INTERMEDIATE
Paper 6

Financial Accounting

Study Notes
SYLLABUS 2022

The Institute of Cost Accountants of India

CMA Bhawan, 12, Sudder Street, Kolkata - 700 016

www.icmai.in

First Edition : August 2022
Revised Edition: July 2024
Revised Edition: October 2024
Reprint : January 2025

Price : ₹ 600.00

Published by :

Directorate of Studies
The Institute of Cost Accountants of India
CMA Bhawan, 12, Sudder Street, Kolkata - 700 016
studies@icmai.in

Printed at:

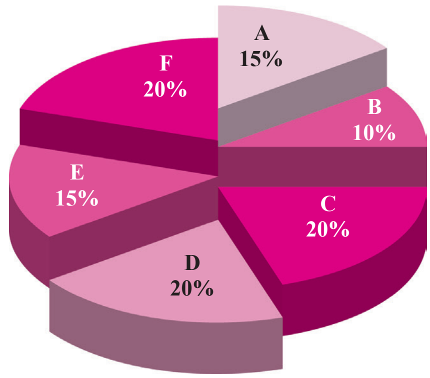
M/S. Infinity Advertising Services Pvt. Ltd.
Plot No. 171 & 172, Sector-58, Faridabad,
Haryana - 121004

PAPER 6 : FINANCIAL ACCOUNTING

Syllabus Structure:

The syllabus comprises the following topics and study weightage:

Module No.	Module Description	Weight
	Section A: Accounting Fundamentals	**15%**
1	Accounting Fundamentals	**15%**
	Section B: Accounting for Special Transactions	**10%**
2	Bills of Exchange, Consignment, Joint Venture	**10%**
	Section C: Preparation of Financial Statements	**20%**
3	Preparation of Final Accounts of Commercial Organisations, Not-for-Profit Organisations and from Incomplete Records	**20%**
	Section D: Partnership Accounting	**20%**
4	Partnership Accounting	**20%**
	Section E: Lease, Branch and Departmental Accounts etc.	**15%**
5	Lease Accounting	**15%**
6	Branch (including Foreign Branch) and Departmental Accounts	
7	Insurance Claim for Loss of Stock and Loss of Profit	
8	Hire Purchase and Installment Sale Transactions	
	Section F: Accounting Standards	**20%**
9	Accounting Standards	**20%**



Learning Environment – Paper 6

<table>
<tr><td>Subject Title</td><td>FINANCIAL ACCOUNTING</td></tr>
<tr><td>Subject Code</td><td>FA</td></tr>
<tr><td>Paper No.</td><td>6</td></tr>
<tr><td>Course Description</td><td>This subject highlights the fundamental concepts of financial accounting, discusses accounting of certain special transactions and focuses on the preparation of financial statements of various forms of organisations viz. non-corporate commercial organisations and also not-for-profit organisations. It also focuses on accounting of various aspects of partnership form of business and gives an overview of selected accounting standards.</td></tr>
<tr><td>CMA Course Learning Objectives (CMLOs)</td><td>1. Interpret and appreciate emerging national and global concerns affecting organizations and be in a state of readiness for business management.
a. Identify emerging national and global forces responsible for enhanced/varied business challenges.
b. Assess how far these forces pose threats to the status-quo and creating new opportunities.
c. Find out ways and means to convert challenges into opportunities
2. Acquire skill sets for critical thinking, analyses and evaluations, comprehension, syntheses, and applications for optimization of sustainable goals.
a. Be equipped with the appropriate tools for analyses of business risks and hurdles.
b. Learn to apply tools and systems for evaluation of decision alternatives with a 360-degree approach.
c. Develop solutions through critical thinking to optimize sustainable goals.
3. Develop an understanding of strategic, financial, cost and risk-enabled performance management in a dynamic business environment.
a. Study the impacts of dynamic business environment on existing business strategies.
b. Learn to adopt, adapt and innovate financial, cost and operating strategies to cope up with the dynamic business environment.
c. Come up with strategies and tactics that create sustainable competitive advantages.
4. Learn to design the optimal approach for management of legal, institutional, regulatory and ESG frameworks, stakeholders' dynamics; monitoring, control, and reporting with application-oriented knowledge.
a. Develop an understanding of the legal, institutional and regulatory and ESG frameworks within which a firm operates.
b. Learn to articulate optimal responses to the changes in the above frameworks.
c. Appreciate stakeholders' dynamics and expectations, and develop appropriate reporting mechanisms to address their concerns.
5. Prepare to adopt an integrated cross functional approach for decision management and execution with cost leadership, optimized value creations and deliveries.
a. Acquire knowledge of cross functional tools for decision management.
b. Take an industry specific approach towards cost optimization, and control to achieve sustainable cost leadership.
c. Attain exclusive knowledge of data science and engineering to analyze and create value.</td></tr>
</table>

Subject Learning Objectives [SLOB(s)]	1. To obtain in-depth knowledge on the four frameworks within which accounting operates and the principles on which accounting theories and practices are based. (CMLO 4a, b) 2. To develop detail application-oriented knowledge on various stages of accounting right from the identification of transactions up to finalisation of accounts. (CMLO 4a, b) 3. To equip oneself with the detail understanding of accounting of certain special transactions to determine surplus, ensure control on resources, for divisional performance evaluation or acquisition of assets through deferred payments. (CMLO 2a, 4c) 4. To develop application-oriented knowledge to prepare financial statements of profit seeking and not-for-profit entities and from incomplete records. (CMLO 3a and 4c) 5. To develop detail understanding of accounting for changes in partnership structure and accounting in an LLP. (CMLO 4a, c) 6. To gain application-oriented knowledge on identifying the impact of various standards on treatment of certain transactions to ensure appropriate reporting. (CMLO 4a, c)
Subject Learning Outcome (SLOC) and Application Skill (APS)	**SLOC(s)** 1. Students will be able to record transactions in a systematic manner in compliance with the four frameworks of accounting and reporting. 2. They will be able to perform periodical finalization of accounts and prepare financial statements for reporting to stakeholders. 3. They will guide management on divisional performance evaluation, responsibility accounting and control of resources based on the outcome of accounting records and reports on special transactions. 4. They will be able to handle accounting of various restructuring events in partnership form of business. 5. They will ensure compliance to the standards of accounting with respect to the treatment of certain specified transactions. **APS** 1. Students will develop appropriate skills to record transactions systematically within the given organisational set-up. 2. They will be able to independently draft mandatory financial statements and other reports of various types of organisations. 3. They will acquire necessary skill sets to prepare customised internal reports on resource utilisation and control, divisional performance evaluation and claim management.

Module wise Mapping of SLOB(s)

Module No.	Topics	Additional Resources (Research articles, books, case studies, blogs)	SLOB Mapped
Section A: Accounting Fundamentals			

Module wise Mapping of SLOB(s)			
Module No.	**Topics**	**Additional Resources (Research articles, books, case studies, blogs)**	**SLOB Mapped**
1.	**Accounting Fundamentals**	Toward a Science of Accounting – Sterling https://www.tandfonline.com/doi/abs/10.2469/faj.v31.n5.28?journalCode=ufaj20	1. To obtain in-depth knowledge on the four frameworks within which accounting operates and the principles on which accounting theories and practices are based. 2. To develop detail application-oriented
			knowledge on various stages of accounting right from the identification of transactions up to finalisation of accounts.
Section B: Accounting for Special Transactions			
2.	**Accounting for Special Transactions**	The Negotiable Instruments Act, 1881 https://legislative.gov.in/sites/default/files/A1881-26.pdf	To equip oneself with the detail understanding of accounting of certain special transactions to determine surplus, ensure control on resources, for divisional performance evaluation or acquisition of assets through deferred payments.
Section C: Preparation of Financial Statements			
3.	**Preparation of Financial Statements**	Understanding Financial Statements – Fraser	To develop application-oriented knowledge to prepare financial statements of profit seeking and not-for-profit entities and from incomplete records.
Section D: Partnership Accounting			
4.	**Partnership Accounting**	The Partnership Act, 1932 https://www.mca.gov.in/Ministry/actsbills/pdf/Partnership_Act_1932.pdf The LLP Act, 2008 https://www.mca.gov.in/content/mca/global/en/acts-rules/llp-act-2008.html	To develop detail understanding of accounting for changes in partnership structure and accounting in an LLP.
Section E: Lease, Branch and Departmental Accounts etc.			

Module wise Mapping of SLOB(s)

Module No.	Topics	Additional Resources (Research articles, books, case studies, blogs)	SLOB Mapped
5.	**Lease Accounting**	Lease Accounting: Theory and Practice – Kaur	To equip oneself with the detail understanding of accounting of certain special transactions to determine surplus, ensure control on resources, for divisional performance evaluation or acquisition of assets through deferred payments.
6.	**Branch and Departmental Accounting**	Financial Accounting – Tulsian – Person education	
7.	**Insurance Claim for Loss of stock and Loss of profit**	Financial Accounting – Hanif and Mukherjee – McGraw Hill	
8.	**Hire Purchase and Installment Sale Transactions**	Financial Accounting – Tulsian	
		Section F: Accounting Standards	
9.	**Accounting Standards**	Accounting Standards https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/accounting-standards.html	To gain application-oriented knowledge on identifying the impact of various standards on treatment of certain transactions to ensure appropriate reporting.

Contents as per Syllabus

Contents as per Syllabus

Contents as per Syllabus

SECTION-A

Accounting Fundamentals

Accounting Fundamentals 1

This Module Includes

Accounting Fundamentals

SLOB Mapped against the Module

- To obtain in-depth knowledge on the four frameworks within which accounting operates and the principles on which accounting theories and practices are based. (CMLO 4a, b)
- To develop detail application-oriented knowledge on various stages of accounting right from the identification of transactions up to finalisation of accounts. (CMLO 4a, b)

Module Learning Objectives:

After studying this module, the students will be able to:

- Understand the frameworks of accounting;
- Know the principles of accounting i.e. Accounting concepts and Accounting conventions;
- Understand the concept transaction and its different types;
- Understand the Accounting cycle;
- Get the knowledge of different books of accounts and related concepts;
- Learn the preparation and scrutiny of trial balance;
- Pass adjustment entries and rectification entries;
- Do accounting for depreciation, amortisation, bad debts and provisions thereof

Four Frameworks of Accounting

1.1

According to Collins Dictionary, the term 'framework' refers to 'a structure that forms a support or frame for something'. In the context of any system, it is 'a particular set of rules, ideas, or beliefs which you use in order to deal with problems or to decide what to do'.

In accounting, 'framework' provides a common set of rules and guidelines that is used to measure, recognize, present, and disclose the information appearing in an entity's financial statements.

Four Frameworks of Accounting

The framework of accounting has four pillars – Conceptual, Legal, Institutional and Regulatory. These are discussed below.

a. Conceptual Framework

The Conceptual Framework is a body of interrelated objectives and fundamentals. The objectives identify the goals and purposes of financial reporting and the fundamentals are the underlying concepts that help achieve those objectives. Those concepts provide guidance in selecting transactions, events and circumstances to be accounted for, how they should be recognized and measured, and how they should be summarized and reported. It states the objectives of General-Purpose Financial Reporting and the information provided by it. Conceptual Framework also guides on the qualitative characteristics that the financial statements must possess.

Conceptual Framework often plays an important role in the development of Institutional Framework and assists preparers to develop consistent accounting policies when no accounting standard applies to a particular transaction or other event, or when a standard allows a choice of accounting policy.

b. Legal Framework

Businesses are often controlled by various statutes under which they are formed. For example, in India, partnership organisations are governed by Indian Partnership Act, 1932 or Limited Liability Partnership Act, 2008, co-operatives are controlled by the Co-operative Societies Act, 1912, companies are governed by the Companies Act, 2013. In addition, banks are controlled by Banking Regulation Act, 1949, insurance companies are under the Insurance Act, 1938, electricity companies are also governed by the Central Electricity Act, 2003. All these statutes (including various Rules framed under them) not only govern the administrative set up of these organisations, but also provide important guidelines regarding use of resources, financing and also on the maintenance of books of accounts and treatment of specified transactions. For example, the Companies Act, 2013 and Companies (Accounts) Rules, 2014 provide useful provisions on maintenance of accounting records, accounting for issue and redemption of securities, investments to be done, consolidation and even winding up of the company. Companies (Corporate Social Responsibility) Rules, 2014 provides the guidelines regarding accounting of CSR expenses as well as carry forward and set-off of excess amount spent. Thus, legal framework plays an important role in accounting. The Schedules of this Act also provide important guidelines on the form and contents of financial statements.

c. Institutional Framework

Institutional framework refers to the guidelines issued in form of certain pronouncements by institutions entrusted by the sovereign authorities to oversee the development of the respective field. In India, the Institute of Chartered Accountants of India has been entrusted to develop standards in the field of accounting to ensure comparability and consistency in accounting information. The Indian Accounting Standard Board of ICAI thus develops quality accounting standards on different areas of accounting. Currently, there are two sets of accounting standards in India – Accounting Standards as per Companies (Accounting Standards) Rules, 2021 and Ind ASs under Companies (Indian Accounting Standards) Rules, 2015. In addition, the Cost Accounting Standards Board (CASB) of the Institute of Cost Accountants of India has, so far, developed 24 Cost Accounting Standards to facilitate cost accounting and reporting.

d. Regulatory Framework

The activities of organisations often come under the regulatory ambit of various regulators. In India, there are different regulatory authorities in different segments of financial market, such as RBI in money market operations, SEBI in capital market operations, IRDAI in insurance sector, PFRDA in pension funds. In addition, there are Telecom Regulatory Authority of India (TRAI), Competition Commission etc. The regulations imposed by these authorities may also have important bearing on accounting of a concerned entity. For example, regulations issued by SEBI largely shape the accounting and, more importantly, reporting by a listed firm in India. Similarly, regulations framed by IRDAI affect the accounting and reporting in insurance companies. In banking, BASEL Norms and other guidelines issued by RBI largely determine the accounting of NPA (Non-Performing Assets). Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2009 affect the determination of tariff and accounting in an electricity company in India.

The above four frameworks provide the foundation on which accounting and more specifically corporate accounting is based in India. They help to streamline the accounting process and help to improve the quality of the reports generated and thereby contribute in the overall development of accounting.

Accounting Principles, Concepts and Conventions

1.2

The responsibility of the discipline of accounting is to provide financial information to the users of accounting information. For this purpose, it keeps records of the various transactions in its books of accounts. The practice of record keeping may be practiced differently by different organisations. In order to ensure uniformity and consistency in record keeping, the accounting profession has developed rules, conventions, standards, and procedures which are generally accepted and universally practiced. This common set of rules, conventions, standards, and procedures is referred to as **Generally Accepted Accounting Principles (GAAP)**.

The GAAPs indicate how to report economic events and are thus, used by organisations in drafting their financial statements. They are to be followed by organisations so that the users of accounting information have an optimum level of consistency in the financial statements they use, when analyzing companies for investment purposes.

Such accounting principles have been developed from research, accepted accounting practices, and pronouncements of regulators.

In India, financial statements are prepared on the basis of accounting standards issued by the Institute of Chartered Accountants of India (ICAI) and the law laid down in the respective applicable statutes (like, Schedule III to Companies Act, 2013 is required to be followed by all companies).

Concept of Accounting Principles, Accounting Concepts, and Accounting Conventions

Accounting Principles are the basic rules which act as a primary standard for recording business transactions and maintaining books of accounts. They provide standards for scientific accounting practices and procedures. They guide as to how the transactions are to be recorded and reported. They assure uniformity and understandability. Accounting principles are accepted as such if they happen to be (1) objective (2) usable in practical situations (3) reliable (4) feasible (they can be applied without incurring high costs); and (5) comprehensible to those with a basic knowledge of accounting and finance.

The accounting principles can be split into – [A] Accounting Concepts and [B] Accounting Conventions.

[A] Accounting Concepts refer to the assumptions and conditions that define the parameters and constraints within which the accounting operates. They lay down the foundation for accounting principles, and ensure recording of financial facts on sound bases and logical considerations. The common accounting concepts are:

(a) Entity Concept

(b) Going Concern Concept

(c) Periodicity Concept

(d) Money Measurement Concept

(e) Accrual Concept

(f) Dual Aspect Concept

(g) Matching Concept

(h) Realisation Concept

(i) Cost Concept

[B] Accounting Conventions are customs, methods, procedures or guidelines associated with the practical application of accounting principles. These are widely accepted, and are the common practices which are used as a guideline when recording transactions. Accounting conventions are a necessary part of the accounting profession, since they result in transactions being recorded in the same way by multiple organizations. This allows for the reliable comparison of the financial facts and figures. However, accounting conventions may change over a period of time, thus reflecting shifts in the general opinion and/ or practice of dealing with a transaction. The different accounting conventions are:

(a) Convention of Conservatism

(b) Convention of Consistency

(c) Convention of Materiality

(d) Convention of Full Disclosure.

Accounting Concepts

(a) Entity Concept: As per this concept, an organisation is treated as distinct and separate from the persons who own or manage it. In other words, this concept assumes that the organization and business owners are two independent entities. Hence, the personal transaction of its owner is different from the transactions of the organisation. Application of this concept enables recording of transactions between the entity and its owners and/ or other stakeholders. The entity concept requires that all the transactions are to be viewed, interpreted and recorded from organisation's point of view.

For example, if the owner pays his personal expenses from business cash, this transaction can be recorded in the books of business entity. This transaction will take the cash out of business and also reduce the obligation of the business towards the owner.

(b) Going Concern Concept: The basic assumption of this concept is that an organisation is assumed to continue to exist for an indefinite period of time. This simply means that every concern has continuity of life. Unless, there is good evidence to the contrary, the accountant assumes that an organisation is a 'going concern'. This concept enables the accountant to carry forward the values of assets and liabilities from one accounting period to the other without asking the question about usefulness and worth of the assets and recoverability of the receivables. The going concern concept forms the basis for preparation of Balance Sheet of an organisation.

(c) Accounting Period Concept: Accounting period concepts assumes that the infinite life of an organisation can be split into smaller periods of equal duration (viz. a quarter, half-year or year). Due to this concept, the operating results are ascertained for a specific period, the financial position is reflected (through the balance sheet) at regular intervals.

(d) Money Measurement Concept: Any event which can be expressed in terms of money is always recorded in the books of accounts. The advantage of this concept is that different types of transactions could be recorded as homogenous entries with money as common denominator. A business may own ₹ 3 Lacs cash, 1500 kg of raw material, 10 vehicles, 3 computers etc. Unless each of these is expressed in terms of money, the assets owned by the business cannot ascertained. When expressed in the common measure of money, transactions could be added or subtracted to find out the combined effect. However, the limitation of this concept is that only the absolute value of the money is considered, whereas the real value may fluctuate from time to time due to inflation, exchange rate changes, etc.

(e) **Accrual Concept:** This concept is based on recognition of both cash and credit transactions. In case of a cash transaction, owner's equity is instantly affected as cash either is received or paid. In a credit transaction, however, a mere obligation towards or by the organisation is created. When credit transactions exist (which is generally the case), revenues are not the same as cash receipts and expenses are not same as cash paid during the period.

(f) **Dual Aspect Concept:** The dual aspect concept assumes that every transaction recorded in the books of accounts is based on two aspects (technically called 'Debit' and 'Credit'). This concept provides the basis for recording business transactions in the books of accounts. This implies that the transaction that is recorded affects two (or more) accounts on their respective opposite sides. Hence, the transaction should be recorded in at least two accounts. For example, goods purchased in cash have two aspects such as 'paying cash' and 'receiving goods'. Such duality of the transaction is commonly expressed in the terms of an equation as: Assets = Liabilities + Capital.

(g) **Matching Concept:** This concept states that the revenues and expenses must be recorded at the same time at which they are incurred. In general, the revenues earned should be matched with the expenses incurred during the accounting period. For the application of this concept several adjustments are made for prepaid expenses, accrued incomes, etc. The operating result of an accounting period can be measured only when incomes are compared with the related expenses incurred.

(h) **Realisation Concept:** The concept of realisation talks about how much of the revenue should be recognized in the books of accounts. It says, amount should be recognized only to the tune of which it is certainly realizable. Thus, mere getting an order from the customer won't make it eligible to be recognized as revenue. The reasonable certainty of realizing the money will come only when the goods ordered are actually supplied to the customer and he is billed. This concept ensures that any income which is unearned or unrealized will not be considered as revenue.

(i) **Cost Concept:** The cost concept states all the business assets should be written down in the book of accounts at the costs incurred for their acquisition, including any capital cost incurred in relation to installation. The assets are not to be recorded at their market price. For example, a packing machine was purchased by Bharat Ltd. for ₹40,00,000. An amount of ₹30,000 was spent on transporting the machine to the factory site, and further ₹20,000 was additionally spent on its installation. Hence, the total amount at which the machine will be recorded in the books of accounts would be the aggregate of all these costs i.e. ₹40,50,000. This cost is also termed as 'Historical Cost'.

Accounting Conventions

(a) **Convention of Conservatism:** The convention of conservatism essentially assumes an uncertain future and as such, advocates providing for all possible losses, but never for possible future gains. As such, application of this convention would always result in understatement of incomes, profits and thus, resources.

(b) **Convention of Consistency:** This convention advocates the continuous observation and application of the rules and practices of accounting. The uniformity and consistency of accounting rules is vital to profit and loss calculations as well as comparisons of company performance. Frequent changes in the treatment of accounts would result in inconsistency and hence, make the accounting information less reliable. It would result in making accounting information truthful, accurate and complete.

(c) **Convention of Materiality:** The convention of materiality advocates the recording and reflection of all material facts (i.e. those pieces of information that can potentially influence the decision of informed investor) in the accounting records, and elimination of insignificant information. It should be noted that any item of fact which is considered material by on organisation may be treated as unimportant by another organisation. In the same way, an item that is considered material during a particular time period may be treated as unimportant in subsequent time periods.

(d) Convention of Full disclosure: This convention advocates the full disclosure of all material information, whether favourable or otherwise, in the accounting statements of a business enterprise. This convention requires that all accounting statements must be prepared honestly. The convention of disclosure holds greater importance in the case of businesses where the ownership is separate from the management.

Conclusion

Accounting principle, concepts and conventions are very vital to the accounting profession, since they bring about uniformity in the process of recording transactions. Such uniformity makes it possible to reliably compare the financial results, financial position, and cash flows of different organizations and also over different periods. These, thus go a long way in helping to standardize the financial reporting process.

Capital and Revenue Transactions

1.3

Proper distinction between transactions of capital and revenue nature is one of the fundamental requirements of accounting. It is very significant as without this being done properly, the very objective of accounting gets affected. The application of accounting concepts of periodicity, accrual and matching leads to the identification of a transaction as either capital natured transaction or revenue natured transaction.

When transactions get properly classified between capital and revenue nature, it achieves the following purposes:

1. Ensures proper accounting of transactions by identifying them either as income or as liability, and expense or asset;
2. Determination of true operating result by correct identification of incomes and expenses;
3. Proper disclosure of financial position in the balance sheet of the entity by correct disclosure of its assets and liabilities.

1.3.1 Capital and Revenue Expenditures

After the incurrence of an expenditure by an entity, that expenditure has to be recognized as either a capital expenditure or a revenue expenditure before being recorded in the books of accounts.

Capital Expenditure refers to that expenditure, benefit from which can be enjoyed by an entity over a number of accounting periods. This type of expenditure happens to be non-recurring in nature. A capital expenditure takes place when an asset or service is acquired or improvement of a fixed asset is affected. These assets resulting from such expenditure are not intended for resale in the ordinary course of business.

Example: Purchase of machinery; Construction of building; Development of website; Heavy repairs of a non-current asset etc.

Accounting Treatment: An expenditure of capital nature is not written off completely (i.e. charged) against income in the accounting period in which it is acquired. Rather, it is capitalised (i.e. recorded) as an asset and gets reflected in the balance sheet. However, over time the amount of capital expenditure sliced for being recognized as revenue expenditure i.e. it gets gradually charged against the profit. For example, the acquisition of a machinery is a capital expenditure, but charging regular depreciation on this machinery is a revenue expenditure.

Revenue Expenditure refers to that expenditure, benefit from which can be enjoyed by an entity in the current accounting period. This type of expenditure happens to be recurring in nature. Revenue expenditures are incurred to carry on the regular course of operations by an organisation.

Example: Purchase of goods for sale; payment of recurring expenses (like salaries, wages, rent, depreciation, conveyance charges, monthly internet charges etc.); Repairs and maintenance of non-current assets etc.

Accounting Treatment: An expenditure of revenue nature charged as an expense against profit of the accounting period in which it is incurred or recognised.

The following are the points of distinction between Capital Expenditure and Revenue Expenditure:

Capital Expenditure	Revenue Expenditure
1. The economic benefits from capital expenditure are enjoyed for more than one accounting period.	1. The economic benefits from revenue expenditure are enjoyed for only one accounting period.
2. It is non-recurring in nature.	2. It is recurring in nature.
3. Normally, it involves heavy cash outlay.	3. Normally, it involves lower cash outlay.
4. It is reflected in the Balance Sheet.	4. It is debited to Income Statement.
5. It may be incurred before or after the commencement of operations of an entity.	5. It is always incurred after the commencement of operations of an entity.
6. It tends to increase the earning capacity or, reduce the operating expenses of an entity.	6. It helps in carrying on the activities in the current accounting period.
7. A portion of capital expenditure may get matched against the revenue to determine the operating result.	7. Entire amount of such expenditure is matched against the revenue to determine the operating result.

Certain Rules for Identification of Capital Expenditure

An expenditure can be recognised as capital if it is incurred for the following purposes:

- An expenditure incurred for the purpose of acquiring long term assets (useful life is at least more than one accounting period) for use in the organisation to carry on its operations (and not meant for resale) will be treated as a capital expenditure. For example, if a second hand motor car dealer buys a piece of furniture with a view to use it in business; it will be a capital expenditure. But if he buys second hand motor cars, for re-sale, then it will be a revenue expenditure because he deals in second hand motor cars.
- When an expenditure is incurred to improve the present condition of a machine or putting an old asset into working condition, it is recognised as a capital expenditure. The expenditure is capitalised and added to the cost of the asset. Likewise, any expenditure incurred to put an asset into working condition is also a capital expenditure. For example, if one acquires a machine for ₹5,00,000 and pays ₹20,000 as transportation charges and ₹40,000 as installation charges, the total cost of the machine coming to ₹5,60,000. Similarly, if a building is purchased for ₹40,00,000 and ₹2,00,000 is spent on registration and stamp duty, the capital expenditure on the building stands at ₹42,00,000.
- An expenditure incurred for improving the earning capacity of an organisation will be considered to be of capital nature. For example, expenditure incurred for shifting the factory for easy supply of raw materials will be a capital expenditure.
- Preliminary expenses incurred before the commencement of business is considered capital expenditure. For example, legal charges incurred by a company for drafting the memorandum of association, articles of association of a company or brokerage paid to brokers, or commission paid to underwriters for raising capital etc.

Deferred Revenue Expenditures

Deferred Revenue Expenditure is the expenditure for which payment has been made or a liability has been incurred but which is carried forward on the presumption that will be of benefit over a subsequent period or periods.

Example: Heavy advertisement expenditure incurred prior to launching a new product; Development expenses of a product etc.

Accounting Treatment: A part of such expenditure (the expense portion) is recorded in the debit-side of the Income Statement, while the unwritten-off portion appears as an asset in the Balance Sheet.

NB: After the issuance of AS-26, the expenditures which were recognised as deferred revenue expenditure has to be treated as simple revenue expense. The accounting standard has specifically mentioned that any expenditure incurred for research, training, advertising and promotional activities should be recognised as an expense of the accounting period in which it has been incurred.

1.3.2 Capital and Revenue Receipts

A receipt of money may be of a capital or revenue nature depending upon the source of the receipt. A clear distinction should be made between capital receipts and revenue receipts to ensure proper determination of operating results.

Capital Receipts refer to the receipts which are obtained by an entity from operations other than the regular operations of the entity. Capital receipts do not have any effect on the operating result (i.e. profits earned or losses incurred) during the course of a year.

Example: A company issues new shares to raise funds for expansion.

Number of share issued: 1000

Issue price per share: 50

Total Capital Raised: ₹ (1000 * 50) = ₹ 50,000.

