance Sheet of the firm as it would appear immediately after B's retirement. Prepare B's Loan Account till it is finally closed.

Solution

Journal

Particulars		Dr. Rs.	Cr. Rs.
Building A/c	Dr.	7,000	
To Revaluation A/c			7,000
(Being appreciation in the value of Building)			
Revaluation A/c	Dr.	400	
To Provision for Bad Debts			400
(Being provision for bad debts created on debtors)			
Revaluation A/c	Dr.	6,600	
To A's Capital A/c			3,300
To B's Capital A/c			2,200
To C's Capital A/c			1,100
(Being profit on revaluation credited to old partners)			
A's Capital A/c	Dr.	2,250	
C's Capital A/c	Dr.	750	
To B's Capital A/c			3,000
(Being B's share of goodwill adjusted in gaining ratio of 3:1 in A and C)			
B's Capital A/c	Dr.	5,000	
To Bank A/c			5,000
(Being the amount paid to B on retirement)			
B's Capital A/c	Dr.	10,200	

To B's Loan A/c (Balance of amount due to B transferred to his loan account)		10,200

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		1986	
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 :		
Goodwill	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			

Death of a Partner: Accounting Entries

Death of a partner dissolves the partnership and the rights of the representatives of the deceased partner would depend on the provisions of the partnership deed. Usually, the surviving partners carry on the business, purchasing the share of the deceased partner after determining the among due to him and then treating it as a loan to the firm. There are no special problems in death except that death may occur at any time of the year; this would mean that the executors of the deceased partner would be entitled to the decreased partner's share of profits arising after the last closing up of accounts to the date of accounts death.

The partnership deed usually states how this share is to be determined. In the absence of any agreement or decision by arbitration, accounts will have to be prepared as on the date of death and the profit or loss ascertained. Apart from this additional point regarding the deceased partner's share of profits up the date of his death, the treatment in accounts is not different from that in case of retirement. After ascertaining the amount due to the deceased partner, the balance in his capital account should be transferred to an account opened in the name of his executors.

It should be noted that under section 37 of the Partnership Act, the executors would be entitled, at their choice, to interest at 6% p.a. on the amount due from the date of death to the date of payment or to that portion of profit which is earned by the firm with the help of the amount due to the deceased partner. This also applies to a retiring partner.

Illustration 1:

A, B and C are partners sharing profits and losses in the ratio of 2: 1: 1 respectively. On 31st March, 2012, their balance sheet was as follows:

Liabilities	₹	*Assets*	₹
A's capital	85,000	Freehold property	1,35,000
B's capital	90,000	Furniture	44,500
C's capital	70,000	Joint life policy	20,000
Creditors	45,000	Stock	61,000
Bills Payable	15,000	Debtors	34,500
		Cash at bank	10,000
	3,05,000		3,05,000

A died on 1st April, 2012. The firm had taken a joint life policy for Rs 1, 20,000, the payment for which was received by the firm. According to the partnership deed, on retirement or death of a partner, the goodwill of the firm was to be valued at 1½ times of the average profit for the last four years. The profits for the last four years were Rs 64,000, Rs 69,000, Rs 72,000 and Rs 75,000 respectively. For paying the amount due to A's legal representative, B and C brought as much cash as would bring their capitals in profit sharing ratio and the firm would have a cash balance of Rs 3,000 Pass journal entries to record the above mentioned transactions and prepare partners' capital accounts.

Solution :

Journal

			Dr. ₹	Cr. ₹
B's Capital Account	... Dr.		26,250	
C's Capital Account	... Dr.		26,250	
To *A*'s Capital Account				52,500
Deceased partner's share of goodwill credited to his capital account, debit being given to the remaining partners in the ratio of gain.				
Bank	... Dr.		1,20,000	
To Joint-Life Policy Account				1,20,000
Receipt of amount of joint life policy.				
Joint Life Policy Account	... Dr.		1,00,000	
To *A*'s Capital Account				50,000
To *B*'s Capital Account				25,000
To *C*'s Capital Account				25,000
Transfer of profit on joint life policy to capital accounts of all the partners				

Bank	... Dr.	77,500	
To B's Capital Account			28,750
To C's Capital Account			48,750
Cash brought in by *B* and *C* to make their capitals in profit sharing ratio enabling the firm to pay off the amount due to *A*'s legal representatives, leaving a cash balance of ₹ 20,000			
A's Capital Account	... Dr.	1,87,500	
To Bank			1,87,500
Payment made to legal representatives of *A*, the deceased partner			

Capital Accounts

Dr. *Cr.*

	A ₹	B ₹	C ₹		A ₹	B ₹	C ₹
T *A*'s Capital A/c		26,250	26,250	By Balance b/fd	85,000	90,000	70,000
To Bank	1,87,500			By B's Capital A/c	26,250		
To Balance c/d		1,17,500	1,17,500	By C's Capital A/c	26,250		
				By Joint Life Policy	50,000	25,000	25,000
				By Bank		28,750	48,750
	1,87,500	1,43,750	1,43,750		1,87,500	1,43,750	1,43,750
				By Balance b/d		1,17,500	1,17,500

Working Notes :

Calculation of value of goodwill :

Total profits for the last four years = ₹ (64,000 + 69,000 + 72,000 + 75,000) = ₹ 2,80,000

Average profit = ₹ $\frac{2,80,000}{4}$ = ₹ 70,000

Goodwill at $1\frac{1}{2}$ times of the average profit = ₹ $70,000 \times \frac{3}{2}$ = ₹ 1,05,000

A's share of goodwill = ₹ $1,05,000 \times \frac{2}{4}$ = ₹ 52,500

B and *C* will bear the amount in the ratio of gain *i.e.* 1 : 1

Hence, each will be debited will with ₹ $\frac{52,500}{2}$ = ₹ 26,250

Calculation of amount to be brought in by B and C :

	₹
Cash at bank at the time of death	10,000
Add : Amount of joint life policy received	1,20,000
	1,30,000
Amount to be paid to *A*'s legal representatives	1,87,500
Add : Cash balance required	20,000
	2,07,500
Amount to be brought in by *B* and *C* = ₹ 2,07,500 – ₹ 1,30,000	77,500
Add : *B*'s Capital	88,750
Add : *C*'s Capital	68,750
	2,35,000

As *B* and *C* are equal partners, each one's capital account must show a balance of ₹ 1,17,500

Hence, *B* will bring ₹ 1,17,500 – ₹ 88,750 = ₹ 28,750

and *C* will bring ₹ 1,17,500 – ₹ 68,750 = ₹ 48,750

Illustration 2:

R. J and D carried on a business sharing profits in the ratio of 7: 5: 4 respectively.

The balance sheet of the firm on 31st March, 2012 was as follows:

Liabilities		₹	*Assets*	₹
Bills Payable		123,500	Cash in hand and at Bank	58,300
Creditors		1,54,500	Bills Receivable	1,09,500
Loans		1,42,000	Stock in trade	4,94,700
Capitals:—	₹		Debtors	1,62,500
R	5,27,500		Furniture	1,21,000
J	4,52,500		Plant and Machinery	2,68,000
D	3,20,000	13,00,000	Leasehold Building	5,06,000
		17,20,000		17,20,000

Profit for the year ended 31st March, 2012 amounted Rs 2, 40,000. D died on 30th June, 2012, the partnership deed provides that (1) the opening assets and liabilities are to be revalued by an independent person; (2) goodwill is to be calculated on the basis of three years' purchases of five years' average profits and deceased partner's capital account is to be credited with his share of goodwill; and (3) the share of the deceased partner in the profits of the year up to the date of his death is to be calculated on the basis of the previous year's profits.

Profits for the previous years were:

	₹		₹
2007-2008	2,96,000	2009-2010	2,87,000
2008-2009	2,89,000	2010-2011	2,68,000

Revaluation of assets and liabilities resulted in the following:

Stock in trade at Rs 4,00,000; debtors at Rs 1,60,000; furniture at Rs 1,16,000; plant and machinery at Rs 1,79,000 and leasehold building at Rs 5,70,000 A liability for bills discounted for Rs 12,800 is expected to arise. It was agreed between the executors of D and the remaining partners that this revaluation should have no effect on the previous year's profits. The executors accepted Rs 27,000 immediately, the balance to be repaid by four half yearly installments together with interest at 10% on the amount outstanding. Show D's Executors Account until it is paid off.

Working Notes:

(*i*)

Dr. **Revaluation Account** Cr.

		₹				₹
	To Stock	94,700		By Leasehold Building		6,4000
	To Provision for Bad Debts	2,500		By Loss on revaluation transferred :	₹	
	To Furniture	5,000		*R* 7/16	61,250	
	To Plant and Machinery	89,000		*J* 5/16	43,750	
	To Liability for Bills Discounted	12,800		*D* 4/16	35,000	1,40,000
		2,04,000				2,04,000

(*ii*) D's share of profits up to 30th June, 2012 (for three months) on the basis of profits for the year ended 31st March, 2012 = ₹ 2,40,000 = $\frac{3}{12} \times \frac{4}{16}$ = ₹ 15,000

(*iii*) Calculation of *D*'s share of goodwill:

Average profits for the last 5 years = ₹ $\frac{2,96,000 + 2,89,000 + 2,87,000 + 2,40,000}{5}$

$$= ₹\ \frac{13,80,000}{5} = ₹\ 2,76,000$$

Goodwill at 3 years' purchase = ₹ 2,76,000 × 3 = ₹ 8,28,000

D's share of goodwill = ₹ 8,28,000 × $\frac{4}{16}$ = ₹ 2,07,000

The amount to be borne by *R* = ₹ 2,07,000 × $\frac{7}{12}$ = ₹ 1,20,750

The amount to be borne by *J* = ₹ 2,07,000 × $\frac{5}{12}$ = ₹ 86,250

(*iv*) **D's Capital Account**

Date	Particulars	₹	Date	Particulars	₹
2012 June 30	To Revaluation A/c	35,000	2012 Apr. 1	By Balance b/fd	3,20,000
	To *D*'s Executors A/c —transfer	5,07,000	June 30	By Profit & Loss Suspense A/c (Profit for 3 months)	15,000
				By *R*'s Capital A/c	1,20,750
				By *J*'s Capital A/c	86,250
		5,42,000			5,42,000

(*v*) Half-yearly instalment = ₹ $\frac{5,07,000-27,000}{4}$ = ₹ 1,20,000

Dr. **D's Executors Account** *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2012 June 30	To Bank	27,000	2012 June 30	By *D*'s Capital Account	5,07,000
Dec. 31	To Bank (₹ 1,20,000 + ₹ 24,000)	1,44,000	Dec. 31	By Interest—10% on ₹ 4,80,000 for 6 months	24,000
2013 Mar. 31	To Balance *c/d*	360,000			
		5,31,000			5,31,000
2013 June 30	To Bank (₹ 1,20,000 + ₹ 18,000)	1,38,000	2013 Apr. 1	By Balance *b/d*	36,000
Dec. 31	To Bank (₹ 1,20,000 + ₹ 18,000)	1,32,000	June 30	By Interest—10% on ₹ 3,60,000 for 6 months	18,000
2014 Mar. 31	To Balance *c/d*	1,20,000	Dec. 31	By Interest—10% on ₹ 2,40,000 for 6 months	12,000
		3,90,000			3,90,000
2014 June 30	To Bank	1,26,000	2014 Apr. 1	By Balance *b/d*	1,20,000
			June 30	By Interest—10% on ₹ 1,20,000 for 6 months	6,000
		1,26,000			1,26,000

Sometimes, the surviving partners may not agree to take over all the assets but may, instead, realize the assets slowly and they pay to the executors of the deceased partner whatever is due to them. This would involve making a profit or loss adjustment account annually (or half yearly) by the surviving partners.

Illustration 3:

A and B entered into partnership on 1st April, 2010 sharing profits and losses equally. On 31st March, 2011 A died.

The various accounts on that date were as follows:

	₹		₹
A's Drawings	89,380	*A's* Capital	75,000
B's Drawings	34,720	*B's* Capital	75,000
Stock	87,500	Sundry Creditors	40,580
Plant	37,500	Profit and Loss Account	2,21,100
Furniture	12,500		
Cash at Bank	5,660		
Mortgages	25,000		
Bills Receivable	20,000		
Accounts Receivable	99,420		
	4,11,680		4,11,680

The surviving partner took over stock, plant and furniture at the values stated, continued the business under his own name, acting as agent of the firm in realizing the remaining assets. On 1st April, 2012 he reported to his late partner's executors that he had collected Rs 65,000 of the accounts receivable, Rs 12,500 of the bills receivable and had received Rs 930 as interest on mortgage.

His expenses had been Rs 12,500 for salaries, Rs 2,750 for lawyer's charges and Rs 500 for sundry expenses. He had made allowance to customers amounting to Rs 3,400 and had discharged the whole of the liabilities to sundry creditors by payments amounting to Rs 38,530. The statement rendered by B was accompanied by a cheque for Rs 30,000, dated 31st March, 2012. Make the necessary accounts. Also show the balance sheet on March 31, 2012.

Solution:

Dr. **A's Capital Account** *Cr*

		₹			₹
2011			2011		
Mar. 31	To Drawings	89,380	Mar. 31	By Balance *b/d*	75,000
" "	To *A's* Executors Account —transfer	96,170	" "	By P. & L. Account	1,10,550
		1,85,550			1,85,550

A's Executors Account

		₹			₹
2011			2011		
Mar. 31	To Balance *c/d*	9,6170	Mar. 31	By *B's* Capital Account	96,170
2012			2011		
Mar. 31	To Profit & Loss Adjustment A/c (loss)	2,460	Apr. 1	By Balance *b/d*	96,170
" "	To Bank	30,000			
" "	To Balance *c/d*	63,710			
		96,170			96,170
			2012		
			Apr. 1	By Balance *b/d*	63,710

B's Capital Account

		₹			₹
2011			2011		
Mar. 31	To Drawings	34,720	Mar. 31	By Balance *b/d*	75,000
" "	To Stock	87,500	" "	By P & L. Account	1,10,550
" "	To Plant	37,500			
" "	To Furniture	12,500			
" "	To Balance *c/d*	13,330			

		₹			₹
		1,85,550			1,85,550
2011 Mar. 31	To Profit & Loss Adjustment A/c (loss)	2,460	2011 Apr. 1	By Balance b/d	13,330
" "	To Balance c/d	10,870			
		13,330			13,330
			2012 Apr. 1	By Balance b/d	10,870

Dr. Cash Book (or Bank Account) Cr.

			₹			₹		₹
2012 Apr. 1	To Balance b/d		5,600	Apr. 1, 11 to Mar. 31, 2012	By Expenses paid:			
Apr. 1, 11 to Mar. 31, 2012	To Accounts Receivable		65,000		Salaries	1250		
	To Bills Receivable		12,500		Lawyer's Charges	2,750		
	To Interest on Mortgage		930		Sundries	500		4,500
				2012 Mar. 31	By Sundry Creditors			38,530
					By A's Executors A/c			30,000
				" "	By Balance c/d			11,060
			84,090					84,090
2012 Apr. 1	To Balance b/d		11,060					

Dr. Accounts Receivable Account Cr.

			₹				₹
2011 Apr. 1	To Balance b/d		99,420	Apr. 1, 11 to Mar. 31, 2012	By Bank		65,000
					By Discount allowed		3,400
				2012 Mar. 31	By Balance c/d.		31,020
			99,420				99,420
2012 Apr. 1	To Balance b/d.		31,020				

Dr. Bills Receivable Account Cr.

			₹				₹
2011 Apr. 1	To Balance b/d.		2,000	Apr. 1. 11 to Mar. 31, 2012	By Bank		12,500
				2012 Mar. 31	By Balance c/d		7,500
			20,000				20,000
2012 Apr. 1	To Balance b/d		7,500				

Dr. Mortgages Account Cr.

			₹				₹
2011 Apr. 1	To Balance b/d		25,000	2012 Mar. 31	By Balance c/d		25,000
2012 Apr. 1	To Balance b/d.		25,000				

Dr. **Sundry Creditors Account** Cr.

			₹				₹
Apr. 1 2011 to Mar. 31, 2012	To Bank		38,530	2012 Apr. 1	By Balance b/d		40,580
	To Discount (balancing figure)		2,050				
			40,580				40,580

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

		₹	₹			₹	₹
2012 Mar. 31	To Expenses Paid:			2012 Mar. 31	By Interest on Mortgage		930
	Salaries	1,250			By Discounts received		2,050
	Lawyer's Charges	2,750			By Loss transferred to:		
	Sundries	500	4,500		*A*'s Executors	2,460	
	To Discounts Allowed		3,400		*B*'s Capital	2,460	4,920
			7,900				7,900

Balance Sheet as on March 31, 2012

Liabilities	₹	*Assets*	₹
A's Executors	63,710	Cash (or Bank)	11,060
B's Capital	10,870	Mortgages	25,000
		Accounts Receivable	31,020
		Bills Receivable	7,500
	74,580		74,580

Illustration 4:

On 1st April, 2011 the capitals of the partners of the firm, M/s. Singh, Khan & Sharma were as follows:

	₹
Singh	60,000
Khan	40,000
Sharma	20,000

The partners were sharing profits and losses in the ratio of 4: 3: 2 after allowing interest on capitals at 9% p.a. Sharma died on 1st October, 2011. For the purpose of settlement of account, goodwill of the firm was raised to the extent of Rs 45,000. Sharma's Executors agreed to wait till the finalization of the year's accounts for determining his share of profits. The profits were ascertained to be Rs 36,000 (subject to interest) accruing evenly over the year.

The partners' drawings were:

	Up to 1st Oct., 2011 ₹	After 1st Oct., 2011 ₹
Singh	4,300	6,000
Khan	3,000	6,500
Sharma	2,700	—

Singh & Khan agreed to share profits & losses in future in the ratio of 5 : 4 respectively (interest on capitals remaining at 9% p.a.) and decided not to have goodwill account in the books.

Show the distribution of profit for the year ended 31st March, 2012 and the accounts of the partners and Sharma's Executors for the year.

Solution:

Profit and Loss Appropriation Account

Particulars	Up to 1st Oct., 2011 ₹	After 1st Oct., 2011 ₹	Particulars	Up to 1st Oct., 2011 ₹	After 1st Oct., 2011 ₹
To Sharma's Executors	—	3,225	By Net Profit	18,000	18,000
To Interest on Capital:					
Singh	2,700	2,655			
Khan	1,800	1,710			
Sharma	900	—			
To Profit transferred to:					
Singh	5,600	5,783			
Khan	4,200	4,627			
Sharma	2,800	—			
	18,000	18,000		18,000	18,000

Sharma's Executors Account

Date	Particulars	₹	Date	Particulars	₹
2012 Mar. 31	To Balance c/d	34,225	2011 Oct. 1	By Sharma's Capital A/c	31,000
			2012 Mar. 31	By Profit & Loss A/c	3,325
		34,225			34,225
			2012 Apr. 1	By Balance b/d	34,225

Note:

(1) Interest on capitals for the period after 1st October, 2011 has been calculated at 9% for six months on the balance in capitals of Singh and Khan after debit in respect of the writing off of goodwill.

(2) The amount due to Sharma's executors has been calculated according to Section 37 of the Partnership Act whereby the executors are entitled, at their option, to interest at 6% p.a. or to that part of profits which has been earned with the help of amount due to Sharma on his death.

The calculation is as under:

	₹
Capitals on 1st October, 2011—	
Singh	84,000
Khan	58,000
Amount due to Sharma	31,000
Total	1,73,000
Profit earned	18,000

The portion that can be said to have been earned by use of amount due to Sharma —

₹ $\frac{18,000}{1,73,000} \times 31,000$ or ₹ 3,225 which is more than interest @ 6% p.a. on ₹ 31,000

POSSIBLE QUESTIONS
PART A
Online Examination
PART B (2 MARKS)

1. What is partnership?
2. What is partnership deed?
3. What do you mean by retirement of a partner?
4. What is mean by admission of a partner?
5. What is the difference between gaining ratio and sacrificing ratio?

PART C (8 MARKS)

1. P, Q and R are in the partnership and on 1st January, 1995 their respective capitals were Rs. 20,000, Rs, 12,000 and Rs, 10,000. Q is entitled to a salary of Rs. 2,500 and R Rs. 2,000 per annum, payable before division of profits. Interest is allowed on capital @ 5% per annum but is not charged on drawings. Of the net divisible profits of first Rs. 10,000; P is entitled to 40%, Q to 35% and R to 25% and over that amount profits are shared equally. The profit for the year ended 31st December, 1995 after debiting partnership salaries, but before charging interest on capitals, was Rs. 18,000 and partners had withdrawn Rs. 800 each. Prepare partners' accounts for the year.
2. Ravi, Shanker and Sastry are partners sharing profits and losses as 6:5:4. They have a Joint Life Policy for Rs. 2,00,000 on which they pay Rs. 7,500 per annum as premium and debit the same to Profit and Loss Account as premium. Accounts are closed annually on 31 December.
    a. Shanker died on 1st April, 1995 and his legal representatives are entitled to :
        i. His capital as appearing in the last Balance Sheet.
        ii. Interest on capital at 6 per cent per annum to the date of death.
    b. His share of profit calculated till date of his death on the basis of the previous years profit; and
    c. His share of goodwill calculated as two years purchase on the average of the last

three years' profit before inclusion of the policy premium as business expense.

d. Shanker's drawing in 1995 amounted to Rs. 3000. His capital shown in 1994 Balance Sheet was Rs. 80000. The profit for the three years 1992, 1993 and 1994 after inclusion of the policy premium as business expense amounted to Rs. 65000, Rs. 64000 and Rs. 69000 respectively.

e. Prepare Shanker's Capital Account

3. Explain goodwill and describe various methods of valuing goodwill.

4. Explain the treatment of goodwill in case of admission of a new partner with journal entries.

5. What is Revaluation Account? How is it prepared? How is it different from Memorandum Revaluation Account?

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DEPARTMENT OF COMMERCE
I B.COM PA - Higher Financial Accounting (17PAU201)
Unit - IV (PARTNERSHIP ACCOUNT)

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
1	At the time of admission of a partner, goodwill brought in cash by the new partner is shared by the old partners in their ______________	Sacrificing ratio	Gaining ratio	Old ratio	New ratio	Sacrificing ratio
2	At the time of admission of a partner, goodwill brought in cash by the new partner is shared by the old partners in their sacrificing ratio, the method is known as _________	Goodwill method	Premium method	Revaluation method	Average method	Premium method
3	On the admission of a partner if goodwill account is raised, this should be debited to ______________	Partner account	New partner account.	Goodwill account.	Old partner account.	Goodwill account.
4	On the admission of a new partner the balance of the P & L adjustment account should be transferred to the capital account of old partners in their __________	New profit sharing ratio.	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
5	On the admission of a new partner the decrease in value of asset is debited to ______________	Capital account	Balance sheet.	Revaluation account	P & L account	Revaluation account
6	The difference between total assets minus liabilities is _____	Net assets	Gross assets	Net liabilities	Gross liabilities	Net assets
7	Revaluation account is also known as ____________	Trading account	P & L account	P & L Appropriation account	Balance sheet	P & L Appropriation account
8	Profit or loss from revaluation account will be transferred to the partners _______________	Personal account	Current account	P & L account	Capital account	Capital account
9	Profit or loss from revaluation account will be transferred to the partners capital account in their _____________	New profit sharing ratio	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
10	At the time of admission of a new partner undistributed profits is credited to the old Partners _____________-	Personal account	Current account	P & L account	Capital account	Capital account

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
11	At the time of admission of a new partner undistributed profits is credited to the old partners capital account in ____________	New profit sharing ratio	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
12	At the time of admission of a new partner undistributed losses should be distributed to the old partners ____________	Personal account	Current account	P & L account	Capital account	Capital account
13	At the time of admission of a new partner undistributed losses should be distributed to the old partners capital account in __________________	New profit sharing ratio	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
14	In the absence of an agreement, profit and losses are shared by partners _____________	Equally	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Equally
15	In the absence of an agreement, interest on capital is ___________	Allowed	Not allowed	Allowed after one year	Allowed after two year	Not allowed
16	Current account of the partners should be opened when the capital are _____________	Fixed	Fluctuating	Variable	Equal	Fixed
17	Revaluation account is a ___________	Personal account	Real account	Nominal account	Duplicate account	Nominal account
18	Goodwill is an --------------.	Liability	Capital	Nominal account	Intangible account	Intangible account
19	On the admission of a partner, the goodwill is raised at full value, it should be debited to ____________	Goodwill account	Current account.	P & L account	Capital account	Goodwill account
20	In the case of retirement of a partner, goodwill at its full value is credited to the account of ___________	New partner	Old partner	All partners	Working partner	All partners
21	Gaining ratio is calculated at the time of _________	Admission of a partner	Death of a partner	Insolvency of a partner	Leave of a partner	Death of a partner
22	The difference between new profit ratio and old profit ratio is ______________	New profit sharing ratio.	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Sacrificing ratio
23	In case of death of a partner, all accumulated profits are distributed among all partners in the _____________	New profit sharing ratio.	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
24	In case of death of a partner, all accumulated losses are distributed among all partners in the____________	New profit sharing ratio.	Old profit sharing ratio	Sacrificing ratio	Gaining ratio	Old profit sharing ratio
25	How is the premium paid on the Joint Life Policy of partners treated? It is to the accounts	Debited, Partners capital	Credited, Partners current	Debited, P&L	Credited, P&L	Debited, P&L
26	Creditors ledger is also called ___	Sales ledger	General ledger	Purchase ledger	Debtor ledger	Purchase ledger
27	____ are undistributed profits	Reserves	Provisions	Depreciation	Appreciation	Reserves
28	In the absence of an agreement, profits and losses are divided ____________	In the ratio of capitals, devoted by each partner	In the ratio of time	Equally	In the ratio of drawings	In the ratio of time
29	Current accounts for partners should be opened when__________	Capitals are fixed	Capitals are fluctuating	When capitals are either fixed or fluctuating	When capitals are neither fixed nor fluctuating	Capitals are fixed
30	To which account would the interest on the capital accounts of the partners be credited?	Profit & Loss A/c	Partners capital A/c	Partners current A/c	Interest A/c	Partners capital A/c
31	When A and B sharing Profit and Losses in the ratio of 3:2, admit C as a partner giving him 1/5 share of profit. This will be given by A and B __________	Equally	In the ratio of their profits	In the ratio of their capitals	In the ratio of their drawings	In the ratio of their profits
32	When a new partner gives cash for goodwill, the amount is credited to____________	Goodwill account.	Capital account of the new partner	Cash account	Saving account	Cash account
33	A, B and C are equal partners. If A and B die together in a bus accident, this would result in the dissolution____________	Of the firm	Of the partnership	Of both the partnership and the firm	Of neither the partnership nor the firm	Of both the partnership and the firm
34	General Reserve at the time of admission of a new partner is transferred to ______________.	Profit and Loss Adjustment A/c	Partners Capital Accounts	Neither of the two	Balance Sheet	Partners Capital Accounts
35	If the goodwill account is raised for Rs.10,000, the amount is debited to ______________	The capital accounts of partners.	Goodwill account	Cash account	Balance Sheet	Balance Sheet
36	In case of admission of a partner the profit or loss on revaluation of assets and liabilities is shared by partners ______________	New	Old	Active	Sleeping	Old

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
37	Goodwill is withdrawn by the partner account is credited _____________	Cash/Bank	Revaluation	Profit and Loss	Creditors	Cash/Bank
38	A partner who takes active part in the firms business is known as partner _____________	New	Active	Old	Chief	Active
39	Debit balance of current account of a partner will appear on the side of the Balance Sheet	Liabilities	Debit	Assets	Upper	Assets
40	Upon the dissolution of a firm, the profit or loss is shared by the partners_______________	In the profit sharing ratio	In the ratio of capital balance	Equally	Ratio	In the profit sharing ratio
41	Realization account is a account _______________	Personal.	Nominal	Real	Fictitious	Nominal
42	Reserves are debited to ____	Profit and loss account	Profit and Loss Appropriation account	Balance sheet	Asset	Profit and Loss Appropriation account
43	Whenever a new partner is admitted the Profit Sharing Ratio will change and the changed ratio will be known as________	p/v ratio	New ratio	Old ratio	Sacrificing ratio	New ratio
44	The ratio in which the old partners have agreed to sacrifice their charges in profit in favour of new partner is called the ____________	New ratio	Old ratio	Sacrificing ratio	p/v ratio	Sacrificing ratio
45	In the event of dissolution of partnership firm, the Provision for Doubtful Debts is transferred to___________	Sundry debtors A/c	Realization A/c	Revaluation A/c	Partners Capital A/c	Realization A/c
46	Unrecorded liability when paid on dissolution of a firm is debited to ________________	Realization A/c	Liability A/c	Partners Capital A/c	Revaluation A/c	Realization A/c
47	In the event of dissolution of a firm, the partners personal assets are first used for payment of ____________	Personal liabilities	Firms liability	Creditors	Real account	Personal liabilities
48	In the absence of any contract, to the contrary, on dissolution of the partnership firm the capital profit is credited to the partners _____________	In capital ratio.	In profit sharing ratio	Equally	Not equal	In profit sharing ratio
49	The sacrificing ratio is used at the time of ____________	Death of a partner	Admission of a partner	Retirement of a partner	Dissolution of a firm	Admission of a partner

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
50	General reserve at the time of admission of a partner is transferred to____________	Revaluation a/c	Partners capital a/c	Profit and loss a/c	Creditors a/c	Partners capital a/c
51	All accumulated losses are transferred to the capital a/c partners in the ____________	New profit sharing ratio.	Old profit sharing ratio	Capital ratio	Profit ratio	Old profit sharing ratio
52	All such assets which have not been taken over by the new firm at the time of amalgamation will be transferred to ___________	Capital a/c of partners	Revaluation a/c	New firms a/c	Partners a/c	Capital a/c of partners
53	The balance in the revaluation a/c is transferred to capital a/c of the partners in the ____________	Profit sharing ratio	Capital ratio	Equally	Not equal	Profit sharing ratio
54	Partners salaries to be debited to __________	Trading account.	Profit and loss account	Profit and loss appropriation account	Partners account	Profit and loss appropriation account
55	Balance Sheet items like profit and loss account balance and general reserve must be transferred to ____________	Revaluation account.	Partners capital accounts	Realisation account	Drawings account	Partners capital accounts
56	In case of sale of partnership to a company, the profit or loss on the sale is ascertained through ___________	Revaluation method	Memorandum realization account	Realization account	Balance sheet	Realization account
57	An agreement of sale is made under ____________	A partner is insolvent	A partner has debit balance	The firm is insolvent	insolvent	The firm is insolvent
58	When goodwill is brought in cash by the new partner, the method is known as ____________	Revaluation Method.	Premium Method	Depreciation method	Solvent method	Revaluation Method.
59	The general reserve appearing in the books of partnership should be transferred to the old partners ____________	New profit sharing ratio.	Old profit sharing ratio	Capital ratio	Profit ratio	Capital ratio
60	The Profits of the business is to be shared among the partners , when the profit sharing term is silent __________	Capital ratio.	Equal ratio	Agreed ratio	Unequal ratio	Equal ratio

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DEPARTMENT OF COMMERCE

I B.COM PA - Higher Financial Accounting (17PAU201)

Unit - V (RESOLUTION OF PARTNERSHIP AND ACCOUNTING STANDARDS)

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
1	Outstanding expenditure is a __________ account	Nominal	Personal	Real	Current	Personal
2	_________ deals with the depreciation account.	AS4	AS6	AS10	AS13	AS6
3	According to which concept, proprietor of a business is treated as a creditors to the extent of his capital ?	Money measurement	cost	Dual aspect	Business entity	Business entity
4	Cash paid to creditors + closing creditors – opening creditors =_____	total purchase	cash purchase	credit purchases	total debtors	credit purchases
5	Net worth of business means_______	Total assets	Fixed assets – current assets	Equity capital	Total assets – total liabilities	Total assets – total liabilities
6	The policy of anticipate no profit and provide for all possible losses arises due to_____	Convention of consistency	Convention of conservatism	Convention of materiality	Convention of full disclosure	Convention of consistency
7	Capital account is a ___________	Fictitious account	Personal account	Liability account	Nominal account	Personal account
8	Revenue is generally recognized as being earned at the point of time _____________	Sale is effected	Cost is effected	Expenditure is effected	Overcast is effected	Sale is effected
9	Transactions of a general nature which occur frequently are first recorded in the__________	General ledger	Special journal	Cashbook	Subsidiary book	Special journal
10	The fundamental accounting equation Assets = liabilities is the formal expression of_________	Matching concept	Entity concept	Going concern concept	Dual aspect concept	Dual aspect concept

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
11	Depreciation is__________	An accounting necessity only	Tax necessity only	Tax and accounting necessity	Tax, account and audit necessity	Tax, account and audit necessity
12	'Every debit has a corresponding credit' it is the concept of_________	Incomplete records	Cost sheets	Single entry system	Double entry system	Double entry system
15	Bank loan account is a ______	Real Account	Nominal Account	Personal Account	Current Account	Personal Account
16	The process of recording transactions in a journal is known as _______	Journalizing	Journal	Posting	Journal entry	Journalizing
17	Accounting records transactions in term of ________	Commodity units	Production units	Monetary units	Expense units	Monetary units
18	Income received in advance by a business units is___________	liability	An assets	A loss	Gain	Liability
19	Income and expenditure account is the ______ account of a non trading concern	Balance sheet	P & L account	Ledger	General	P & L account
20	Expenditure incurred by a publisher for acquiring copyright is a_________	Deferred revenue expenditure	Capital expenditure	Revenue expenditure	Assets	Capital expenditure
21	Loss of cash by theft committed by cashier after business hours is a ____________	Revenue loss	Deferred revenue loss	Capital loss	Business loss	Capital loss
22	An expenditure incurred to derive long term advantage is ________	Revenue expenditure	Expense	Capital expenditure	Deferred capital expenditure	Capital expenditure
23	In accounting only ________ discount is recorded	Trade	Cash	Real	Nominal	Cash
24	Debit balance of all personal accounts are collectively called__________	Sundry creditors	Sundry debtors	Personal account balance	Total of personal accounts	Sundry debtors
25	Under______ system branch profit or loss is ascertained by preparing branch accounts	Debtors	Stock and debtors	Wholesale	Final accounts	Debtors