Accounting Treatment: Such receipt is credited to the respective account of capital nature, and gets reflected in the Balance Sheet.

Revenue Receipts refer to the receipts which are obtained by an entity from its regular course of operations. Receipts of money in the revenue nature increase the profits or decrease the losses of a business and must be set against the revenue expenses in order to ascertain the profit for the period.

Example: A company sells 1000 unit @ ₹ 20 per unit in the normal course of business, in this case Revenue Receipt would be ₹ (1000 * 20) = ₹ 20,000.

Accounting Treatment: These are recognised as income and should be credited to the Income Statement.

The following are the points of difference between capital receipts and revenue receipts:

Capital Receipt	Revenue Receipt
1. These receipts are obtained by an entity from operations other than from the regular operations.	1. These receipts are obtained by an entity from regular day-to-day operations.
2. It is irregular and hence, non-recurring in nature.	2. It is recurring in nature.
3. It is not recognised as an income.	3. It is recognised as an income.
4. It gets reflected in the Balance Sheet.	4. It is credited to Income Statement.
5. It does not affect the operating result of an entity.	5. It affects the operating result of an entity.
6. It may result in creation of liability.	6. It does not create any liability.

The matching of revenues and expenses result in either profit or loss. As such, an extension of the discussion on expenditures and receipts of capital and revenue nature naturally leads to the concepts of 'Capital and Revenue Profits' and 'Capital and Revenue Losses'.

1.3.3 Capital and Revenue Profits

While ascertaining the operating result of an entity in relation to an accounting period, proper distinction is to be made between capital profits and revenue profits.

Capital Profit refers to a profit which arises out of the non-operating activities of an entity. It is non-recurring in nature. Generally, capital profits arise out of the sale of assets other than inventory, or in connection with the raising of capital or at the time of purchasing an existing business.

Examples: Profit prior to incorporation; Premium received on issue of shares; Profit made on re-issue of forfeited shares; Redemption of Debenture at a discount; Profit made on sale or revaluation of a non-current tangible asset etc.

Accounting Treatment: Capital profits are generally capitalised i.e. transferred to a Capital Reserve Account.

Revenue Profit refers to a profit which arises out of the regular operating activities of an entity. It is recurring in nature.

Example: Profit arising out of the sale of the merchandise that the business deals in; Profit made by rendering regular services to clients; Surplus earned by a non-profit organisation etc.

Accounting Treatment: Revenue profits, which get determined in the Income Statement, are distributed to the owners of the business or transferred to any Reserve Account.

1.3.4 Capital and Revenue Losses

While ascertaining losses, revenue losses are differentiated from capital losses, just as revenue profits are distinguished from capital profits.

Capital Loss refers to a loss which does not arise to an entity in the regular course of its operations.

Example: Capital losses may result from the sale of assets other than inventory for less than written down value; Diminution/ elimination of assets other than as the result of use or sale i.e. from extra-ordinary activities (viz. loss by flood, fire etc.) or in connection with raising debt capital by a company (issue of debentures at a discount) or on the settlement of liabilities for a consideration more than its book value (debenture issued at par but redeemed at a premium).

Accounting Treatment: It is either charged against the revenue i.e. debit-side of Income Statement or reflected in the asset-side of Balance Sheet (as fictitious assets).

Revenue Loss arise to an entity from the normal course of business.

Example: Discount allowed to customers for prompt payment; loss due to bad debts etc.

Accounting Treatment: Such loss is to be recorded in the debit-side of Income Statement.

Example 1

Classify the following items as capital or revenue expenditure:

(i) An extension of railway tracks in the factory area;

(ii) Wages paid to machine operators;

(iii) Installation costs of new production machine;

(iv) Materials for extension to foremen's offices in the factory;

(v) Rent paid for the factory;

(vi) Payment for computer time to operate a new stores control system,

(vii) Wages paid to own employees for building the foremen's offices. Give reasons for your classification.

Solution:

(i) Expenses incurred for extension of railway tracks in the factory area should be treated as a Capital Expenditure because it will yield benefit for more than one accounting period.

(ii) Wages paid to machine operators should be treated as a Revenue Expenditure as it will yield benefit for the current period only.

(iii) Installation costs of new production machine should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.

(iv) Materials for extension to foremen's offices in the factory should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.

(v) Rent paid for the factory should be treated as a Revenue Expenditure because it will benefit only the current period.

(vi) Payment for computer time to operate a new stores control system should be treated as Revenue Expenditure because it has been incurred to carry on the normal business.

(vii) Wages paid for building foremen's offices should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.

Example 2

State with reasons whether the following are Capital Expenditure or Revenue Expenditure:

(i) Expenses incurred in connection with obtaining a license for starting the factory were ₹ 10,000.

(ii) ₹ 1,000 paid for removal of stock to a new site.

(iii) Rings and Pistons of an engine were changed at a cost of ₹ 5,000 to get full efficiency.

(iv) ₹ 2,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.

(v) ₹ 10,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.

(vi) A factory shed was constructed at a cost of ₹ 1,00,000. A sum of ₹ 5,000 had been incurred for the construction of the temporary huts for storing building materials.

Solution:

(i) ₹10,000 incurred in connection with obtaining a license for starting the factory is a Capital Expenditure. It is incurred for acquiring a right to carry on business for a long period.

(ii) ₹1,000 incurred for removal of stock to a new site is treated as a Revenue Expenditure because it is not enhancing the value of the asset and it is also required for starting the business on the new site.

(iii) ₹ 5,000 incurred for changing Rings and Pistons of an engine is a Revenue Expenditure because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.

(iv) ₹ 2,000 incurred for defending the title to the firm's assets is a Revenue Expenditure.

(v) ₹ 10,000 incurred on advertising is to be treated as a Revenue Expenditure. [As per As-26]

(vi) Cost of construction of Factory shed of ₹ 1,00,000 is a Capital Expenditure, similarly cost of construction of small huts for storing building materials is also a Capital Expenditure.

Accounting Cycle, Analysis of Transaction etc.

1.4

The **Accounting Cycle** is a sequence of activities performed by an accountant to document and report an organisation's financial transactions during an accounting period. This cycle follows financial transactions from when they occur to how they affect financial documents. The entire process starting with identification of transactions, their recording and processing all transactions of an organisation, to its representation on the financial statements, and also to closing the accounts, if applicable, is referred to as Accounting Cycle. To keep track of the full accounting cycle from start to finish is one of the main duties of a bookkeeper.

Stages of Accounting Cycle

The accounting cycle consists of the following sequential steps:

1. **Identifying transactions:** The first step in the accounting cycle is to analyze events to determine if they are "transactions". Transactions are the starting point from which the rest of the accounting cycle will follow.
2. **Recording transactions in Books of Original Entry:** The second step in the accounting cycle is to record the identified transactions in the relevant Books of Original Entry as journal entries.
3. **Posting to the ledger:** The next step is to record a summary of the activities in relevant account in the ledger (referred to as Posting).
4. **Drafting of Unadjusted Trial Balance:** At the end of an accounting period, data from the ledger accounts may be taken to draft a trial balance. It is prepared for identifying any errors that may have occurred during the initial stages of the accounting cycle. However, this step is not mandatory.
5. **Passing of adjustment entries:** Identification of necessary adjustments and passing of adjusting entries make up the fifth step in the cycle.
6. **Drafting of Adjusted Trial Balance:** Once all adjusting entries are completed, then an Adjusted Trial Balance can be prepared. This happens to be the last step before the preparation of the financial statements.
7. **Closing of books:** In this stage of the accounting cycle, the ledger accounts are closed and balanced (also referred to as "zeroed out") at the end of every accounting period.
8. **Drafting the Financial Statements:** In the last stage of the accounting cycle, the Income Statement is prepared with the closing balances of the nominal accounts, while the balances of real and personal accounts gets reflected in the Balance Sheet.Financial statements are prepared in the following order: Income Statement, Statement of Retained Earnings, Balance Sheet and Statement of Cash Flows.

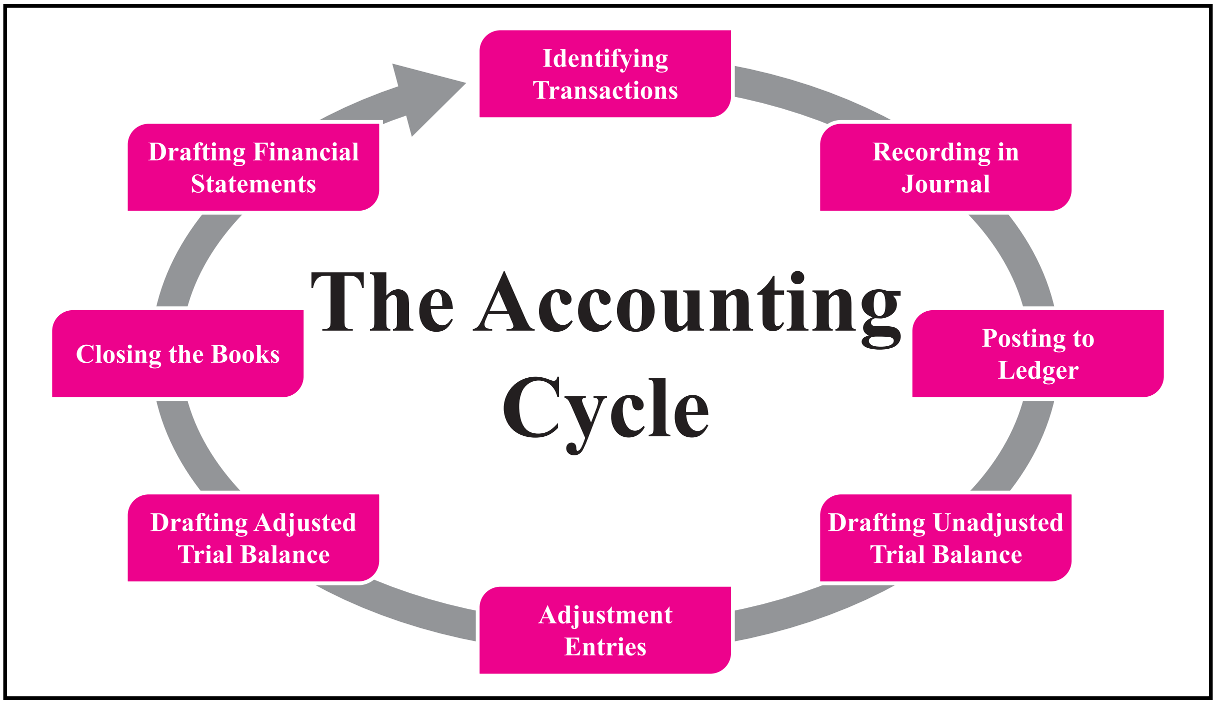


Fig: 1.1 Accounting Cycle

Events & Transactions

The primary purpose of financial accounting is to record the transactions entered into by an organisation during an accounting period. So, transactions are the staring point of the accounting cycle.Transactions are created through events, but all events are not transactions.

- **Events:** Everything that is happening in every moment of human life is an event. Simply stated, any happening is an event. As such, events can be financial (like, purchasing a book, paying cab fare, receiving a cheque etc.) and non-financial (like, visiting a book store, going for morning walk etc.). An event may involve any number of parties, and may be complete and may be incomplete.
- **Transactions:** An accounting transaction is an event which has a monetary impact on the financial position of the organisation. In order to be considered as a transaction, an event has to satisfy the following conditions:
  1. It must be measurable in terms of money.
  2. It must involve atleast two parties.
  3. It involves a monetary exchange for a goods or service.
  4. It must cause a change in the financial position of the entity.

Analysis of Transactions

An organisation enters into various transactions during the course of its operations. These transactions cause changes in financial position of the organisation. **Analysis of transactions** implies observing the changes in financial position of the organisation caused by the transactions entered into by it during an accounting period. A change in financial position means change in one or more of the five basic elements of accounting, they being: Assets, Liabilities, Capital/ Equity, Expenses, and Revenue.

In the following example of a trading proprietorship business, various illustrative transactions are used to understand the changes in different elements of accounting:

Transaction 1: Mr. Suman De commences his business by investing ₹ 5,00,000 in cash.
Changes brought about by this transaction are:
Cash increases in the business by ₹ 5,00,000; (Element changed: Asset increase)
Capital increases by ₹ 5,00,000 (Element changed: Capital/ Equity increase)
Transaction 2: Mr. De opened a current account with the bank by depositing ₹ 2,00,000.
Changes brought about by this transaction are:
Cash balance decreases by ₹ 2,00,000; (Element changed: Asset decrease)
Bank balance increases by ₹ 2,00,000 (Element changed: Asset increase)
Transaction 3: He borrows ₹ 1,20,000 from bank interest @ 10% p.a.
Changes brought about by this transaction are:
Bank balance increases by ₹ 1,20,000 (Element changed: Asset increase);
Bank loan increases by ₹ 1,20,000 (Element changed: Liability increase)
Transaction 4: Mr. De purchases equipments worth ₹ 80,000 for cash.
Changes brought about by this transaction are:
Equipments increase by ₹ 80,000; (Element changed: Asset increase)
Cash decrease by ₹ 80,000 (Element changed: Asset decrease)
Transaction 5: He purchased goods worth ₹ 1,00,000 for resale, out of which 60% was paid in cash, 30% by cheque and balance was due.
Changes brought about by this transaction are:
Purchases increases by ₹ 1,00,000; (Element changed: Expenses increase)
Cash balance decreases by ₹ 60,000 (Element changed: Asset decrease)
Bank balance decreases by ₹ 30,000 (Element changed: Asset decrease)
Creditors/ Payables increases by ₹ 10,000 (Element changed: Liability increase)
Transaction 6: Goods sold in cash ₹ 1,70,000.
Changes brought about by this transaction are:
Cash increases by ₹ 1,70,000; (Element changed: Asset increase)
Sales increase by ₹ 1,70,000 (Element changed: Revenue increase)

Transaction 7: Goods sold on credit for ₹ 80,000.
Changes brought about by this transaction are:
Debtors/ Receivables increases by ₹ 80,000 (Element changed: Asset increase)
Sales increase by ₹ 80,000 (Element changed: Revenue increase)
Transaction 8: Mr. De incurred ₹ 20,000 as wages.
Changes brought about by this transaction are:
Wages increases by ₹ 20,000; (Element changed: Expenses increase)
Cash decreases by ₹ 20,000 (Element changed: Asset decrease)
Transaction 9: Interest on bank loan charged ₹ 3,000.
Changes brought about by this transaction are:
Bank interest increased by ₹ 3,000; (Element changed: Expenses increase)
Bank balance decreased by ₹ 3,000 (Element changed: Asset decrease)
Transaction 10: He collected cash ₹ 20,000 from his customer.
Changes brought about by this transaction are:
Cash increases by ₹ 20,000; (Element changed: Asset increase)
Debtors/ Receivables decreases by ₹ 20,000 (Element changed: Asset decrease)
Transaction 11: Mr. De paid ₹ 8,000 to his supplier.
Changes brought about by this transaction are:
Cash decreases by ₹ 8,000; (Element changed: Asset decrease)
Creditors/ Payables decreases by ₹ 8,000 (Element changed: Liability decrease)
Transaction 12: He withdrew cash ₹ 7,000 for his personal use.
Changes brought about by this transaction are:
Cash decreases by ₹ 7,000; (Element changed: Asset decrease)
Capital decreases by ₹ 7,000 (Element changed: Capital/ Equity decrease)

Such analysis of the transactions helps in identification of the accounts which would be involved for accounting purposes and also helps in identification of the debit and credit aspects of every transaction.

Charts of Accounts and Codification Structure

The primary purpose of financial accounting is to record the transactions entered into by an organisation during an accounting period. To achieve this, various accounts are opened and after the classification exercise the transactions get posted in the ledger (which itself is classified as personal and impersonal). These happen to be the building blocks for developing the financial statements and other management reports of the organisation.

However, with the increase in the complexity of business and flow of data, it has become quite a challenge to retrieve the information stored in the accounting records. It is for the purpose of effective management and retrieval of the already recorded accounting information, Chart of Accounts are developed and they are codified.

Charts of Accounts

- A Chart of Accounts (COA) is a listing of all accounts in the general ledger, each account accompanied by a reference number. It is a financial organizational tool that provides a complete listing of every account in the general ledger of a company, broken down into subcategories.Specifically, it is an index of all the financial accounts in the general ledger of an organisation.
- Chart of Accounts is the driving force behind an organisation's book-keeping and accounting systems, and is considered to be the foundation of financial reporting.
- The basic purpose of such charting is to organize the accounts and group similar ones together.
- It is used to organize finances and give the stakeholders (viz. investors and shareholders) a clearer insight into a company's financial health. This process makes it easier for the users to locate specific accounts.A well-structured chart of accounts is often the single best and most effective way to raise the financial reporting of an organization to the next level.

Codification Structure

- A Chart of Accounts provides the structure for the general ledger accounts of a concern. It lists specific types of accounts, describes each account, and includes account numbers. A chart of accounts typically lists asset accounts first, followed by liability and capital accounts, and then by revenue and expense accounts.
- **Setting up of a Chart of Accounts:** To set up a chart of accounts, the first is to define the various accounts to be used by the organisation. Each account should have a number to identify it. Each chart of accounts typically contains a name, brief description, and an identification code.
- **Ordering of Accounts:** Balance Sheet Accounts tend to follow a standard that lists the most liquid assets first. Revenue Accounts and Expense Accounts tend to follow the standard of first listing the items most closely related to the operations of the business. For example, sales would be listed before non-operating income. In some cases, part of all the expense accounts simply may be listed in alphabetical order.
- **Designing of Chart of Accounts:** The designing of a detailed chart of accounts would typically begin with an initial design which would reflect the major headings of the accounts. Thereafter, the detailed descriptions of the transaction are added, which may act as future references.

Illustration of Account Codification for a small business organisation:

For a small business, three digits code may suffice for the account number, although more digits are desirable. However, in order to allow for new accounts to be added as the business grows with more digits, new accounts can be added while maintaining the logical order. Complex businesses may have thousands of accounts, and require longer account reference numbers.As such, it is worthwhile to put thought into assigning the account numbers in a logical way and to follow any specific industry standards.

The following is an example of some of the accounts that may be included in a chart of accounts and reflecting how the digits might be coded:

Account Numbering & Description of Accounts
1000 to 1999: Asset accounts
2000 to 2999: Liability accounts
3000 to 3999: Equity accounts
4000 to 4999: Revenue accounts
5000 to 5999: Cost of goods sold accounts
6000 to 6999: Expense account
7000 to 7999: Other revenue (for example rent received, bad debt recovery etc.)
8000 to 8999:Other expenses (for example depreciation income taxes etc.)

An alternative presentation of a typical Chart of Accounts is as follows:

Balance Sheet Accounts	Income Statement Accounts
Assets (1000 – 1999) Liabilities (2000 – 2999) Owner's Equity (3000 -3999)	Operating Revenues (4000 – 4999) Operating Expense (5000 – 5999) Overhead Costs or Expenses (6000 – 6999) Non-operating revenue and gains (7000 – 7999) Non- operating expenses and Losses (8000 – 8999)

It is to be noted that by separating each account by several numbers many new accounts can be added between any two while maintaining the logical order.

Accounting Equation

The accounting equation is a representation of how the three important components of accounting namely Assets, Liabilities and Equity are associated with each other.

In the most simplistic form, the accounting equation is presented as: **Assets = Liabilities + Equity**.

Assets represent the valuable resources controlled by the company such as cash, accounts receivable, fixed assets, inventory etc. **Liabilities** represent its obligations of an organisation to its external stakeholders, while **Equity** represents owners net claim on the assets. It is to be noted that, the liabilities and equity represent how the assets of the organisation has been financed.

All three components of the accounting equation appear in the balance sheet, which reveals the financial position of an entity at any given point in time.

Expanded Accounting Equation: The above equation can be further expanded by incorporating the various elements of the Equity component as under:

Assets = Liabilities + Equity

or, Assets = Liabilities + [Capital + (Revenue – Expenses) – Drawings]

or, Assets + Expenses + Drawings = Liabilities + Capital + Revenue

This equation is considered to be the foundation of the double-entry accounting system.At a general level, this means that whenever there is a recordable transaction, the choices for recording it all involve keeping the accounting equation in balance.

Illustrative Accounting Equation Transactions

The following table shows a few of the common accounting transactions and their recording within the framework of the accounting equation:

Transaction	Assets + Expenses + Drawings	Liabilities + Capital + Revenue
1. Cash introduced by proprietor	Cash (Assets) increases	Capital increases
2. Purchase of goods in cash	Inventory (Asset) increases; Cash (Assets) decreases	N.A.
3. Purchase of goods in credit	Inventory (Asset) increases	Creditors/ Payables (Liabilities) increases
4. Sale of goods in cash	Cash (Assets) increases; Inventory (Assets) decreases	N.A.
5. Sale of goods in credit	Debtors/ Receivables (Assets) increases; Inventory (Assets) decreases	N.A.
6. Salaries paid	Salaries (Expenses) increases; Cash/ Bank (Assets) decreases	N.A.
7. Rent received	Cash/ Bank (Assets) increases	Rent received (Revenue) increases
8. Goods withdrawn by proprietor	Inventory (Assets) decreases	Capital decreases

Double Entry System

Double Entry System of Bookkeeping is an accounting system which recognizes the fact that every transaction has two aspects and both aspects of the transaction are recorded in the books of accounts.It is a fundamental concept encompassing accounting and book-keeping in present times.

Double entry system records the transactions by understanding them as a Debit item or Credit item. A debit entry in one account gives the opposite effect in another account by credit entry. This means that the sum of all Debit accounts must be equal to the sum of Credit accounts.

This system is based on the accounting equation and requires:

1. Every business transaction to be recorded in at least two accounts.
2. The total debits recorded for each transaction to be equal to the total credits recorded.

Rules of Debit and Credit under Double Entry System

The double-entry accounting system is based on specific rules of debit and credit for recording transactions in the accounts. The rules of debit and credit can be explained by applying two methods:

1. Golden Rules; and
2. Accounting Equation

Successive Processes of the Double Entry System

- Firstly, transactions are recorded in the **Books of Original Entry** (i.e. **Journal and other Subsidiary Books**).

- Secondly, the transactions are classified in a suitable manner and recorded in another book of account known as **Ledger**.
- Thirdly, the arithmetical accuracy of the books of account maychecked by means of drafting a **Trial Balance**.
- Finally, the result of the operations of the accounting period is ascertained through the drafting of **Income Statementand** financial position of the entity at the end of the accounting period is reflected through the **Balance Sheet**.

Books of Original Entry& Subsidiary Books

- Simply stated, **Books of original entry** refer to the accounting books (technically called Journals) in which transactions entered into by an organisation are initially recorded. These are the primary books of accounts which are used by the accountants for recording the transactions in the first place. These are also referred to as Books of Primary Entry or Books of First Entry.
- Whenever an event is recognised as a transaction, it is entered into the accounting system of an entity by first recording it in the journal (with their description and detailed reference to supporting documents).
- The transactions are recorded in the journals in the form of individual entries (referred to as Journal Entries) as and when they occur in chronological order. As because the transactions are recorded on daily basis, the books of original entry are also referred to as Day Books.
- The information in these books is thereafter summarized and posted into the ledger accounts.

Types of Books of Original Entry

The books of original entry are broadly classified into two categories:– Special Journals (Day Books) and General Journal. (Refer to para 1.5- Types of Journal).

Posting in Ledger & Finalization of Accounts

- After the transactions relating to a particular accounting period have been recorded in the journal and/ or subsidiary books, they are posted in respective accounts in the ledger (the Book of Final entry). At the end of the accounting period (viz. quarter, half-year or year), the ledger accounts are balanced and closed.
- The closure of the ledger accounts is based on the nature of the respective accounts. Specifically, the nominal accounts (viz. accounts representing incomes, expenses, gains and losses) are closed by transfer to the Income Statement (namely, Trading A/c and Profit & Loss A/c for a profit-oriented organisation, and Income & Expenditure A/c for a non-profit organisation). The income statement is prepared to ascertain the operating results (viz. profit/ loss or surplus/ deficit) in relation to a specific accounting period.
- The balances of the accounts of real and personal nature are carried forward to the next accounting period. Their balances are reflected in a specific financial statement called the Balance Sheet. It shows the financial position of an organisation at the end of a specific accounting period by reflecting the different assets owned, liabilities and equity of the organisation.

Journal and Ledger

1.5

The first step in the accounting cycle, after the identification of transactions happens to be recording of transactions in the journal, followed by their posting in respective accounts in the ledger.

Journal

Journal is the book of original entry in which financial transactions are firstly recorded after their occurrence in chronological order. It is in this book of accounts where the transactions are recorded in the first place.

The word 'Journal means' a daily record. Journal is derived from French word 'Jour' which means a day. This book of account is also referred to as the Book of Prime Entry or Books of First Entry.

The process of recording the transactions in a journal is called 'Journalizing'. This is the first activity that a book-keeper performs after identification of the transactions which has to be recorded in the books of accounts of a concern.

The entry made in this book is called a 'Journal Entry'. Every entry in the journal is followed by a short summary which describes the particular transaction. This short summary is referred to as 'Narration'. Every entry in the book of original entry must be followed by such a narration.

Example of a Transaction and its Journal Entry:

As per voucher no. 31 of Roy Brothers, on 09.02.2023 goods of ₹50,000 were purchased. Cash was paid immediately. The folios of the Purchase A/c and Cash A/c in the ledger are 5 and 17 respectively. Journal entry of the above transaction is given below:

In the books of Roy Brothers

Journal **Dr.** **Cr.**

Date	Particulars	Voucher No.	Ledger Folio	(₹)	(₹)
09.02.2023	Purchase A/c Dr.	31	5	50,000	
	To Cash A/c		17		50,000
	(Being goods purchased for cash)				

- Each journal entry is passed in the books on the basis of some source documents. Some of the common source documents are: purchase invoices (also called inward invoices), sales receipts (also called outward invoices), debit notes, credit notes etc. The process of accounting does not end after recording of transactions in the journal. Rather, with the objective of classification, the transactions are summarized and posted to respective accounts in the ledger(s).

- A journal entry can be a Simple journal entry or a Compound journal entry. When in a journal entry only two accounts are affected – one account is debited and another account is credited, it is called a **Simple journal entry**. For example, the journal entry for the transaction 'Goods worth ₹44,000 sold by Ramesh to Rajesh for cash' will be a simple journal entry as in this case Cash A/c will be debited with ₹44,000 and Sales A/c will get credited with ₹44,000.
- While in case of a **Compound journal entry** at least two debits and at least one credit or at least one debit and two or more credit items are involved. For example, the journal entry for the transaction 'Goods worth ₹54,000 sold by Ramesh to Rajesh involving cash sale ₹44,000 and balance on credit' will be a compound journal entry as in this case Cash A/c as-well as Debtors A/c will be debited with ₹44,000 and ₹10,000 respectively, and Sales A/c will get credited with ₹54,000.

Types of Journal

The books of original entry are broadly classified into two categories:

1. **Special Journal:**
2. **General Journal**

1. Special Journal:

A Special Journal is a book of primary entry in which transactions of a specific type viz. credit purchases, credit sales, return inwards etc. are first recorded before being posted in the respective ledger account. These are also referred to as Subsidiary Books. During the lifecycle of and organisation, when the volume of transactions increases to an extent that a single journal may no longer be adequate to record the transactions effectively, then special purpose books or subsidiary books are required for more efficient record keeping purposes. The different special journals that are usually maintained by an organisation for primary recording of its transactions are:

(a) **Cash Journal or Cash Book** is a special journal which is maintained for recording all transactions which involve cash, whether cash inflows or cash outflows.

(b) **Purchase journal** is a special journal which is used by an organization to record all the credit purchases made by it during an accounting period. It is also known as Purchase Book or Purchase Daybook.

(c) **Sales Journal** is a type of special journal that is used to record credit sale transactions of an organisation. It is also known as Sales Book or Sales Daybook.

(d) **Purchase Return Journal** is the special journal that is used for recording the goods which have been returned by an organisation to its suppliers, for any reason. It is also known as Purchase Return Book or Purchase Daybook.

(e) **Sales Return Journal** is the special journal that is used for recording the goods which have been returned to an organisation by its customers, for any reason. It is also known as Sales Return Book or Sales Daybook.

(f) **Bills Receivable Journal** is the special journal which is used to record the details of bills of exchange received by an entity from its customers during an accounting period. It is also known as Bills Receivable Book or Bills Receivable Daybook.

(g) **Bills Payable Journal** is the special journal which is used to record the details of bills of exchange accepted by an entity towards its suppliers during an accounting period. It is also known as Bills Payable Book or Bills Payable Daybook.

2. General Journal:

This is a book of original entry in which those transactions are recorded for which no specific day book is maintained are recorded.

In the following section, the important subsidiary books have been discussed.

1(a): Cash Journal or Cash Book

Cash Journal or Cash Book is a special journal which is maintained for recording all transactions which involve cash, whether cash inflows or cash outflows. In this book of original entry, transactions of every type (whether capital natured transactions or revenue natured transactions) are entered. This journal records the details of each transaction effected in cash by an organisation. Such details include the date, particulars, voucher number, ledger folio and the amount of the transaction.

The various aspects of the Cash Book has been discussed in detail in Para 1.6 of the study material.

1(b): Purchase Journal

The Purchase Journal is a book of original entry which is meant for recording credit purchase of goods. It is also known as Purchase Day Book or simply, Purchase Book. It is to be noted that cash purchases of goods are not recorded in this day book. Also purchase of other long term assets (like equipment, furniture, machinery etc.) on credit does not find place in purchase day book.

The Purchase journal records the details of the credit purchase of goods made by an organisation. Such details include the date of purchase, particulars of items purchased, inward invoice number, ledger folio and the amount of purchase.

The format of a purchase journal is as given below:

Date	Particulars	Inward Invoice No.	Ledger Folio No.	(₹)

Source document for entry in purchase journal:

All entries in this book are made from the Purchase invoices. A purchase invoice is a statement which is issued by the seller of goods to the buyer of goods reflecting the details of the goods like the date of purchase, the quantity of purchase, the rate per unit, the total amount and also the terms of payment, if any.

Posting from Purchase Journal to Ledger

The Purchase Journal, being a book of original entry, transactions entered here are thereafter required to be posted to the respective ledger accounts in the ledger. The total of the purchases made during a period is posted to Purchases Account in the general ledger, while the individual credit purchase transactions posted in the personal ledger accounts of the respective suppliers (in the suppliers ledger).

1(c): Sales Journal

Sales Journal is the book of original entry which records credit sales of goods. It is also known as Sales Day Book or simply, Sales Book. It is to be noted that sale of goods for cash are not recorded in this day book. Also sale of other long term assets (like equipment, furniture, machinery etc.) does not find place in this book of original entry.

The Sales journal records the details of the credit sales of goods made by an organisation during a period. Such details include the date of sale, particulars of items sold, outward invoice number, ledger folio and the amount of sales.

The format of a typical sales journal is as given below:

Date	Particulars	Outward Invoice No.	Ledger Folio No.	(₹)

Source Document for Entry in Sales Journal:

All entries in this book are made from the Sales invoices. A sales invoice is a statement which is issued by the seller of goods to the buyer of goods reflecting the details of the goods like the date of sale, the quantity of sale, the rate per unit, the total amount and also the terms of payment, if any.

Posting from Sales Journal to Ledger

The Sales Journal, being a book of original entry, transactions entered here are thereafter required to be posted to the respective ledger accounts in the ledger. The total amount of sales made during a period is posted to Sales Account in the general ledger, while the individual entries of credit sale are posted in the personal ledger accounts of the respective customers/ debtors (in the debtors ledger).

1(d): Purchase Returns Journal

The Purchase Returns Journal is a book of original entry which is meant for recording returns of goods purchased on credit from the suppliers. It is also known as Returns Outward Day Book. It is to be noted that returns arising out of cash purchases of goods, or return of any assets other than merchandising goods on credit does not find place in this day book.

The Purchase returns journal records the details of the returns arising out of credit purchase of goods viz. the date of return, particulars of items returned, name of supplier, debit note number, ledger folio and the total amount.

The format of a purchase returns journal is as given below:

Date	Particulars	Debit Note No.	Ledger Folio No.	(₹)

Source Document for Entry in Purchase Returns Journal:

All entries in this book are made from the debit notes issued to respective suppliers or credit notes received from the respective suppliers.

Posting from Purchase Returns Journal to Ledger

The Purchase Returns Book, being a book of original entry, transactions entered here are thereafter required to be posted to the respective ledger accounts in the ledger. The total of the purchase returns made during a period is posted to Purchase Returns or Return Outwards Account in the general ledger, while the individual purchase return transactions posted in the personal ledger accounts of the respective suppliers (in the Creditors Ledger).

1(e): Sales Returns Journal

Sales Return Journal is the book of original entry which records returns of goods earlier sold on credit basis. It is also known as Sales Returns Day Book or simply, Sales Returns Book.

The Sales Returns Book records the details of the goods returned out of credit sales made by an organisation during a period. Such details include the date of return, particulars of items returned, credit note number, ledger folio and the amount of sales returns.

The format of the sales return journal is as given below:

Date	Particulars	Credit Note No.	Ledger Folio No.	(₹)

Source Document for Entry in Sales Returns Journal:

All entries in this day book are made from the Credit Note issued by the seller of goods. A sales invoice is a statement which is issued by the seller of goods to the buyer of goods reflecting the details of the goods like the date of sale, the quantity of sale, the rate per unit, the total amount and also the terms of payment, if any.

Posting from Sales Returns Journal to Ledger

As the Sales Return Journal is a book of original entry, and so transactions recorded here are thereafter required to be posted to the respective accounts in the ledger. The total amount of sales returns made during a period is posted to Returns Inward (or Sales Returns) Account in the general ledger, while the individual entries of sale returns are posted in the personal ledger accounts of the respective customers/ debtors (in the Debtors ledger).

1(f): Bill Receivable Journal

The Bill Receivable Journal is a book of original entry which is meant for recording the bills of exchange received from the customers to whom goods have been sold on credit. This journal records the details like the details of the customer, name of drawer, name of acceptor, date of receipt of the bill, date of drawing of the bill, date of acceptance of the bill, tenure of the bill, date of maturity, ledger folio and the amount of the bill.

Source document for entry in purchase journal:

All entries in this book are made from the bills of exchanges received from the customers.

Posting from Bill Receivable Journal to Ledger

The Bill Receivable Journal, being a book of original entry, transactions entered here are thereafter required to be posted to the respective ledger accounts in the ledger. The total of the bill of exchanges received during a period is posted to Bills Receivable Account in the general ledger, while the individual transactions posted in the personal ledger accounts of the respective customers (in the Debtors Ledger).

1(g): Bill Payable Journal

The Bill Payable Journal is a book of original entry which is meant for recording the bills of exchange issued to the suppliers from whom goods have been purchased on credit. This journal records the details like the details of the supplier, name of drawer, name of acceptor, date of issue of the bill, date of drawing of the bill, date of acceptance of the bill, tenure of the bill, date of maturity, ledger folio and the amount of the bill.

Source document for entry in purchase journal:

All entries in this book are made from the bills of exchanges issued to the suppliers.

Posting from Bill Payable Journal to Ledger

The Bill Payable Journal, being a book of original entry, transactions entered here are thereafter required to be posted to the respective ledger accounts in the ledger. The total of the bill of exchanges issued during a period is posted to Bills Payable Account in the general ledger, while the individual transactions posted in the personal ledger accounts of the respective customers (in the Creditors Ledger).

2. General Journal or Journal Proper

General Journal is the book of original entry in which those transactions for which no special journal is maintained are recorded. In other words, transactions like credit purchases, credit sales, purchase returns, sales returns etc. (for which specific subsidiary books are maintained) are recorded in this book of primary entry. This book of original entry is also known as Journal Proper. The following transactions are recorded in this book of original entry:

- Purchase of a non-current asset on credit,
- Sale of a non-current asset on credit,
- Entries passed to rectify errors made in books of accounts (rectification entries),
- Entries passed to adjust ledger balances (adjustment entries),
- Entries passed to open accounts passed when the business starts operations (opening entries),
- Closing entries to transfer Nominal Accounts to Trading & Profit and Loss Account.

Types of Entries Recorded in Journal Proper

Opening entries: These entries are passed for bringing the balances of certain accounts in the books of the current accounting period. The different accounts whose balances are brought forwards are the assets, liabilities and equity accounts appearing the Balance Sheet of the preceding accounting period.

Transfer entries: In accounting, it is sometimes necessary to transfer an amount or balance of one account to some other account. The journal entries through which the amount of an account are transferred to another account are referred to as Transfer entries. Such entries are used when a wrong booking has been made in respect of any account or to allocate an expense/ revenue from one account to another.

Closing entries: All the expenses and gains or income related nominal accounts must be closed at the end of the year. The entries which are passed at the end of an accounting period for closing the nominal accounts by transferring them to the profit determining accounts like Trading Account, Profit & Loss Account, Consignment Account, Joint Venture Account, Income & Expenditure Account etc.

Adjustment entries: These entries are passed at the time of finalization of accounts for honouring the different generally accepted accounting principles i.e. accounting concepts and accounting conventions.

Rectification entries: These entries are passed for correcting the different errors that get committed while recording, posting, casting, balancing etc. in the books of accounts.

Occasional/Miscellaneous Entries: It means entries other than above for which no specific subsidiary books are maintained.

Rules of Journalising

- The process of passing an entry in a journal is called Journalising. The rule for journalising is same as that of rules of debit and credit. The debiting and crediting of the accounts are done on the basis of certain rules. There are two alternative bases for the rules of debit and credit such as follows.

1. Rules of Debit and Credit based on the types of account; and
2. Rules of Debit and credit based on the accounting equation.

Rules of Debit and Credit Based on the Types of Account (Golden Rules Approach)

- Under double-entry system every account can be classified into any of the following three types: Personal account, Real account and Nominal account. For each of these types of account, there are separate rules of debiting and crediting the transactions. The rules of debit and credit under different types of account are as follows:

Nature of Account	Rule of Debit and Credit	
Nominal Account	Debit	Expenses and Losses
	Credit	Incomes and Gains
Real Account	Debit	What comes in
	Credit	What goes out
Personal Account	Debit	The receiver
	Credit	The giver

Rules of Debit and credit Based on the Accounting Equation (Accounting Equation Approach)

Accounting equation is a statement of equality between the three basic elements of accounting viz. assets, liabilities and equity. Each and every financial transaction affects any one or more of these three basic elements. However, the total of all assets is always equal to the total of liabilities and equity at any point in time. The rules of debiting and crediting an account based on the accounting equation have been summarized hereunder:

Components of Accounting Equation	Rule of Debit and Credit	
Assets	Debit	Increase
	Credit	Decrease
Liabilities	Debit	Decrease
	Credit	Increase
Capital	Debit	Decrease
	Credit	Increase
Drawings	Debit	Increase
	Credit	Decrease
Expenses	Debit	Increase
	Credit	Decrease
Revenue	Debit	Decrease
	Credit	Increase

Steps in Journalising

The process of journalising involves the following steps:

1. Determination of the accounts involved in the transaction.
2. Classifying the accounts either as 'Nominal, Real and Personal' or into 'Assets, Liabilities, Capital, drawings, Expenses and Revenue'.
3. Appling the rules of debit and credit for the identified accounts for identifying which account is to be debited and which accounts is to be credited.
4. Recording the details of the transaction viz. date, particulars and its narration, and also the amount to be debited and credited.
5. Writing a brief summary of the transactions (called narration) at the end.

Functions of Journal

The functions performed by the book of original entry are:

- **Historical Function:** It contains a chronological record of the transactions for future references.
- **Recording Function:** Accountancy is a business language which helps to record the transactions based on the principles. Each such recording entry is supported by a narration, which explains the transaction in simple language.
- **Analytical Function:** Each transaction is analysed into the debit aspect and the credit aspect. This helps to find out how each transaction will financially affect the business.

Advantages of Journal

The book of original entry provides the following advantages:

- **Chronological Record:** It records transactions as and when it happens. So it is possible to get detailed day-to-day information, and also acts as a future reference.
- **Minimising the possibility of errors:** The nature of transaction and its effect on the financial position of the business is determined by recording and analyzing into debit and credit aspect.
- **Narrative explanation of the recorded transactions:** It maintains the detailed record of transactions written immediately after passing the entry, thus provides a highlight of the transaction done.
- **Helps to classify the accounts:** Journal is the basis of ledger posting and the ultimate Trial Balance.
- **Evidence in court:** Information recorded in the journal which certainly serves as a proof or evidence in the court of law.

Limitations of Journal

- When a single journal is maintained, it becomes unsuitable for organizations that enter into a large number of transactions.
- It is not a simple system of recording of transactions.
- The process of journalising is a time consuming process.
- It does not facilitate internal control, because in journal transactions are recorded in chronological order.

Ledger

The book of account in which transactions are recorded in respective account, after they have been entered in the journal is called the Ledger. It is the book of account in which the transactions are recorded in a classified and permanent manner. It is the final destination of all the accounts, and hence, it is also called the Book of Final Entry. The process of recording the entry in the ledger is technically known as Posting. It is the book of account in which transactions are recorded from the journal. It contains various 'ledger accounts'. The transactions are recorded in each of the relevant ledger accounts in a chronological order. It reflects the final position of each account on any particular date. It forms the basis for preparation of Trial Balance. . A ledger account has a specific format, as under:

Dr. ………………. Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)

Functions of Ledger

- It acts as a permanent store-house of all the transactions of a concern arranged for ready reference.
- It summarizes the effects of business transactions in terms of the individual accounts, so that a conclusion concerning the status of each account may be drawn periodically. In other words, it shows under each account heading all positive and negative changes pertaining to that account as a result of operations to date, and the balance of the account, if any, at the end of each significant period.
- It is like a 'mirror' reflecting the image of the concern which enables it to analyse business operations for the purpose of deciding future plan of action

Subdivisions of Ledger

On the basis of the nature of accounts maintained, ledger can be classified into Personal Ledger and General Ledger.

1. **Personal Ledger:** The ledger which contains the personal accounts of the debtors and creditors is called Personal Ledger. It can be further sub-divided into:
   (a) Debtors'/Customers'/Sales ledger: It contains the personal accounts of all the customers/trade debtors.
   (b) Creditors'/Suppliers'/Purchase/Bought ledger: It contains the personal accounts of all the suppliers/ trade creditors.
2. **Impersonal Ledger or General Ledger:** The ledger which contains the accounts other than those contained in the 'Personal Ledger' is called Impersonal/General Ledger. The types of accounts maintained in this ledger are Real, Nominal and Personal (except Trade Debtors and Trade Creditors).

The advantages of such sub-division are:

- It provides complete and detailed information of all accounts of similar nature in one book.
- It discloses the summarised information by getting the ledger accounts balanced.

Ledger Posting

As and when the transaction takes place, it is recorded in the journal in the form of journal entry. This entry is posted again in the respective ledger accounts under double entry principle from the journal. This is called ledger posting.

The rules for writing up accounts of various types are as follows:

Assets: Increases on the left hand side or the debit side and decreases on the credit side.

Liabilities: Increases on the credit side and decreases on the debit side.

Capitals: The same as liabilities.

Expenses: Increases on the debit side and decreases on the credit side.

Incomes or Gains: Increases on the credit side and decrease on the debit side.

To summarise

Dr.	Assets	Cr.
Increase		Decrease

Dr.	Liabilities & Capital	Cr.
Decrease		Increase

Dr.	Expenses or Loses	Cr.
Increase		Decrease

Dr.	Income or Gains	Cr.
Decrease		Increase

Concepts of Debit and Credit

A debit denotes:

(a) In the case of a person that he has received some benefit against which he has already rendered some service or will render service in future. When a person becomes liable to do something in favour of the firm, the fact is recorded by debiting that person's account : (relating to Personal Account)

(b) In case of goods or properties, that the value and the stock of such goods or properties has increased, (relating to Real Accounts)

(c) In case of other accounts like losses or expenses, that the firm has incurred certain expenses or has lost money. (relating to Nominal Account)

A credit denotes:

(a) In case of a person, that some benefit has been received from him, entitling him to claim from the firm a return benefit in the form of cash or goods or service. When a person becomes entitled to money or money's worth for any reason. The fact is recorded by crediting him (relating to Personal Account)

(b) In the case of goods or properties, that the stock and value of such goods or properties has decreased. (relating to Real Accounts).

(c) In case of other accounts like interest or dividend or commission received, or discount received, that the firm has made a gain (relating to Nominal Account)

Balancing of Ledger Accounts

After all the transactions of a period get posted in the ledger, the net effect of these transactions is ascertained. This process of ascertaining the net effect of all the transactions posted in a particular ledger account for a period is called Balancing of a ledger account. The process of balancing an account involves totaling both the sides (i.e.

debit side and credit side) of an account and ascertaining the difference between the two.

An account can show debit balance, or credit balance or nil balance. An account is said to be having a debit balance when its debit-side total is higher than the credit side total; while an account is said to have a credit balance when its credit-side total is higher than the debit-side total. When both side have same total, the account is said to have nil balance. This is very significant function of accounting as the finalization of accounts is done with the balances of the ledger accounts.

Illustration 1

For the following transactions pass the journal entries and post them in Ledger:

2023
April 1 – Mr. Vikas and Mrs. Vaibhavi who are husband and wife start consulting business by bringing in their personal cash of ₹ 5,00,000 and ₹ 2,50,000 respectively.
April 10 – Bought office furniture of ₹ 25,000 for cash.
April 11 – Opened a Current Account with Bank of BB by depositing ₹ 1,00,000
April 15 – Paid office rent of ₹ 15,000 for the month by cheque.
April 20 – Bought a motor car for ₹ 4,50,000 from Millenium Motors by making a down payment of ₹ 50,000 by cheque and the balance by taking a loan from HH Bank.
April 25 – Vikas and Vaibhabi carried out a consulting assignment for AA Pharmaceuticals and raised a bill for ₹ 10,00,000 as consultancy fees. AA Pharmaceuticals have immediately settled ₹ 2,50,000 by way of cheque and the balance will be paid after 30 days. The cheque received is deposited into bank.
April 30 – Salary of a receptionist at the rate ₹ 5,000 per month and an officer at the rate ₹ 10,000 per month the salary for the current month is payable to them.

Solution: **Books of Vikas and Vaibhavi**

Journal

Date	Particulars	L.F.	V.N.	Dr. (₹)	Cr. (₹)
2023	Cash A/c……. Dr.			7,50,000	
April 1	To Vikas's Capital A/c				5,00,000
	To Vaibhavi's Capital A/c				2,50,000
	(Being capital brought by the partner)				
April 10	Furniture A/c………. Dr.			25,000	
	To Cash A/c				25,000
	(Being furniture purchased in cash)				
April 11	Bank of BB A/c……. Dr.			1,00,000	
	To Cash A/c				1,00,000
	(Being current account opened with Bank of BB)				

Date	Particulars	L.F.	V.N.	(₹)	(₹)
April 15	Rent A/c……………. Dr.			15,000	
	To Bank of BB A/c				15,000
	(Being Rent paid)				
April 20	Motor Car A/c ……. Dr.			4,50,000	
	To Bank of BB A/c				50,000
	To Loan from HH Bank A/c				4,00,000
	(Being car purchased from Millenium Motors by making a down payment and Loan arrangements)				
April 25	Bank of BB A/c……. Dr.			2,50,000	
	AA Pharmaceuticals A/c….. Dr.			7,50,000	
	To Consultancy Fees A/c				10,00,000
	(Being amount received and revenue recognized for fees charged)				
April 30	Salary A/c………. Dr.			15,000	
	To Salary Payable A/c				15,000
	(Being the entry to record salary obligation for the month.)				

Ledger

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

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
1.4.23	To Vikas's Capital A/c		5,00,000	10.4.23	By Furniture A/c		25,000
1.4.23	To Vaibhavi's Capital A/c		2,50,000	11.4.23	By Bank of BB A/c		1,00,000
				30.4.23	By Bal c/d		6,25,000
			7,50,000				7,50,000
1.5.23	To Bal b/d		6,25,000				

Dr. **Mr.Vikas's Capital Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
30.4.23	To Bal c/d		5,00,000	1.4.23	By Cash A/c		5,00,000
				1.5.23	By Bal b/d		5,00,000

Dr. **Mrs.Vaibhavi's Capital Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
30.4.23	To Bal c/d		2,50,000	1.4.23	By Cash A/c		2,50,000
				1.5.23	By Bal b/d		2,50,000

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

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
1.4.23	To Cash A/c		25,000	30.4.23	By Bal b/d		25,000
1.5.23	To Bal b/d		25,000				

Dr. **Bank of BB Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
11.4.23	To Cash A/c		1,00,000	15.4.23	By Rent A/c		15,000
25.4.23	To Consultancy Fees A/c		2,50,000	20.4.23	By Motor Car A/c		50,000
				30.4.23	By Bal c/d		2,85,000
			3,50,000				3,50,000
1.5.23	To Bal b/d		2,85,000				

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

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
15.4.23	To Bank of BB A/c		15,000	30.4.23	By Bal c/d		15,000
1.5.23	To Bal b/d		15,000				

Dr. **Motor Car Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
20.4.23	To Bank of Baroda A/c		50,000				
"	To Loan from HH Bank A/c		4,00,000	30.4.23	By Bal c/d		4,50,000
			4,50,000				4,50,000
1.5.23	To Bal b/d		4,50,000				

Dr. **Loan from HDFC Bank Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
30.4.23	To Bal c/d		4,00,000	20.4.23	By Motor Car A/c		4,00,000
				1.5.23	By Bal b/d		4,00,000

Dr. **Avon Pharmaceuticals Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
25.4.23	To Consultancy Fees A/c		7,50,000	30.4.23	By Bal c/d		7,50,000
	To Bal b/d		7,50,000				

Dr. **Consultancy Fees Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
				25.4.23	By Bank of BB A/c		2,50,000
30.4.23	To Bal c/d		10,00,000	"	By AA Pharmaceuticals A/c		7,50,000
			10,00,000				10,00,000
				1.5.23	By Bal b/d		10,00,000

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

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
30.4.23	To Salary Payable A/c		15,000	30.4.23	By Bal c/d		15,000
	To Bal b/d		15,000				

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

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
30.4.23	To Bal c/d		15,000	30.4.23	By Salary A/c		15,000
							15,000
				1.5.23	By Bal b/d		

Cash Book, Bank Book, Bank Reconciliation Statement

1.6

Cash Book

Any organisation enters into numerous transactions during an accounting period, and amongst those a majority of the transactions get settled (either received or paid) involving cash. For this purpose, a separate book of account is maintained for recording only the cash transactions (whether effected in liquid cash, cheque or online transfers).

The book of account that records all cash receipts and cash payments of an organisation is referred to as cash book. The receipts are entered on the debit side, while the payments are recorded in the credit side of the cash book.

Features of Cash Book

- This is the book of account in which only cash transactions are recorded.
- All receipts of cash and payments involving cash are recoded in this book of account.
- Transactions are recorded in this book in chronological order.
- The proforma of the cash book is similar to that of a ledger account i.e. having two sides – Debit side and Credit side.
- It is a book of account which is a book of primary entry as-well-as a book of final entry. So, it is referred to as **journalized ledger**.
- Its balance reflect the balance of cash available.

Types of Cash Book

For the purpose of recording cash and bank related transactions at one place cash book is maintained. These cash books can be broadly classified into two categories – Regular Cash Book and Petty Cash Book.

1. **Regular Cash Book:** The cash book which records all cash and sometimes bank related transactions of an entity is called the Regular Cash Book or simply Cash Book. Such cash book can be classified into the following categories based on the number of amount columns maintained on each side of the cash book.

- **Single Column Cash Book:** In this cash book, only one amount column is maintained on each side to record transactions involving liquid cash. This type of cash book is usually maintained by the small organisations which do not have any bank account.Sometimes an organisation having a bank account can also maintain a single column cash book and open a separate bank account in the ledger. This cash book is actually the cash account of the entity.The balance of this cash book represent cash-in-hand at a particular point of time. The proforma of the single column cash book is a under:

Dr. **Cash Book (Single Column)** **Cr.**

Date	Particulars	L.F.	Cash (₹)	Date	Particulars	L.F.	Cash (₹)

- **Double Column Cash Book:** In many cases, two amount columns are maintained by organisation on each side of the cash book. This type of a cash book is called Double Column Cash Book. It is a popular practice to add an amount column to each side – the additional column to record the banking transactions entered into by an entity, instead of opening a separate bank account in the ledger.The balance of this cash book reflects the amounts of Cash-in-hand as-well-as Cash-at-bank at a particular point of time. The proforma of the double column cash book is a under:

Dr. **Cash Book (Double Column)** **Cr.**

Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)

This type of cash book gives rise to a unique type of entry referred to as the Contra Entry. When any transaction takes place involving Bank A/c and Cash A/c, the posting will happen on both side of the same account (here, the Double Colum Cash Book). Examples of such transactions are: Deposit of cash into bank, Withdrawal of cash from bank etc. For recording such a transaction, the letter 'C' is written on both sides in the Ledger Folio (L.F.) column.

- **Triple Column Cash Book:** A Cash book with three amount columns on each side (namely Cash, Bank and Discount columns) is called the Triple Column Cash Book. The discount columns of each side represent separate discount accounts. Specifically, the discount column of the debit side of cash book represent Discount Allowed and that on the credit side represent Discount Received.

  Conceptually, there are two types of discounts – Trade Discount and Cash Discount. The former discount is allowed by the seller to the buyer for making bulk purchases, while the later is allowed to encourage the buyer to make prompt payment. Trade discount is never recorded in the books of account. It is the Cash Discount which is recorded in the discount columns of the treble column cash book.

  Further it is to be noted that unlike the cash and bank columns, the discount columns are not balanced; rather they are transferred to the respective discount accounts in general ledger. To be specific, the total of the debit side discount column represents the total discount allowed during a period and it is transferred to Discount Allowed Account in the general ledger, while the total of the credit side discount column represents the total discount received during a period and it is transferred to Discount Received Account in the general ledger. The proforma of the double column cash book is a under:

Dr. **Cash Book (Treble Column)** **Cr.**

Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount (₹)	Date	Particulars	L.F.	Cash (₹)	Bank (₹)	Discount (₹)

Multi-columnar Cash Book: This is a customized form of cash book that is maintained by organisations where huge cash transactions take place under certain fixed heads. Generally, organisations like clubs, schools, colleges etc. maintain this type of cash book. The proforma of the multi-columnar cash book is a under:

Dr. **Multi-columnar Cash Book** **Cr.**

Date	Particulars	Subscription	Donation	Interest Received	Misc. Income	Date	Particulars	Salaries & wages	Rent & Taxes	Communication charges	Misc. Expenses

2. **Petty Cash Book:** In organisations where the number of cash transactions are numerous, it becomes tough for one personnel to handle and record all cash and bank related transactions. In such a case, the cash handling is split between two groups – one group handling petty cash transactions and the other handing transactions other than petty cash. This gives rise to a specific type of cash book called the Petty Cash Book. This book of account records only those cash transactions which are not of heavy amount, but the type of transactions are frequently entered into by an entity. The cashier in charge of the petty cash book is known as the Petty Cashier, the cashier of the other group is called the Principal Cashier or Chief Cashier.

   The amount of petty cash is provided to the petty cashier either on Ordinary System or on Imprest System. Under the Ordinary System, a pre-decided amount of cash is given in lump sum by the chief cashier to the petty cashier. When the entire amount of petty cash gets spent, the petty cashier submits the details of petty expenditures to the chief cashier for review, and reimbursement.

   Under theImprest System, the total amount of petty expenses for a particular period is estimated beforehand. This amount if referred to as Imprest Cash or Imprest Float. The imprest cash is advanced by the principal cashier to the petty cashier out of which the later meets all the petty expenses incurred during the period. At the end of the fixed period, petty cashier prepares a State of Petty Cash reflecting the petty expenses incurred and submits the same to the chief cashier. The chief cashier after examination of the petty transactions remit an amount equal to the total petty expenses incurred to the petty cashier. Thus, at the beginning of the next accounting period, the petty cashier will have the same amount of imprest cash to meet the petty expenses of the period. Thus, the amount lying with the petty cashier will never exceed the amount of imprest cash. The proforma of petty cash book is exactly similar to that of a single column cash book. Some organisations, also maintain the petty cash book in multi-columnar format. In such a case, the credit side of the petty cash book has pre-specified columns of the common expenses usually incurred by the organisation.