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
26	Discount on issue of share is ___________	Capital loss	Revenue loss	Capital expenditure	Revenue expenditure	Capital loss
27	Trial balance will detect ________	Errors of commission	Errors of omission	Errors of principle	Compensating errors	Errors of commission
28	Machinery purchased on account is recorded in________________	Journal	Ledger	Purchase book	Cash book	Journal
29	The error disclosed by Trial Balance is______	Wrong amount posted in ledger account	Error of principle	Non recording of a transaction in the books of original entry _____	Errors of omission	Wrong amount posted in ledger account
30	Normally value of closing stock ________ in the trial balance	Appears	Does not appear	May or may not appear	Sometime appear	Does not appear
31	Cost of goods sold plus selling expenses equals________________	Cost of production	Gross profit	Sales	Cost of sales	Gross profit
32	Trading account is a _______ account	Personal	Real	Nominal	Expenses	Nominal
33	Cash discount is allowed by____________	Wholesaler	Debtor	Creditor	Retailer	Creditor
34	Rent prepaid is______________	Assets	Liability	Income	Expense	Assets
35	Unearned income is a __________	Liability	Asset	Expense	Income	Liability
36	Closing stock given in the trial balance will be taken to_______	P&L account only	Income and expenditure account only	Trading account only	Balance sheet only	Balance sheet only
37	Sale of grass in the case of a sports club is____________	assets	Revenue receipt	Capital receipt	Income	Revenue receipt
38	In income & Expenditure accounts, we record _________	Items of capital nature alone	Items of revenue nature alone	Items of Capital and Revenue	Items of expenditure	Items of revenue nature alone

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
39	Double entry system was propounded by _____________	Chanakya	Lee	Confucius	Luca Pacioli	Luca Pacioli
40	Fixed assets purchased on hire purchased on hire purchase terms are recorded at _____________	Net realization value	Cash value	Hire purchase price	Cost price	Cash value
41	Treatment of capital expenditure as revenue expenditure is	Errors of principle	Compensating errors	Errors of commission	Errors of omission	Errors of principle
42	Prepaid expenses are ______ account	Nominal	Personal	Personal account without name	Real	Personal account without name
43	In non – profit organizations excess of assets over liabilities is called_________	Capital block	General fund	Shareholders fund	Capital	General fund
44	Collection of all accounts us called________	Trial balance	Journal	Ledger	Cash book	Ledger
45	Source document for sales returns is noted in __________	Debit note	Credit note	Source note	Journal	Credit note
46	Petty cash book is prepaid under ______ system	Cash	Impress	Credit	Mercantile	Impress
47	Special journal is also called___________	Journal proper	Subsidiary books	Original books	Ledger	Subsidiary books
48	Unexpired expenses is a _______	Liability	Asset	Income	Expenditure	Asset
49	Gross assets – liabilities will be equal to ______	Net assets	Total assets	Capital	Net liabilities	Capital
50	Purchase ledger contains the accounts of _________	Debtors	Creditors	Total purchase	Purchasers	Creditors
51	Allowance made for prompt payment is called_______	Cash allowance	Cash discount	Trade discount	Discount	Cash discount

Sl.No	Question	Option - 1	Option - 2	Option - 3	Option - 4	Answer
52	In sole trader balance sheet asset are arranged in the order of_______	Liquidity	Permanence	Transferability	Type of accounts	Liquidity
53	Sales ledger contains accounts of	Suppliers	Customers	Total sales	Creditors	Suppliers
54	________ is an expenditure which does not bring any benefit to the concern	Revenue expenditure	Capital expenditure	Deferred revenue expenditure	Loss	Loss
55	Credit note is sent by_________	Seller	Customer	Buyer	Borrower	Seller
56	Total sales book indicates__________	Total credit sales	Total cash sales	Total sales	Creditors	Total sales
57	Asset which reduce is value, on use, but are not replaced is called________	Contingent assets	Fictitious assets	Intangible assets	Wasting assets	Wasting assets
58	Total sales made during a year is found out from the________	Sales book	Sales account	Total sales book	Creditors account	Sales account
59	Sales return account is a _______ account	Personal	Nominal	Real	Current	Nominal
60	Debit note is prepared in connection with___________	Sales return	Purchase return	Sales	Purchase	Purchase

Dissolution of Partnership - Insolvency of Partners - Rule in Garner Vs. Murray - Piecemeal Distribution - Sale to a company - Accounting Standards (Theory Only) - AS 2: Valuation of Inventory - AS 6: Depreciation Accounting - AS 7: Construction Contracts - AS 8: Revenue Reorganization, AS 13 Accounting for Investments.

Dissolution of Partnership Firm (Accounting Procedure)

Accounting Procedure of Dissolution of Partnership Firm

The dissolution of partnership among all the partners of a firm is called the Dissolution of the Firm (Sec. 39 of the Partnership Act, 1932). Dissolution of Partnership involves a change in the relation of partnership business, if the remaining partners resolve to continue the concern. In such cases there will be a new partnership but the firm will continue in a reconstituted form.

Dissolution:

Dissolution of firm means complete breakdown of the relation of partnership among all the partners. When all the partners resolve to dissolve the partnership, the dissolution of firm occurs, i.e. the firm is wound up.

If the business comes to an end, it is said that the firm has been dissolved. Dissolution of firm means the closing down of the business. Firm's dissolution implies partnership dissolution but not vice versa.

That is dissolution of partnership does not mean dissolution of firm, but the dissolution of firm will be dissolved on any one of the following ways:

(A) Dissolution by Agreement (Sec. 40):

A firm may be dissolved at any time with the consent of all partners. For instance, when a firm does not expect good prospects in the future, a firm can be dissolved by mutual consent of all partners.

(B) Compulsory Dissolution (Sec. 41):

A firm is compulsorily dissolved by operation of law when all the partners except one become insolvent or when all the partners become insolvent or when business becomes illegal or when the number of partners exceeds twenty in case of ordinary business or ten in case of banking.

(C) Dissolution on the Happening of Certain Contingencies (Sec. 42):

A firm is dissolved, in the absence of contrary, in the event of any of the following circumstances:

(i) The expiry of the term for which it was formed.

(ii) The completion of the venture for which the partnership was constituted.

(iii) The death of a partner.

(iv) The adjudication of a partner as an insolvent.

(D) Dissolution by Notice of Partnership at Will (Sec. 43):

Where a partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.

(E) Dissolution by the Court (Sec. 44):

The court is empowered to order the dissolution of a firm consequent on a suit by a partner in the following cases:

(i) When a partner becomes insane or unsound of mind.

(ii) When a partner becomes permanently incapable of performing his duties, be it mental or physical.

iii) When a partner is proved guilty of misconduct which is likely to affect adversely the business of the firm.

(iv) When a partner conduct himself in such a way that it is not possible for the other partners to carry on partnership with him.

(v) When a partner transfers his interest or share to third party.

(vi) When the business cannot be carried out except at a loss. (It must be remembered that the object of partnership is to earn profits and if that object is not fulfilled, the firm can be dissolved).

(vii) When it appears to be just and equitable. For instance, continued quarrelling, deadlock in the management, refusal to attend matters of business, absence of cooperation etc. among the partners. (The court has wide discretionary powers).

Liability for Acts Done After Dissolution (Sec. 45):

When a firm is dissolved a public notice must be given of the dissolution. If it is not done, the partners continue to be liable as such to third parties for any act done by any of them after the dissolution, and in such a case, the act of a partner done after dissolution is deemed to be an act done before the dissolution.

Settlement of Accounts (Sec. 48):

As soon as a firm is dissolved, it ceases to transact normal business. The mode of settlement of accounts between partners after the dissolution of a firm is determined by the partnership agreement. In the absence of any specific agreement as to the mode of settlement of accounts after the dissolution of the firm, the Partnership Act laid down the following provisions (Sec. 48) for settlement of accounts.

(a) Losses, including deficiencies of capital, shall be paid first out of profit, next out of capital, and lastly, if necessary, by the partners individually in their profit-sharing ratio.

(b) The assets of the firm including any sums contributed by the partners to make up deficiencies of capital shall be applied in the following manner and order:

(i) In paying the debts of the firm to third parties.

(ii) In paying each partner rateably what is due to him from the firm for advances.

(iii) In paying to each partner rateably what is due to him on account of capital, and

(iv)The surplus, if any, will be divided among the partners in their profit sharing ratio.

Firm's Debt and Personal Debts:

Where debts owe both the firm and the partners individually, the rule under section 49 is:

(i) To apply the firm's assets first in paying off the firm's debts and out of the surplus left, if any, each partner's share thereof is applied in meeting his personal debts, and

(ii) To apply the private property of each partner first in paying off his personal debts and the residue, if any, is applied to pay off the firm's debts.

Dissolution Accounts:

When a business is discontinued, the firm is said to be dissolved. As a result, all the accounts be closed. It is, therefore, necessary to open Realization Account, Cash or Bank Account and Partners Capital Accounts.

(i) Realization Accounts is opened for all transactions relating to realisation of assets and payment of liabilities. That is, on dissolution, it is essential to make sale of assets of the firm, realize cash and paying off the liabilities.

Realisation of assets and settlement of liabilities are centred round the Realisation Account. It is a nominal Account. The transactions – realisation and settlement – are over, the difference, being gain or loss will be transferred to Capital Accounts.

(ii) Cash/Bank Account is opened to record all cash transactions. When the purpose is over the Cash Account shows a balance, which is equal to the amounts due to partners.

(iii) Capital Accounts are opened to make all entries connected with the partners' accounts. Current Accounts, if any, are transferred to Capital Accounts. Finally the Capital Accounts are closed by receiving or paying cash.

The following steps are taken to close the books of accounts:

1.	Transfer all the assets of the firm at their book value excepts cash, Bank and Losses.	Realisation Account Dr. To Individual Assets Accounts (Being transfer of various assets at their books value to Realisation Account)

Note : (*a*) Cash Account and Bank Accounts are not transferred to Realisation Account as they are already in liquid form.

(*b*) Similarly Sundry Debtors Account and Provision for Doubtful Debts Accounts are two separate Accounts. The Sundry Debtors amount, i.e., gross amount to be transferred.

(*c*) Losses, debit balance of Profit and Loss Account are not transferred to Realisation Account.

2.	Transfer to losses of debit balance of Profit and Loss Account.	Partner's Capital/ Current Account Dr. To Profit & Loss Account (Being transfer to accumulated losses)
3.	Transfer all outside Liabilities.	Various Liabilities Account Dr. To Realisation Account (Being transfer of various liabilities such as Creditors, Bills payable, Bank Overdraft O/S expenses etc. to Realisation Accounts)
4.	Transfer Past Profits or Reserve Fund.	Profit & Loss Account Dr. Reserve Fund Account Dr. To Partner's Capital/ Current Account (Being transfer of past profits and Reserve Fund to Partners' Capital/Current Account)
5.	When assets are sold or may be taken over by any partner.	(*a*) Cash Account Dr. To Realisation Account (Being assets sold for cash) (*b*) Partners' Capital Account Dr. To Realisation Accounts (Being assets taken over by partners)
6.	When outside liabilities are paid off.	Realisation Account Dr. To Cash/ Bank Account (Being payment of liabilities to third parties)

7.	When outside liabilities are discharged by a partner	Realisation Accounts Dr. To Partner's Account (Being liabilities taken over at an agreed valuation by the partner)
8.	(*a*) When expense are paid on realisation by the firm.	Realisation Account Dr. To Cash/Bank Account (Being expense on realisation paid)
	(*b*) When it is paid by a partner.	Realisation Account Dr. To Partner's Capital Account (Being expenses paid on realisation by the partners)
9.	When the purpose of the Realisation Account is over, it is closed to find out profit or loss on realisation of assets and discharging the liabilities.	
	(*a*) If it shows profit	Realisation Account Dr. To Partners' Capital Account (Being profit on realisation accounts is transferred to Capital Accounts of partners in profit sharing ratio)
	(*b*) If it shows loss	Partners' Capital Accounts Dr. To Realisation Account (Being loss incurred on realisation is transferred to Partner's Capital Account in profit sharing ratio)
10.	When Partner's loan is paid off.	Partners' Loan Account Dr. To Cash/Bank Account (Being partner's loan repaid)
11.	Now transfer Current Accounts, if any. (*a*) If it shows credit balance	Partner's Current Account Dr. To Partners' Capital Account (Being transfer of current accounts)
	(*b*) If it shows a debit balance.	Partner's Capital Account Dr. To Partners' Current Account (Being transfer of current accounts)
12.	When Capital Account of any partner shows a debit balance (after the adjustment or Realisation Account), then he must clear off his debt.	Cash/ Bank Account Dr. To Concerned Partner's Capital A/c (Being the deficiency in Capital account brought by the partner)
13.	If there are unrecorded or undisclosed assets and liabilities, they may be dealt with as follows:	
	(*a*) When unrecorded assets are realised (it is a gain).	Cash/ Bank Account Dr. To Realisation Account (Being realisation or unrecorded assets)
	(*b*) When unrecorded liabilities are paid off (it is a loss).	Realisation Account Dr. To Cash/Bank Account (Being payment of unrecorded liabilities)
14.	When closing Capital Accounts.	Partners' Capital Account Dr. To Cash/ Bank Account (Being final payment paid to partners what is due to each partner).

To sum up, when all the assets are realized and the liabilities are paid off, the balance of cash or Bank must be equal to the amount due finally to the partners' capital account, after transferring the current account, if any. Sometimes, the capital account shows a debit balance, representing the amount due to the firm by the concerned partner.

The principle of unlimited liability is applied, that is, the partner, whose capital account shows a debit balance, should bring the amount to clear off the debit balance in his capital account. Then the cash in hand plus the amount so received, is applied in paying off all the partners whose accounts show credit balances. Thus, all the accounts of assets, liabilities, partners' capital, and cash are closed.

The above method of preparation of Realisation Account is called Total Method. Alternatively, there is another method, known as Balance Method to prepare the Realisation Account.

Under the Balance Method, the assets appearing in the Balance sheet are not transferred to Realisation Account at their book value. But, only the difference between the Book Value of Assets and the amount realized by their sale is transferred to Realisation.

The sales proceeds are not taken through Realisation Account. The liabilities too are not transferred to Realisation Account but only the difference between the book value and payments paid is transferred to Realisation Accounts.

For instance, consider the following:

(*i*) When assets realised in cash	Cash Account To Assets Account (Being proceeds against the sale of assets)	Dr.
(*a*) If there is a loss on realisation of the assets.	Realisation Account To Assets Account (Being loss on sale transferred to Realisation Account)	Dr.
(*b*) If there is a gain on realisation of the assets.	Assets Account To Realisation Account (Being gain on sale transferred to Realisation Account)	Dr.

Note: Return of Premium on Premature Dissolution:

Where a partner has paid a premium on entering into partnership for a fixed term, and the firm is dissolved before the expiration on the term otherwise than by the death of a partner, he shall be entitled to repayment of the premium or of such part thereof as may be reasonable unless the dissolution is mainly due to his own misconduct, or the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

(ii) When liabilities are paid off	Liabilities Account Dr. To Cash/ Bank Account (Being Liabilities are paid off)
(a) If there is loss.	Realisation Account Dr. To Liabilities Account (Being loss on settlement is transferred to Realisation Accounts)
(b) If there is a gain.	Liabilities Account Dr. To Realisation Account (Being gain on settlement is transferred to Realisation Account)
(iii) When Cash received against sale of unrecorded assets (it is gain).	Cash/Bank Account Dr. To Realisation Account (Being sale of unrecorded assets)
(iv) When cash paid against unrecorded liabilities (it is loss).	Realisation Account Dr. To Cash/Bank Account (Being payment to unrecorded liabilities)

Illustration 1:

The following is the Balance Sheet of a firm as on 31st December 2005:

Liabilities		*Rs.*	*Assets*	*Rs.*
Sundry Creditors		8,000	Cash in hand	500
Bills Payable		2,000	Sundry Debtors	2,000
Bank Overdraft		1,500	Machinery	6,000
Capital Accounts			Stock	2,000
Ram:	10,000		Factory Premises	15,000
Shyam:	6,000	16,000	Profit & Loss Account	2,000
		27,500		27,500

The firm was dissolved on 31st December 2005.

The assets were realized as follows:

Debtors Rs. 1,500; Machinery Rs. 3,000; Stock Rs. 1,200 and Factory Premises Rs, 10,000. Bank overdraft and Bills Payable were paid in full. Creditors were settled in Rs 7,800. Realisation expenses amounted to Rs. 200.

Pass journal entries and prepare ledger accounts to close the books of the firm assuming that the profit sharing ratio between Ram and Shyam is 3: 2.

SOLUTION

Journals Entries

Date	Particulars		Dr.	Cr.
			Rs	Rs
2005 Dec. 31	Realisation Account	Dr	25,000	
	To Sundry Debtors Account			2,000
	To Machinery Account			6,000
	To Stock Account			2,000
	To Factory Premises Account			15,000
	(Being various assets transferred to Realisation A/c)			
	Sundry Creditors Account	Dr.	8,000	
	Bills Payable Account	Dr.	2,000	
	Bank Overdraft Account	Dr.	1,500	
	To Realisation Account			11,500
	(Being various liabilities transferred to Realisation Account)			
	Cash Account	Dr.	15,700	
	To Realisation Account			15,700
	(Being amount realised on Debtors Rs, 1,500; Machinery Rs, 3,000. Stock Rs, 1,200 and Factory premises Rs, 10,000)			
	Realisation Account	Dr.	11,300	
	To Cash Account			11,300
	(Being Settlement, Creditors Rs, 7,800 and Bills Payable Rs 2,000 and Overdraft Rs, 1,500)			

Realisation Account	Dr.		200	
To Cash Account				200
(Being expenses paid)				
Ram's Capital Account	Dr.		5,580	
Shyam's Capital Account	Dr.		3,720	
To Realisation Account				9,300
(Being realisation loss transferred to Capital Account)				
Ram's Capital Account	Dr.		1,200	
Shyam's Capital Account	Dr.		800	
To Profit & Loss Account				2,000
(Being loss transferred to Capital Account)				
Ram's Capital Account	Dr.		3,220	
Shyam's Capital Account	Dr.		1,480	
To Cash Account				4,700
(Being final settlement of partners account)				

Dr. **Cash Account** Cr.

2005		Rs	2005		Rs
Dec. 31	To Balance b/d	500	Dec. 31	By Realisation Account (Payment of Liabilities)	11,300
"	To Realisation A/c (sale of assets)	15,700		By Realisation Account (Expenses paid)	200
				By Ram's Capital Account (Final settlement)	3,220
				By Shyam's Capital Account (Final settlement)	1,480
		16,200			16,200

Dr. **Realisation Accounts** Cr.

2005		Rs	2005			Rs
Dec. 31	To Sundry Debtors A/c	2,000	Dec. 31	By Sundry Creditors A/c		8,000
"	To Machinery A/c	6,000	"	By Bills Payable A/c		2,000
"	To Stock A/c	2,000	"	By Bank Overdraft A/c		1,500
"	To Factory Premises A/c	15,000	"	By Cash A/c (Assets realised)		15,700
"	To Cash A/c (Payment of liabilities)	11,300		Ram:	5,580	
"	To Cash A/c (Expenses paid)	200		Shyam:	3,720	9,300
		36,500				36,500

Dr. **Capital Accounts** Cr.

		Ram	Shyam			Ram	Shyam
2005		Rs	Rs	2005		Rs	Rs
Dec. 31	To Realisation A/c (Loss)	5,580	3,720	Dec. 31	By Balance b/d	10,000	6,000
"	To Profit and Loss A/c (Loss)	1,200	800				
"	To Cash A/c	3,220	1,480				
		10,000	6,000			10,000	6,000

Garner Vs Murray: Loss by Insolvent Partner (Dissolution of Partnership Firm)

If, at the time of dissolution, a partner owes a sum of money to the firm, he has to pay it to the firm. But if he is insolvent, he will not be able to do so, at least lot fully. The sum which is irrecoverable from an insolvent partner is, therefore, a loss. The question arises whether this loss is an ordinary loss to be shared by the solvent partners in the profit sharing ratio or whether it is an extraordinary loss. Before the decision in Garner vs. Murray was made, such a loss was treated as an ordinary loss.

The following illustration shows the practice prevailing before this case was decided:

Illustration:

A, B and C were equal partners. On 31st December, 1900, their position was as follows:

	₹		₹
A's Capital	2,000	Cash	1,500
B's Capital	600	*C*'s Capital	200
		Loss on Realisation	900
	2,600		2,600

Solution:

Dr. **Cash Book** *Cr.*

		₹			₹
1900 Dec. 31	To Balance *b/fd*	1,500	1900 Dec. 31	By *A*'s Capital A/c	1,450
			" "	By *A*'s Capital A/c	50
		1,500			1,500

Loss on Realisation

		₹			₹
1900 Dec. 31	To Balance *b/fd*	900	1900 Dec. 31	By *A*'s Capital A/c	300
			" "	By *B*'s Capital A/c	300
			" "	By *C*'s Capital A/c	300
		900			900

Capital Accounts

Particulars	*A*	*B*	*C*	*Particulars*		*A*	*B*	*C*
	₹	₹	₹		₹	₹	₹	₹
To Balance *b/fd*			200	By Balance *b/fd*		2,000	600	—
To Loss on Realisation	300	300	300	By Capital Accounts—				
To *C*'s Capital A/c				*A*	250			
(deficiency)	250	250		*B*	250			500
To Cash—settlement	1,450	50						
	2,000	600	500			2,000	600	500

In the above illustration, B can, with some justification, complain that he is getting too little. He can say that since A's claim is Rs 1,700 (after debiting the loss on realisation) and his own is Rs 300, the available cash balance of Rs 1,500 should be divided in the ratio of the claims, viz, 17: 3. In this way, B would get Rs 1, 500 x 3 / 20 or Rs 225. In other words, the loss due to C;s insolvency should not be treated as an ordinary loss. This contention was broadly upheld in garner vs. Murray.

The judgment in this case was that:

(a) First, the solvent partners should bring in cash equal to their respective shares of the loss on realisation; and

(b) Second, the loss due to the insolvency of a partner should be divided among the other partners in the ratio of capitals then standing (i.e., after partners have brought in cash equal to their shares of loss on realisation).

The practical effect of this is that the loss due to the insolvency of a partner has to be borne by the solvent partners in the ratio of their capitals standing just prior to dissolution.

The above illustration would be worked out in accordance with this decision as follows:

Cr. **Cash Book** Cr

			₹				₹
	To Balance *b/fd*		1,500		By *A*'s Capital A/c		1,615
	By *A*'s Capital A/c		300		By *B*'s Capital A/c		485
	By *B*'s Capital A/c		300				
			2,100				2,100

Capital Account

	A	B	C		A	B	C
	₹	₹	₹		₹	₹	₹
To Balance *b/fd*			200	To Balance *b/fd*	2,000	600	
To Loss on Realisation	300	300	300	By Cash—to make up loss on realisation	300	300	
To *C*'s Capital A/c—loss written off in the ratio of 20 : 6	385	115		By *A*'s Capital A/c			385
				By *B*'s Capital A/c			115
To Cash—settlement	1,615	485					
	2,300	900	500		2,300	900	500

Fixed and Fluctuating Capitals:

If the ratio in which an insolvent partner's loss is to be written off is the ratio of capitals just prior to dissolution or as last agreed upon, the fact of capitals being fixed or fluctuating is important. If the capitals are fixed, then that will be the ratio in which an insolvent partner's loss will be borne. But if the capitals are fluctuating, all necessary adjustments in respect of reserves or profit and loss account, etc., should first be made (but without adjusting the loss on realisation). The ratio in which the insolvent partner's loss will be divided will be the ratio of the resultant capitals.

The student will note, however, that if there are any balances lying in the Profit and Loss Account or the General Reserve, these must in any case be transferred to all partners' capital accounts in the profit-sharing ratio. The above paragraph merely discusses the ratio in which the insolvent partner's loss will be divided. Suppose, A's capital is Rs 1, 00,000 and B's capital is Rs 60,000, C's capital shows a debit balance of Rs 40,000. There is a reserve of Rs 60,000. Dividing the reserve among A, B and C, each partner will be credited with Rs 20,000. C is insolvent.

(a) If the capitals are fixed, the loss on C's Capital Account will be borne by A and B in the ratio of 10 : 6, i.e., capitals without adjustment for reserve; and

b) If the capitals are fluctuating, the deficiency in C's Capital Account will be borne by A and B in the ratio of 12 : 8 respectively, i.e., capitals after adjustment for reserve.

Equity:

It must not be supposed that the decision in Gamer vs. Murray always works equitably; it considers only the capitals standing in the books and not the private estates of solvent partners. It is possible that a partner who has contributed a large capital is made to bear a large proportion of an insolvent partner's loss as compared to a partner who is richer but has not contributed so much capital. If a partner is lucky to Rave drawn all his money away before the dissolution, so that his capital account does not show a credit balance, he will bear no part of the loss due to a partner's insolvency.

It is, therefore, quite common to find clauses in the partnership deed laying down how a loss in an insolvent partner's capital account will be shared by the solvent partners. If such a clause exists, it must be followed because the decision in Garner vs. Murray applies only where there is no agreement on this point.

Application in India:

Some people believe that in India the decision in Garner vs. Murray does not apply. But there is nothing in Indian Partnership Act which goes against the rule laid down in the case and it would be safe to follow it till an Indian Court definitely rules against it. According to section 48, partners are required to make up their shares of losses and then assets, remaining after satisfaction of claims of outsiders and after repayment of the advances of partners over and above capitals contributed by them, have to be distributed rateably amongst the partners. A partner is required to make up his share of the realisation loss but not that of other partners.

The effect of this would be that assets remaining after paying off creditors' claims and partners' loans, as increased by the share of loss contributed by solvent partners, would be distributed amongst solvent partners in the ratio of their capitals minus their shares of loss plus cash brought in by them for it or, in other words, capitals just before dissolution. This is precisely the decision in Garner vs. Murray. In practice, only entries are made and no cash is brought actually; notional adjustment is sufficient.

The whole position, when a partner is insolvent, may be summed up as follows:

(a) Make a Realisation Account in the ordinary way and transfer its profit or loss to the capital accounts of all the partners in the profit-sharing ratio.

(b) If anything is received from the estate of the insolvent partner, it should be credited to his capital account.

(c) The debit balance in the capital account of the insolvent partner should be transferred to the capital accounts of solvent partners in the ratio of capitals as they stand just before dissolution (or in the ratio of fixed capitals, if capitals are fixed).

(d) The solvent partners will then draw out cash according to their claims.

Illustration 1:

The following is the balance sheet of A, B and C. on March 31, 2012:

	₹		₹
Creditors	20,000	Cash	6,000
General Reserve	15,000	Sundry Debtors	10,000
Capital Accounts:		Stock	20,000
A	25,000	Furniture	10,000
B	15,000	Machinery	20,000
		C's Capital—overdrawn	9,000
	75,000		75,000

C is insolvent but his estate pays Rs 2,000. It is decided to wind up the partnership. The assets realized as follows: sundry debtors, Rs 7,500; stock, Rs 16,000 furniture, Rs 7,000; and machinery, Rs 14,000. The cost of winding up came to Rs 2,500. Give accounts to close the books of the firm (1) if the capitals are fixed, and (2) if the capitals are fluctuating.

Solution:

(1) Fixed Capitals

Dr. **Realisation Account** Cr.

2012		₹	₹	2012		₹	₹
Mar. 31	To Sundry Assets—			Mar. 31	By Cash—		
	Sundry Debtors	10,000			Sundry Debtors	7,500	
	Stock	20,000			Stock	16,000	
	Furniture	10,000			Furniture	7,000	
	Machinery	20,000	60,000		Machinery	14,000	44,500
Mar. 31	To Cash—expenses		2,500	Mar. 31	By Loss transferred to:		
					A's Capital A/c	6,000	
					B's Capital A/c	6,000	
					C's Capital A/c	6,000	18,000
			62,500				62,500

Dr. **Cash Book** Cr.

2012		₹	2012		₹
Mar. 31	To Balance b/fd	6,000	Mar. 31	By Realisation A/c—exp.	2,500
" "	To Realisation A/c— assets realised	44,500	" "	By Creditors	20,000
" "	To C's Capital A/c	2,000	" "	By A's Capital A/c — settlement	25,000
" "	To A's Capital A/c	6,000	" "	By A's Capital A/c — settlement	17,000
" "	To B's Capital A/c	6,000			
		64,500			64,500

Dr. **Creditors** Cr.

2012		₹	2012		₹
Mar. 31	To Cash	20,000	Mar. 31	By Balance b/fd	20,000

Dr. **Capital Accounts** Cr.

Particulars	A	B	C	Particulars	A	B	C
	₹	₹	₹		₹	₹	₹
To Balance b/fd			9,000	By Balance b/fd	25,000	15,000	
To Realisation A/c (loss)	6,000	6,000	6,000	By General Reserve	5,000	5,000	5,000
To C's Capital A/c, (₹ 8,000 in the ratio of 25 : 15)	5,000	3,000		By Cash		2,000	
				By Cash	6,000	6,000	
				By A's Capital A/c			5,000
To Cash (settlement)	25,000	17,000		By B's Capital A/c			3,000
	36,000	26,000	15,000		36,000	26,000	15,000

(2) Fluctuating Capitals:

Realisation Account will be the same as given above.

Dr. **Cash Book** Cr.

2012		₹	2012		₹
Mar. 31	To Balance *b/d*	6,000	Mar. 31	By Realisation A/c —expenses	2,500
Mar. 31	To Realisation A/c —assets realised	44,500	Mar. 31	By Creditors	20,000
Mar. 31	To *C*'s Capital A/c	2,000	Mar. 31	By *A*'s Capital A/c — settlement	25,200
Mar. 31	To *A*'s Capital A/c	6,000	Mar. 31	By *B*'s Capital A/c — settlement	16,800
Mar. 31	To *B*'s Capital A/c	6,000			
		64,500			64,500

Dr. **Capital Accounts** Cr.

Particulars	*A*	*B*	*C*	*Particulars*	*A*	*B*	*C*
	₹	₹	₹		₹	₹	₹
To Balance *b/fd*			9,000	By Balance *b/fd*	25,000	15,000	—
To Realisation A/c (loss)	6,000	6,000	6,000	By General Reserve	5,000	5,000	5,000
To *C's* Capital A/c (₹ 8,000 in the ratio of 30 : 20)	4,800	3,200		By Cash	6,000	6,000	
				By Cash		2,000	
				By *A's* Capital A/c			4,800
To Cash (settlement)	25,200	16,800		By *B's* Capital A/c			3,200
	36,000	26,000	15,000		36,000	26,000	15,000

Piecemeal Distribution: Realisation Account (Dissolution of Partnership Firm)

Piecemeal distribution of cash does not introduce really any new complication so far as recording the sale of assets, payment of liabilities, etc., are concerned.

The points of departure from the practice already outlined earlier will be as follows:

(a) Assets will be realized gradually and hence whenever cash is received, cash will be debited and Realisation Account credited (instead of there being only one such entry).

(b) The statement of piecemeal distribution will show how cash is be utilised. For expenses, Realisation Account will be debited and Cash Account credited. For payment to creditors, the account concerned will be debited and Cash Account credited. After this, if anything is paid to partner, his loan or capital account (as the case may be) will be debited and cash credited. After all assets are realized, the Realisation Account will be closed in the usual way, i.e., by transfer of the balance to the capital accounts in the profit sharing ratio.

Illustration 1:

A, B and C were partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. On March 31, 2009 their balance sheet was as follows:

		₹		₹
Sundry Creditors		60,000	Cash at Bank	6,000
A's Loan		30,000	Debtors	90,000
B's Loan		12,000	Stock	84,000
Capitals:	₹		Furniture	12,000
A	45,000			
B	96,000			
C	9,000	90,000		
		1,92,000		1,92,000

The firm was dissolved on the 1st April, 2012. The assets were realised as follows:

	Debtors ₹	Stock ₹	Furniture ₹	Expenses ₹
April 30	18,000	15,000	4,500	1,500
May 31	12,000	21,000	—	2,400
June 30	45,000	30,000	—	4,500
July 31	9,000	12,000	6,000	1,500

Cash received was paid to the rightful claimants. Give accounts to close the books of the firm after preparing a statement showing distribution of cash.