Illustration 2

Prepare a triple column cash book from the following transactions in the books of Mr.Ratanlal:

1.3.2023	Opening cash balance	20,000
	Bank balance in S.B.I	26,000
2.3.2023	Purchase of printer in cash	12,000
5.3.2023	Sold goods for cash.	34,000
7.3.2023	Received from Hriday on account	32,000

8.3.2023	A laptop purchase for the personal use of the proprietor by cheque	22,000
10.3.2023	Amount deposited into Bank	31,000
17.3.2023	Mr. Sen settled his account against a gross claim of ₹ 24 500.	24000
	Office rent paid by cheque	2,000
19.3.2023	Cash withdrawn from bank for personal use	3,400
	Receive from Mr. Ratul against his account of ₹ 23000.	22,800
	Goods purchased on credit from Sneha	24,000
24.3.2023	Salaries paid to employees	12,000
	Cheque received from Sandeep and kept in cash box	12,800
25.3.2023	The cheque of Sandeep deposited in the bank account	
	Bank charges shown in the bank statement	300
	Interest received from the savings account of bank	200
28.3.2023	The cheque of Sandeep was returned dishonoured by the bank	
	Amount paid to Sneha in full settlement of her claim	23,700

Solution:

Books of Mr. Ratanlal

Dr. **Cash Book (Triple Column)** **Cr.**

Date	Particulars	LF	Cash	Bank	Disc.	Date	Particulars	LF	Cash	Bank	Disc.
2023 Mar 1	To Balance b/f		20,000	26,000		Mar 2	By Office Equipment A/c		12,000		
Mar 5	To Sales A/c		34,000			Mar 8	By Drawings A/c			22,000	
Mar 7	To Hriday A/c		32,000			Mar 10	By Bank A/c		31,000		
Mar 10	To Cash A/c			31,000		Mar 17	By Rent A/c			2,000	
Mar 17	To Mr. Sen A/c		24,000		500	Mar 19	By Drawings A/c			3,400	
Mar 19	To Mr. Rahul A/c		22,800		200	Mar 24	By Salaries A/c		12,000		
Mar 25	To Sandeep A/c			12,800		Mar 25	By Bank Charges A/c			300	
Mar 25	To Interest A/c			200		Mar 28	By Sandeep A/c Dishonour of Cheque			12,800	
						Mar 28	By Sneha A/c		23,700		300
						Mar 28	By Balance c/f		54,100	29,500	
			1,32,800	**70,000**					**1,32,800**	**70,000**	

Cheque received from Sandeep and kept in cash box – will not be added to the balance of Cash Column at all, the amount will be added to the balance of Bank Column on the date on which it was submitted to the bank.

Alternatively, in between this period, a temporary A/c namely Cheque in Hand A/c may be used to record the transactions.

On the date of receipt of the cheque: Cheque in Hand A/c…………..Dr.

To Sandeep A/c

On the date of deposit of the cheque: Bank A/c……………………..Dr.

To Cheque in Hand A/c

When the cheque will dishonour - the amount will get credited in the bank column of the cash book.

Illustration 3

Prepare an Analytical Petty Cash Book on the Imprest System of Ashutosh, Kolkata from the following transactions:

2023 Jan. 1	Received Cash for Petty Expenses	20,000
Jan. 2	Paid Bus fare	100
Jan. 2	Paid cartage	500
Jan. 3	Paid for postage	1000
Jan. 3	Paid wages for casual labourers.	1200
Jan. 4	Paid for stationery.	800
Jan. 4	Paid auto charges	400
Jan. 5	Paid for repairs of chairs	3000
Jan. 5	Paid Bus fare.	200
Jan. 6	Paid Conveyance charges	600
Jan. 6	Paid cartage.	600
Jan. 6	Paid for Stationery	400
Jan. 6	Refreshment to customers	1000

In the Books of Ashutosh, Kolkata

Petty Cash Book

Receipts	Date	V/N	Particulars	Total Payment (₹)	Conveyance (₹)	Cartage (₹)	Stationery (₹)	Postage (₹)	Wages (₹)	Sundries (₹)
20,000	2023 Jan. 1		To Cash A/c							
	Jan. 2		By Conveyance A/c	100	100					
	Jan. 2		By Cartage A/c	500		500				

Receipts	Date	V/N	Particulars	Total Payment (₹)	Conveyance (₹)	Cartage (₹)	Stationery (₹)	Postage (₹)	Wages (₹)	Sundries (₹)
	Jan. 3		By Postage A/c	1,000				1,000		
	Jan. 3		By Wages A/c	1,200					1,200	
	Jan. 4		By Stationery A/c	800			800			
	Jan. 4		By Conveyance A/c	400	400					
	Jan. 5		By Repairs of Furniture A/c	3,000						3,000
	Jan. 5		By Conveyance A/c	200	200					
	Jan. 6		By Conveyance A/c	600	600					
	Jan. 6		By Cartage A/c	600		600				
	Jan. 6		By Stationery A/c	400			400			
	Jan. 6		By General Expenses A/c	1,000						1,000
				9,800	1,300	1,100	1,200	1,000	1,200	4,000
	Jan. 6		By Bal. c/d	10,200						
20,000				20,000						
10,200	Jan. 7		To bal B/d							
9,800	Jan. 7		To Cash A/c							

Bank Book

Deviating from the traditional method of keeping an additional column for bank transactions in a double and triple column cash book, today organisations keep a separate subsidiary book similar to cash book to record all receipts and payments made through the bank. This is known as Bank Book or Bank Journal.

Usually, big companies maintain this book where the volume of bank transactions is very high. Small businesses may still continue to record their bank transactions along with the cash book in an additional column.

Similar to a Single Column Cash Book, a Bank Book consists of two sides, receipts side and payment side. Receipts are debited and payments are credited in the bank book.

Maintaining a Bank Book or Bank Journal helps to ease the process of bank reconciliation. It also helps to decrease the chances of missing entries or any mistake. Separate Bank Books can be maintained for each bank account.

Thus, Bank Book can be distinguished from a Pass Book and a Bank Statement. These are basically the copy of a client's account (as it appears in the book's personal ledger).

Bank Reconciliation Statement

At any point of time, the balances as per cash book (bank column) and pass book should be equal in amount. But, in reality it rarely happens due to certain specific reasons. To reconcile the balances as reflected by these two related books a statement is prepared, which is referred to as the Bank Reconciliation Statement.

This statement is not a part of the books of accounts of an organisation. These are prepared at periodical intervals for verification of the accuracy of cash book and pass book. It is to be noted that this statement does not rectify any error that may exist in the books. Its primary objective is to identify the causes of discrepancy between the two books as on a particular date.

The main reason for disagreement between the balances of cash book and pass book is caused by time gap and or communication gap between the entries made at the end of the client and bank. Some of the common transactions which cause disagreement between the cash book (bank cloumn) and pass book are:

- Cheque issued but not presented at the bank;
- Cheque deposited in bank, but not yet collected;
- Amount deposited directly in bank by other parties;
- Incidental charges, interest on overdraft etc. debited by bank;
- Interest on deposits credited by bank;
- Dishonor of cheque deposited;
- Clerical errors made in recording of transactions etc. both by customer and Bank
- Payment by Bank under standing instruction.

It is worth mentioning at this point that in this technologically advanced era many of the abovementioned causes of disagreement has been done away with the emergence of digital transactions.

Preparation of Bank Reconciliation Statement

- **Without Amended Cash Book Method:** The preparation of Bank Reconciliation Statement can start with any of the available balances viz. balance of cash book (bank column) or balance of pass book. To this logical adjustments must be made of the transactions that has caused the disagreement – either by making addition or subtraction of the relevant items. Once all the items of disagreement gets adjusted, the balances as per the two books should get tallied.
- **Amended Cash Book Method:** Alternatively, the cash book (amended) can be prepared for ascertaining the correct balance of the cash book (bank column) and thereafter the Bank Reconciliation Statement is to be drafted to reconcile this correct balance of cash book with the balance as per pass book. The amended cash book is drafted with the items that have been correctly recorded in the pass book but is yet to be recorded in the cash book. Moreover, any error committed and appearing in the cash book should also be considered while drafting the amended cash book. But any error Committed by Bank would be reflected in the Reconciliation statement instead of Cash book.

Illustration 4

On comparing the Cash Book of Saksham with the Bank Pass Book for the year ended 31st March, 2023, following discrepancies were noticed:

(a) Out of ₹ 82,000 paid in by cheques into the bank on 25th March, cheques amounting to ₹ 30,000 were collected on 5th April.

(b) Out of cheques drawn amounting to ₹ 31,200 on 28th March a cheque for ₹ 10,000 was presented on 3rd April.

(c) A cheque for ₹ 4,000 entered in Cash Book but omitted to be banked on 31st March.

(d) A cheque for ₹ 2,400 deposited into bank but omitted to be recorded in Cash Book and was collected by the bank on 29th March.

(e) A bill receivable for ₹ 2,080 previously discounted (discount ₹ 80) with the bank had been dishonoured but advice was received on 3rd April.

(f) A bill for ₹ 40,000 was retired/paid by the bank under a rebate of ₹ 600 but the full amount of the bill was credited in the bank column of the Cash Book.

(g) A cheque of ₹ 10,000 wrongly credited in the Pass Book on 29th March was reversed on 2nd April.

(h) Bank had wrongly debited ₹ 20,000 in the account on 31st March and reversed it on 10th April, 2023.

(i) A cheque of ₹ 800 drawn on the Savings Account has been shown as drawn on Current Account in Cash Book.

Prepare a Bank Reconciliation Statement as on 31st March, 2023, if the Balance as per Cash Book on 31st March was ₹ 1,58,280.

Solution:

Bank Reconciliation Statement
as on 31st March 2023

Particulars	(₹)	(₹)
Balance as per Cash Book (Dr.)		1,58,280
Add: (b) Cheques issued on 28th March but not yet presented for payment	10,000	
(d) A cheque deposited into bank but not recorded in Cash Book	2,400	
(f) Rebate on bill not entered in Cash Book (Note)	600	
(g) Cheque wrongly credited by bank	10,000	
(i) Cheque drawn on Savings Bank A/c but wrongly recorded in Current A/c	800	23,800
		1,82,080
Less: (a) Cheques deposited on 25th March but not yet collected till 31st March	30,000	
(c) A cheque entered in Cash Book but not yet banked	4,000	
(e) Discounted Bills Receivable dishonoured but not recorded in Cash Book	2,080	56,080
(h) Amount Wrongly debited by the Bank	20,000	
Balance as per Bank Pass Book (Cr.)		1,26,000

If the same question is solved through amended Cash Book, then all the transactions will be divided into two parts i.e. items to be shown in the cash book and items to be shown in Reconciliation statement. Given below Reconciliation after amending cash book.

Amended Cash Book (Bank column only)

Dr. **as on 31.3.2022** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2023 Mar 31	To balance b/d	158280	2023 Mar 31	Discounted B/R dishonored not recorded in cash book	2080
	Cheque deposited not recorded	2400			
	Rebate not entered in cash book	600			
	Cheque drawn recorded in different account	800			
				Balance c/d	160000
		162080			162080

Bank Reconciliation Statement
as on 31st March 2022

Particulars	(₹)	(₹)
Balance as per Cash Book (Dr.)		160000
Add: (b) Cheques issued on 28th March but not yet presented for payment	10,000	
(g) Cheque wrongly credited by bank	10,000	
Less: (a) Cheques deposited on 25th March but not yet collected till 31st March	30,000	
(c) A cheque entered in Cash Book but not yet banked	4,000	
(h) Amount Wrongly debited by the Bank	20,000	
Balance as per Bank Pass Book (Cr.)		126000

Students are advised to analyse Illustration-4 and can understand which items are shown incash book and which items are shown in reconciliation statement.

Illustration 5

On 31st January, 2023, Sethi's cash book showed a bank overdraft of ₹ 2,50,000. On comparing with the pass book, the following differences were noted.

(a) Cash and cheques amounting to ₹ 26,800 were sent to the bank on 27th January, but cheques worth 4600 were credited on 2nd February and one cheque for 900 was returned by them as dishonoured on 4th February.

(b) During the month of January, Sethi issued cheques worth ₹ 33,400 to his creditors. Out of these, cheques worth 27,400 were presented for payment on 5th February.

(c) According to Sethi's standing orders, the bankers have made the following payments during the month of January:

i. Life insurance premium ₹ 3,840

ii. Television license fee ₹ 2,400

(d) Sethi's bankers have collected ₹ 3,000 as dividend on his shares.

(e) Interest charged by the bank ₹ 2,500

(f) A bill receivable of ₹ 2,000 discounted with the bank in December, 2022, was dishonoured on 31st January, 2023.

You are required to:

(i) Ascertain the amended cash book balance as on 31st January, 2023

(ii) Prepare a Bank Reconciliation Statement from the amended cash book as on 31st January 2023

Solution:

In the Books of Sethi

Dr. **Cash Book (Bank column only)** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2023 Jan-31	To Dividend on shares	3,000	2023 Jan-31	By Balance b/f	2,50,000
	To Bal c/d	2,57,740		By Drawings (₹ 3840 + ₹ 2400)	6,240
				By Interest	2500
				By Debtors- discounted bill dishonoured	2000
		2,60,740			2,60,740
			2022 Feb:1	By Bal b/d	2,57,740

Bank Reconciliation Statement
as on 31.01.2023

Particulars	(₹)	(₹)
Bank balance as per Cash Book (overdrawn)		2,57,740
Add: Cheques deposited but not credited in the Pass Book (4600+ 900)		5,500
		2,65,240
Less: Cheques issued but not presented for payment		27,400
Bank balance as per Pass Book (overdrawn)		2,35,840

Trial Balance (Preparation and Scrutiny)

1.7

The process of accounting involves recording transactions in the journal and thereafter posting them in the respective accounts in the ledger. At the end of an accounting period, these ledger accounts are balanced and now they are ready to be used for drafting of the financial statements. However, before starting the process of finalization of accounts, for ensuring the accuracy of the accounting a document is prepared using the balances of the ledger accounts after they have been closed. This document is called the Trail Balance.

Concept

The Trial Balance is a statement drawn up using the ledger balances to test of the arithmetical accuracy of the ledger account. The primary purpose of drafting a Trial Balance is to ensure that there are no arithmetical errors. However, it is to be noted that after the use of computers in accounting, the requirement of drafting trial balance has substantially reduced. It is a columnar statement having five columns – Serial number, Name of ledger account, Ledger Folio (L.F.), Debit amount, and Credit amount. In case the accounting happen to be correct and complete, the two amount columns of the Trial Balance should tally i.e. be of equal amount. The proforma of a Trail Balance is as under:

Trial Balance of …….. as on ……..

Sl. No.	Ledger Accounts	L.F.	Dr. (₹)	Cr. (₹)

Features

- A trial balance is just a statement, and not an account.
- It does not form part of the double entry system.
- It does not appear in the actual books of accounts. It is usually prepared as a separate document.
- It is prepared as on a particular date, and not for a period.
- A trial balance may be prepared at any time, say, on monthly, quarterly, half-yearly or on annual basis. However, it is to be noted that the Trial Balance must be drafted at the end of every accounting year before the preparation of financial statements.
- If the books are arithmetically accurate, the total of the debit balances must agree with the total of the credit balances.
- The agreement of a trial balance is only a prima facie evidence of the arithmetical accuracy of the books of accounts but not a conclusive proof of absolute accuracy.

Advantages of a Trial Balance

- The agreement of the trial balance provides a useful check upon the ledger postings. It proves that both the aspects of each transaction have been posted into the ledger – debit aspects on the debit side and corresponding credit aspects on the credit side.
- It proves that the accounts are arithmetically correct, i.e., correct amount has been written against each posting in the ledger.
- It facilitates the preparation of financial statements by presenting the ledger balances in a summarised form.
- It acts as a connecting link between ledger accounts and the financial statements of an entity.

Limitations of a Trial Balance

Some of the limitations of trial balance are:

- Trial balance can be drafted only when books are maintained under double entry system of book keeping. As such, smaller concerns who do not follow double entry system cannot draft the trial balance.
- The agreement of a trial balance is not a conclusive proof of absolute accuracy of the books of accounts. It is only a prima facie proof. Certain errors do not get disclosed by the trial balance.

Errors Not Identified by Trial Balance

The errors and omissions not revealed by the trial balance are:

- **Error of Omission or Duplication:** An entry has been completely omitted to be recorded in the book of original entry.
- **Error of Commission:** When a wrong amount has been entered in the correct accounts, or a account is involved while recording the transactions.
- **Errors of Principle:** recording not in accordance with accounting principles, e.g., the purchase of office furniture debited to purchases account, instead of furniture and fittings account.
- **Errors of Original Entry** – if the amount of a transaction is entered incorrectly in a subsidiary book.
- **Compensating Errors** – two or more mistakes in the books which result in cancelling each other out.

Preparation of Trial Balance

There are two recognised methods of preparing Trial Balance. They are **(1) Total Method, and (2) Balance Method**.

(1) Total Method: In this method, for each ledger account the total of debit side and total of credit side are collected and placed on the debit and credit columns of the Trial Balance. Trial Balance can be drafted under this method even though the ledger accounts have not been balanced.

(2) Balance Method: Under this method, Trial Balance is prepared only after each ledger account has been balanced. So, for each ledger account only one amount is posted in the Trial Balance.

Illustration 6

From the following ledger account balances, prepare a Trial Balance of Mr. Sen for the year ended 31st March, 2023.

Capital ₹ 80,000 ; Sales ₹ 10,00,000; Adjusted Purchase ₹ 8,00,000; Current A/c(Cr) ₹ 10,000; Petty Cash ₹ 10,000; Sales Ledger Balance ₹ 1,20,000; Purchase Ledger Balance ₹ 60,000; Salaries ₹ 24,000; Carriage Inwards ₹ 4,000; Carriage Outward ₹ 6,000; Discount Allowed ₹ 10,000; Building ₹ 80,000; Outstanding Expenses ₹ 10,000; Prepaid

Insurance ₹2,000 ; Depreciation ₹4,000 ; Cash at Bank ₹80,000 ; Loan A/c (Cr) ₹66,000; Profit & Loss A/c(Cr) ₹20,000; Bad Debts Recovered ₹2,000 ; Stock at 31.03.2022 ₹1,20,000; Interest Received ₹10,000; Accrued Interest 4,000; Investment 20,000; Provision for Bad Debts (01.04.2021) ₹6,000 ; General Reserve ₹20,000.

Solution:

Trial Balance of Mr. Sen

Dr. **as on 31st March, 2023** **Cr.**

Heads of Accounts	(₹)	Heads of Accounts	(₹)
Adjusted Purchase	8,00,000	Capital	80,000
Petty Cash	10,000	Sales	10,00,000
Sales Ledger Balance	1,20,000	Current A/c	10,000
Salaries	24,000	Purchase Ledger Balance	60,000
Carriage Inward	4,000	Outstanding Expenses	10,000
Discount Allowed	10,000	Loan A/c	66,000
Building	80,000	Profit & Loss A/c (Cr.)	20,000
Prepaid Insurance	2,000	Bad Debts Recovered	2,000
Depreciation	4,000	Interest Received	10,000
Cash at Bank	80,000	Provision for Bad debts	6,000
Stock (31.03.2022)	1,20,000	General Reserve	20,000
Accrued Interest	4,000		
Investment	20,000		
Carriage outward	6,000		
	12,84,000		**12,84,000**

Note: Closing Stock will appear in Trial Balance since there is adjusted purchase.

Adjusted purchase = Opening Stock + Purchase - Closing Stock.

It may be noted that if only adjusted purchase is considered then the matching concept is affected. Hence, to satisfy the matching concept, closing stock is also considered in Trial Balance.

Illustration 7

The given trial balance of MM Bakery for the quarter January to March, 2023 has been prepared by an intern.

Ledger Accounts	Dr. (₹)	Cr. (₹)
Cost of Goods Sold	7,50,000	
Closing Stock		1,20,000
Sundry Debtors		1,80,000

Ledger Accounts	Dr. (₹)	Cr. (₹)
Sundry Creditors		90,000
Fixed assets	1,50,000	
Opening Stock	1,80,000	
Expenses		60,000
Sales		9,00,000
Capital	2,70,000	
	13,50,000	**13,50,000**

You are the senior accountant of the concern and has been given responsibility to check the same and redraft it if required.

Solution:

The Trial Balance drafted by the intern has tallied, but it has some errors. The correct Trial Balance is redrafted and presented hereunder:

Redrafted Trial Balance of MM bakery as on 31.03.2023

Sl. No.	Ledger Accounts	Dr. (₹)	Cr. (₹)	Remarks
1	Cost of Goods Sold.	7,50,000		Expense
2	Closing Stock	1,20,000		Asset
3	Sundry Debtors.	1,80,000		Asset
4	Sundry Creditors		90,000	Liability
5	Fixed assets	1,50,000		Asset
6	Wages, Salaries & other expenses	60,000		Expenses
7	Sales		9,00,000	Income
8	Capital		2,70,000	Equity
		12,60,000	**12,60,000**	

Adjustments and Rectifications

1.8

1.8.1 Depreciation and Amortisation

Fixed Assets are purchased in the business for long-term use. During the course of their use, every year a part of fixed assets expires (i.e., is consumed or utilised or lost) due to physical wear and tear, passage of time, obsolescence etc. The gradual decline in the value of a tangible asset is termed as Depreciation. Thus, it can be stated that depreciation is a part of cost of tangible fixed asset which has expired because of its usage, lapse of time etc.

The purpose of providing for depreciation is to write off cost of fixed assets over their estimated useful life. It is important to note that depreciation is charged on all fixed assets except freehold land. The reason is that unlike other fixed assets like machinery and furniture, useful life of land (because it has infinite life) is not limited to few years.

Characteristics of Depreciation

- Depreciation is a reduction in the book value of fixed assets (except freehold land).
- Such reduction in the book value of a fixed asset is permanent, gradual and of continuing nature.
- Depreciation is a continuous process i.e. provided every year because the book value is reduced either due to use or with the passage of time.
- It occurs gradually unless there is a quick physical deterioration or obsolescence due to technological developments.

The processes of Depreciation in case of Corporate Entities have been given in Schedule-II of Companies Act, 2013 which is effective w.e.f. 1.4.14. students are advised to refer MCA notification in this regard.

Depreciation, Amortisation and Depletion

Depreciation: The term 'Depreciation' is a measure of wearing out, consumption or other loss of value of a depreciable asset, arising from use, efflux of time or obsolescence through technology and market changes. It is an allocation of cost of fixed asset as expense over its estimated useful life. Depreciation expense is charged on all tangible fixed assets whose useful life is limited. For example, cost of the machine is written off over its estimated useful life. On the other hand, useful life of freehold land is normally infinite. As a result, it is not depreciated.

Amortisation: Amortisation is a gradual and systematic writing-off of intangible asset over its estimated useful life. For example, patents, purchased goodwill, copyrights are amortised over their useful life being intangible assets.

Depletion: Depletion is the value of wasting asset extracted from quarry, mine, etc. Extraction reduces the available quantity of material. For example, extraction of coal from a coal mine is depletion of coal stock.

Methods of Recording (Accounting) Depreciation

There are two alternative methods of recording depreciation.

1. When depreciation is charged to the Asset Account; and They are:
2. When Provision for Depreciation/Accumulated Depreciation Account is opened.

1. When Depreciation is charged against asset

Under this method, the amount of depreciation is credited to the concerned Asset Account. Depreciation Account, being a nominal account, is transferred to the Profit and Loss Account at the end of every accounting period. In the Balance Sheet, asset is shown at its written down value (i.e., cost less depreciation provided till date).

Journal entries for charging depreciation and transferring it to Profit and Loss Account are:

- Depreciation A/c Dr
  To Asset A/c.
  (Being the depreciation on asset charged)

- Profit and Loss A/c Dr.
  To Depreciation A/c
  (Being the depreciation transferred to Profit and Loss A/c)

2. When Provision for Depreciation/Accumulated Depreciation Account is maintained

Under this method, depreciation is not credited to the Asset Account but is credited to Provision for Depreciation Account or Accumulated Depreciation Account.

- As a result, Asset Account continues to be shown at its cost. The balance of Provision for Depreciation/ Accumulated Depreciation Account shows total depreciation till date (year after year). In the Balance Sheet, asset is shown at Cost less Provision for Depreciation.

  Journal entries for charging depreciation and closing the Depreciation Account are as follows:

- Depreciation A/c Dr.
  To Provision for Depreciation A/c
  (Being the depreciation on asset charged)
- Profit and Loss A/c Dr.
  To Depreciation A/c
  (Being the depreciation transferred to Profit and Loss Account)

Methods of calculating depreciation

There are a number of methods that have been developed from calculating the amount of depreciation. Some of the most commonly used methods are:

1. Fixed Installment Method or Straight Line Method
2. Reducing Balance Method/ Diminishing Balance Method
3. Sum of Years' Digit Method
4. Sinking Fund Method
5. Annuity Method
6. Insurance Policy Method

Straight Line Method

Under this method, a fixed portion of the cost of a fixed asset is allocated and charged as periodic depreciation. Such depreciation becomes an equal amount in each period. The formula for calculation of depreciation is as under:

Depreciation = (V-S)/n

where,

V = Cost of the asset

S = Residual value or the expected scrap value of the asset

n = Estimated life of the asset

Reducing Balance Method/ Diminishing Balance Method/ Written Down Value Method

Under this method, depreciation is calculated at a fixed percentage on the original cost in the first year, and in subsequent years it is calculated at the same percentage on the written down values i.e. book value over the expected working life of the asset. In this case, the rate of allocation is constant (usually a fixed percentage) but the amount allocated for every year gradually decreases.

Under this method, Depreciation p.a. is calculated as under:

For newly acquired Fixed Asset = Original Cost × Rate of Depreciation

For existing Fixed Asset = Opening WDV × Rate of Depreciation

Provision for Depreciation Account

Provision of depreciation is the collected value of all depreciation. Provision of depreciation account is the account of provision of depreciation. With making of this account we are not crediting depreciation in asset account, but transfer every year depreciation to provision of depreciation account. Every year we adopt this procedure and when assets are sold we will transfer sold asset's 'total depreciation' to credit side of asset account, for calculating correct profit or loss on fixed asset. This provision uses with any method of calculating depreciation.

There are the following features of provision for depreciation account:

- Fixed asset is made on its original cost and every year depreciation is not transfer to fixed asset account.
- Provision of depreciation account is Conglomerated value of all old depreciation.
- This system can be used both in straight line and diminishing method of providing depreciation. The journal entries will be :

(i) For purchase of asset

Asset A/c	Dr.
To Cash/Bank A/c	

(ii) For providing depreciation at end of year

Depreciation A/c	Dr.
To Provision for depreciation A/c	

(iii) For sale of assets

Cash/Bank A/c	Dr.
Provision for depreciation A/C	Dr.
To Asset Sales A/c	

Or if sale of Asset A/C is opened :

(a) When asset Sold

Asset Disposal A/c Dr.

To Asset A/c (original cost)

(b) Cash Realised on sale of Asset

Cash/Bank/ Debtor A/c Dr.

Provision for depreciation A/C Dr.

P/L Account Dr (in case of loss)

To Asset Sales A/c

To P/L Account (in case of profit)

Illustration 8

Machine No.	Cost of Machine (₹)	Expenses incurred at the time of purchase to be capitalized (₹)	Estimated Residual Value (₹)	Expected Useful Life in years
1	90,000	10,000	20,000	8
2	24,000	7,000	3,100	6
3	1,05,000	20,000	12,500	3
4	2,50,000	30,000	56,000	5

Compute the amount of depreciations to be charged and the rate of depreciations under SLM method.