Solution :

First of all, a statement will have to be prepared showing how the available cash has been utilised. Hence—

Statement Showing Distribution of Cash

		Creditors ₹	A's Loan ₹	B's Loan ₹	A's Capital ₹	B's Capital ₹	C's Capital ₹
Amounts due	*a*	60,000	30,000	12,000	45,000	36,000	9,000
Cash in hand—to creditors	*b*	6,000					
Balances due	*c*	54,000	30,000	12,000	45,000	36,000	9,000
April—Cash available, ₹ 36,000 to creditors	*d*	36,000					
May—Cash available, ₹ 30,600— ₹ 18,000 paid to creditors		18,000					
₹ 12,600 to *A* and *B* (Loans) in the ratio of 10 : 4	*f*		9,000	3,600			
Balances due	*g*		21,000	8,400	45,000	36,000	9,000
June—Cash available, ₹ 70,500— ₹ 21,000 paid to *A* (Loan) and ₹ 8,400 paid to *B* (Loan)	*h*		21,000	8,400			
Cash in hand is ₹ 41,100							
Maximum possible loss, ₹ 48,900 allocated to *A, B* and *C* in ratio of 5 : 3 : 2	*i*				24,450	14,670	9,780
Amounts at credit					20,550	21,330	—780
C's "Deficiency" allocated to *A* and *B* in the ratio of 15 : 12	*j*				—433	—347	+780
Amount at credit and cash paid	*k*				20,117	20,983	
Balances due, (*g*—*k*)	*l*				24,883	15,017	9,000
July—Cash available, ₹ 25,500 Loss, ₹ 48,900—₹ 25,500 or ₹ 23,400, allocated to *A, B* and *C* in the profit-sharing ratio	*m*				11,700	7,020	4,680
Amounts at credit and cash paid (*l*—*m*)	*n*				13,183	7,997	4,320

Dr. **Realisation Account** *Cr.*

2012		₹	₹	2012		₹	₹
Apr. 1	To Sundry Assets—			Apr. 30	By Cash—assets realised:		
	Debtors	90,000			Debtors	18,000	
	Stock	48,000			Stock	15,000	
	Furniture	12,000	1,86,000		Furniture	4,500	37,500

			₹				₹	₹
Apr.	30	To Cash—expenses	1,500	May	31	By Cash—assets realised:		
May	31	To Cash—expenses	2,400			Debtors	12,000	
June	30	To Cash—expenses	4,500			Stock	21,000	33,000
July	31	To Cash—expenses	1,500	June	30	By Cash—assets realised:		
						Debtors	45,000	
						Stock	30,000	75,000
				July	31	By Cash—assets realised:		
						Debtors	9,000	
						Stock	12,000	
						Furniture	6,000	27,000
				July	31	By Loss transferred to:		
						A's Capital A/c	11,700	
						B's Capital A/c	7,020	
						C's Capital A/c	4,680	23,400
			1,95,900					1,95,900

Dr. **Cash Book** *Cr.*

2012			₹	2012			₹	₹
Apr.	1	To Balance *b/fd*	6,000	Apr.	1	By Creditors		6,000
Apr.	30	To Realisation A/c—		„	30	By Realisation A/c—		
		assets realised	37,500			expenses		1,500
May.	30	To Realisation A/c—		„	„	By Creditors		36,000
		assets realised	33,000	May	„	By Realisation A/c—		
June.	30	To Realisation A/c—				expenses		2,400
		assets realised	75,000	„	31	By Creditors		18,000
July.	31	To Realisation A/c—		„	„	By *A*'s Loan		9,000
		assets realised	27,000	„	„	By *A*'s Loan		3,600
				June	30	By Realisation A/c—		
						expenses		4,500
				„	„	By *A*'s Loan A/c		21,000
				„	„	By *B*'s Loan A/c		8,400
				„	„	By Capital Accounts—		
						A	20,117	
						B	20,983	41,100
				July	31	By Realisation A/c—		
						expenses		1,500
				„	„	By Capital Accounts—		
						A	13,183	
						B	7,997	25,500
			1,78,500			*C*	4,320	1,78,500

Dr. **Sundry Creditors Account** Cr.

Date		Particulars	₹	Date		Particulars	₹
2012				2012			
Apr.	1	To Cash	6,000	Apr.	1	By Balance *b/fd*	60,000
"	30	To Cash	36,000				
May	31	To Cash	18,000				
			60,000				60,000

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

Date		Particulars	₹	Date		Particulars	₹
2012				2012			
May	31	To Cash	9,000	Apr.	1	By Balance *b/fd*	30,000
June	30	To Cash	21,000				
			30,000				30,000

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

Date		Particulars	₹	Date		Particulars	₹
2012				2012			
May	31	To Cash	3,600	Apr.	1	By Balance *b/fd*	12,000
June	30	To Cash	8,400				
			12,000				12,000

Dr. **Capital Accounts** Cr.

Particulars	A	B	C	*Particulars*	A	B	C
	₹	₹	₹		₹	₹	₹
To Cash (June 30)	20,117	20,983	—	By Balance *b/fd*	45,000	36,000	9,000
To Cash (July 31)	13,183	7,997	4,320				
To Realisation A/c—loss	11,700	7,020	4,680				
	45,000	36,000	9,000		45,000	36,000	9,000

Conversion of Partnership Firm to a Company (Realisation Account)

Often, a partnership firm converts itself into a joint stock limited company or sells its business to an existing one. Realisation Account will be opened and assets transferred to it, so also liabilities (but not if liabilities are not assumed by the company).

Whatever the company pays as consideration will be credited to the Realisation Account. If expenses are incurred by the firm, the amount will be debited to the Realisation Account. If the creditors are taken over by the company, no further treatment is necessary beyond transferring them to the credit of Realisation Account; but if creditors are to be paid by the firm, the actual amount paid to them will be debited to liability account concerned; the difference between the book figure and the amount actually paid will be transferred to

Realisation Account. The profit or' loss on realisation will be transferred to the capital accounts in the profit-sharing ratio.

Besides the above, the main points to be noted are the following:

a) Usually, the company takes over all the assets including cash. Therefore, cash should also be transferred to Realisation Account. If, however, the company does not take over cash, it will not be transferred.

(b) Usually, the company will discharge the amount due from it in the form of cash, debentures and shares. Separate accounts will, of course, be opened for debentures and shares received. Partners will divide the debentures and shares among themselves, in the absence of an express agreement, in the ratio of their final claims, that is to say, in the ratio of capitals standing after the loss or profit on realisation and other reserves and profits have been transferred.

Further, since no fraction of a share or debenture can be allotted, the nearest whole number of shares or debentures should be given to a partner, the necessary adjustment being made in cash. If there is an agreement to divide the shares of debentures in a particular manner, the agreement should be followed.

Notes:

1) Some authorities recommend that shares in joint stock companies should be divided among partners in the profit-sharing ratio. This will enable partners to enjoy any future profit or loss on shares in the profit-sharing ratio. However, it seems that in the absence of an agreement, the Partnership Act does not permit this method of distribution.

Profits and losses after dissolution have no bearing on partnership accounts. Shares cannot be treated differently from other assets, say stock and furniture. It would, of course, be better if the partnership deed contains a clause regarding this matter. If there is some valueless asset in the books of the firm and if this has to be divided among the partners, it should be divided in the profit-sharing ratio so that any ultimate profit or loss may correspond to the ratio in which profits are shared.

Illustration 1:

A, B and C carry on business in partnership sharing profits and losses in the proportions of 1/2, 3/8 and 1/8 respectively. On 31st March, 2012, they agreed to sell their business to a limited company.

Their position on that date was as follows:

	₹		₹
A's Capital	40,000	Machinery	48,000
B's Capital	30,000	Furniture	42,000
C's Capital	26,000	Stock	23,000
Loan on Mortgage	16,000	Book Debts	15,000
Sundry Creditors	18,000	Cash	2,000
	1,30,000		1,30,000

The company took the following assets at the valuation shown below:—

	₹
Machinery	61,000
Furniture	31,800
Stock	22,000
Book Debts	14,000
Goodwill	10,000

The company also agreed to pay the creditors which was agreed at ₹ 17,700. The company paid ₹ 67,000 in fully paid shares of ₹ 10 each and the balance in cash. The expenses amounted to ₹ 1,500.

Prepare ledger accounts in the books of the firm.

Solution:

Dr. **Realisation Account** *Cr.*

2012		₹	₹	2012		₹	₹
Mar. 31	To Sundry Assets—			Mar. 31	By Loan on Mortgage		16,000
	Machinery	48,000		Mar. 31	By Sundry Creditors		18,000
	Furniture	42,000		Mar. 31	By Ltd. Company's A/c—		
	Stock	23,000			Machinery	61,000	
	Book Debts	15,000	1,28,000		Furniture	31,800	
Mar. 31	To Cash—expenses		1,500		Stock	22,000	
Mar. 31	To Cash—loan paid		16,000		Book Debts	14,000	
Mar. 31	To Profits transferred to:				Goodwill	10,000	
	A's Capital, 1/2	4,800				1,38,800	
	B's Capital, 1/2	3,600					
	C's Capital, 1/2	1,200	9,600		*Less:* Creditors	17,700	1,21,1000
			1,55,100				1,55,100

Dr. **Limited Company's Account** *Cr.*

2012		₹	2012		₹
Mar. 31	To Realisation A/c—		Mar. 31	By Shares in Ltd.	67,000
	— consideration	1,21,100	" "	By Cash	54,100
		1,21,100			1,21,100

Dr. Cash Account Cr.

Date	Particulars		₹	Date	Particulars	₹	₹
2012				2012			
Mar. 31	To Balance b/fd		2,000	Mar. 31	By Realisation A/c—		
Mar. 31	To Ltd. Company		54,100		Expenses		1,500
					Loan		16,000
				Mar. 31	By Capital Accounts:—		
					A	16,380	
					B	12,280	
					C	9,940	38,600
			56,100				56,100

Dr. Shares in Ltd. Co. Cr.

Date	Particulars		₹	Date	Particulars	₹
2012				2012		
Mar. 31	To Ltd. Company		67,00	Mar. 31	By A's Capital A/c	28,420
				Mar. 31	By B's Capital A/c	21,320
				Mar. 31	By C's Capital A/c	17,360
			67,000			67,000

Dr. Capital Accounts Cr.

Particulars	A	B	C	Particulars	A	B	C
	₹	₹	₹		₹	₹	₹
To Shares in... Ltd. Co.	28,420	21,320	17,360	By Balance b/fd	40,000	30,000	26,000
To Cash— settlement, balancing figure	16,380	12,280	9,940	By Realisation A/c— profits	4,800	3,600	1,200
	44,800	33,600	27,200		44,800	33,600	27,200

Note:

Total number of shares received from the limited company is 6,700. Theses have been divided among A, B and C in the ratio of 448, 336 and 272 or 28, 21 and 17 respectively, namely, in the ratio of the amount finally due to them.

A gets $\frac{6,700}{66} \times 28$ or 2,842 shares of ₹ 28,420;

B gets $\frac{6,700}{66} \times 21$ or 2,132 shares of ₹ 21,320; and

C gets $\frac{6,700}{66} \times 17$ or 1,736 shares of ₹ 17,360;

ACCOUNTING STANDARDS

Accounting standards codify the generally accepted accounting principles. They lay down the norms of accounting policies and practices by way of codes or guidelines to direct as to how the items appearing in the financial statements should be dealt with in the books of account and shown in the financial statements and annual reports. They present the general principles to be put to application using professional judgment.

The main purpose of accounting standards is to provide information to the user as to the basis on which the accounts have been prepared. They make the financial statements of different business unit or the financial statements of the same business unit comparable. In the absence of accounting standards, comparison of different financial statements may lead to misleading conclusions. Accounting standards bring about uniformity of assumptions, rules and policies adopted in financial reporting and thus they ensure consistency and comparability in the data published by the business enterprises. To be useful, an accounting standard must be capable of being well understood and it must be able to reduce significantly the degree of manipulation of the reported data.

Utiliity of Accounting Standards

The management of every business house is interested in reliable accounting data so that it may get the required information for making correct decisions and discharge its functions efficiently. Then, there are shareholders, investors, creditors, workers, Governments, researchers etc. who are also interested in reliable accounting data. Accounting standards play a very significant role; they make it possible that the people get the reliable and comparable accounting data. Thus, they help the investor to make more informed investment decisions. The Government officials can use the accounting data for planning etc. with greater confidence. The researchers can make better analysis and draw more reliable conclusions. Even the job of Chartered Accountants is made easy. They can guide their clients much betler and refuse any demand by clients to accept data which are not in conformity with accounting standards.

Sometimes, there is a conflict of financial interests among the various groups that rely upon published financial statements. For example, potential shareholders and existing shareholders may have opposite interests in assessing the profitability and the net worth of a company. Accounting standards help in resolving such a conflict because financial statements which have been prepared on the basis of accounting standards will be acceptable to all the parties. If follows that accounting standards must be such as may command the greatest possible credibility among all those who use accounting data.

Accounting Standards in India

Realising that there was a need of accounting standards in India and keeping in view the international developments in the field of accounting, the Council of the Institute of Chartered Accountings of India constituted the Accounting Standards Board (ASB) in April, 1977. The Accounting Standards Board is performing the function of formulating the accounting standards. While doing so, it takes into account the applicable laws, customs, usages and business environment. It gives adequate representation to all the interested parlies; the Board consists of representatives of industries, Central Board of Direct Taxes and the Comptroller and Auditor General of India.

To start with, ASB finalised the procedure to be followed in the formulation of standards. The "Preface to the Standards of Accounting Standards" was issued in January, 1979. The preface outlines scope and functions of ASB, the scope of accounting standards, the procedure to be followed by ASB in formulating the standards and the phased manner in which the compliance with the standards will be encouraged by the Institute. **Procedure of Preparing Accounting Standards**

The Accounting Standards Board determines the broad areas in which accounting standards are to be formulated and the priority which is to be given to each one of the selected areas. In the task of preparation of accounting standards. ASB is assisted by different study groups constituted to consider specific subjects. In the formation of study groups, care is taken that there is wide participation by members of the Institute of Chartered Accountants and other bodies. A dialogue is held with the representatives of the Government, the public sector undertakings, industries and other organisations to ascertain their views. Then, an exposure draft of the proposed accounting standard is prepared and issued for comments by the members of the Institute and the public at large. The draft is sent to various outside bodies like **FICCI, ASSOCHAM, SCOPE, C&AG, ICWA1, 1CSI, CBDT** etc. for their views. The draft includes the following points :

(i) A statement of concepts and fundamental accounting principles relating to the standard,

(it) Definitions of the terms used in the standard.

(iii) The manner in which the accounting principles have been applied for formulating the standard.

(iv) The presentation and disclosure requirements in complying with the standard. .

(v) Class of enterprises to which the standard will apply,

(vi) Date from which the standard will be effective.

After taking into the consideration the comments received from different quarters, the draft of the proposed standard is finalised by the Accounting Standards Board and submitted to the Council of the Institute of Chartered Accountants of India for the latter's approval. The Council considers the draft and if found necessary, modifies it in consultation with the Accounting Standards Board. Finally. the accounting standard is issued under the authority of the Council. Initially, the standard is made recommendatory and after some time it is made mandatory.

Propagation of Accounting Standards

The following measures have been taken to propagate the accounting standards :

(i) Information regarding the current status of the various project relating to the accounting standards and drawing the attention of the members to the standards already issued is published in the journal of the Institute of Chartered Accountants of India.

(ii) Discussions on the accounting standards issued by the 1CAI are arranged in the continuing education programmes organized by the ICAI and its Regional Councils and Students' Associations.

(iii) There is regular communication with universities, colleges, business management institutes, public and private sector undertakings etc. with a view to keeping them informed about the issuance of different accounting standards from time to time and seeking their co-operation in the implementation of these accounting standards.

(iv) The institute uses the compliance with the accounting standards an important criterion in deciding about the awards which the Institute gives every year for the best presented accounts and the Institute has been drawing attention of the companies and corporations to this fact.

The following is the text of Preface to the Statements of Accounting Standards issued by the Institute of Chartered Accountants of India in January, 1979:

Preface To The Statements of Accounting Standards

1. Formation of the Accounting Standards Board

The Institute of Chartered Accountants of India, recognising the need to harmonise the diverse accounting policies and practices at present in use in India, constituted an Accounting Standards Board (ASB) on 21" April, 1977. 2. Scope and Functions of Accounting Standards Board

2.1 The main function of ASB is to formulate accounting standards so that such standards may be established by the Council of the Institute in India. While formulating the accounting standards, ASB will take into consideration the applicable laws, customs, usages and business environment.

2.2 The Institute is one of the Members of the International Accounting Standards Committee (IASC) and has agreed to support the objectives of IASC. While formulating the Accounting Standards, ASB will give due consideration to International Accounting Standards, issued by IASC and try to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.

2.3 The Accounting Standards will be issued under the authority of the Council. ASB has also been entrusted with the responsibility of propagating the Accounting Standards and of persuading the concerned parties to adopt them in the preparation and presentation of financial statement. ASB will issue guidance notes of the Accounting Standards and give clarifications on issues arising therefrom. ASB will also review the Accounting Standards .at periodical intervals.

3. Audited Financial Statements

3.1 For discharging the above functions, ASB will keep in view the purpose and limitations of published financial statements and the attest function of the auditors. ASB will enumerate and describe the basic concepts to which accounting principles should be oriented and stale the accounting principles to which the practices and procedures should conform.

3.2 ASB will clarify the phrases commonly used in such financial statements and suggest improvements in the terminology wherever necessary. ASB will examine the various current alternative practices in vogue and identify such alternatives which should be preferred.

3.3 The Institute will issue the Accounting Standards for use in the presentation of the general purpose financial statements issued to the public by such commercial, industrial or business enterprises as may be specified by the Institute from time to time and subject to the attest function of its members. The term "General Purpose Financial Statements" includes balance sheet, statement of profit and loss and other statements and explanatory notes which form part thereof, issued for the use of shareholders/members, creditors, employees and public at large References to financial statements in this Preface and in the Standards issued from time to time will be construed to refer to General Purpose Financial Statements.

3.4 Responsibility for the preparation of financial statements and for adequate disclosure is that of the management of the enterprise. The Auditor's responsibility is to form his opinion and report-on such financial statements.

4. Scope of Accounting Standards

4.1 Efforts will be made to issue Accounting Standards which are in conformity with the provisions of the applicable laws, customs, usages and business environment of our country. However, if due to subsequent amendments in the law, a particular Accounting Standard is found to be not in conformity with such law, the provisions of the said law will prevail and the financial statements should be prepared in conformity with such law.

4.2 The Accounting Standards by their very nature cannot and do not override the local regulations which govern the preparation and presentation of financial statements in our country. However, the Institute will determine the extent of disclosure to be made in financial statements and the related Auditor's reports. Such disclosure may be by way of appropriate notes explaining the treatment of particular items. Such explanatory notes will be only in the nature of clarification and therefore, need not be treated as adverse comments on the related financial statements.

4.3 The Accounting Standards are intended to apply only to items which are material. Any limitations with regard to the applicability of a specific Standard will be made clear by the Institute from time to time. That date from which a particular Standard will come into effect, as well as the class of enterprises to which it will apply, will also be specified by the Institute. However, no standard will have retroactive application, unless otherwise stated.

4.4 The Institute will use its best endeavours to persuade the Government, appropriate authorities, industrial and business community to adopt these Standards in order to achieve uniformity in the presentation of financial statements.

4.5 In carrying out the task of formulation of Accounting Standards, the intention is to concentrate on basic matters. The endeavour would be to confine Accounting Standards to essentials and not to make them so complex that they cannot be applied effectively and on a nation-wide basis. In the years to come, it is to be expected that Accounting Standards will undergo revision and a greater degree of sophistication may then be appropriate.

5. Procedure for Issuing Accounting Standards

Broadly, the following procedure will be adopted for formulating Accounting Standards :

5.1 ASB shall determine the broad areas in which Accounting Standards need to be formulated and the priority in regard to the selection thereof.

5.2 In the preparation of Accounting Standards. **ASB** will be assisted by Study Groups constituted to consider specific subjects. In the formation of Study Groups, provision will be made for wide participation by the members of the Institute and others.

5.3 ASB will also hold a dialogue with the representatives of the Government, public sector undertakings, industry and other organisations for ascertaining their views.

5.4 On the basis of the work of the Study Groups and the dialogue with the organisations referred to in 5.3 above, an exposure draft of the proposed standard will be prepared and issued for comments by members of the Institute and the public at large.

5.5 The draft of the proposed standard will include the following basic points :

5.5.1 A statement of concepts and fundamental accounting principles relating to the Standard.

5.5.2 Definitions of the terms used in the Standard.

5.5.3 The manner in which the accounting principles have been applied for formulating the Standard.

5.5.4 The presentation and disclosure requirements in complying with the Standard.

5.5.5 Class of enterprises to which the Standard will apply.

5.5.6 Date from which the Standard will be effective.

5.6 After taking into consideration the comments received, the draft of the proposed Standard will be finalised by **ASB** and submitted to the Council of the Institute.

5.7 The Council of the Institute will consider the final draft of the proposed Standard, and if found necessary, modify the same in consultation with **ASB**. The Accounting Standard on the relevant subject will then be issued under the authority of the Council.

6. Compliance with the Accounting Standards

6.1 While discharging their attest functions, it will be the duty of the members of the Institute to ensure that the Accounting Standards are implemented in the presentation of financial statements covered by their audit reports. In the event of any deviation from the Standards, it will be also their duty to make adequate disclosures in their reports so that the users of such statements may be aware of such deviations.

6.2 In the initial years, the Standards will be recommendatory in character and the Institute will give wide publicity among the users and educate members about the utility of Accounting Standards and the need for compliance with the above disclosure requirements. Once an awareness about these requirements is ensured, steps will be taken, in course of time, to enforce compliance with the accounting standards in the manner outlined in para 6.1 above.

6.3 The adoption of Accounting Standards in our country and disclosure of the extent to which they have not been observed will, over the years, have an important effect, with consequential improvement in the quality of presentation of financial statements.

Indian Accounting Standards

The Institute of Chartered Accountants of India has so far issue twenty two accounting standards. They are as follows—

Mandatory- from accounting period
beinning an or afte*r*

(i) AS-1 — Disclosure of Accounting Policies. 1.4.1991

(ii) AS-2 (Revised) — Valuation of Inventories. 1.4.1999

(iii) AS-3 (Revised) — Cash Flow Statements

(iv) AS-4 (Revised) — Contingencies and Events Occuriring after the
Balance Sheet Date. 1.4.1995

(v) AS-5 (Revised) — Net Profit or Loss for the Period. Prior Period Items and Changes in Accounting Policies 1.4.1996

(vi) AS-6 (Revised) — Deprecation Accounting 1.4.1995

(vii) AS-7 — Accounting for Construction Contracts. 1.4.1991 (viii) AS-8 — Accounting for Research and Development 1.4.1991

(ix) AS-9 — Revenue Recognition 1.4.1991

(x) AS-10 — Accounting for Fixed Assets. 1.4.1991

(xi) AS-11 (Revised) — Accounting for the Effects of Changes in

Foreign Exchange Rates 1.4.1995

(xii) AS-12 — Accounting for Governments Grants 1.4.1994

(xiii) AS-13 — Accounting for Investment. 1.4.1995

(xiv) AS-14 — Accounting for Amalgamations 1.4.1995

(xv) AS-15 — Accounting for Retirement Benefits in the

Financial Statements of Employers. 1.1.1995

(xvi) AS-16 — Borrowing costs 1.4.2000

(xvii) AS-17 — Segment Reporting 1.4.2001

(xviii) AS-18 — Related Party Disclosures 1.4.2001

(xix) AS-19 — Leases 1.4.2001

(xx) AS-20 — Earnings Per Share 1.4.2001

(xxi) AS-21 — Consolidated Financial Statements 1.4.2001

(xix) AS-22 — Accounting for Taxes on Income` 1.4.2001

The **IASC** and the **ICAI**. both consider Going Concern, Accrual and Consistency as fundamental. In other words, it will be assumed, without the fact having to be stated, that the financial statements have been drawn up on accrual basis, without any change in the accounting policies and without there being any necessity or intention to liquidate or wind up the firm or a substantial part of it. The going concern assumption is very important; only on its basis can fixed assets be stated at cost less depreciation and their realisable value can be ignored. Also, some liabilities (such as gratuities, retrenchment compensation) arise only when the firm is liquidated. These can be ignored as long as the firm is a going concern. One can see that if the going concern assumption is not valid, the financial statements as ordinarily drawn up, will not be true at all.

It is recognized that since the circumstances governing each firm differ, it should have the right of choosing the accounting policy that is appropriate to it. The **IASC** and the **ICAI** state that the choice should be made on the basis of prudence, materiality and substance over form. In other words, the real state of affairs (not merely sticking to, say, strict legal interpretation) and the information disclosed should be material from the point of view of appraisal of the profitability and the financial position of the firm; insignificant information should not be disclosed separately. Further, it is recommended that the accounting policy chosen should be disclosed.

As I issued by the **ICAI** in November, 1979 is given below. The standard has become mandatory with effect from 1.4.1991.

Accounting Standard 1 (AS-1)

Disclosure of Accounting Policies

The following is the text of Accounting Standard 1 (AS-1) issued by the Accounting Standards Board of the Institute of Chartered Accountants of India, on "Disclosure of Accounting Policies". The Standard deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements.

Introduction

1. This statement deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements.

2. The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements. The accounting policies followed vary from enterprise to enterprise. Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.

3. The disclosure of some of the accounting policies followed in the preparation and presentation of the financial statements is required by law in some cases.

4. The Institute of Chartered Accountants of India has, in Statements issued by it, recommended the disclosure of certain accounting policies, *e.g.*, translation policies in respect of foreign currency items.

5. In recent years, a few enterprises in India have adopted the practice of including in their annual reports to shareholders a separate statement of accounting policies followed in preparing and presenting the financial statements.

6. In general, however, accounting policies are not at present regularly and fully disclosed in all financial statements. Many enterprises include in the Notes on the Accounts, descriptions of some of the significant accounting policies. But the nature and degree of disclosure vary considerably between the corporate and the non-corporate sectors and between units in the same sector.

7. Even among the few enterprises that presently include in their annual reports a separate statement of accounting policies, considerable variation exists. The statement of accounting policies forms part of accounts in some cases while in others it is given as supplementary information.

8. The purpose of this statement is to promote better understanding of financial statements by establishing through an accounting standard the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

Explanation

Fundamental Accounting Assumptions

9. Certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. They are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

10. The following have been generally accepted as fundamental accounting assumptions:—

(a) *Going Concern*

The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially scale of the operations.

(b) *Consistency*

It is assumed that accounting policies are consistent from one period to another.

(c) *Accrual*

Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. (The considerations affecting the process of matching costs with revenues under the accrual assumption are not dealt with in this statement).

Nature of Accounting Policies

11. The accounting policies refer to the specific accounting principles and the methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

12. There is no single list of accounting policies which are applicable to all circumstances. The differing circumstances in which enterprises operate in a situation of diverse and complex economic activity make alternative accounting principles and methods of applying those principles' acceptable. The choice of the appropriate accounting principles and the methods of applying those principles in specific circumstances of each enterprise calls for considerable judgment by the management of the enterprise.

13. The various statements of the Institute of Chartered Accountants of lndia combined with the efforts of government and other regulatory agencies and progressive managements have reduced in recent years the number of acceptable alternatives particularly in the case of corporate enterprises. While continuing efforts in this regard in future are likely to reduce the number still further, the availability of alternative accounting principles and methods of applying those principles is not likely to be eliminated altogether in view of the differing circumstances faced by the enterprises.

Areas in which differing accounting policies are encountered

14. The following are examples of the areas in which different accounting policies may be adopted by different enterprises :

• Methods of depreciation, depletion and amortization
• Treatment of expenditure during construction
• Conversion or translation of foreign currency items
• Valuation of inventories
• Treatment of goodwill
• Valuation of investments
• Treatment of retirement benefits
• Recognition of profit on long-term contracts
• Valuation of fixed assets
• Treatment of contingent liabilities

15. The above list of examples is not intended to the exhaustive.

Considerations in the Selection of Accounting Policies

16. The primary consideration in the selection of Accounting Policies by an enterprise that the financial statements prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the Balance Sheet date and of the profit or loss for the period ended on that date.

17. For this purpose the major considerations governing the selection and application of accounting policies are :

(a) Prudence

In view of the uncertainly attached to future events; profits are not anticipated but recognised only when realized though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information.

(b) Substance over Form

The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.

(c) *Materiality*

Financial statements should disclose all "material" items, *i.e.*, items the knowledge of which-might influence the decisions of the user of the financial statements.

Disclosure of Accounting Policies

18. To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

19. Such disclosure should form part of the financial statements.

20. It would be helpful to the reader of financial statements if they are all disclosed as such in one place instead of being scattered over several statements, schedules and notes.

21. Examples of matters in respect of which disclosure of accounting policies adopted will be required are contained in paragraph 14. This list of examples is not, however, intended to be exhaustive.

22. Any change in an accounting policy which has a material effect should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in

part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted. 23. Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Accounting Standard

(The Accounting Standard comprises paragraphs 24-27 of the Statement. The Standard should be read in the context of paragraphs 1-23 of this Statement and of the Preface to the Statements of Accounting Standards).

24. All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

25. The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place.

26. Any change in the accounting policies which has material effect in the current period of which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

27. If the fundamental accounting assumptions, *viz.* Going Concern, Consistency and Accrual are followed in financial statements specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

AS 22—Accounting For Taxes on Income

In this Accounting Standard, the standard portions have been set in **Bold** type. These should be read in the context of the background material which has been set in normal type, and in the context of the `Preface to the Statements of Accounting Standards.'*

Accounting Standard (AS) 22, `Accounting for Taxes on Income', issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 01-04-2001. It is mandatory in nature** for :

(a) All the accounting periods commencing on or after 01.04.2001, in respect of the following : (i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognized stock exchange in India as evidenced by the board of directors resolution in this regard.

(ii) All the enterprises of a group, if the parent presents consolidated financial statements and the Accounting Standard is mandatory in nature in respect of any of the enterprises of that group in terms of (i) above.

(b) All the accounting periods commencing on or after 01.04.2002. in respect of companies not covered by (a) above.

(c) All the accounting periods commencing on or after 01.04.2003, in respect of all other enterprises.

The Guidance Note on Accounting for Taxes on Income, issued by the Institute of Chartered

* Attention is specifically drawn to paragraph 4.3 of the Preface, according to which accounting standards the intended to apply only to material items.

** This implies that, while discharging their attest function, it will be the duty of the member of the Institute to examine whether this Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from this Accounting Standard. it will be their duly to make adequate disclosure in their audit reports so that the users of financial statements may be aware of such deviations.

Accountants of India in 1991, stands withdrawn from 01.04.2001. The following is the text of the Accounting Standard.

Objective

The objective of this Statement is to prescribe accounting treatment for taxes on income. Taxes on income is one of the significant items in the statement of profit and loss of an enterprise. In accordance with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate. Matching of such taxes against revenue for a period poses special problems arising from the fact that in a number of cases, taxable income may be significantly different from the accounting income. This divergence between taxable income and accounting income arises due to two main reasons. Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income.

Scope

1. This Statment should be applied in accounting for taxes on income. This includes the determination of the amount of the expense or saving related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements.

2. For the purposes of this Statement, taxes on income include all domestic and foreign taxes which are based on taxable income.

3. This Statement does not specify when, or how, an enterprise should account for taxes that are payable on distribution of dividends and other distributions made by the enterprises.

Definitions

4. For the purpose of this Statement, the following terms are used with the meanings specified:*Accounting income (loss)* is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving.

Taxable income (tax loss) is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined.

Tax expense (tax saving) is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

Current tax is the amount of income tax determined to be payable (recoverable) In respect of the taxable income (tax loss) for a period.

Deferred tax is the tax effect of timing differences.

Timing differences are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.

Permanent differences are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.

5. Taxable income is calculated in accordance with tax laws. In some circumstances, the requirements of these laws to compute taxable income differ from the accounting policies applied to determine accounting income. The effect of this difference is that the taxable income and accounting income may not be the same.

6. The differences between taxable income and accounting income can be classified into permanent differences and timing differences. Permanent difference are those differences between taxable income and accounting income which originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.

7. Timing differences are those differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. Timing differences arise because the period in which some items of revenue and expenses are included in taxable income do not include with the period in which such items of revenue and expenses are included or considered in arriving at accounting income. For example, machinery purchased for scientific research related to business is fully allowed as deduction in the first year for tax purposes whereas the same would be charged to the statement of profit and loss as depreciation over its useful life. The total depreciation charged on the machinery for accounting purposes and the amount allowed as deduction for tax purposes will ultimately be the same, but periods over which the depreciation is charged and the deduction is allowed will differ. Another example of timing difference is a situation where, for the purpose of computing taxable income, tax laws allow depreciation on the basis of the written down value method, whereas for accounting purposes, straight line method is used. Some other example of timing differences arising under the Indian tax laws are given in Appendix 1.

8. Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income are also considered as timing differences and result in deferred tax assets, subject to consideration of prudence.

Recognition

9. Tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period.

10. Taxes on income are considered to be an expense incurred by the enterprise in earning income and are accrued in the same period as the revenue and expenses to which they relate. Such matching may result into timing differences. The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets (subject to the consideration of prudence as set out in paragraphs 15-18) or as deferred tax liabilities in the balance sheet.

11. An example of tax effect of a timing difference that results in a deferred tax asset is an expense provided in the statement of profit and loss but not allowed as a deduction under Section 43B of the Income-tax Act, 1961. This timing difference will reverse when the deduction of that expense is allowed under Section 43B in subsequent year (s). An example of tax effect of a timing difference resulting in a deferred tax liability is the higher charge of depreciation allowable under the Income-tax Act, 1961, compared to the depreciation provided in the statement of profit and loss. In subsequent year, the difference will reverse when comparatively lower depreciation will be allowed for tax purposes.

12. Permanent differences do not result in deferred tax assets or deferred tax liabilities.

13. Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 15-**18.** 14. This Statement requires recognition of deferred tax for all the timing differences. This is based on the principle that the financial statements for a period should recognise the tax effect, whether current or deferred, of all the transactions occuring in that period.

15. Except in the situations stated in paragraph 17, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

16. While recognising the tax effect of timing differences, consideration of prudence cannot be ignored. Therefore, deferred tax assets are recognised and carried forward only to the extent that there is a reasonable certainty of their realisation. This reasonable level of certainty would normally be achieved by examining the past record of the enterprise and by making realistic estimates of profits for the future.

17. Where an enterprise has unabsorded depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convicting evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.

18. The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognises deferred tax assets only to the extent that it has timing differences the reversal of which will result in sufficient income or there is other convincing evidence that sufficient taxable income will be available against which such deferred tax assets can be realised. In such circumstances, the nature of the evidence supporting its recognition is disclosed.