Solution:

Machine No	Cost of Machine (₹)	Expenses incurred at the time of purchase to be capitalize (₹)	Total Cost of Asset = (b+c) (₹)	Estimated Residual Value (₹)	Expected Useful Life in years	Depreciation = (d-e)/f (₹)	Rate of Depreciation under SLM = (g/d)×100
a	b	c	d	e	f	g	h
1	90,000	10,000	1,00,000	20,000	8	10,000	10%
2	24,000	7,000	31,000	3,100	6	4,650	15%
3	1,05,000	20,000	1,25,000	12,500	3	22,500	30%
4	2,50,000	30,000	2,80,000	56,000	5	22,400	16%

Illustration 9

A machine is purchased for ₹ 7,00,000. Expenses incurred on its cartage and installation ₹ 3,00,000. Calculate the amount of depreciation @ 20% p.a. according to Straight Line Method for the first year ending on 31st March, 2023 if this machine is purchased on:

(a) 1st April, 2022

(b) 1st July, 2022

(c) 1st October, 2022

(d) 1st January, 2023

Solution:

Here, Total Cost of Asset = Purchased Price + Cost of Cartage and Installation

= ₹ 7,00,000 + ₹ 3,00,000 = ₹ 10,00,000

Amount of Depreciation:

$$= \text{Total Cost of Asset} \times \text{Rate of Depreciation} \times \frac{\text{Period from the date of purchase to date of closing accounts}}{12}$$

(a) The machine was purchased on 1st April, 2022:

$$\text{Amount of Depreciation} = ₹\ 10{,}00{,}000 \times 20\% \times \frac{12}{12} = ₹\ 2{,}00{,}000$$

(b) 1st July, 2022

$$\text{Amount of Depreciation} = ₹\ 10{,}00{,}000 \times 20\% \times \frac{9}{12} = ₹\ 1{,}50{,}000$$

(c) 1st October, 2022

$$\text{Amount of Depreciation} = ₹\ 10{,}00{,}000 \times 20\% \times \frac{6}{12} = ₹\ 1{,}00{,}000$$

(d) 1st January, 2023

$$\text{Amount of Depreciation} = ₹\ 10{,}00{,}000 \times 20\% \times \frac{3}{12} = ₹\ 50{,}000$$

Reducing / Diminishing Balance Method or Written Down Value Method

Features:

(i) Depreciation is calculated at a fixed percentage on the original cost in the first year. But in subsequent years it is calculated at the same percentage on the written down values gradually reducing during the expected working life of the asset.

(ii) The rate of allocation is constant (usually a fixed percentage) but the amount allocated for every year gradually decreases.

Illustration 10

On 1.1.2021 a machine was purchased for ₹ 1,00,000 and ₹ 50,000 was paid for installation. Assuming that the rate of depreciation was 10% on Reducing Balance Method, calculate amount of depreciation upto 31.12.2023.

Solution:

Year	Opening Book Value (₹)	Rate	Depreciation (₹)	Closing Book Value (₹)
2021	1,50,000	10%	15,000	1,35,000
2022	1,35,000	10%	13,500	1,21,500
2023	1,21,500	10%	12,150	1,09,350

Note: Cost of the machine (i.e. Opening Book Value for the year 2021)

= Cost of Purchase + Cost of Installation

= ₹ 1,00,000 + ₹ 50,000 = ₹ 1,50,000

Sum of the Units Method:

Depreciation for the period —

Production during the year / Estimated Total Production

Illustration 11

A machine is purchased for ₹60,00,000, estimated life of which is 10 years residual value is ₹ 4,00,000. Expected production of the machine is 2,00,000 during its useful life.

Production pattern is as follows:

Year	Units
1-2	20,000 per year
3-6	15,000 per year
7-10	25,000 per year

Compute the amount of depreciation for each year applying Sum of the Units Method.

Solution:

Year	Computation	Depreciation (₹)
1-2	$\frac{20,000}{2,00,000} \times (60,00,000 - 4,00,000)$	5,60,000
3-6	$\frac{15,000}{2,00,000} \times (60,00,000 - 4,00,000)$	4,20,000
7-10	$\frac{25,000}{2,00,000} \times (60,00,000 - 4,00,000)$	7,00,000

Illustration 12

On 1.1.2021 machinery was purchased for ₹ 80,000. On 01.07.2022 additions were made to the amount of ₹ 40,000. On 31.3.2023, machinery purchased on 1.7.2022, costing ₹ 12,000 was sold for ₹ 11,000 and on 30.06.2023 machinery purchased on 01.01.2021 costing ₹ 32,000 was sold for ₹ 26,700. On 1.10.2023, additions were made to the amount of ₹ 20,000. Depreciation was provided at 10% p.a. on the Diminishing Balance Method.

Show the Machinery Accounts for three years from 2021-2023. (year ended 31st December)

Solution:

Statement of Depreciation.

Date	Particulars	Machines – I Cost = ₹ 80,000		Machines – II Cost = ₹ 40,000		Machines – III Cost = ₹ 20,000	Total Depreciation
		(₹)	(₹)	(₹)	(₹)	(₹)	(₹)
01.01.2021	Book Value	48,000	32,000				
31.12.2021	Depreciation	4,800	3,200				8,000
01.01.2022	W.D.V.	43,200	28,800				
01.07.2022	Purchase			28,000	12,000		
31.12.2022	Depreciation	4,320	2,880	1,400	600		9,200
01.01.2023	W.D.V.	38,880	25,920	26,600	11,400		
31.03.2023	Depreciation				285		285

Date	Particulars	Machines – I Cost = ₹ 80,000		Machines – II Cost = ₹ 40,000		Machines – III Cost = ₹ 20,000	Total Depreciation
		(₹)	(₹)	(₹)	(₹)	(₹)	(₹)
	W.D.V.				11,115		
	Sold For				11,000		
	Loss on sale				115		
30.06.2023	Depreciation		1,296				1,296
	W.D.V.		24,624				
	Sold For		26,700				
	Profit on Sale		2,076				
01.10.2023	Purchase					20,000	
31.12.2023	Depreciation	3,888		2,660		500	7,048
01.01.2024	W.D.V.	34,992		23,940		19,500	

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

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To Bank A/c	80,000	31.12.21	By Depreciation A/c ,, Balance c/d	8,000 72,000
		80,000			**80,000**
01.01.22 01.07.22	To Balance b/d " Bank A/c	72,000 40,000	31.12.22	By Depreciation A/c ,, Balance c/d	9,200 1,02,800
		1,12,000			**1,12,000**
01.01.23 30.06.23	To Balance b/d " P & L A/c (Profit on Sale) " Bank A/c	1,02,800 2,076 20,000	31.3.23 30.6.23 31.12.23	By Bank (Sale) A/c ,, Depreciation A/c ,, P & L A/c (Loss on Sale) ,, Bank A/c (Sale) ,, Depreciation A/c ,, Depreciation A/c ,, Balance c/d	11,000 285 115 26,700 1,296 7,048 78,432
		1,24,876			**1,24,876**

Illustration 13

S & Co. purchased a machine for ₹ 1,00,000 on 1.1.2021. Another machine costing ₹1,50,000 was purchased on 1.7.2022. On 31.12.2023, the machine purchased on 1.1.2021 was sold for ₹ 50,000. The company provides depreciation at 15% on Straight Line Method. The company closes its accounts on 31st December every year. Prepare – (i) Machinery A/c, (ii) Machinery Disposal A/c and (iii) Provision for Depreciation A/c.

Solution:

S & Co.

Machinery Account

Dr. **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To Bank A/c	1,00,000	31.12.21	By Balance c/d	1,00,000
		1,00,000			1,00,000
01.01.22	To Balance b/d	1,00,000			
01.07.22	To Bank A/c	1,50,000	31.12.22	By Balance c/d	2,50,000
		2,50,000			2,50,000
01.01.23	To Balance b/d	2,50,000	31.12.23	By Machinery Disposal A/c	1,00,000
			31.12.23	By Balance c/d	1,50,000
		2,50,000			2,50,000
01.01.24	To Balance b/d	1,50,000			

Provision for Depreciation Account

Dr. **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.21	To Balance c/d	15,000	31.12.21	By Depreciation A/c	15,000
		15,000			15,000
31.12.22	To Balance c/d	41,250	01.01.22	By Balance b/d	15,000
			31.12.22	By Depreciation A/c (₹ 15,000 + ₹ 11,250)	26,250
		41,250			41,250
31.12.21	To Machinery Disposal A/c	30,000	01.01.23	By Balance b/d	41,250
31.12.23	To Balance c/d	33,750	31.12.23	By Depreciation A/c	22,500
		63,750			63,750
			01.01.24	By Balance b/d	33,750

Dr. **Machinery Disposal Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.23	To Machinery A/c	1,00,000	31.12.23	By Provision for Depreciation A/c	30,000
				By Depreciation A/c	15,000
				By Bank A/c	50,000
				By Profit & Loss A/c(Loss on Sale)	5,000
		1,00,000			**1,00,000**

Working Notes:

1. Depreciation for the machine purchased on 1.7.2022
   For the year 2022 (used for 6 months) = ₹ 1,50,000 × 15% × 6/12 = ₹ 11,250
   For the year 2023 (used for full year) = ₹ 1,50,000 × 15% = ₹ 22,500
2. Depreciation for the machine purchased on 1.1.2021
   Depreciation = ₹ 1,00,000 × 15% = ₹ 15,000
   So, Depreciation for 2 years = ₹ 15,000 × 2 = ₹ 30,000

Profit or Loss on Sale of Assets – Method of Depreciation Calculation

Sometimes an asset is sold before the completion of its useful life for some unavoidable circumstances (due to obsolescence etc.) including a part of the asset which is no longer required in future. If the sale price is less than the WDV, there will be loss, and vice versa. The profit & loss on sale of asset is adjusted in the year of Sale in Profit & Loss Account.

Accounting Treatment

a. Where no provision for depreciation account is maintained:

WDV of the amount sold will be transferred to 'Assets Disposal Account'. The entries will be as follows:

(i) WDV of asset has been transferred to Asset Disposal A/c

Asset Disposal A/c Dr.
To Asset A/c

(ii) In case of Sale of an Asset

Cash/Bank A/c Dr.
To Asset Disposal A/c

(iii) For depreciation (if any)

Depreciation (P & L A/c) Dr.
To Asset Disposal A/c

(iv) In case of Profit on Sale of Asset

Asset Disposal A/c Dr.
To Profit & Loss A/c

(v) In case of Loss on Sale of Asset

Profit & Loss A/c Dr.
To Asset Disposal A/c

b. Alternative Approach

In this situations, all adjustments are to be prepared through the assets account. The entries are as follows:

(i) In case of Assets sold

Cash/Bank A/c Dr.

To Assets A/c

(ii) In case of Depreciation

Depreciation (Profit & Loss) A/c Dr.

To Assets A/c

(iii) In case of Profit on Sale

Assets A/c Dr.

To Profit & Loss

(iv) In case of Loss on Sale

Profit & Loss A/c Dr.

To Assets A/c

Illustration 14

On 1st April, 2021, Som Ltd. purchased a machine for ₹66,000 and spent ₹5,000 on shipping and forwarding charges, ₹7,000 as import duty, ₹1,000 for carriage and installation, ₹500 as brokerage and ₹500 for an iron pad. It was estimated that the machine will have a scrap value of ₹ 5,000 at the end of its useful life which is 15 years. On 1st January, 2022 repairs and renewals of ₹3,000 were carried out. On 1st October, 2023 this machine was sold for ₹ 50,000. Prepare Machinery Account for the 3 years, assuming year ends as 31st March.

Solution:

In the books of Som Ltd.

Dr. Machinery Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.04.21	To Bank A/c	66,000	31.03.22	By Depreciation A/c	5,000
	To Bank A/c	14,000		By Balance c/d	75,000
		80,000			80,000
01.04.22	To Balance b/d	75,000	31.03.23	By Depreciation A/c	5,000
				By Balance c/d	70,000
		75,000			75,000
01.04.23	To Balance b/d	70,000	01.10.23	By Depreciation A/c	2,500
				By Bank A/c (sale)	50,000
				By Profit & Loss A/c (Loss)	17,500
		70,000			70,000

Working Note:

1. Total Cost = ₹ 66,000 + ₹ 5,000 + ₹ 7,000 + ₹ 1,000 + ₹ 500 + ₹ 500 = ₹ 80,000

$$\text{Depreciation} = \frac{\text{Total Cost} - \text{Scrap Value}}{\text{Expected life}} = \frac{80{,}000 - 5{,}000}{15} = ₹\,5{,}000$$

The amount spent on repairs and renewals on 1st January, 2022 is of revenue nature and hence, does not form part of the cost of asset.

Change of Method

The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise. The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.

Depreciation is an Accounting estimate and not accounting policy. The depreciation method selected should be applied consistently from period to period. Change in depreciation method , if required to match with revenue, should be done prospectively.

1.8.2 Adjustment Entries and Rectifications of Errors

Adjustment Entries

- The financial statements are prepared at the end of an accounting period by considering the ledger balances appearing in the books of accounts. But, in many cases, the balances reflected by the ledger accounts are not true. Certain adjustments are required to reflect the true picture of the actual happenings in the organisation. These journal entries are referred to as adjustment entries as they adjust the ledger account balances to reflect the reality. These entries update accounting records at the end of a period for any transactions that have not yet been properly reflected.
- The passing of adjusting entry(s) is a fundamental book keeping and accounting process. The primary purpose for the adjusting process is to reflect true essence of the transactions and the proper situation of the organisation as on the date of passing of such entries. It happens to be a necessary part of the accounting cycle and has to be built into the accounting system.
- The adjustment entries are passed at the end of an accounting period, and these entries usually have reflections in the income statement as-well-as the balance sheet. These entries are not passed on the basis of source documents like invoice, bill etc.
- Once the adjusting entries are complete, the adjusted trial balance can be drafted, which can ultimately be used to prepare the financial statements, the balance sheet, the income statement, and the statement of equity.

Features of Adjustment Entries

The features of adjustment entries are:

- These are a special type of journal entries.
- These entries are recorded on the General Journal/ Journal Proper.
- They are passed to reflect the reality.
- These entries are passed to comply with the accounting principles.
- Adjustment entries are pass**ed at the end of an accounting** period.

Classification of Adjustment Entries

Adjustment entries are classified into three main types:

- Pre-payments and Pre-receipts: The transactions under pre-payments category involve – Prepaid expenses and Unearned revenues. The forme**r refers t**o money paid in advance for expenses not yet incurred, while the **later are** money received in advance but yet to be earned.

  Example : Prepaid insurance, subscription received by a club in advance.

- Accruals: The accrual transactions can be either accrued expenses or accrued incomes. Accrued expenses, also referred to as outstanding expenses, are expenses which have actually taken place, but for which no payment has yet been made. As such, they **are not a**ccounted for in the books. On the other hand, accrued incomes **are incomes earned, but not ye**t recorded nor money received.

  Example 3: Monthly electricity bill outstandings 31.03.2022 expense.

- Non-cash expenses (Estimates):

Adjustment	Adjustment Entry	
Closing stock	Stock-in-trade A/c To Purchases/ Trading A/c	Dr.
Goods withdrawn by owner for personal use	Drawing A/c To Purchases A/c	Dr.
Goods distributed as free samples to public	Advertisement A/c To Purchases A/c	Dr.
Goods distributed as free samples to employees	Wages/ Salaries A/c To Purchases A/c	Dr.
Goods-in-Transit	Goods-in-transit A/c To Purchases/ Trading A/c	Dr.
Abnormal loss of stock	Abnormal Loss A/c To Purchase/ Trading A/c	Dr.
Stock used as stationary	Stationery A/c To Purchases/ Stock A/c	Dr.
Materials used for constructing Fixed Assets	Fixed Assets A/c To Purchases/ Stock A/c	Dr.
Goods sent on approval basis, pending approval on Balance Sheet date	Sales A/c To Sale or Return Suspense A/c	Dr.
	Stock on Sale or Return A/c To Trading A/c	Dr.
Outstanding expenses	Expenses A/c To Outstanding Expenses A/c	Dr.

Adjustment	Adjustment Entry
Prepaid expenses	Prepaid Expenses A/c Dr. To Expenses A/c
Pre-received Incomes	Income A/c Dr. To Pre-received Income A/c
Accrued Incomes	Accrued Income A/c Dr. To Income A/c
Depreciation/Amortisation on fixed assets	Depreciation/Amortisation A/c Dr. To Fixed Assets A/c
Provision for Bad Debts	P/L A/c Dr. To Provision for Bad Debts A/c
Provision for Discount on Debtors	P/L A/c Dr. To Provision for Discount on Debtors A/c
Mutual Set-off between debtors and creditors	Creditors A/c Dr. To Debtors A/c

1.8.3 Accounting Treatment of Bad Debts, Provision for Doubtful Debts, Provision for Discount on Debtors and Provision for Discount on Creditors

For any business, purchase and sales are the most regular and main activity. This attracts business connection with lots of people either giving or taking benefits of credit. Debtors refer to those entities who take the benefit of delayed payment and creditors allow credit period to pay later. That means in each case there is a time gap between the date of sale or purchase and the date of recovery of cash or payment of cash.

The amount which is receivable from a person or a concern for supplying goods or services is called Debt. On the basis of the chances o**f collectio**n from the debtors, debts may be classified into the following three categories: Good debts, Doubtful debts and Bad debts.

Good Debts: The debts which are not bad i.e., there is neithe**r any possibili**ty of bad debts nor any doubts about its realization, is called good debts. As such, no provision is necessary for it.

Doubtful Debts: The debts which will be receivable or cannot be ascertainable at the date of preparing the final accounts (i.e., the debts which are doubtful to realise) is known as doubtful debts. Practically it cannot be treated as a loss on that particular date, as such, it cannot be written off. But, it should be charged against Profit and Loss Account on the basis of past experience of **the firm.** This is done as per matching principle so that the anticipated loss of the year charged against the revenue of that year.

Bad Debts: Bad debts are uncollectable or irrecoverable debt or debts which are impossible to collect is called Bad Debts. If it is definitely known that amount recoverable from a customer cannot be realized at all, it should be treated as a business loss and should be adjusted against profit. In short, the amount of bad debt should be transferred to Profit and Loss Account for the current year to confirm the principles of matching.

Bad Debts Account is by nature a nominal account. For recording the bad debt in the journal, Bad Debts A/c is debited and Debtors A/c is credited. At the end of an accounting period the total amount of bad debts may be either transferred to Profit & Loss Account or Provision for Doubtful debts A/c as the case may be.

Provisions for Doubtful Debts

The amount charged against the profit by an entity to provide for the possible collection loss from customers is known as Provision for Doubtful Debts. Provision for Doubtful debts account is a credit balance account and it reflected in the Balance Sheet by was of deduction from the balance of Debtors/ Accounts Receivable.

The accounting for bad debts and provision for doubtful debts is as under:

In the 1st year

(a) For Bad Debts

Bad Debts A/c Dr.

To Sundry Debtors A/c

(b) For creating provision for Doubtful Debts

Profit and Loss A/c Dr.

To Provision for Doubtful Debts A/c

(c) For Transferring Bad Debts

Profit and Loss A/c Dr.

To Bad Debts A/c

In Second/ Subsequent Year

(a) (i) For Bad Debts

Bad Debts A/c Dr.

To Sundry Debtors A/c

(ii) Profit and Loss A/c Dr.

To Bad Debts A/c

(b) For provision of Doubtful Debts

(i) If closing provision is more than the opening provision-

Profit and Loss A/c Dr.

To Provision for Doubtful debts A/c

(ii) If Closing Balance is less than opening provision –

Provision for Doubtful Debts A/c Dr.

To Profit and Loss A/c

Illustration 15

M/s Adhuna & Co. had a provision for bad debts of ₹13,000 against their book debts on 1st April, 2022. During the year ended 31st March, 2023, ₹8,500 proved irrecoverable and it was desired to maintain the provision for bad debts @ 5% on Debtors which stood at ₹3,90,000 before writing off Bad Debts.

Prepare the provision for Bad Debt Account for the year ended March 31, 2023.

Solution

Books of M/s Adhuna & Co.

Dr. **Provision for Bad Debt Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To Bad Debts A/c	8,500	01.04.22	By Balance b/d	13,000
31.03.23	To Balance c/d 5% of (3,90,000 - 8,500)	19,075	31.03.23	By Profit& Loss A/c (Balancing figure) (further provn. required)	14,575
		27,575			**27,575**

Illustration 16

On 1st April, 2022 the balance of provision for bad and doubtful debts was ₹13,000. The bad debts during the year 2022-23 were ₹9,500. The sundry debtors as on 31st March, 2023 stood at ₹3,25,000 out of these debtors of ₹2,500 are bad and cannot be realized. The provision for bad and doubtful debts is to be raised to 5% on sundry debtors. You are required to:

(i) Pass necessary adjustment entries for bad debts and its provision on 31st March, 2023.

(ii) Prepare the necessary ledger accounts.

(iii) Show the relevant items in the Profit & Loss Account and Balance Sheet.

Solution

(i) **In the books of ....**

Journal

Date	Particulars		Debit (₹)	Credit (₹)
31.03.23	Bad Debts A/c To Sundry Debtors A/c (Being Bad Debts)	Dr.	2,500	 2,500
31.03.23	Provision for Bad & Doubtful Debts A/c To Bad Debts A/c (2500 + 9500) (Being Bad Debts during the year)	Dr.	12,000	 12,000
31.03.23	Profit and Loss A/c To Provision for Bad & Doubtful Debts A/c (Being Provision for Bad Debts transferred to Profit & Loss A/c)	Dr.	15,125	 15,125

(ii) Ledger Accounts

Dr. Bad Debts Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To Balance b/d	9,500	31.03.23	By Provision for Bad & Doubtful Debts A/c	12,000
31.03.23	To Sundry Debtors A/c	2,500			
		12,000			**12,000**

Dr. Provision for Bad & Doubtful Debts Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To Bad Debts A/c	12,000	01.04.22	By Balance b/d	13,000
31.03.23	To Balance c/d [5% on (3,25,000 - 2,500)]	16,125	31.03.23	By Profit and Loss A/c (b/fig)	15,125
		28,125			**28,125**

Dr. Sundry Debtors Account (includes) Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To Balance b/d	3,25,000	31.03.23	By Bad Debts A/c	2,500
			31.03.23	By Balance c/d	3,22,500
		3,25,000			**3,25,000**

(iii) Profit and Loss Account for the year ended 31st March, 2023 (includes)

Particulars	(₹)	(₹)
To Provision for Bad & Doubtful Debts:		
Provision as on 31.3.2023	16,125	
Add: Bad Debts (9,500 + 2,500)	12,000	
	28,125	
Less: Provision as on 1.4.2022	13,000	15,125

Balance Sheet as on 31st March, 2022 (includes)

Liabilities	(₹)	Assets		(₹)
		Sundry Debtors	3,25,000	
		Less: Further Bad Debts	2,500	
			3,22,500	
		Provision for Bad Debts	16,125	3,06,375

Provisions for Discount on Debtors

It is a common practice of the suppliers to allow cash discount to its customers for prompt settlement of cash. For such loss, it would be prudent to create a provision. Thus, the provision which is created on Sundry Debtors for allowing discount on receipt of cash in that accounting period is called Provision for Discount on Debtors.

It is needless to say that if the customer pays their debts before the due dates, they may claim discounts and that is why it would be prudent to create a separate provision for the amount of discount that might be allowed to debtors for prompt settlement. The provision for discount on debtors is made on the basis of past experience and predicting at an estimate rate on the balance of Sundry Debtors.

Provision for discount allowed should be calculated at a specified rate on of debtors (i.e. after deducting bad debts and provision for bad debts). The debtors becoming bad are deleted from the list of debtors and the amount is deducted for the amount of gross debtors. The balance remains is all doubtful and hence provision for doubtful debt is maintained on the amount of doubtful debt. When such provision is also deducted from the net debtors the balance remains is expected to be good and are supposed to clear their dues in due time. Therefore a provision for discount allowed is made on such amount.

The accounting for provision for discount on debtors' as follows:

For the First year:

(a) (i) For Discount Allowed-

Discount Allowed A/c Dr.

To Sundry Debtors A/c

(ii) When Discount Allowed is transferred

Profit & Loss A/c Dr.

To Discount Allowed A/c

(b) For Provision for Discount on Debtors –

Profit & Loss A/c Dr.

To Provision for Disc on Debtors A/c

For the Second/ Subsequent year

(a) (i) For Discount Allowed-

Discount Allowed A/c Dr.

To Sundry Debtor A/c

(ii) For Provision for Discount on Debtors –

Provision for Discount on Debtor A/c Dr.

To Discount Allowed A/c

(b) Next year provision is estimated-

(i) If new provision is more than old one-

Profit and Loss A/c Dr.

To Provision for Discount on Debtor A/c

(ii) If new provision is less than old one-

Provision for Discount on Debtor A/c Dr.

To Profit and Loss A/c

Illustration 17

A company maintains its provision for bad debts @ 5% and a provision for discount on debtors @ 2%. You are given the following details: (in '000s)

Particulars	2022 (₹)	2023 (₹)
Bad debts	800	1,500
Discount allowed	1,200	500
Sundry debtors (before providing all bad debts and discounts)	60,000	42,000

On 01.01.2022, Provision for bad debts and Provision of discount on debtors had balance of ₹4,550 and ₹800 respectively.

Show Provision for Bad Debts and Provision for Discount on Debtors Account for the year 2022 and 2023.

Solution:

In the Books of ……

Dr. Provision for Bad Debts A/c Cr. (in '000s)

Date	Particulars	₹ '000	Date	Particulars	₹ '000
31.12.22	To Bad Debts A/c	800	01.01.22	By Balance b/d	4,550
31.12.22	To Profit & Loss A/c	850			
31.12.22	To Balance c/d 5% of (₹58,000)	2,900			
		4,550			**4,550**
31.12.23	To Bad Debts A/c	1,500	01.01.23	By Balance b/d	2,900
31.12.23	To Balance c/d 5% of (₹40,000)	2,000	31.12.23	By Profit & Loss A/c	600
		3,500			**3,500**

Dr. Provision for Discount on Debtors Account Cr. (in '000s)

Date	Particulars	₹ '000	Date	Particulars	₹ '000
31.12.22	To Discount A/c	1,200	01.01.22	By Balance b/d	800
31.12.22	To Balance c/d [2% on (₹58,000 – ₹2,900)]	1,102	31.12.22	By Profit & Loss A/c	1,502
		2,302			**2,302**
31.12.23	To Discount	500	01.01.23	By Balance b/d	1,102
31.12.23	To Balance c/d [2% on (₹40,000 – ₹2,000)]	760	31.12.23	By Profit & Loss A/c	158
		1,260			**1,260**

Recovery of Bad Debts

We know that bad debt is a loss and as such, transferred to current year's Profit and Loss Account, either directly or indirectly. However, if in any case the amount of bad debt is received from any debtor in any succeeding accounting period, the same is referred to as Bad Debt Recovery. This happens to be an item of income for the organisation and as such is credited to Profit and Loss of the year of receipt. It is accounted for as under:

(a) When bad debts are recovered

Cash/Bank A/c. Dr.

To Bad Debts Recovery A/c.

(b) When the same is transferred

Bad Debts Recovery A/c. Dr.

To Profit & Loss A/c.

Illustration 18

On 31.12.2022, Sundry Debtors and Provision for Doubtful Debts are ₹50,000 and ₹5,000 respectively. During the year 2023, ₹3,000 are bad and written off on 30.9.2023, an amount of ₹400 was received on account of a debt which was written off as bad last year. On 31.12.2023, the debtors ledger was verified and it was found that sundry debtors stood in the books were ₹40,000 out of which a customer Mr. X who owed ₹800 was to be written off as bad.

Prepare Bad Debt A/c and Provision for Doubtful A/c assuming that same percentage should be maintained for provision for Doubtful debt as it was on 31.12.2022.

Also show how the illustration appear in Profit & Loss A/c and Balance Sheet.

Solution:

In the Books of ....