Re-assessment of Unrecognised Deferred Tax Assets

19. At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets. The enterprise recognises previously unrecognised deferred tax assets to the extent that it has become reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be realised. For example, an improvement in trading conditions may make it reasonably certain that the enterprise will be able to generate sufficient taxable income in the future.

Measurement

20. Current tax should be measured at the amount expected to be paid (recovered from) the taxation authorities, using the applicable tax rates and tax laws.

21. Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

22. Deferred tax assets and liabilities are usually measured using the tax rates and tax laws that have been enacted. However, certain announcements of tax rates and tax laws by the Government may have the substantive effect of actual enactment. In these circumstances, deferred tax assets and liabilities are measured using such announced tax rate and tax laws.

23. When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using average rates.

24. Deferred tax assets and liabilities should not be discounted to their preset value.

25. The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each timing difference. In a number of cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between enterprise. Therefore, this Statement does not require or permit the discounting of deferred tax assets and liabilities.

Review of deferred tax assets

26. The carrying amount of deferred tax assets should be reviewed at each balance sheet date. An enterprises should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which deferred tax asset can be realized. Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be (sec paragraphs 15 to 18), that sufficient future taxable income will be available.

27. An enterprise should offset assets and liabilities representing current tax if the enterprise:

(a) has a legally enforceable right to set off the recognized amounts; and

(b) intends to settle the asset and the liability on a net basis.

28. An enterprise will normally have a legally enforceable right to set off an asset and liability representing current tax when they relate to income taxes levied under the same governing taxation laws and the taxation laws permit the enterprise to make or receive a single net payment.

29. An enterprise should offset deferred tax assets and deferred tax liabilities if:

(a) The enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(b) The deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

30. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.

31. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

32. the nature of the evidence supporting the recognition of deferred tax assets should be disclosed, If an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

Transitional Provisions

33. On the first occasion that the taxes on income are accounted for in accordance with this Statement, the enterprise should recognize, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this Statement as deferred tax assets/liability with a corresponding credit/charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets (see paragraphs 15-18). The amount so credited/charged to the revenue reserves should be the same as that which would have resulted if this Statement had been in effect from the beginning.

34. For the purpose of determining accumulated deferred tax in the period in which this Statement is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences and timing differences. For example, in the year in which an enterprise adopts this Statement, the opening balance of a fixed asset is Rs. 100 for accounting purposes and Rs. 60 for tax purposes. The difference is because the enterprise applied written down value method of depreciation for calculating taxable income whereas for accounting purposes straight line method is used. This difference will reverse in future when depreciation for tax purposes will be lower as compared to the depreciation for accounting purposes. In the above case, assuming that enacted tax rate for the year is 40% and that there are no other timing differences, deferred tax liability of Rs. 16 [(Rs. 100 - Rs. 60) x 40%] would be recognized. Another example is an expenditure that has already been written off for accounting purposes in the year of its incurrence but is allowable for tax purposes over a period of time. In this case, the asset representing that expenditure would have a balance only for tax purposes but not for accounting purposes. The difference between balance of the asset for tax purpose and the balance (which is nil for accounting purposes would be a timing difference which will reverse in future when this expenditure would be

allowed for tax purposes. Therefore, a deferred tax asset would be recognized in respect of this difference subject to the consideration of prudence.

Example of Timing Differences

Note : *This appendix is illustrative only and does not form part of Accounting Standard. The purpose of this appendix is to assist in clarifying the meaning of the Accounting Standard. The sections mentioned hereunder are references to section in the Income-tax Act. 1961, as amended by the Finance Act, 2001.*

1. Expenses debited in the statement of profit and losses for accounting purposes but allowed for tax purposes in subsequent years, *e.g;*

(a) Expenditure of the nature mentioned in Section 43 B *(e.g..* taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis but allowed for tax purposes in subsequent years on payment basis.

(b) Payments to non-residents accrued in the statement of profit and loss on mercantile basis, but disallowed lor tax purposes under Section 40 (a) (i) and allowed for tax purposes in subsequent years when relevant tax is deducted or paid.

(c) Provisions made in the statement of profit and loss in anticipation of liabilities where the relevant liabilities are allowed in subsequent years when they crystallize.

2. Expense amortized in the books over a period of years but are allowed for tax purpose wholly in the first year *(e.g.,* substantial advertisement expenses to introduce a product, etc. treated as deferred revenue expenditure in the books) or if amortization for tax purposes is over a longer or shorter period *(e.g.,* preliminary expenses under section 35D, expenses incurred for amalgamation under Section 35DD, prospecting expenses under Section 35E).

3. Where book and tax depreciation differ. This could arise due to :

(a) Differences in depreciation rates.

(b) Differences in method of depreciation *e.g.,* **SLM** or **WDV**.

(c) Differences in method of calculation *e.g.,* calculation of depreciation with reference to individual assets in the books but on block basis for tax purposes and calculation with reference to time in the books but on the basis of full or half depreciation under the block basis for tax purposes.

(d) Differences in composition of actual cost of assets.

4. Where a deduction is allowed in one year for tax purposes on the basis of a deposit made under a permitted deposit scheme *(e.g.,* tea development account Scheme under Section 33 **AB** or site restoration fund scheme under Section 33**ABA**) and expenditure out of withdrawal from such deposit is debited in the statement of profit and loss in subsequent years.

5. Income credited to the statement of profit and loss but taxed only in subsequent years *e.g.,* conversion of capital assets into stock in trade.

6. If for any reason the recognition of income is spread over a number of years in the accounts but the income is fully taxed in the year of receipt.

POSSIBLE QUESTIONS

PART – A

Online Examination

PART – B (2 MARKS)

1. What do you mean by dissolution of a partnership firm?
2. Define Accounting Standard.
3. Write a short note on Accounting Standards 6 of Depreciation Accounting?
4. Write short note on AS 13?
5. Give a short note on Piecemeal distribution.
6. What is AS 2?
7. What is AS 6?
8. What is AS 7?
9. What is AS 8?
10. What is the Rule of Garner and Murray?

Part - C

11. Define the term Accounting Standards and explain the objectives of Accounting Standards?
12. Describe the different modes or way in which a partnership firm may be dissolved.?
13. P,Q and R share profits in proportion of ½, ¼ and ¼. On the date of dissolution their Balance Sheet was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	14,000	Sundry Assets	40,000
P's Capital	10,000		
Q's Capital	10,000		
R's Capital	6,000		
	40,000		**40,000**

The assets realized Rs. 35,000. Creditors were paid in full. Realisation expenses amounted to Rs. 1,500. Close the books of the firm.

14. Determine the functions and scope of Accounting Standards and explain the various provisions of Indian Accounting Standards 6?
15. Determine the various conditions regarding Accounting Standards 14?
16. Explain in detail the rule laid down in 'Garner vs. Murray' case?
17. Determine the various Provisions of Indian Accounting Standards for investments?
18. Describe the Piece meal distribution and the Methods of making such distribution?
19. a. Red, White and Blue are in partnership. The following is their Balance sheet as at 31.12.2005 on which date, they dissolved partnership. They share profits in the ratio of 5:3:2

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	40,000	Sundry Debtors	60,000

Capitals:		Premises	40,000
Red	50,000	Plant	30,000
White	15,000	Stock	30,000
Blue	45,000		
Red's loan	10,000		
	1,60,000		**1,60,000**

It was agreed to repay the amounts due to the partners as and when the assets were realized, as

1.2.2006 Rs. 30,000
1.4.2006 Rs. 73,000
1.6.2006 Rs. 47,000

Prepare a statement showing how the distribution to the partners should be made.

20. Explain the provisions, contingent liabilities and contingent assets as per AS:10.

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

[14CMU301]

KARPAGAM UNIVERSITY

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

B.Com., DEGREE EXAMINATION, NOVEMBER 2015

Third Semester

COMMERCE

HIGHER FINANCIAL ACCOUNTING

Time: 3 hours   Maximum : 60 marks

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

PART B (5 x 8 = 40 Marks) (2 ½ Hours)
Answer ALL the Questions

21. a) Pragathi and Barkavi are partners sharing profits in the ratio of 3:1. Their balance sheet stood as under on 31.3.2004.

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Salary Due		5,000	Stock		10,000
Creditors		40,000	Prepaid Insurance		1,000
Capital			Debtors	8,000	
Pragathi:	30,000		Less: Provision	500	7,500
Barkavi:	20,000	50,000	Cash		18,500
			Machinery		22,000
			Buildings		30,000
			Furniture		6,000
		95,000			95,000

Charumathi is admitted as a new partner introducing a capital of Rs.20,000, for her 1/4th share in future profits.
Following revaluation are made:
i. Stock to be depreciated by 5%
ii. Furniture be depreciated by 10%
iii. Building be revalued at Rs.45,000
iv. The provision for doubtful debts should be increased to Rs.1,000.
Pass journal entries, prepare revaluation account and balance sheet after admission of Charumathi.

Or

b) Differentiate fixed capital account and fluctuating capital account.

22. a) R,S and M are partners in a firm sharing profits and losses in the ratio of 2:2:1 respectively. Their Balance Sheet as on 31st March 2008 was as follows.

Liabilities	Rs.	Assets	Rs.
Creditors	4,000	Cash at Bank	5,000
Reserve Fund	5,000	Stock	5,000
Capitals: R	10,000	Debtors	4,000
S	4,000	Fixtures	2,000
M	2,000	Machinery	9,000
	25,000		25,000

Adjustments:
They decided to dissolve the business. The following are the amounts realised.
Machinery Rs.8, 500; Fixtures Rs.1, 500; Stock Rs.7, 000; and Debtors Rs.3,700. Creditors allowed a discount of 2% and R agreed to bear all realisation expenses. For this service, R is paid Rs.120. Actual expenses amounted to Rs.900 which was withdrawn by him from the firm. There was an unrecorded asset of Rs.500 which was taken over by S at Rs.400.
Pass journal entries, prepare realisation account, capital account and bank account

Or

b) P,Q and R are partners in a firm. They share profits and losses equally. Their Balance Sheet on 31-12-2010 is given as under

Liabilities	Rs.	Assets	Rs.
Creditors	74,000	Machinery	60,000
Reserve Fund	18,000	Furniture	16,000
Capitals: P	16,000	Debtors	40,000
R	22,000	Cash at bank	8,000
		Q's Capital	6,000
	1,30,000		1,30,000

Adjustments:
The partnership is dissolved due to insolvency of Q who is unable to contribute anything in the payment of his debt to the firm. Machinery realized Rs.30,000 and furniture Rs.6,400 Only Rs.24,000 was recovered from debtors. Creditors were paid at a discount of 5%. Prepare the necessary accounts in the books of the firm when the capitals are fluctuating. Apply Garner Vs Murray rule.

23. a) Fire occurred in the premises of Prithvi on 10th May 2006. In order to make a Claim on their fire policies in respect of the stock, they ask your advice and you are able to obtain the following information:

Particulars	2003 Rs.	2004 Rs.	2005 Rs.	2006 Rs.
Opening Stock	16,000	15,000	16,000	18,000
Purchases	47,000	47,200	56,600	78,000
Sales	60,000	66,000	78,000	99,000
Closing Stock	15,000	16,000	18,000	?

The stock salvaged was Rs.3, 800. Compute the amount of claim.

Or

b) From the following information, prepare Cattle Account to ascertain the profit made by the cattle division.

Particulars	No.	Value (in Rs.)
Opening stock of livestock	100	2,00,000
Closing stock of livestock	118	2,42,000
Opening stock of cattle food		4,000
Closing stock of cattle food		5,000
Purchases of cattle during the year	180	3,70,000
Sales of cattle during the year	175	4,38,000
Sales of carcasses	5	1,000
Purchase of cattle food		40,000
Wages of rearing cattle		10,000

Crop worth Rs.11,100 grown in the farm was used for feeding the cattle. Out of the calves born 4 died and their carcasses realized Rs.100.

24. a) The Lakshmanan Sea ways undertook a voyage from Athens to Kolkata on 1st January, 2004, and reaching on 31st March 2004. The cargo consisted of 900 tonnes of foodgrains and 100 tonnes of engineering goods. The freight charges were Rs.150 per tonne for food grains and Rs.100 per tonne for engineering goods. In addition primage was 10%. Brokerage was payable at 5%. The expenses were.

Particulars		Part A Rs.	Part B Rs.
Coal and Diesel		20,000	-
Port Charges		9,000	2,000
Harbour Wages		3,000	1,000
Loading Charges		2,000	-
Other Expenses	Rs.		
Stores	10,000		
Discharging Expenses	2,000		
Postage	1,000		
Salaries to Crew	10,000		

The ship was insured for Rs.10,00,000 at 1% for a Voyage Policy of the hull. The freight was insured at 1/2%. Depreciation is charged on the written down value of the ship at 5% per annum. The value on January 1, 2006 Rs.8,00,000. Prepare voyage account.

Or

b) India Shipping Co. of Mumbai had a ship by name Bharat, whose written down value as on 1st July,2005 was Rs.25 Lakhs. The ship was insured Rs.30 Lakhs at 1% for voyage policy of hull. The ship makes a trip to S and returned to Chennai during the period 1st July, 2005 to 30th Septem 2005. The particulars relating to the voyage are given below:

(i) Expenses incurred:
Salaries of the crew Rs.25,000; Fuel Rs.55,000; Port Dues Rs.
Stores expenses Rs.32,000; Shares of overhead for the ship Rs.

(ii) Stevendoring at the rate of Rs.3 per tonne

(iii) Depreciation was charged on the written value of the ship at the of 10% per annum.
The freight was insured at 1%

(iv) The particulars of the freight consisted of the following:
(a) Leather goods 1,100 tonnes at the rage of Rs.120 per tonne
(b) Cotton 500 tonnes at the rate of Rs.150 per tonne
(c) Sugar 1,700 tonnes at the rate of Rs.100 per tonne.

(v) In addition to primage @ 10% the brokerage payable was @5%

Prepare Voyage Accounts for three months.

25. a) On 31-12-2005 Eswaran's Assets and liabilities were Rs.60,000 and Rs. respectively. He estimated that his deficiency to be Rs.20,000. Later he that the following were not taken into account

i) Interest on capital at 6% on Rs.30,000
ii) Bills discounted Rs.10,000 and of which likely to be dishonored Rs.
iii) Outstanding expenses: Salaries Rs.1,400, Wages Rs.500 Rent for 3 months Rs.600

Prepare the statement of affairs and deficiency Accounts.

Or

Part B Rs.
-
2,000
1,000
-

ıyage Policy of th
charged on the w
ı January 1, 2006

rat, whose writte
ship was insured
makes a trip to S
5 to 30th Septem
below:

)0; Port Dues Rs.
d for the ship Rs.

ıe of the ship at th

following:
of Rs.120 per ton
per tonne
) per tonne.
payable was @5%

Rs.60,000 and Rs.
.20,000. Later he

be dishonored Rs
Rs.500 Rent for 3

nts.

b) What are preferential creditors in the following liabilities of insolvent Bhupesh according to Presidency Towns Insolvency Act and Provincial Insolvency Act?

Particulars	Rs.
3 months salary for 10 clerks	3,600
One month wages of 12 labourers	1,600
Sales tax	400
3 months rent of landlord	600
Income tax	1,000
Wages of four servants	1,400
Salaries	1,000
Municipal tax	400
Wages	6,000

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KARPAGAM UNIVERSITY

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B.Com., DEGREE EXAMINATION, NOVEMBER 2015

Third Semester

COMMERCE (PROFESSIONAL ACCOUNTING)

HIGHER FINANCIAL ACCOUNTING

Time: 3 hours — Maximum : 60 marks

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

PART B (5 x 8 = 40 Marks) (2 ½ Hours)
Answer ALL the Questions

21. a. Eswar owes to Faruk the following amounts
Rs. 5,000 due on 10th March, 2011
Rs. 18,000 due on 2nd April, 2011
Rs. 60,000 due on 30th April, 2011
Rs. 2,000 due on 10th June, 2011
He desires to make the full payment on 30th June, 2011, with interest 10% per annum after age due date. Find out the Average Due Date and the amount of interest.

Or

b. From the following particulars make out an account current to be rendered by Nataraj to Aruna in product method as at 30th June, charging interest @ 5% per annum.

Date	Particulars	Amount (Rs.)
01.01.2013	Balance due to Nataraj by Aruna	800
11.01.2013	Goods sold by Nataraj to Aruna	2,200
20.01.2013	Received bill accepted by aruna @ 2 Months for	1,000
25.02.2013	Cash received from Aruna	1,200
12.03.2013	Bought goods of Aruna	5,500
13.03.2013	Nataraj accepted Aruna's draft @ one month for	2,000
25.04.2013	Cash paid to Aruna	2,000
30.04.2013	Goods sold to Aruna, due end of May	2,400
21.05.2013	Bought Goods from Aruna	1,500
10.06.2013	Sold Goods to Aruna, due 20th June	2,200
25.06.2013	Bought goods from Aruna	3,000

22. a. How will you convert Income and Expenditure Account into Receipts and Payments Account?