Dr. Bad Debt Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2023 Sept. 30	To Sundry Debtors A/c	3,000	2023 Dec. 31	By Provision for Bad Debt A/c	3,800
Dec. 31	To X A/c.	800			
		3,800			**3,800**

Dr. Provision for Doubtful Debt Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2023 Dec. 31	To Bad Debt A/c	3,800	2023 Dec. 31	By Balance b/d	5,000
	" Balance c/d [10% on ₹ 39,200 (₹ 40,000 - ₹ 800)]	3,920		" Profit & Loss A/c (for the provision required)	2,720
		7,720			**7,720**

Profit & Loss Account (Extract)

Dr. **For the year ended 31.12.2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Provision for Doubtful Debts		2,720	By Bad Debts Recovery A/c		400

Balance Sheet (Extract) as at 31.12.2023 (includes)

Liabilities	(₹)	Assets	(₹)	(₹)
		Sundry Debtors	40,000	
		Less: Bad Debts	800	
			39,200	
		Less: Provision for Bad Debts	3,920	35,280

Working Notes:

Calculation of Rate of Provision for bad debts — (5,000/50,000 × 100) = 10%

Provision for Discount on Creditors

On the purchase of goods/ services by an entity on credit basis, payment is required to be made at a future date. In such a case, the party to whom amount remains payable is referred to as Creditors or Trade Payables. With the object of ensuring prompt collection, many times discount may be allowed by the suppliers. This option, when availed by the customer happens to be Discount Received for the customer, and is a gain to the paying organisation.

In line with discount that is allowed by a seller to its customers, as this anticipated income may accrue in a future accounting period, some organisations may create and maintain a provision for discount received from the creditors. This provision account is known as Provision for Discount Received or Provision for Discount on Creditors. The closing balance of this account is usually maintained at a fixed percentage on the closing creditors balance. It is accounted for as under:

Provision for Discount Received A/c Dr.

To Profit & Loss A/c

Provision for Discount on Creditors Account is shown in the liabilities-side of Balance Sheet as deduction from the balance of Sundry Creditors.

However, creation and maintenance of p**rovision on creditors is a** violation to the conservatism convention or the doctrine of prudence.

Rectification Entries

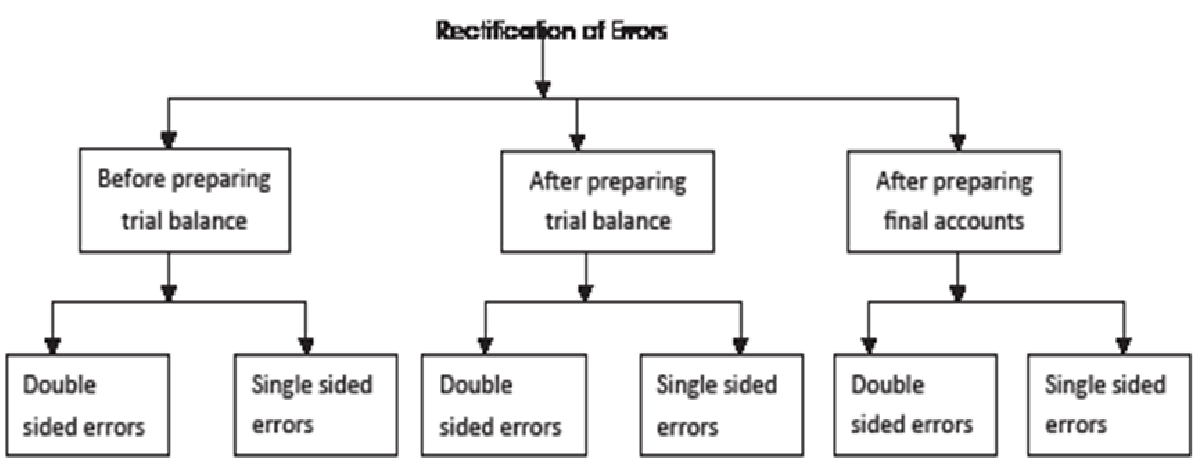
Rectification Entries (Rectification of errors): These entries are passed when errors or mistakes are discovered in accounting records. These entries are also known as Correction Entries. These entries are also passed in Journal Proper.

In this study note, you were introduced to the reasons why errors could occur and to the fact that while some errors affect trial balance and some errors do not affect it. In this section, we will see in depth how the corrections are made to the wrong entries.

When the errors affecting the T.B. are made, the normal practice is to put the difference to an A/c called as 'Suspense A/c' till the time errors are located. On identification of errors, the one effect goes to the correct A/c and the other effect to the Suspense A/c. This is done for one sided errors e.g. if sales book total is wrongly taken, but individual customers are correctly debited. Such error will cause difference in trial balance as only Sales A/c is wrongly credited. In such cases the rectification entry will be passed through Suspense A/c. In all other cases the rectification is done by debiting or crediting the correct A/c head and by crediting or debiting the wrong A/c head.

Let us recapitulate the types of errors and the ways to rectify them in the following table

Type of error	Rectification
Error of principle – entering revenue expense as capital expense or vice versa or entering revenue receipt as capital receipt or vice versa.	A journal entry is passed to give correct effect.
Error of Omission – transaction forgotten to be entered in books of accounts.	Simply, the correct entry is passed.
Errors of commission – entering to wrong head of account.	Debit or credit wrong A/c head and post it to correct head.
Compensating errors – more than one error that could compensate effect of each other.	Pass correcting entry
Wrong totaling of subsidiary books	As it affects T.B., pass through Suspense A/c
Posting on wrong side of an A/c	Pass an entry with double effect – one to cancel wrong side and other to give effect on correct side
Posting of wrong amount	Pass entry with differential amount



A. Before Preparation of Trail Balance

If errors are detected before the preparation of Trail Balance, the effect of each error should be known.

The errors are of two types: viz

(a) Double Sided Error; (b) Single Sided Error

(a) Double Sided Error:

The following principles should be followed for the purpose.

(i) What was the correct entry?

(ii) What entry had been done?

(iii) Rectifying entry.

Example: Purchased a Building for ₹ 3,00,000 wrongly passed through purchase account.

Solutions:

(i)	Building A/c To Cash A/c	Dr.	3,00,000	 3,00,000
(ii)	Purchase A/c To Cash A/c	Dr.	3,00,000	 3,00,000
(iii)	Building A/c To Purchase A/c	Dr.	3,00,000	 3,00,000

(b) Single Sided Error:

Under the circumstances, no separate entry is required but the affected account should be rectified by appropriate posting.

Example: Purchase account was overcast by ₹ 10,000.

Solution:

The correction to be made in Purchase Account in the following manner.

Dr. Purchase Account Cr.

Particulars	₹	Particulars	₹
		By Error - Wrong posting	10,000

So, purchase account should be credited by ₹ 10,000.

A. After Preparation of Trial Balance

If the errors are detected after the preparations of trial balance, the following procedure should be followed:

(a) Double Sided Errors; and (b) Single Sided Errors.

(a) Double Sided Errors:

- Same as method (A) above i.e., before preparation of Trial Balance.

(b) Single Sided Errors:

- In case of Single side errors, relevant account to be rectified by applying Suspense Account.

Suspense Account

If the Trial Balance does not agree we cannot prepare final accounts. In order to prepare final account, the difference so appeared in trail balance is to be passed through Suspense Account. When the errors will be located and rectified suspense account will automatically be Nil or closed. The suspense account will appear in the Balance Sheet. When it appears in the debit side of trial balance, the same will appear in the assets side of the Balance Sheet and vice-versa.

Example: Sales Day Book was overcast by ₹ 1,000.

Particulars	Dr. (₹)	Cr. (₹)
Sales A/c	1,000	
To Suspense A/c		1,000

C. After Preparation of Final Accounts

If the errors are detected after the preparation of final accounts, the following steps should carefully be followed.

(a) For Double Sided Errors

(i) Same as (A) before preparation of Trial Balance or (B) after preparation of Trail Balance. But all the nominal accounts are to be replaced by Profit and Loss Adjustment Account. And the rest one will be same as (A) or (B) stated earlier.

(ii) Suspense Account will be carried forward to the next year; and

(iii) Real and Personal Accounts are to be carried forward to the next year.

Example: Purchase a Plant wrongly debited to Purchase Account for ₹ 10,000

Solution:

(i) If after Trial Balance

Plant A/c Dr.

To Purchase A/c

(ii) If after Final Account

Plant A/c Dr.

To Profit and Loss Adjustment A/c

(b) for Single Sided Errors:

Same principle is to be followed like (B) after preparation of Trial Balance and all the nominal account are to be preplaced by Profit and Loss Adjustment Account.

Example – Discount allowed was not posted to discount Account.

Solution:

(i) If after Trial Balance

Discount Allowed A/c Dr.

To Suspense A/c

(ii) If after Final Account

Profit and Loss Adjustment A/c Dr.

To Suspense A/c

SUMMARY: -

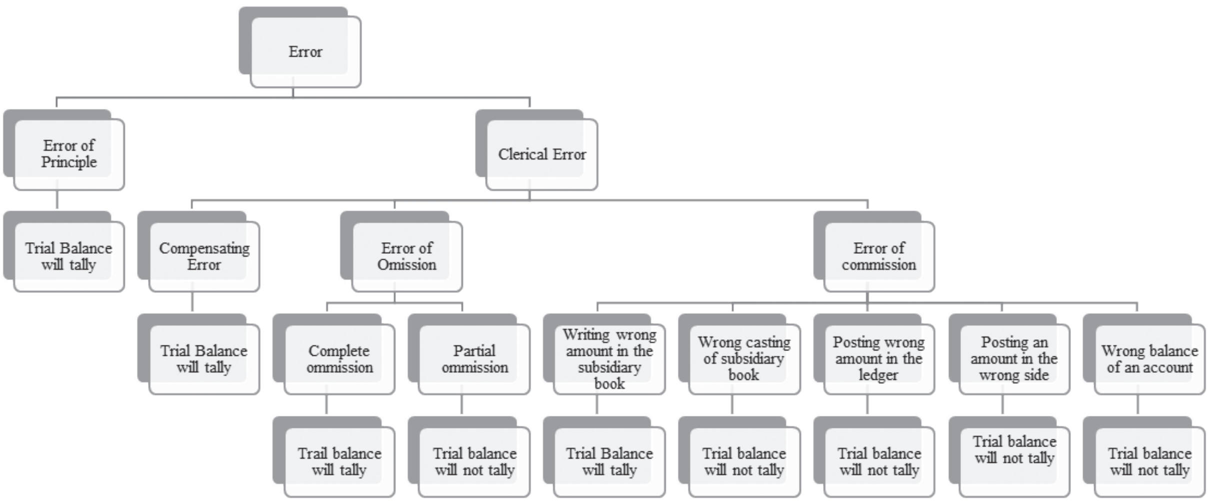


Illustration 19

Rectify the following errors assuming that the errors were detected (a) Before the Preparation of Trial Balance; (b) After the preparation of Trial Balance and (c) After the preparation of Final Accounts.

(i) Purchase Plant for ₹ 10,000 wrongly passed through Purchase Account.

(ii) Sales Day Book was cast short by ₹ 1,000.

(iii) Cash paid to Mr. X for ₹ 1,000 was posted to his account as ₹ 100.

(iv) Purchase goods from Mr. T for ₹ 3,500 was entered in the Purchase Day Book as ₹ 500.

(v) Paid salary for ₹ 3,000 wrongly passed through wages account.

Solution:

In the Books of ……………………

Journal (without narration)

Date	Before preparation of Trial Balance	After preparation of Trial Balance	After preparation of Final Accounts
(i)	Plant A/c Dr. 10,000 To Purchase A/c 10,000	Plant A/c Dr. 10,000 To Purchase A/c. 10,000	Plant A/c Dr. 10,000 To P&L Adjustment A/c 10,000
(ii)	Sales account will be credited with ₹ 1,000	Suspense A/c Dr. 1,000 To Sales A/c 1,000	Suspense A/c Dr. 1,000 To P&L Adjustment A/c 1,000
(iii)	X Account will be debited when ₹ 900	X A/c Dr. 900 To Suspense A/c 900	X A/c Dr. 900 To Suspense A/c 900
(iv)	Purchase A/c Dr. 3,000 To T A/c 3,000	Purchase A/c Dr. 3,000 To T A/c 3,000	P&L Adjustment A/c Dr. 3,000 To T's A/c. 3,000
(v)	Salary A/c Dr. 3,000 To Wages A/c 3,000	Salary A/c Dr. 3,000 To wages A/c 3,000	

Illustration 20

A merchant, while balancing his books of accounts notices that the T.B. did not tally. It showed excess credit of ₹1,700. He placed the difference to Suspense A/c. Subsequently he noticed the following errors:

(a) Goods brought from Narayan for ₹ 5,000 were posted to the credit of Narayan's A/c as ₹ 5,500

(b) An item of ₹ 750 entered in Purchase Returns Book was posted to the credit of Pandey to whom the goods had been returned.

(c) Sundry items of furniture sold for ₹ 26,000 were entered in the sales book.

(d) Discount of ₹ 300 from creditors had been duly entered in creditor's A/c but was not posted to discount A/c. Pass necessary journal entries to rectify these errors. Also show the Suspense A/c.

Solution:

(a) Goods bought from Narayan are posted to credit of his A/c as ₹ 5,500 instead of ₹ 5,000. Here, it is correct to credit Narayan's A/c. But the mistake is extra credit of ₹ 500. This is one sided error, as posting to purchases A/c is correctly made. So the rectification entry will affect the suspense A/c. This needs to be reversed by the rectification entry:

Narayan's A/c Dr. 500

To Suspense A/c 500

(b) Goods bought from Pandey were returned back to him. It should have appeared on the debit side of his A/c. For rectifying we will need to debit his A/c with double the amount i.e. ₹ 1500 (₹ 750 to cancel the wrong credit and another ₹ 750 to give effect for correct debit) and the effect will go to Suspense A/c. The correction entry is:

Pandey A/c Dr. 1,500

To Suspense A/c 1,500

(c) Sale of furniture was recorded in sales book. What's wrong here? Remember that sales book records sale of goods only and nothing else. Sale of furniture will appear in either cash book (if sold for cash) or journal proper (if sold on credit). Hence, wrong credit to Sales A/c must be removed and credit should be given to Furniture A/c. It's important to note that this rectification entry will not affect the Suspense A/c. The correction entry is:

Sales A/c Dr. 26,000

To Furniture A/c 26,000

(d) The discount received from creditor is not entered in discount A/c but was correctly recorded in creditors' A/c. This is one sided error and will therefore be routed through suspense for correction. A discount is received; it must be credited being an income.

Suspense A/c Dr. 300

To Discount received A/c 300

Let us now see how suspense A/c will Look like. Excess credit of ₹1,700 in Trial Balance will be shown on the debit side of suspense A/c. This will bring in total debit equal to total credit.

Dr Suspense Account Cr

Date	Particulars	J. F.	Amount (₹)	Date	Particulars	J. F.	Amount (₹)
	To Balance b/d		1,700		By Narayan		500
	To Discount received		300		By Pandey		1,500
			2,000				2,000

Please observe that after correcting passing all rectification entries, the Suspense A/c tallies automatically.

Illustration 21

Pass necessary journal entries to rectify the following errors:

(a) An amount of ₹ 200 withdrawn by owner for personal use was debited to trade expenses.

(b) Purchase of goods of ₹ 300 from Nathan was wrongly entered in sales book.

(c) A credit sale of ₹ 100 to Santhanam was wrongly passed through purchase book.

(d) ₹ 150 received from Malhotra was credited to Mehrotra.

(e) ₹ 375 paid as salary to cashier Dhawan was debited to his personal A/c.

(f) A bill of ₹ 2,750 for extension of building was debited to building repairs A/c.

(g) Goods of ₹ 500 returned by Akashdeep were taken into stock, but returns were not recorded.

(h) Old furniture sold for ₹ 200 to Sethi was recorded in sales book.

(i) The period end total of sales book was under cast by ₹ 100.

(j) Amount of ₹ 80 received as interest was credited to commission.

Solution:

Sl. No.	Type of Entry	Particulars	Debit (₹)	Credit (₹)
a.	Wrong Entry	Trade Expenses To Cash	200	 200
	Correct entry	Drawings To cash	200	 200
	Rectification entry	Drawings To Trade Expenses	200	 200
b.	Wrong Entry	Nathan To Sales	300	 300
	Correct entry	Purchases To Nathan	300	 300
	Rectification entry	Purchases Sales To Nathan	300 300	 600

c.	Wrong Entry	Purchases To Santhanam	100	 100
	Correct entry	Santhanam To Sales	100	 100
	Rectification entry	Santhanam To Sales To Purchases	200	 100 100
d.	Wrong Entry	Cash To Mehrotra	150	 150
	Correct entry	Cash To Mehrotra	150	 150
	Rectification entry	Mehrotra To Malhotra	150	 150
e.	Wrong Entry	Dhawan To cash	375	 375
	Correct entry	Salary To cash	375	 375
	Rectification entry	Salary To Dhawan	375	 375
f.	Wrong Entry	Building Repairs To Cash	2,750	 2,750
	Correct entry	Buildings To Cash	2,750	 2,750
	Rectification entry	Buildings To Building Repairs	2,750	 2,750
g.	Wrong Entry	No entry passed		
	Correct entry	Sales Returns To Akashdeep	500	 500
	Rectification entry	Sales Returns To Asashdeep	500	 500

h.	Wrong Entry	Sethi To Sales	200	 200
	Correct entry	Sethi To Furniture	200	 200
	Rectification entry	Sales To Furniture	200	 200
i.	Wrong Entry	No entry passed		
	Correct entry	Suspense To Sales	100	 100
	Rectification entry	Suspense To Sales	100	 100
j.	Wrong Entry	Cash To Commission	80	 80
	Correct entry	Cash To Interest	80	 80
	Rectification entry	Commission To Interest	80	 80

Effect of Errors on Profit or Loss

Some errors may affect the profit or loss for the period while other won't. How to find it out? Remember, the P&L A/c reflects items of incomes, gains, expenses and losses. All these accounts are nominal accounts. When an error occurs which affects a nominal account, it will affect profit or loss otherwise not. So, errors that affect real and personal accounts will not affect profit or loss.

Illustration 22

The books of accounts of A Co. Ltd. for the year ending 31.3.2023 were closed with a difference of ₹21,510 in books carried forward. The following errors were detected subsequently:

(a) Return outward book was under cast by ₹ 100.

(b) ₹ 1,500 being the total of discount column on the credit side of the cash book was not posted.

(c) ₹ 6,000 being the cost of purchase of office furniture was debited to Purchase A/c.

(d) A credit sale of ₹ 760 was wrongly posted as ₹ 670 to the customers A/c. in the sales ledger.

(e) The Sales A/c was under casted by ₹ 10,000 being the carry over mistakes in the sales day book.

(f) Closing stock was over casted by ₹ 10,000 being casting error in the schedule or inventory. Pass rectification entries in the next year.

Prepare suspense account and state effect of the errors in determination of net profit of last year.

Solution:

In the Books of A Co. Ltd.

Journal

Date	Particulars	L/F	Dr. Amount (₹)	Cr. Amount (₹)
(a) 2023 April 1	Suspense A/c Dr.		100	
	To Profit & Loss Adjustment A/c			100
	(Returns outward book was under cast now rectified).			
(b)	Suspense A/c Dr.		1,500	
	To Profit & Loss Adjustment A/c			1,500
	(Discount received was not recorded, now rectified).			
(c)	Office Furniture A/c Dr.		6,000	
	To Profit & Loss Adjustment A/c			6,000
	(Office furniture purchased wrongly debited to Purchase A/c, now rectified.)			
(d)	Debtors' A/c Dr.		90	
	To Suspense A/c			90
	(Debtors account was posted ₹ 670 in place of ₹ 760, now rectified.)			
(e)	Suspense A/c Dr.		10,000	
	To Profit & Loss Adjustment A/c			10,000
	(Sales account was under casted, now rectified)			
(f)	Profit & Loss Adjustment A/c Dr.		10,000	
	To Closing Stock A/c			10,000
	(Closing Stock was overcastted, now rectified.)			

Dr. Suspense Account Cr.

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
2023	To Profit & Loss Adjustment A/c	100	2023	By Difference in Trial Balance	21,510
April	To Profit & Loss Adjustment A/c	1,500	April	By Debtors A/c.	90
1	To Profit & Loss Adjustment A/c	10,000	1		
	To Profit & Loss Adjustment A/c	10,000			
		21,600			21,600

Effect on Profit

	Increase (+) (₹)	Decrease (-) (₹)
Item		
(a)……………………………….	---	100
(b)……………………………….	---	1,500
(c)……………………………….	---	6,000
(d) No effect	---	---
(e)……………………………….	---	10,000
(f)……………………………….	10,000	---
	10,000	17,600
Profit will be decreased by	7,600	---
	17,600	17,600

Illustration 23

The Trial Balance of a concern has agreed but the following mistakes were discovered after the preparation of final Accounts.

(a) No adjustment entry was passed for an amount of ₹2,000 relating to outstanding rent.

(b) Purchase book was overcast by ₹1,000.

(c) ₹ 4,000 depreciation of Machinery has been omitted to be recorded in the book.

(d) ₹ 600 paid for purchase of stationary has been debited to Purchase A/c.

(e) Sales books was overcast by ₹ 1,000.

(f) ₹ 5,000 received in respect of Book Debt had been credited to Sales A/c.

Show the effect of the above errors in Profit and Loss Account & Balance Sheet.

Solution:

Effects of the errors in profit and loss A/c and Balance Sheet

Profit & Loss A/c.	Balance Sheet
(a) Profit was overstated by ₹ 2,000	(a) Capital was also overstated by ₹2,000 & outstanding Liability was understated by 2,000.
(b) Gross profit was under stated by ₹ 1,000 & also the Net Profit.	(b) Capital was understated by ₹ 1,000.
(c) Net Profit was overstated by ₹ 4,000.	(c) Machinery was overstated by ₹ 4,000 & so the Capital A/c was also overstated by ₹ 4,000.
(d) No effect on Net Profit.	(d) No effect in Balance Sheet.
(e) Gross Profit and Net Profit were overstated by ₹1,000.	(e) Capital was overstated by ₹ 1,000.
(f) Gross Profit & Net Profit were overstated by ₹5,000.	(f) Capital & Sundry Debtors were overstated by ₹5,000.

Adjusting Entry: Adjusting Entries are passed in the journal to bring into the books of accounts certain unrecorded items like closing stock, depreciation on fixed assets, etc. These are needed at the time of preparing the final accounts.

E.g. Depreciation A/c Dr.

To Fixed Assets A/c

EXERCISE

A. Theoretical Questions:

- Multiple Choice Questions

1. __________ concept assumes that the infinite life of an organisation can be split into smaller periods of equal duration.
   (a) Accounting Period
   (b) Entity
   (c) Going concern
   (d) None of the above

2. The accounts related to expenses or losses and incomes or gains are called __________.
   (a) Personal Account
   (b) Representative Personal Account
   (c) Nominal Account
   (d) Real Account

3. The accounting equation is presented as:
   (a) Assets = Liabilities + Equity
   (b) Assets = Liabilities + [Capital + (Revenue – Expenses) – Drawings]
   (c) Assets + Expenses + Drawings = Liabilities + Capital + Revenue
   (d) All of the above

4. The book of account which records only those cash transactions which are not of heavy amount, but the type of transactions is frequently entered into by an entity is ___________.
   (a) Triple Column Cash Book
   (b) Petty Cash Book
   (c) Ledger
   (d) None of the above

5. Which of the following is/ are true regarding Trial Balance?
   (a) It is prepared for a particular period.
   (b) A trial balance is just a statement.
   (c) The agreement of a trial balance is a conclusive proof of absolute accuracy of the books of accounts.
   (d) All of the above

6. A resource owned by the business with purpose of using it for generating future profit, is known as --------------------.
   (a) Capital
   (b) Asset
   (c) Liability
   (d) Surplus

7. Which of the following transaction is of capital nature?

(a) Commission on purchases
(b) Cost of repairs
(c) Rent of factory
(d) Wages paid for installation of machinery

8. At the end of the accounting year the capital expenditures are shown in the:
(a) assets side of the Balance Sheet.
(b) liabilities side of the Balance Sheet.
(c) debit side of the Profit and Loss A/c.
(d) credit side of the Profit and Loss A/c.

9. Which of the following book is both a journal and a ledger?
(a) Cash Book
(b) Sales Day Book
(c) Bills Receivable Book
(d) Journal Proper

10. Purchase of a laptop for office **use wrongly debite**d to Purchase Account. It is an error of __________.
(a) Omission
(b) Commission
(c) Principle
(d) Misposting

Answer:

1	**a**	**2**	**c**	**3**	**d**	**4**	**b**	**5**	**b**
6	**b**	**7**	**d**	**8**	**a**	**9**	**a**	**10**	**c**

- State True or False

1. There are four frameworks of accounting.
2. Revenue Expenditures are recognised as expenses and losses in the debit-side of the income statements.
3. Provision for depreciation account is a debit balance account.
4. Cash Book is a book of account which is, by nature, a book of primary entry as-well-as a book of final entry.
5. Errors which are identified and rectified before the preparation of Trial Balance may involve Suspense Account.
6. One of the objectives achieved by providing depreciation is saving cash resources for future replacement of assets.
7. As per full disclosure principle, the financial statements should disclose all irrelevant information.
8. Trade discount is recorded in the books of original entry.
9. Bad debts recovered **is credited to debtor**'s personal account.

10. Mistake in balancing an account will affect the agreement of a Trial balance.

Answer:

1	**True**	**2**	**True**	**3**	**False**	**4**	**True**	**5**	**False**
6	**True**	**7**	**False**	**8**	**False**	**9**	**True**	**10**	**True**

- Fill in the Blanks

1. __________ are the assumptions and conditions that define the parameters and constraints within which the accounting operates.
2. _________ is a listing of all accounts in the general ledger, each account being accompanied by a reference number.
3. _________ is prepared to reconcile the balances as reflected by two related books, namely Cash Book and Pass Book.
4. The method of preparing Trial Balance under which the Trial Balance can be prepared only after each ledger account has been balanced is called the _________ method.
5. The amount charged by an entity against the profits to provide for the possible collection loss from customers is known as _________.
6. The____________ discount is never entered in the books of accounts.
7. The Bank A/c is a _________ Account.
8. While posting an opening entry in the ledger, in case of an Account having debit balance, in 'Particulars' column the words ____________ are written on debit side.

Answer:

1	**Accounting Concepts**	**2**	**Chart of Accounts**
3	**Bank Reconciliation Statement**	**4**	**Balance**
5	**Provision for bad& doubtful debts**	**6**	**Trade**
7	**Personal**	**8**	**To, Balance b/f**

- Short Essay Type Questions

1. What is capital loss? How is it reflected in the financial statements of an entity?
2. What is meant by Accounting Cycle? Discuss the different stages of an accounting cycle.
3. State the conditions which an event has to satisfy to be **considered as a tran**saction.
4. What do you mean by Compensating Error? Give an example.
5. State the features of adjustment entries.

- Essay Type Questions

1. What are Accounting Conventions? Discuss the different conventions of accounting.
2. Distinguish between capital expenditure and revenue expenditure.

3. Give an overview of the different types of cash book that are prepared by a large organisation.

4. Discuss the advantages of a Trial Balance.

5. What do you mean by Depreciation? Differentiate depreciation from amortization and depletion.

B. Numerical Questions

- Multiple Choice Questions

1. Provision for Doubtful Debt on 1st April, 2022 was ₹ 13,000.During the year 2022-23 the Bad-debt was ₹ 9,500 . The Sundry Debtors on 31st March, 2023 were ₹3,25,000. Provision is to be made @ 5% on Debtors. If on 31st March, 2023, there was additional Bad debt of ₹2,500 then Provision for doubtful-debt will be:
   (a) debited to Profit & Loss Account by ₹ 16,125.
   (b) debited to Profit & Loss Account by ₹15,125.
   (c) debited to Profit & Loss Account by ₹ 3,000.
   (d) debited to Profit & Loss Account by ₹ 900.

2. Original cost of a machine is ₹ 1,50,000, residual value ₹ 10,000, if depreciation is charged @ 10% per annum under WDV method then depreciation for 3rd year will be
   (a) ₹12,240
   (b) ₹11,340
   (c) ₹12,150
   (d) ₹14,000

3. Purchased goods from Mr. R for ₹ 3,600 but wrongly recorded as ₹6,300 to the debit of Mr. R. In the rectification entry, Mr. R's account will be credited with —
   (a) ₹9,900
   (b) ₹2,700
   (c) ₹2,600
   (d) ₹6,300

Answer:

1	**b**	**2**	**c**	**3**	**a**

- Comprehensive Numerical Problems

1. Classify the following transactions between capital and revenue:
   (a) A plant constructed for ₹ 10,50,000.
   (b) Profit earned by sale of fixed assets ₹ 25,000.
   (c) Amount received from customers for services rendered ₹ 2,00,000
   (d) Regular repairs and maintenance incurred on old machine ₹ 24,000.
   (e) Annual rates and taxes paid to local authority ₹ 2,000.

2. KK Transport Co. of Ludhiana purchased 4 Trucks at ₹ 12,50,000 each on July 1, 2020. On Jan. 1, 2023 one of the trucks met with a massive accident and as a result was completely destroyed. Insurance company paid ₹ 7,00,000 in full and final settlement of the claim. On the same day the company purchased a used truck for ₹ 8,70,000 and spent ₹ 1,30,000 on its overhauling.

   You are required to show the treatment of these transactions in the final accounts and Balance Sheet of KK Transport Co. for the three years ending on March 31,2023, given that the company writes off depreciation @ 20% p.a. on straight line basis.

   Ans: Written Down Value as on 31.03.2023 - ₹26,37,500

3. The following errors were detected in the books of M/s S R Traders while preparing the Trial Balance.
   a. Freight paid for bringing purchased goods wrongly debited to Machinery Account ₹ 72,600.
   b. Equipments purchased worth ₹ 8,50,000 wrongly passed through Purchases A/c.
   c. Returns Outward book was overcast by ₹ 54,000.
   d. Goods purchased from Rohan worth ₹ 79,000 has been debited to his account.
   e. An amount of rent outstanding ₹ 13,000 in the previous year, had not been brought forward as an opening balance in the current year.
   f. Fresh cash introduced by the proprietor of ₹ 44,000 was not posted in ledger account.

   You are required to pass necessary journal entries to rectify the errors.

4. The total of debit side of the Trial Balance of SR Ltd. as at 31.3.2023 is ₹ 2,92,000 and that of the credit side is ₹ 1,80,800. After detailed checking, the following errors were identified:

Name of Accounts	Correct Figures (as it should be)	Figures as it appears in the Trial Balance
Opening stock	12,000	8,000
Salaries	28,800	50,400
Accounts Receivable	83,200	1,26,400
Trade Creditors	64,800	14,400

   You are required to ascertain the correct total of the Trial Balance.

   Ans: ₹2,31,200

Unsolved Case

Mr. Rishan Chaudhury is a trader engaged in retailing of computer hardware items. The name of his business is M/s TechnoLink, which is a proprietary form of business. The business procures the different items and goods of trade from a number of wholesalers, both on cash as-well-as on credit. The primary customers of TechnoLink were different academic institutions like schools and colleges. The books of accounts of the business are maintained by two accountants, and at the end of the financial year 2022-23, after balancing the ledger accounts, they drafted the Trial Balance to check the arithmetical accuracy of the books. But to their discomfort the Trial Balance did not tally and reflected excess credit ₹ 37,200. The difference in books was posted to Suspense Account. On critical checking of the books, the accountants could identify the following three errors:

(i) Purchase of four office chairs (costing ₹ 10,000 each) and two office tables (costing ₹ 40,000 each) from Godrej Interio has been passed through Purchase Day Book.

(ii) Purchase of USB drives worth ₹ 26,800 has been posted to the Supplier's Account as ₹ 12,000.

(iii) A cheque worth ₹ 80,000 received from ABS Higher Secondary School has been dishonoured, but debited to Allowances Account.

Mr. Chaudhury, himself an honour graduate in Commerce with speciailisation in Accounting from City College, Kolkata, himself sat with the accounts. He managed to identify two more errors that existed in the books but were missed by the accountants. He identified that the total of the Returns Inward Book has been cast short by ₹ 40,000, and that ₹ 1,50,000 paid for making showcases of the shop has been charged to Wages Account. However, he too was still uncertain whether he has been able to locate the errors.

1. Develop the rectification entries that would be recorded in the Journal Proper of M/s TechnoLink.
2. Ascertain by what amount would Furniture Account change after the necessary rectifications are carried out?
3. State whether all the errors that existed in the books have been identified? If not, what is the amount of such undetected error(s)?
4. What can be the possible reasons for which the Trial Balance is still not tallying?

SECTION-B

Accounting for Special Transactions

Bills of Exchange, Consignment, Joint Venture

2

This Module Includes

Bills of Exchange, Consignment, Joint Venture

SLOB Mapped against the Module

To equip oneself with the detail understanding of accounting of certain special transactions to determine surplus, ensure control on resources, for divisional performance evaluation or acquisition of assets through deferred payments. (CMLO 2a, 4c)

Module Learning Objectives:

After studying this module, the students will be able to:

- Learn the detail understanding the process and accounting for Bills of exchange
- Understand accounting related to Consignment business
- Equip themselves with detail understanding the accounting for Joint Venture under different methods.

Accounting for Bills of Exchange

2.1

Definition of Negotiable Instrument

As per legal terminology, the word 'negotiable' means transferable from one person to another and the word 'instrument' means any written document by which a right is created in favour of some person. Therefore 'negotiable instrument' means any document which entitles a person to a certain sum of money and which is transferable from one person to another by delivery or by indorsement and delivery in accordance with the provisions of the Negotiable Instruments Act, 1881.

According to section 13(1) of the Act, "A negotiable instrument means a promissory note or bill of exchange or cheque, payable either to order or to the bearer".

Note: The Negotiable Instruments Act, 1881, is an act to define and amend the law relating to promissory notes, bills of exchange and cheques.

Definition of Bills of Exchange

According to Section 5 of the Negotiable Instrument Act, 1881, 'A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.'

- A promise or order to pay is not conditional, within the meaning of this Section and section 4, by reason of the time for payment of the amount or any instalment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectation of mankind, is certain to happen, although the time of its happening may be uncertain.
- The sum payable may be certain, within the meaning of this Section and Section 4, although it includes future interest or is payable at an indicated rate of exchange, or is according to the course of exchange, and although the instrument provides that, on default of payment of an instalment, the balance unpaid shall become due.
- The person to whom it is clear that the direction is given or that payment is to be made may be a certain person, within the meaning of this Section and section 4, although he is mis-named or designated by description only.

Essential Elements of a Bills of Exchange

Following are the essential elements of a Bill of Exchange

1. It must be in writing and may be in any language and in any form
2. It must be drawn on a particular date
3. There are three parties to a Bill of Exchange – Drawer / Maker, Drawee and Payee
4. It must be signed by the Drawer / Maker

5. It must contain an unconditional and imperative order to pay
6. The order to pay must be directed to a certain person
7. The order must be to pay a certain sum of money only
8. It must be accompanied with proper stamp as per the requirement of the law

Parties to a Bills of Exchange

A Bill of Exchange transaction often includes the following three parties:

Drawer: Drawer is the party that issues a Bill of Exchange - Creditor, Lender or Seller. He is the maker of the bill and his signature is necessary.

Drawee: Drawee is the party to which the order to pay is sent – Debtor, Lendee or Purchaser. The drawee becomes the acceptor of the bill when he/she/it has written the acceptance on the bill of exchange.

Payee: Payee or the beneficiary is the party to which the bill of exchange is payable – May be Drawer or Other Party.

Classification of Bills of Exchange

- **Documentary Bill** - In this, the bill of exchange is supported by the relevant documents that confirm the genuineness of sale or transaction that took place between the seller and buyer.
- **Demand Bill** - This bill is payable when it demanded. The bill does not have a fixed date of payment, therefore, the bill has to be cleared whenever presented.
- **Usance Bill** - It is a time-bound bill which means the payment has to be made within the given time period and time.
- **Inland Bill** - An Inland bill is payable only in one country and not in any other foreign country. This bill is opposite to the foreign bill.
- **Clean Bill** - This bill does not have any proof of a document, so the interest is comparatively higher than the other bills.
- **Foreign Bill** - A bill that can be paid outside India is termed as a foreign bill. Two examples of a foreign bill are an export bill and import bill.
- **Accommodation Bill** - A bill that is sponsored, drawn, accepted without any condition is known as an accommodation bill.
- **Trade Bill** - This kind of bill is specially related only to trade.
- **Supply Bill** - The bill that is withdrawn by the supplier or contractor from the government department is known as the supply bill.

Difference between Trade Bill and Accommodation Bill

	Trade Bill	Accommodation Bill
Objectives	These bills are drawn to facilitate the trade transactions of sale and purchases of goods.	These bills are drawn to help someone in need of financial assistance.
Consideration	There is a definite consideration for which the bill is accepted.	These bills are drawn without consideration.

	Trade Bill	Accommodation Bill
Extension of Credit	Trade bills are a form of credit extension.	These bills are not a form of credit extension.
Proceeds	When trade bills are discounted, the proceeds remain with the holder.	When these bills are discounted, the proceeds may be shared by two parties in an agreed ratio.
Recovery	If trade bills are dishonoured, the amount may be recovered easily through the court.	In case of dishonour of these bills, the drawer cannot file a suit against the drawee.

Maturity / Due Date of a Bill of Exchange and Days of Grace

Due Date	
Maturity date in case of On Demand Bill / At Sight Bill / On Presentation Bill	• The bill at sight becomes due for payment, as soon as it is presented for payment. • In case of 'Instrument payable on demand', No time for payment is mentioned. • Such Bills are not entitled to the Days of Grace.
Maturity date in case of After Date Bill	• In the case of 'Bill after date,' the time for payment is mentioned. • Three Days of Grace is allowed on such a bill.
Maturity date in case of After Sight Bill	• In case of 'Bill after Sight, payable at a fixed period 'after sight'. • The period begins from the date of accepting the bill. • Three Days of Grace is allowed on such a bill.

Grace Period	
When the Period of Bill is Given in Months	• In this case, the maturity date is calculated according to calendar months. • Ignoring the number of days in a month. • 3 days of the Grace period are added. **For example: –** if a bill dated 4th May, 2022 is payable 3 months after date:- = Then the maturity date will be 4th August 2022 + 3 Days of Grace = 7th August 2022.
When the Period of Bill is Given in Days	• The maturity date will be calculated in days, • This excludes the date of transaction but includes the date of payment. • 3 days of the Grace period are added in this case also. **For example: -** if a bill dated 5th June 2022 is payable after 65 days, then the maturity date will be:- =25 Days of June + 31 Days of July + 9 Days of August + 3 Days of Grace =12th August 2022

When Maturity Date Falls on a National Holiday	• If the due date of the bill is on the national holiday • Then the maturity day of the bill shall be the preceding business day. **Example:-** If due date of the bill falls on 26th January (Republic Day), then its due date will be 25th January. • If the due date is 15th August (Independence Day), then the due date will be 14th August.
When the Maturity Date Has Been Declared as Emergency Holiday	• If the due date of the bill is declared as an emergency holiday, • Then the due date of the bill shall be after 1 day from the date of maturity. **Example:-** if the due date of a bill is 25th July and it is declared as an emergency holiday, then the due date will be 26th July.

Concept of Bills Receivable and Bills Payable

Bills Receivable or B/R	• For the person who draws the bill of exchange and is entitled to receive its payment is known as Bill Receivable. • The drawer of the bill will show B/R on the assets side of the Balance Sheet.
Bills Payable or B/P	• For the person who accepts the bill, and is liable to make its payment, is known as Bills Payable. • The Drawee of the bill will show B/P on the liabilities side of the Balance Sheet.

Journal Entries for Trade Bills

Sl. No.	Transactions	In the Books of Drawer (X)	In the books of Drawee (Y)
1	If a bill is received by X from Y after acceptance	Bills Receivable A/c Dr To Drawee / Y A/c	Drawer / X A/c Dr To Bills Payable A/c
2	If the bill is retained by X till due date	No entry	No entry
3	If the bill is discounted with a Bank	Bank / Cash A/c Dr Discount A/c Dr To Bills Receivables A/c	No entry
4	If the bill is endorsed to a Creditor (Z)	Creditor / Z A/c Dr Discount Allowed A/c (if any) Dr To Bills Receivables A/c To Discount Receivables A/c (if any)	No entry
5	If the bill is sent to the Bank for collection	Bills for Collection A/c Dr To Bills Receivables A/c	No entry

Journal Entries for Trade Bills			
Sl. No.	**Transactions**	**In the Books of Drawer (X)**	**In the books of Drawee (Y)**
6	If the bill is retired before maturity	Cash / Bank A/c Dr Rebate Allowed A/c Dr To Bills Receivables A/c To Bills for Collection A/c (if already sent to Bank for collection)	Bills Payable A/c Dr To Cash / Bank A/c To Rebate Received A/c
7	If the bill is honoured / paid on the due date Previously retained by X	Cash / Bank A/c Dr To Bills Receivables A/c	Bills Payable A/c Dr To Cash / Bank A/c
8	If the bill is honoured / paid on the due date Previously discounted with a Bank	No entry	Bills Payable A/c Dr To Cash / Bank A/c
9	If the bill is honoured / paid on the due date Previously sent to the Bank for collection	Bank A/c Dr To Bills for Collection A/c	Bills Payable A/c Dr To Cash / Bank A/c
10	If the bill is honoured / paid on the due date Previously endorsed to Z	No entry	Bills Payable A/c Dr To Cash / Bank A/c
11	If the bill is dishonoured / unpaid on due date Previously retained by X	Drawee / Y A/c Dr To Bills Receivables A/c To Cash / Bank A/c (For Noting charges if any)	Bills Payable A/c Dr Noting / Sundry Charges A/c (if any) Dr To Drawer / X A/c
12	If the bill is dishonoured / unpaid on due date Previously discounted with a Bank	Drawee / Y A/c Dr To Bank A/c To Cash / Bank A/c (For Noting charges if any)	Bills Payable A/c Dr Noting / Sundry Charges A/c (if any) Dr To Drawer / X A/c
13	If the bill is dishonoured / unpaid on due date Previously sent to the Bank for collection	Drawee / Y A/c Dr To Bills for Collection A/c To Cash / Bank A/c (For Noting charges if any)	Bills Payable A/c Dr Noting / Sundry Charges A/c (if any) Dr To Drawer / X A/c

Journal Entries for Trade Bills			
Sl. No.	Transactions	In the Books of Drawer (X)	In the books of Drawee (Y)
14	If the bill is dishonoured / unpaid on due date Previously endorsed to Z	Drawee / Y A/c Dr To Creditor / Z A/c (Bill value + Noting Charges if any)	Bills Payable A/c Dr Noting / Sundry Charges A/c (if any) Dr To Drawer / X A/c
15	If the bill is renewed on due date For old bill cancelled	Drawee / Y A/c Dr To Bills Receivables A/c	Bills Payable A/c Dr To Drawer / X A/c
16	If the bill is renewed on due date For interest charged for delayed payment	Drawee / Y A/c Dr To Interest (Received) A/c	Interest (Allowed) A/c Dr To Drawer / X A/c
17	If the bill is renewed on due date For part payment made in cash	Cash / Bank A/c Dr To Drawee / Y A/c	Drawer / X A/c Dr To Cash / Bank A/c
18	If the bill is renewed on due date For a new bill drawn and accepted	Bills Receivable A/c Dr To Drawee / Y A/c	Drawer / X A/c Dr To Bills Payable A/c

Illustration 1

Calculate the due dates of the bills in the following cases

Sl. No.	Date of Bill	Tenure (Period)
1	1st January 2023	4 months
2	23rd November 2023	2 months

Solution:

Sl. No.	Particulars	Calculation of Due Date
1	Date of drawing of bill Period / Tenure (month) Days of grace Due date / Maturity date	01.01.2023 4 01.05.2023 3 04.05.2023

Sl. No.	Particulars	Calculation of Due Date
2	Date of drawing of bill Period / Tenure (month) Days of grace Due date / Maturity date But 26.01.2024 is a National Holiday. So due date would be one day before i.e. 25.01.2024	23.11.2023 2 23.01.2024 3 26.01.2024

Illustration 2

X sold goods for ₹20,000 to Y on credit on January 01, 2023. X drew a bill of exchange upon Y for the same amount for three months. Y accepted the bill and returned it to X. Y met his acceptance on maturity. Record the necessary journal entries under the following circumstances:

(i) X retained the bill till the date of its maturity and collected directly

(ii) X discounted the bill @ 12% p.a. from his bank on January 01, 2023

(iii) X endorsed the bill to his creditor Z, on January 01, 2023

(iv) X retained the bill and on March 31, 2023 X sent the bill for collection to its bank. On April 05, 2023 bank advice was received.

Solution:

In the Books of X

Journal

(i) When the bill is retained till its maturity

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2023				
January 1	Y's A/c Dr. To Sales A/c (Being goods sold to Y's on credit)		20,000	 20,000
January 1	Bills Receivable A/c Dr. To Y's A/c (Being received Y's acceptance payable after three months)		20,000	 20,000
April 4	Bank A/c Dr. To Bills Receivable A/c (Being Y met his acceptance on maturity)		20,000	 20,000

(ii) When the bill was discounted from the book

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2023					
January 1	Y's A/c To Sales A/c (Sold goods to Y's)	Dr.		20,000	 20,000
January 1	Bills Receivable A/c To Y's A/c (Received Y's acceptance three months)	Dr.		 20,000	 20,000
January 1	Bank A/c Discount A/c (₹ 20,000 × 12% × $\frac{3}{12}$) To Bills Receivable A/c (Y's acceptance discounted with the bank)	Dr. Dr.		19,400 600	 20,000

(iii) When X endorsed the bill in favour of his creditor Z

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2023					
January 1	Y's A/c To Sales A/c (Sold goods to Y's on credit)	Dr.		20,000	 20,000
January 1	Bills Receivable A/c To Y's A/c (Received Y's acceptance for three months)	Dr.		20,000	 20,000
January 1	Z's A/c To Bills Receivable A/c (Y acceptance endorsed in favour of Z)	Dr.		20,000	 20,000

(iv) When the bill was sent for collection by X to the bank

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2023					
Jan. 01	Y's A/c To Sales A/c (Sold goods to Y's on credit)	Dr.		20,000	 20,000

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
Jan. 01	Bills Receivable A/c	Dr.		20,000	
	To Y's A/c				20,000
	(Received Y's acceptance payable after three months)				
Mar. 31	Bills Sent for Collection A/c	Dr.		20,000	
	To Bills Receivable A/c				20,000
	(Bills sent for collection)				
Apr. 05	Bank A/c	Dr.		20,000	
	To Bills sent for collection A/c				20,000
	(Bills sent for collection collected by the bank)				

The following journal entries will be made in the books of Y under all the four circumstances

In the Books of Y

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2023					
Jan. 01	Purchases A/c	Dr.		20,000	
	To X's A/c				20,000
	(Purchases goods from X on credit)				
Jan. 01	X's A/c	Dr.		20,000	
	To Bill's Payable A/c				20,000
	(Accepted bill drawn by X payable after three months)				
Apr. 04	Bills payable A/c	Dr.		20,000	
	To Bank A/c				20,000
	(Met acceptance maturity)				

Dishonour of Bills

Dishonour of Bill	• A bill of exchange can be dishonoured either by non-acceptance or by non-payment.
Dishonour by non-acceptance	• A bill of exchange is said to be dishonoured by non-acceptance when the drawee, or one of several drawees not being partners, makes default in acceptance upon being duly required to accept the bill, or where presentment is excused and the bill is not accepted. When a bill of entry dishonoured by non-acceptance, no accounting is required to be done in the books of any party.
Dishonour by non-payment	• When a bill of entry is not honoured by payment i.e. payment is not made by the drawee to the holder on the date of maturity it is referred to as dishonour by non-payment. In such an event, accounting entries are required to be passed in the books of drawer, drawee and endorsee (if any).

Noting of a Bill	• The recording of the fact of dishonour of bill by a Notary Public is referred to as Noting of a Bill. For this purpose, a fee, called the Noting Fee or Noting Charge , is required to be paid. It is an expense for the holder of the bill and is recovered from the party is responsible for the such dishonour.
Dishonour due to insolvency	• When a bill of exchange is dishonoured due to insolvency of the drawee or acceptor of the bill, either nothing is recovered from the drawee or acceptor, or a partial amount is recovered (referred to as Final Dividend) in full and final settlement of the claim. In the books of the drawer, the amount is debited to Bad Debts Account, while in the books of the drawee it is transferred to Deficiency Account.

Illustration 3

Mr. X sold goods for ₹ 15,000 to Mr. Y and immediately drew a bill upon him on Jan. 01, 2023 payable after 3 months. On maturity the bill was dishonoured and ₹ 50 were paid by the holder of the bill as noting charges. The journal entries will be recorded in the books of Mr. X and Mr. Y as given below under the following circumstances:

(i) When the bill was kept by Mr. X till maturity.

(ii) When the bill was discounted by Mr. X with his bank immediately @ 12% p.a.

(iii) When the bill was endorsed by Mr. X in favour of his creditor Miss. Z.

Solution:

In the Books of X
Journal

(i) When the bill was retained till its maturity

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2023 **Jan. 01**	Y's A/c	Dr.		15,000	
	To Sales A/c				15,000
	(Sold goods to Y)				
Jan. 01	Bills Receivable A/c	Dr.		15,000	
	To Y's A/c				15,000
	(Received Y's acceptance)				
Apr. 04	Y's A/c	Dr.		15,050	
	To Bills Receivable A/c	Dr.			15,000
	To Cash A/c				50
	(Y dishonoured his acceptance and paid ₹ 50 as noting charges)				

(ii) When the bill was discounted with the bank

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2023 **Jan. 01**	Y's A/c	Dr.		15,000	
	To Sales A/c				15,000
	(Sold goods to Y)				

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 01	Bills Receivable A/c Dr. To Y's A/c (Received Y's acceptance payable after three months)		15,000	15,000
Jan. 01	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Y's acceptance discounted)		14,550 450	15,000
Apr. 04	Y's A/c Dr. To Bank A/c (Y dishonoured his acceptance on maturity and bank paid noting charges of ₹50)		15,050	15,050

(iii) When the bill was endorsed to Z

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2023 **Jan. 01**	Y's A/c Dr. To Sales A/c (Sold goods to Y)		15,000	15,000
Jan. 01	Bill's Receivable A/c Dr. To Y's A/c (Received Y's acceptance)		15,000	15,000
Jan. 01	Z's A/c Dr. To Bills Receivable A/c (Y's acceptance endorsed in favour of Z)		15,000	15,000
Apr. 04	Y's A/c Dr. To Z's A/c (Y dishonoured his acceptance on maturity and Z paid ₹ 50 as noting charges)		15,050	15,050

The following journal entries will be made in the books of Y in all the three cases.

In the Books of Y
Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2023 **Jan.01**	Purchases A/c Dr. To X's A/c (Purchase goods from X)		15,000	15,000

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
Jan. 01	X's A/c	Dr.		15,000	
	To Bills Payable A/c				15,000
	(Accepted X's draft)				
Apr. 04	Bills Payable A/c	Dr.		15,000	
	Noting charges A/c	Dr.		50	
	To X's A/c				15,050
	(Acceptance in favour of X dishonoured)				

Renewal of Bills

Renewal of a Bill	• When the holder of a bill is not in a position to meet the bill on its due date, Drawee approaches the Drawer with a request of extension of time for payment. • If Drawer agrees, the old bill is cancelled, and a fresh bill with the new terms of payment is drawn and duly accepted and delivered. This is called Renewal of the Bill. • The new bill is drawn for an extended time period and as such interest is charged for the extended period.

Illustration 4

On February 01, 2023 X sold goods to Y for ₹ 18,000; ₹ 3,000 were paid by Y immediately and for the balance he accepted three months bill drawn upon him by X. On the date of maturity of the bill Y requested X to cancel the old bill and draw a new bill upon him for a period of 2 months. He further agreed to pay interest in cash to X @ 12% p.a. X agreed to Y's request and cancelled the old bill and drew a new bill. The new bill was met on maturity by Y.

Pass necessary journal entries in the books of drawer and drawee.

Solution:

In the Books of X

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2023					
Feb. 01	Y's A/c	Dr.		18,000	
	To Sales A/c				18,000
	(Sold goods to Y)				
Feb. 01	Cash A/c	Dr.		3,000	
	Bills Receivable A/c	Dr.		15,000	
	To Y's A/c				18,000
	(Received ₹ 3,000 in cash from X and				
	an acceptance for the balance)				

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
May 04	Y's Account Dr. To Bills Receivable A/c To Interest A/c (₹ 15,000 × 12% × $\frac{2}{12}$) (Cancelled old bill on renewal ₹ 300 as interest)		15,300	 15,000 300
May 04	Bill's Receivable A/c Dr. Cash A/c Dr. To Y's A/c (Received new acceptance from Y)		15,000 300	 15,300
Jul. 07	Bank A/c Dr. To Bills Receivable A/c (Y met his new acceptance)		15,000	 15,000

In the Books of Y

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2023 **Feb. 01**	 Purchases A/c Dr. To X A/c (Purchased goods from X)		 18,000	 18,000
Feb.01	X's A/c Dr. To Cash's A/c To Bills Payable A/c (Received cash from X and his acceptance)		18,000	 3,000 15,000
May 04	Bill Payable A/c Dr. Interest A/c Dr. To X A/c (Old bill cancelled on renewal, ₹ 300 charged as interest)		15,000 300	 15,300
May 04	X's A/c Dr. To Bills Payable A/c To Cash A/c (Accepted new bill and paid cash for interest)		15,300	 15,000 300

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jul. 07	Bill Payable A/c Dr. To Bank A/c (Met acceptance of the new bill on maturity)		15,000	 15,000

Retirement of a Bill

Retirement of a Bill	• When the Drawee pays the bill before its due date, it is termed as the retirement of a bill. • It happens with the mutual understanding between the Drawer and the Drawee.
Rebate on Bill	• In case of such retirement, interest is payable for the unexpired period of the bill (i.e. time period between date of payment of bill and date of maturity) by the holder of the bill to the payee at an agreed rate of interest. This amount of interest is referred to as Rebate on Bill. This rebate happens to be an income for the drawee and an expense for the payee.

Illustration 5

X sold goods ₹ 10,000 to Y on January 01, 2023 and immediately drew a bill on Y for three months for the same amount, Y accepted the bill and returned it to X. On March 04, 2022 Y retired her acceptance under rebate of 6% per annum. You are required to:

(a) Pass the journal entries to record the above transactions in the books of X and Y;

(b) Prepare Y A/c and Bill Receivable A/c in the books of X; and

(c) Prepare X A/c and Bill Payable A/c in the books of Y.

Solution:

In the books of X

(a) **Journal**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2023				
January 1	Y's A/c Dr. To Sales A/c (Sold goods to Y)		10,000	 10,000
January 1	Bills Receivable A/c Dr. To Y's A/c (Received Y's acceptance for three months)		10,000	 10,000
March 4	Bank A/c Dr. Rebate on bills A/c (₹ 10,000 × 12% × $\frac{1}{12}$) Dr. To Bills Receivable A/c (Y retired her acceptance and rebate allowed to him)		9,950 50	 10,000

(b) The recorded entries will be posted to the following ledger accounts:

Dr. **Y's Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
2023				2023			
Jan. 01	To Sales A/c		10,000	Jan 01	By Bills Receivable A/c		10,000
			10,000				**10,000**

Dr. **Bill Receivable Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
2023				2023			
Jan. 01	To Y A/c		10,000	Mar 04	By Cash A/c		9,950
					By Rebate on Bill A/c		50
			10,000				**10,000**

In the Books of Y

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2023					
January 1	Purchases A/c	Dr.		10,000	
	To X A/c				10,000
	(Purchased goods from X)				
January 1	X's A/c	Dr		10,000	
	To Bills Payable A/c				10,000
	(Accepted X's draft payable after three months)				
March 4	Bill Payable A/c	Dr		10,000	
	To Cash A/c				9,950
	To Rebate on bills A/c				50
	(Acceptance in favour of X retired and rebate received)				

(c) Dr. **X's Account** **Cr.**

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
2023				2023			
Jan. 01	To Bills Payable A/c		10,000	Jan. 04	By Purchases A/c		10,000
			10,000				**10,000**

Dr. Bills Payable Account Cr.

Date	Particulars	J.F.	(₹)	Date	Particulars	J.F.	(₹)
2023				2023			
Jan. 01	To Cash A/c		9,950	Jan. 01	By X A/c		10,000
	To Rebate on bills A/c		50				
			10,000				**10,000**

Accommodation Bill

Ordinary bills are drawn for some consideration – known as 'Trade Bills'. However, Accommodation Bills are those which are drawn and accepted without any consideration. When two or more persons, not being in the relationship of debtors and creditors or without any value passing between them, draws bills on each other with the intention of discounting the bill after acceptance, appropriating the proceeds by one or all by agreed proportion and providing money in the same proportion for honouring the bills at maturity, such bill may be called Accommodation Bill.