Or

b. M.R.P. Singh, who maintains his books by Single Entry System, has submitted returns to the Income Tax Authorities showing his income to be as follows.:

Date	Amount (Rs.)
31st December, 2009	3,675
31st December, 2010	3,700
31st December, 2011	3,935
31st December, 2012	6,875
31st December, 2013	6,070
31st December, 2014	4,630

But the Income Tax Authority is not satisfied as to the accuracy of the accounts submitted. You are asked to help in finding their accuracy. In this regard you are given with the following information:

i. Business assets and liabilities as on 31st December 2008 were: Debtors, Rs. 725: Cash at bank, Rs. 4,735: Stock, Rs. 2,710 (at market price which is 25% above cost): Creditors, Rs. 3,660.

ii. M.R.P.Singh owed his sister, Rs. 2,000 on 31st December, 2008. On 15th March, 2011 he repaid this amount and on 1st April, 2014, he lent his sister Rs. 1,500.

iii. M.R.P.Singh owns a house which he bought in 2004 for Rs. 10,000 and a car which he bought in 2010 for Rs. 3,750. In 2013, he bought Rs. 5,000 shares in X Ltd, for Rs. 3,750.

iv. In 2014, Rs. 1,500 were stolen from his house.

v. M.R.P.Singh stated that his living expenses have been: Rs. 1,500: Rs. 2,000: Rs. 3,000: Rs. 3,500: Rs. 3,500: Rs. 3,500: during the years 2009, 2010, 2011, 2012, 2013 and 2014 respectively. These expenses are exclusive of the amount stolen.

vi. On 31st December, 2014, the business liabilities and assets were: Creditors Rs. 4,200: Debtors, Rs. 2,960: Cash in hand, Rs. 9,725 and stock Rs. 3,370 (at market price which shows as gross profit of 25%).

From the information submitted, prepare a statement showing whether or not the income declared by M.R.P.Singh is accurate

23. a. Determine the characteristics of Hire purchase system and Instalment system

Or

b. On 1.1.2006 Sujatha bought a machine from Chirtra & Co on hire purchase system Rs. 1,20,000 was the cash price, Rs. 30,000 down payment and at the end of I year Rs. 34,500, II year Rs. 33,000 and III year Rs. 31,500 was payable. The vendor charged interest @ 5% and depreciation is provided @ 10% annually. Journalise the entries in the books of both the parties.

24. a. Define the term branch account and explain the various kinds of branches.

Or

b. Company carries on its business through five department's viz., A, B, C, D and E. The Trial Balance as on 31-12-08 is as follows:

Particulars	A (Rs.)	B (Rs.)	C (Rs.)	D (Rs.)	E (Rs.)
Opening Stock	5,000	3,000	2,500	4,000	4,500
Purchases	50,000	30,000	10,000	26,000	30,000
Sales	48,000	21,000	9,500	23,000	30,000
Closing Stock	6,000	4,000	3,500	3,500	5,500

The Opening and closing stocks have been valued at cost. The expenses, which are to be in proportion to the cost of goods sold in the respective departments are as follows :

Particulars	Amount (Rs.)
Salaries and Commission	5,510
Rent and Rates	1,450
Miscellaneous Expenses	1,305
Insurance	580

Show the final result and the percentage on sales in each department and also the combined result with percentage on sales.

25. a. Enumerate the important matters regarding which this committee has laid down standards.

Or

b. Elaborate the significance of Provisions of Accounting Standards 8.

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B.Com., DEGREE EXAMINATION, NOVEMBER 2017

Third Semester

COMMERCE (PROFESSIONAL ACCOUNTING)

HIGHER FINANCIAL ACCOUNTING

Time: 3 hours   Maximum : 60 marks

PART – A (20 x 1 = 20 Marks)
Answer ALL the Questions

1. An Account Current is a copy of the account appearing in the books of the ____ with the additional column for interest on each item.
a. Receiver b. Sender c. Holder d. Accountant

2. Epoque method of calculation of interest is the reverse of the ________
a. Product Method b. Red Ink Interest Method c. Periodic balance Method
d. Interest Tables Method

3. An Average due date is an Equated date of payment on which a single payment may be made in lieu of _______ due for payment on different dates
a. Single Payment b. Huge Payment c. Few Payment d. Several Payment

4. Interest = Interest on Capital - interest on ___________
a. Drawings b. Savings c. Earnings d. Balance of payments

5. Which of the following is generally considered as a non- profit oriented organization?
a. Charitable Institution b. Corporation c. Firms d. Insurance Companies

6. The receipts and payments account of a non-profit organization is a ______
a. Real Account b. Nominal Account c. Personal Account d. Income Account

7. Non-profit organizations prepare all of the following accounts except the ____
a. Income Statement b. Expenditure Statement c. Financial Statement
d. Receipts Statement

8. Expenditures greater than incomes of a non-profit organization give rise to a ____
a. Loss b. Profit c. Surplus d. deficit

9. Down Payment is otherwise called as__________
a. Initial amount b. amount c. Cash d. Finance

10. Hire vendor is the ________of the goods on the hire purchase system
a. Seller b. Purchaser c. Hire Purchaser d. Debtor

11.Hire Purchase Price = Cash Price + ______
a. Cash b. Interest c. Price d. Market Price

12. Hirer is otherwise called as _________
a. Hire Purchaser b. Vendor c. Hire vendor d. Purchaser

13. Department accounts are prepared to know separately the _________ of each department
a. Loss b. Profit c. Surplus d. deficit

14. Selling Expenses should be divided among different departments on the basis of_
a. Sales b. purchases c. profit d. loss

15. Building expenses should be divided among the different departments according to the _____ by each department
a. Space occupied b. Space released c. released d. Space

16. _________accounts are prepared to know separately the profit of each department
a. Department b. Income c. Finance d. Branch

17. Accounting Standards Board was set up in India in the year ________
a. 1964 b.1975 c. 1977 d. 1987

18. International Accounting Standards Committee came into existence in the year_
a. 1962 b.1973 c. 1975 d. 1976

19. IASC's headquarters are situated at __________
a. London b. New York c. New Delhi d. Kolkata

20. Accounting Standards 1 stands for disclosure of accounting________
a. Policies b. Payments c. Incomes d. Earnings

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

21. a. Define the term Account Current and explain the different methods of calculating interest in Account Current.

Or

b. You are required to prepare the Total Debtors Account and Total Creditors Account from the following

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Cash Sales	25,000	Bills Receivable dishonoured	2,500
Credit Purchases	2,80,000	Return Inward	8,500
Collection from Debtors	4,25,000	Payments to Creditors	1,62,000
Bills Receivable Received	20,000	Discount allowed	3,000
Discount Received	2,500	Debtors cheque returned dishonoured	7,500
Cash Purchases	12,000	Credit Sales	4,90,000
Bills Payable paid	6,500	Bills Receivable collected	10,000
Recovery of Bad Debts	1,500	Return Outward	3,700
Bills Receivable discounted with bank	8,000	Bills Receivable endorsed to creditors	7,900
Interest charged on overdue customer's accounts	1,200	Overpayments refunded by suppliers	600
Endorsed Bills Receivable dishonoured (noting charges Rs.75)	5,500	Opening Balances Sundry Debtors Sundry Creditors	 78,000 85,000
Bills payable accepted	16,000	Bad debts	1,000

22. a. State the difference between Receipts and Payments Account and Income and Expenditure Account.

Or

b. Saran keeps his books on single entry system. From the following particulars, prepare a statement showing profit or loss made by his for the year ended March 31, 2014.

Particulars	March 31, 2013 (Rs.)	March 31, 2014 (Rs.)
Debtors	16,000	19,000
Stock	12,000	15,000
Furniture	2,000	4,000
Cash in hand	1,000	1,500
Creditors	1,200	1,800
Bank overdraft		2,000

During the year Saran introduced Rs. 10,000 as further capital in the business and withdrew Rs. 6000.

23. a. Distinguish between Hire purchase system and Installment system.

Or

b. On 31st January 2010, Mr. Anil purchased for cash from Bhajan four 6% 100 debentures of Manian Ltd, at Rs. 110.50 cum interest, interest being payable on 1st June and 1st December each year. How will you record the transactions in the books of both the parties, if each party had to pay bank commission of 25 paise per Rs. 100?

24. a. Explain the accounting treatment of interdepartmental transfers at cost and selling price.

Or

b. Suma Departmental stores has two departments-provisions and Fancy ma... From the following, prepare departmental Trading Account.

Purchase:
Provisions Department – 1,000 units
Cosmetics Department - 2,000 units (at a total cost of Rs. 1,10,000)
Opening Stock:
Provisions Department – 400 units
Cosmetics Department - 600 units
Sales :
Provisions Department – 900 units @ R. 75 per unit
Cosmetics Department - 2,100 units @ Rs. 45 per unit
Assume that Gross Profit rate is uniform for both the departments.

25. a. Define the term Accounting Standards and explain the objectives of Accounting Standards.

Or

b. Discuss the accounting policies and fundamental accounting assumptions given in Accounting Standard 1.

B.Com.,

Time: 3 hours

1. The assessment
a. 2005-06

2. In which sectic
a. Sec 2

3. Agricultural in
a. Fully exemp

4. Income Tax A
a. 1st April,19

5. In which secti
a. Sec 2(1)

6. Scholarship r
a. Fully exem

7. There are ___
a.290

8. Any trade, cc
commerce m
a. Business

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B.Com. DEGREE EXAMINATION, NOVEMBER 2015

Third Semester

COMMERCE

HIGHER FINANCIAL ACCOUNTING

Time: 3 hours Maximum : 60 marks

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

1. Define 'Partnership.
2. What is the meaning of Fluctuating Capital? Give its general format.
3. G and H are partners sharing profits in the ratio of 3:2. They admit I for 1/5th share which he acquires entirely from G. Calculate a) new ratio and b) Sacrificing ratio.
4. List out the various modes of dissolution of a partnership firm.
5. What is meant by piecemeal distribution?
6. What journal entries would you pass for the following assuming all the assets are already transferred to realisation account:
   a) An asset sold for cash Rs.50,000
   b) An asset is taken away by partner 'Z' Rs.65,000
7. What is 'gross profit ratio'?
8. A trader has his stock insured against fire. Subsequently a fire destroyed a part of the stock which was valued on the date of the fire at Rs.60,000. The stock was insured subject to average clause. Stock salvaged was Rs.12,000. Stock was insured for Rs.36,000. Calculate the claim.
9. Mention any two objectives of farm accounting
10. What is the meaning of 'voyage in progress'?
11. What is the meaning of 'Shortworkings'?
12. Calculate the shortworkings and the amount payable to the landlord from the following data:
    Royalty : Rs.1.50 per tonne
    Minimum Rent: Rs.20,000
    Output :
    1^{st} year: 9,000 tonnes
    2^{nd} year: 12,000 tonnes
    Short workings are recoupable during the first two years of lease.
13. Who are partly secured creditors?

14. Give any two differences between 'insolvency' of an individual and that of a partnership firm.
15. What are private liabilities?

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

16. a. A and B are partners in a firm. They share profits and losses in the ratio of 3:1. Their Balance Sheet is as follows:

Liabilities	Rs.	Assets	Rs.
Capital		Buildings	1,00,000
A	80,000	Plant	25,000
B	40,000	Stock	40,000
Reserve	40,000	Debtors	70,000
Creditors	60,000	Cash	5,000
Bills Payable	20,000		
	2,40,000		2,40,000

C is admitted into partnership for $1/5^{th}$ share of the business on the following terms:

i. Building is revalued at Rs.1,20,000.
ii. Plant is depreciated to 80%
iii. Provision for bad debts is made at 5%
iv. Stock is revalued at Rs.30,000
v. C should introduce 50% of the adjusted capitals of both A and B.
Open various accounts and the new Balance Sheet after the admission of C.

Or

b. Sunil, Devan and Ravi are equal partners in a firm and their Balance Sheet as on 31-12-90 is given below:

Liabilities	Rs.	Assets	Rs.
Capital:		Machinery	43,500
Sunil	15,000	Furniture	1,500
Devan	12,000	Debtors	30,000
Ravi	18,000	Stock	15,000
Reserve	4,500		
Creditors	40,500		
	90,000		90,000

Ravi retired on 31.12.90 and assets were revalued as under:
Machinery Rs.51,000, Furniture Rs1,200, Debtors Rs.28,500, Stock Rs.14,700, Goodwill of the firm is valued at Rs.9,000 and Ravi's share of goodwill is to be adjusted to continuing partners capital accounts.
Give journal entries, prepare necessary ledger accounts and new balance sheet.

17. a. The following is the Balance Sheet of A and B as on 31^{st} March 2011, who share profits and losses in the ratio of 2:1.

Liabilities	Rs.	Assets		Rs.
Captial : A 22,250		Land and Buildings		10,500
B 17,750	40,000	Motor Van		4,575
Creditors	24,375	Stock in trade		18,200
		Debtors	28,300	
		Less: Provision	612	27,688
		Cash at bank		3,412
	64,375			64,375

Adjustments:

The Partners decided to dissolve the firm as on the above date and it is agreed that

i. A took over land and buildings at an agreed value of Rs.10, 875.

ii. Stock in trade and motor van were sold for Rs.19, 400 and Rs.4, 235 respectively.

iii. Debtors were realised in full.

iv. Creditors were paid subject to discount of Rs.300.

v. Realisation expenses were Rs.400. Give ledger accounts to close the books of the firm.

Or

b. The following is the Balance Sheet of X,Y and Z as on 31.03.2004.

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	40,000	Cash at Bank	12,000
General Reserve	30,000	Stock	40,000
Capitals: X	50,000	Sundry Debtors	20,000
Y	30,000	Furniture	40,000
		Plant & Machinery	20,000
		Z's Capital	18,000
	1,50,000		1,50,000

Adjustments:

'Z' is insolvent but his estate pays Rs.4,000. It is decided to dissolve the partnership.

(i) The assets realised as follows: Sundry Debtors Rs.15,000; Furniture Rs.28,000; Stock Rs.32,000; Plant & Machinery Rs.14,000.

(ii) The dissolution expenses amounted to Rs.5,000.

Give Accounts to close the books of the firm if the capitals are fluctuating. Apply Garner Vs. Murray Rule.

18. a. The Bengal mines Co. Ltd took from Mr. Dass a lease of a mined for a period of 25 years from 01-01-86, on a royalty of Rs.5 per tonne of mineral raised with a dead rent of Rs.20,000 and power to recoup shortworkings during the first five years of the lease.

The annual outputs were as follows:

1986 - 2,000 tonnes, 1987 - 3,000 tonnes, 1988 - 4,000 tonnes,

1989 - 4,500 tonnes, 1990 - 5,000 tonnes

Give journal entries and Ledger accounts in the books of the Bengal Mines Company.

Or

b. North Peninsula Ship commenced a voyage on 1st March, 2005 from Port A t Port B and back. The voyage was completed on April 31, 2005. It carried a consignment of vegetables on its outward journey and teak wood on its returr journey.

The ship was insured at an annual premium of Rs.6,00,000. From the following particulars, draw up the voyage account:

Port charges Rs.1,25,000; Coal Rs.7,50,000; Wages and Salaries Rs.12,50,000; Stores purchased Rs.2,15,000; Sundry expenses Rs.1,37,500. Depreciation (annual) Rs.24,00,000; Freight earned (out) Rs.32,50,000; Freight earned (return) Rs.17,50,000; Address Commission 5% on outward and 4% on return freight; Passage money received Rs.2,50,000; Primage is 5% on freight. The manager is entitled to 5% commission on the freight earned. After charging such commission, stores and coal on hand were valu at Rs.75,000 on May 31,2005.

19. a. On 31st December, 2004,. Ram's assets and liabilities amounted to Rs.60,00 and Rs.45,000 respectively. He estimated his deficiency to be Rs.20,000. H found subsequently that the following had not been taken into account.

i) Interest on his capital of Rs.30,000 at 6% per annum for one year

ii) Liability on bills discounted amounting in al comes to Rs.10,000 of whic Rs.3,000 were expected to be dishonoured.

iii) Salaries Rs.1,400; Wages Rs. 500 and Rent to landlord for three months Rs.150 have to be paid.

Prepare his statement of affairs and deficiency account.

Or

b. What is the meaning of Statement of affairs and deficiency account? Give t difference between them.

20. **Compulsory :-**

Analyse the loss of stock suffered by a company from the following information:

A fire occurred in the premises of X Ltd. on 10.10.91. All stocks were destroyed except to the extent of Rs.6,200.

	Rs.
Stock on 1.1.1990	40,000
Purchases during the year 1990	1,45,000
Sales during 1990	2,00,000
Stock on 31.12.90	25,000
Purchases during 1991 upto the date of fire	1,52,200
Sales during 1991 upto the date of fire	1,89,000

Time: :

21. (a) I

(b) I

22. (a) E

(b) V

23. (a) D

(b) W
d

24. (a) E
er

(b) D

25. (a) Ex

(b) De