Accommodation Bill is also referred to as the Kite Bill.

Illustration 6

For mutual accommodation of himself and Y, X drew upon Y a bill of ₹6,000 at 3 months on 01.04.2023. Y accepted the bill and returned to X who discounted it immediately @ 6% p.a. According to agreement, X and Y shared the proceeds as 2:1. On the date of maturity X remitted his share to Y who honoured the bill by payment.

Show journal entries in the books of X and Y

Solution:

In the books of X

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
01.04.2023	Bills Receivable A/c	Dr.		6,000	
	To Y A/c				6,000
	(Accommodation bill drawn and acceptance received)				
	Bank A/c	Dr.		5,910	
	Discount on Bills A/c (₹ 6,000 × 6% × $\frac{3}{12}$)	Dr.		90	
	To Bills Receivable A/c				6,000
	(The bill discounted with the bank @ 6%)				
	Y A/c	Dr.		2,000	
	To Bank A/c				1,970
	To Discount on Bills A/c				30
	(1/3rd of the proceeds remitted and proportionate discount charged)				

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
01.07.2023	Y A/c (₹ 6,000 × $\frac{2}{3}$)	Dr.		4,000	
	To Bank A/c				4,000
	(Own share of the accommodation bill remitted to Y)				

In the books of Y

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
01.04.2023	X A/c	Dr.		6,000	
	To Bills Payable A/c				6,000
	(Acceptance give to the Accommodation bill)				
01.04.2023	Bank A/c	Dr.		1,970	
	Discount A/c	Dr.		30	
	To X A/c				2,000
	(1/3rd of the proceed received and proportionate discount allowed)				
01.07.2023	Bank A/c	Dr.		4,000	
	To X A/c				4,000
	(X's share received)				
	Bills Payable A/c	Dr.		6,000	
	To Bank A/c				6,000
	(The bill honoured by payment)				

Note: In case of Accommodation of Bills, no grace period is given as it is not a trade bill and cannot be challenged in the court of law.

Illustration 7

X draws a bill for ₹ 1,200 and Y accepts the same for mutual accommodation in the ratio of 4:2. X discounts the bill for ₹ 1,110 and remits 1/3rd of the proceeds to B. Before the due date, Y draws another bill for ₹ 1,800 on X in order to provide funds to meet the first bill. The second bill is discounted for ₹ 1,740 by Y and a sum of ₹ 360 is remitted to X after meeting the first bill. The second bill is duly met. Show journal entries in the books of both X and Y.

Solution:

In the books of X

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Bills Receivable A/c	Dr.		1,200	
	To Y A/c				1,200
	(Being on 1st bill drawn on Y for mutual accommodation)				

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank A/c Dr. Discount on Bills A/c Dr. To Bills Receivable A/c (Being the bill discounted with the banker for 1110)		1,110 90	 1,200
	Y A/c (₹ 1,200 × $\frac{1}{2}$) Dr. To Bank A/c To Discount on Bills A/c (₹ 90 × $\frac{1}{3}$) (Being 1/3rd of the proceeds remitted to Y – the loss on discount shared proportionately)		400	 370 30
	Y A/c Dr. To Bills Payable A/c (Being the bill drawn on X by Y)		1,800	 1,800
	Bank A/c Dr. Discount on Bills A/c Dr. To Y A/c (₹ 1,200 × $\frac{1}{3}$) (Being the net amount remitted to X by Y)		360 40	 400
	Bank A/c Dr. To Y A/c (Being the balance amount of the 2nd bill remitted by Y)		600	 600
	Bills Payable A/c Dr. To Bank A/c (Being the 2nd bill honoured at maturity)		1,800	 1,800

Note: (Prepare Y A/C to know the balance amount due)

In the books of Y

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	X A/c Dr. To Bills Payable A/c (Being a bill drawn on Y by X for mutual accommodation)		1,200	 1,200
	Bank A/c Dr. Discount on Bills A/c Dr. To X A/c (Being 1/3rd of the proceed received and the loss on discount shared proportionately)		370 30	 400

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Bills Receivable A/c	Dr.		1,800	
	To X A/c				1,800
	(Being the bill drawn on X)				
	Bank A/c	Dr.		1,740	
	Discount on Bills A/c (Bal. fig.)	Dr.		60	
	To Bills Receivable A/c				1,800
	(Being the bill discounted with the banker for ₹ 1,740)				
	X A/c	Dr.		400	
	To Bank A/c				360
	To Discount on Bills A/c				40
	(Being 1/3rd of the proceeds remitted to X – the loss on discount shared proportionately)				
	Bills Payable A/c	Dr.		1,200	
	To Bank A/c				1,200
	(Being the 1st bill honoured at maturity)				
	X A/c	Dr.		600	
	To Bank A/c				600
	(Being the balance amount of the 2nd bill remitted to X)				

Note: Before the due date of the 1st bill, X was to remit ₹ 800 to Y to enable him to honour the bill. But X was not in a position to remit the required amount. He accepted a bill of ₹ 1800 drawn by Y. Y discounted the bill for ₹ 1,740 and remitted to X ₹ 360 after adjusting ₹ 800 in respect of the 1st bill. Therefore, X enjoyed ₹ (360+800) ₹ 1,160 out of ₹ 1,740. X's share of discount will be: ₹ 60/1,740 × ₹ 1,160 = ₹ 40

Illustration 8

Vijay draws a bill for ₹ 60,000 and Anand accepts the same for mutual accommodation of both of them to the extent of Vijay 2/3rd and Anand 1/3rd. Vijay discounts it with bank for ₹ 56,400 and remits 1/3rd share to Anand. Before the due date, Anand draws another bill for ₹ 84,000 on Vijay in order to provide funds to meet the first bill on same sharing basis. The second bill is discounted at ₹ 81,600. With these proceeds, the first bill is settled and ₹14,400 were remitted to Vijay. Before the due date of the second bill, Vijay becomes insolvent and Anand receives a dividend of only 50 paise in a rupee in full satisfaction. Pass journal entries in the books of Vijay.

Solution:

In case of accommodation bills, the proceeds of discounting are shared by parties as agreed. The discounting charges are also shared in agreed proportion. Here, the ratio between Vijay and Anand is given as two-thirds and one-third. The first bill of ₹ 60,000 is discounted at ₹ 56,400 which means the discounting charges are ₹ 3,600. The share of each one is:

	1st Bill	2nd Bill		
	Proceeds (₹)	Discount (₹)	Proceeds (₹)	Discount (₹)
Vijay (2/3rd)	37,600	2,400	54,400	1,600
Anand (1/3rd)	18,800	1,200	27,200	800
Total	56,400	3,600	81,600	2,400

Further, as Vijay has become insolvent, the amount due to Anand is settled at 50% of total. To calculate this amount, it's necessary to post all transactions to Anand's account and arrive at the balance.

In the Books of Vijay

Journal Entries

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Bills Receivable A/c	Dr.		60,000	
	To Anand's A/c				60,000
	(Being bill drawn on Anand)				
	Bank A/c	Dr.		56,400	60,000
	Discount A/c	Dr.		3,600	
	To Bills Receivables A/c				
	(Being discounting of bill)				
	Anand's A/c	Dr.		20,000	
	To Bank A/c				18,800
	To Discount A/c				1,200
	(Being 1/3rd proceeds paid to Anand)				
	Anand's A/c	Dr.		84,000	
	To Bills payable A/c				84,000
	(being acceptance of bill)				
	Bank A/c	Dr.		14,400	
	Discount A/c	Dr.		1,600	16,000
	To Anand's A/c				
	(Being proceeds of discounting 2nd bill)				
	Bills Payable A/c	Dr.		84,000	
	To Anand's A/c				84,000
	(Being dishonour of bill)				
	Anand's A/c	Dr.		56,000	
	To Bank A/c				28,000
	To Deficiency A/c				28,000
	(Being payment of 50% & balance proved to be bad)				

Dr. Anand's Account Cr.

Particulars	Amount (₹)	Particulars	Amount (₹)
To Bank A/c	18,800	By B/R A/c	60,000
To Discount A/c	1,200	By Bank A/c	14,400
To B/P A/c	84,000	By Discount A/c	1,600
To Bank A/c	28,000	By B/P A/c	84,000
To Deficiency A/c	28,000		
	1,60,000		1,60,000

Illustration 9

Rahim, for mutual accommodation, draws a bill for ₹ 3,000 on Ratan. Rahim discounted it for ₹ 2,925. He remits ₹ 975 to Ratan. On the due date, Rahim is unable to remit his dues to Ratan to enable him to meet the bill. He, however, accepts a bill for ₹ 3,750 which Ratan discounts for ₹ 3,625. Ratan sends ₹ 175 to Rahim after discounting the above bill. Rahim becomes insolvent and a dividend of 80 paise in the rupee is received from his estate.

Pass the necessary journal entries in the books of both the parties.

In the books of Rahim

Journal Entries

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bills Receivable A/c Dr. To Ratan A/c (Bill drawn for mutual accommodation and accepted by Ratan.)		3,000	3,000
	Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c (Bill discounted by the bank.)		2,925 75	3,000
	Ratan A/c Dr. To Bank A/c To Discount A/c (1/3 Proceeds remitted to Ratan.)		1,000	975 25
	Ratan A/c Dr. To Bills Payable A/c (Bill accepted.)		3,750	3,750
	Bank A/c Dr. Discount A/c Dr. To Ratan A/c (Proceeds received from Ratan including discount charges.)		175 75	250
	Bills Payable A/c Dr. To Ratan A/c (Bill dishonored since e became insolvent.)		3,750	3,750
	Ratan A/c Dr. To Bank A/c To Deficiency A/c (Cash paid to Ratan @80 paise in the rupee and balance transferred to deficiency account.)		2,250*	1,800 450

* This amount can be ascertained by preparing Ratan's Account in Rahim's book.

In the books of Ratan
Journal Entries

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Rahim A/c To Bills Payable A/c (Bill accepted for mutual accommodation)	Dr.		3,000	3,000
	Bank A/c Discount A/c To Rahim A/c (1/3 proceeds received from Rahim including discount)	Dr. Dr.		975 25	1,000
	Bills Receivable A/c To Rahim A/c (Bill drawn and accepted by Rahim)	Dr.		3,750	3,750
	Bank A/c Discount A/c To Bills Receivable A/c (Bill discounted)	Dr. Dr.		3,625 125	3,750
	Rahim A/c To Bank A/c To Discount A/c (Proceeds remitted to Rahim including discount)	Dr.		250	175 75
	Rahim A/c To Bank A/c (Bill honoured at maturity)	Dr.		3,750	3,750
	Bills Payable A/c To Bank A/c (Bill honoured at maturity)	Dr.		3,000	3,000
	Bank A/c Bad Debt A/c To Rahim A/c (Amount realised from the official liquidator of Rahim @ 80 paise in the rupee and the balance proved bad)	Dr. Dr.		1,800 450	2,250

Note:

Sharing discount:

After discounting of the 1st bills, Rahim received ₹ 2,000 (including discount)

Add: Amount remitted by Ratan (after discounting of the 2nd bill). ₹ 175

Total benefit received by Rahim. ₹ 2,175

Now,

After discounting of the 2nd bill Ratan received ₹ 3,625 (Net)

- Proportion of Rahim to Ratan = ₹ 2,175 × 125 = ₹ 75
- Rahim is to bear = ₹75 of discounting charges, and the balance by Ratan.

Accounting for Consignment

2.2

Business organisations with the intention of expanding their operations adopt different strategies. One of the common strategies involves the engagement of selling agents, technically referred to as entering into consignment agreement. Consignment is a special type of transaction in which one entity sends goods to another entity for selling the goods of the former for a pre-determined commission. In such an arrangement, the two parties are located in different towns or cities.

Three parties are involved in a consignment business – Consignor, Consignee and Buyer. The consignor sends goods to the agent (called consignee) for selling the same on its behalf to the buyers. It is a type of agency contract, where the consignor is the 'principal' and the consignee acts as the 'agent'. Revenue from consignment business is recognised by the consignor on sale of the goods sent by the consignee. [AS-9]

Parties Involved in Consignment

The parties involved in consignment business are Consignor and Consignee.

Consignor

It is the party who sends the goods to its agent for sale of goods. The consignor may be a manufacturer or wholesaler. The consignor is the 'principal' in the principal-agent relationship of consignment business. The consignor remains the owner of the goods sent on consignment basis, till the goods are actually sold by the consignee.

Consignee

It is the party to whom goods are sent on consignment basis by the consignor. It sells the goods received on consignment basis and acts as the 'agent' in a consignment relation. It is to be noted that the consignee does not own the goods received on consignment basis. It is entitled to receive commission from the consignor as consideration .

Documents Related to Consignment Transactions

Consignment business requires certain specific documents for its operations. These documents are 'Proforma Invoice' and 'Account Sales'. These are discussed hereunder:

Proforma Invoice

This document is issued by the consignor to its agent (i.e. the consignee) at the time of sending the goods. It mentions various details regarding the goods sent viz. quantity of the goods consigned, cost/ invoice price of the goods, expenses incurred in relation to the goods, minimum selling price etc. This document acts as an evidence of despatch of goods from the end of the consignor. Its format resembles that of a regular invoice.

Proforma:

XYZ Cloth Merchant Proforma Invoice		
Goods sent on Consignment to: Kamal Garments 80A, Nehru Road, Guwahati – 781005.		Date: March 17, 2023
Particulars		(₹)
1,200 T-Shirts @ ₹ 1,000 each 500 Formal Shirts @ ₹ 800 each		12,00,000 4,00,000
Charges: Packing Carriage Insurance	(₹) 25,000 42,000 13,000	16,00,000 80,000
Goods despatched vide A.W.B. No. 85138 dated 17.3.2023	Total	16,80,000
E.&O.E. Ahmedabad	**For XYZ Cloth Merchant** Suresh Barua Partner	

Account Sales

Account Sales is a document which is periodically sent by the consignee to the consignor.

It contains details of the transactions entered into by the consignee on behalf of the consignor viz. sale proceeds realised, consignee's commission, expenses incurred by consignee in connection with the consignment, amount remitted and any other specific communication (like abnormal loss of goods).

It is a post-sales document that formally conveys the developments of the consignment business (at the consignee's place) to the consignor.

The consignor records the consignment related transactions in its books of accounts on the basis of this document.

Proforma:

Account Sales for Wrist Watches & Wall Clocks sold by Prime Watch Dealers on behalf of GMT Watch Makers		
Particulars	(₹)	(₹)
Gross Sale Proceeds:		
1,050 wrist watches @ ₹ 2,400 each	25,20,000	
180 wall clocks @ ₹ 600 each	1,08,000	26,28,000

Particulars	(₹)	(₹)
Less: Charges:		
Unloading & Carriage to godown	4,500	
Godown rent & insurance	96,000	
Selling expenses	12,500	
Commission @ 5% on ₹ 26,28,000	1,36,800	2,49,800
Net Sale Proceeds		23,78,200
Less: Advance (by Bank Draft No. …. dated ….)		10,00,000
		13,78,200
Less: Amount remitted (by Bank Draft No. …. dated ….)		10,00,000
Balance Due		3,78,200

E.&O.E.

New Delhi

For Prime Watch Dealers

…………………..

(Signature)

Difference between Consignment and Regular Sales

Consignment	Sales
1. It is a business expansion technique.	1. It is a primary business activity.
2. This transaction is entered into by some entities.	2. This transaction is entered into by every commercial organisation.
3. The main parties involved are Consignor and Consignee.	3. The parties involved are Buyer and Seller.
4. The parties share 'Principal-Agent' relationship.	4. The parties share 'Debtor-Creditor' relationship.
5. The ownership and risk of the goods do not pass to the Consignee.	5. The ownership and risk of the goods pass to the Buyer.
6. Expenses incurred on consignment are borne by the Consignor.	6. Prior to transfer of ownership of goods, expenses incurred are borne by the Seller.
7. Goods may be sent on consignment either 'at Cost' or 'at Invoice Price'.	7. Goods are sold at Selling Price which is above cost price.
8. When goods are sent on consignment, the Consignor sends a 'Proforma Invoice' to the Consignee.	8. When goods are sold, the Seller issues a 'Sales Invoice'.
9. The Consignee can return the goods sent to the Consignor.	9. The Buyer can not return the goods sold to the Seller, unless mutually agreed.

Consignment Related Transactions

Goods sent on onsignment:

In consignment business, goods are sent by the consignor to the consignee for the purpose of selling the same. The goods are physically transferred, but the ownership, risk and the property in goods remain with the consignor. This transaction is recorded in the books of the consignor, but in the books of the consignee no accounting is done for the same. As the goods are sent out of the regular stock of goods, necessary adjustment is required to be made by the consignor against Purchases A/c or Trading A/c. The goods so sent on consignment may be recorded by the consignor either 'at Cost Price (CP)' or 'at Invoice Price (IP)'. The IP is determined by adding a fixed percentage of margin (called the Load) over the cost of the goods.

Advance by consignee to consignor:

In consignment business, the consignor usually sends goods to the consignee after receiving adequate amount of advance from the consignee. Such advance money can be provided either through bank draft or the consignee may accept a bill of exchange in favour of the consignor. Such advance is later on adjusted when the money is remitted by consignee to the consignor. Sometimes, as per agreement between the consignor and the consignee, Security Deposit/ Caution Money is required to be sent by the consignee. In such case, the security deposit/ caution money, in proportion to any unsold stock, is retained by the consignor, and is required to be carried forward to the next accounting period.

Expenses on consignment:

The expenses which are specifically incurred in relation to the consignment business may be incurred either by the consignor or by the consignee.

Expenses by consignor: Such expenses are usually incurred for sending the goods to the consignee. Examples of such expenses include carriage & freight to consignee, packing charges, loading charges, export duty, transit insurance etc. These are non-recurring in nature, and are considered for valuation of the unsold stock lying with the consignee, goods abnormally lost and goods-in-transit.

Expenses by consignee: These expenses are incurred by the consignee are recovered from the consignor. The consignor does not reimburse such expenses to the consignee; rather these are adjusted against the amount due to the consignor (sale proceeds) in the Account Sales prepared by the consignee.

Expenses on consignment may be of two types – Recurring and Non-recurring. Recurring expenses are the expenses which are incurred on more than one occasion. These are usually incurred after the goods reach the consignee's premises. Such recurring expenses include godown rent, insurance of godown, carriage outward, establishment charges, advertising & publicity, salary of salesmen, commission and other selling expenses. Non-recurring expenses are incurred only once and are generally incurred prior to reaching the consignee's premises. Common nonrecurring expenses include unloading charges, dock charges, clearing charges, customs (import) duty, octroi, carriage & freight to godown etc. For the purpose of valuation of the unsold consignment stock and goods abnormally lost at the consignee's premises only the non-recurring expenses incurred by the consignee are to be considered.

Consignment Sale: As per consignment contract, goods are sold by the consignee on behalf of the consignor. Such sales form the revenue of the consignment business. The sales may be made either on cash basis or on credit basis. The cash sale transactions are recorded in the books of both consignor and consignee. However, the recording of the credit sale depends on the fact whether del-credere commission is payable by the consignor to the consignee or not. Sale proceeds are generally collected by the consignee and then reimbursed to the consignor at the end of the specified period after making necessary adjustments like expenses by consignee, commission due etc.

Commission

It is the consideration for which the Consignee acts as r agent of the Consignor. It is to be noted that the commission is not directly paid by the Consignor to the Consignee. It is adjusted by the Consignee against the amount due towards the Consignor, and is disclosed in the Account Sales. Commission associated with a consignment contract may be of the following three types:

1. **Ordinary Commission:** This Commission is due to the consignee from the consignor because of rendering of the regular activities of the consignment business. It is calculated on the gross sales made by consignee in the consignment business.
2. **Del-credere Commission:** This is a commission that is payable for taking the risk associated with credit sale of the goods, namely risk of bad debts and collection responsibility. It is generally calculated on the 'gross sales' made by the consignee, unless otherwise agreed upon.
3. **Over-riding Commission:** This is an extra commission which is paid over and above the ordinary commission. It is also referred to as Special Commission. This commission is paid when the consignee manages to sell the goods above a pre-determined selling price, or exceeds the sales target.

Loss of goods sent on consignment

The consignment business involves considerable movement and handling of goods. In this process, some goods may get lost. Such loss may be divided into two broad categories – Normal Loss and Abnormal Loss.

Normal Loss: The loss of goods which occurs due to the inherent nature of the goods involved is referred to as Normal Loss. It is by nature unavoidable loss and forms part of the cost of goods sold. Example: Evaporation of materials, spillage of liquid materials etc.

Abnormal Loss: Abnormal Loss of goods refers to those losses which are avoidable in nature. Such loss is not considered to be a part of the cost of goods sold. Example: Goods pilfered, goods stolen, goods lost by fire and other natural calamities etc. Based on the stage of occurrence of abnormal loss in a consignment business, such loss arising can be broadly discussed under two heads:

- **Goods lost in Transit:** These losses occur on the movement of the goods from the consignor's premise to the consignee's warehouse. Such goods lost are required to be valued after considering the expenses incurred by the Consignor for sending such goods. Any expenses incurred by the consignee which are of non-recurring nature are not to be included in valuing the goods lost in transit.
- **Abnormal loss of goods in Consignee's premises:** Such loss includes goods damaged by fire in consignee's godown, goods stolen from godown, loss due to bad handling etc. For the purpose of valuation of such loss, all expenses incurred by the consignor and the non-recurring expenses incurred by the consignee are considered.

Valuation of Unsold Stock Lying with Consignee

During a particular accounting period, usually the consignee does not manage to sell all the goods received from the consignor. In other words, some of the goods received may remain unsold with the consignee. This is technically called referred to as Consignment Stock. Its ownership lies with the consignor, even though they lie physically with the consignee. Valuation of such consignment stock is necessary for determination of correct operating results of the consignment business. The valuation of unsold stock depends on the fact whether the goods sent have been recorded by the consignor 'at Cost' or 'at IP'.

- **Goods sent at Cost:** Consignment stock is valued considering the cost of the goods sent on consignment. In addition, necessary adjustments are required to be made for the expenses incurred by the consignor and non-recurring expenses incurred by the consignee.

- **Goods sent at Invoice Price:** Consignment stock is valued considering the Invoice Price of the goods sent on consignment. Necessary adjustments are required to be made for the expenses incurred by the consignor and non-recurring expenses incurred by the consignee on these goods. Moreover, for determination of correct operating result, the load margin on such goods needs to be adjusted.

  NB: As per AS-2, unsold stock is to be valued at 'Cost' or 'Net Realisable Value (NRV)', whichever is lower. When the NRV (i.e. Expected Selling Price Less Incidental expenses for making such sale) of the unsold stock fall below its cost, in that case the consignment statement is to be valued at the lower NRV.

Valuation of Goods-in-Transit

The goods which have been despatched by the consignor, but are yet to reach the premises of the consignee are referred to as Goods-in-Transit. The ownership of such goods lies with the consignor, and at the end of an accounting period, such goods are required to be valued for the purpose of reflecting such goods in the financial statements. Such goods-in-transit are required to be valued after considering the expenses incurred by the consignor for sending such goods. It is to be noted that no expenses incurred by the consignee are to be included in valuing the same.

Accounting for Consignment

Accounting for consignment related transactions is done in the books of both Consignor and Consignee. These are discussed as follows:

Books of Consignor: The accounts maintained in the books of the consignor are:

- **Consignment Account:** It is the profit determining account of the consignment business. In this account the expenses and losses are matched against the revenue from such business. This profit/ loss on consignment determined in this account is transferred from this account to the P/L A/c.
- **Goods sent on Consignment Account:** It records the goods that are sent on consignment and also returns from consignee, if any.
- **Consignee's Account:** This is a personal account that records the transactions that are entered into by the consignee for the consignment. This account shows the money due to be received from the consignee at the end of a period.
- **Consignment Stock Account:** This account records the unsold stock of goods that may lie with the consignee at the end of an accounting period.
- **Consignment Debtors Account:** This account is maintained by the consignor when goods are sold by consignee on credit basis and del-credere commission is not paid to the consignee. It records the transactions like credit sale of consignment goods by consignee, collection from consignment debtors, bad debts, discount allowed etc.

Books of Consignee: The accounts which are maintained in the books of the consignee are:

- **Consignor Account:** This account records the transactions that are entered into by the consignee in relation to the consignment. The closing balance of this account reflects the amount due from the consignee to the consignor at the end of a specified period.
- **Commission Account:** Separate commission accounts are required to be maintained for different types of commissions viz. Ordinary Commission, Del credere Commission and Over-riding/ Special Commission.
- **Consignment Debtors Account:** This account is maintained by the consignee when del-credere commission is paid by the consignor to the consignee. This account records the transactions relating to credit sale of consignment goods made, collection from consignment debtors, bad debts, discount allowed etc.

- **Consignment Inwards Account:** Generally, no accounting is done in the books of the consignee for the goods received from consignor. However, sometimes the consignee may open a special account called the Consignment Inward Account to record the movement of the goods.

Journal Entries

	Books of Consignor	Books of Consignee
Opening Stock on Consignment		
At Cost:	Consignment A/c Dr. To Consignment Stock A/c	No entry
At IP:	Consignment A/c Dr. To Consignment Stock A/c [**Note**: Load to be cancelled]	
Cancellation of load on Opening Stock [When goods are sent at IP]		
	Stock Reserve A/c Dr. To Consignment A/c	No entry
Goods Sent on Consignment		
At Cost:	Consignment A/c Dr. To Goods Sent on Consignment A/c	No entry
At IP:	Consignment A/c Dr. To Goods Sent on Consignment A/c [**Note**: Load to be cancelled]	
Cancellation of load on goods sent [When goods are sent at IP]		
	Goods Sent on Consignment A/c Dr. To Consignment A/c	No entry
Advance received from consignee by consignor		
	Bank A/c / Bills Receivable A/c Dr. To Consignee A/c	Consignor A/c Dr. To Bank A/c/ Bills Payable A/c
Discounting of Bills Receivable by consignor		
	Bank A/c Dr. Discount on Bill A/c Dr. To Bills Receivable A/c	No entry
Expenses incurred by consignor		
	Consignment A/c Dr. To Cash/ Bank A/c	No entry

	Books of Consignor	Books of Consignee
Goods-in-Transit		
At Cost:	Goods-in-Transit A/c Dr. To Consignment A/c	No entry
At IP:	Goods-in-Transit A/c Dr. To Consignment A/c [**Note**: Load to be cancelled]	
Cancellation of load on Goods-in-Transit [When goods are sent at IP]		
	Consignment A/c Dr. To Goods-in-Transit A/c	
Expenses paid by consignee		
	Consignment A/c Dr. To Consignee A/c	Consignor A/c Dr. To Bank / Cash A/c
Sale of goods by consignee		
For cash	Consignee A/c Dr. To Consignment A/c	Bank A/c Dr. To Consignor A/c
For Credit: • Del-credere commission provided	Consignee A/c Dr. To Consignment A/c	Consignment Debtors A/c Dr. To Consignor A/c
• Del-credere commission not provided	Consignment Debtors A/c Dr. To Consignment A/c	No entry
Commission payable by consignor to consignee		
	Consignment A/c To Consignee A/c	Consignor A/c Dr. To Commission A/c
Amount received from Consignment Debtors		
Del-credere commission provided	No entry	Bank A/c Dr. To Consignment Debtors A/c
Del-credere commission not provided	Consignee A/c Dr. Bank A/c Dr. [if directly collected by consignor] To Consignment Debtors A/c	Bank A/c Dr. To Consignor A/c
Bad Debt in connection to consignment business		
Del-credere commission provided	No entry	Bad Debt A/c Dr. To Consignment Debtors A/c

	Books of Consignor	Books of Consignee
		Commission A/c Dr. To Bad Debt A/c
Del-credere commission not provided	Consignment A/c Dr. To Consignment Debtors A/c	No entry
Goods returned by consignee		
At Cost:	Goods Sent on Consignment A/c Dr. To Consignment A/c	No entry
At IP:	Goods Sent on Consignment A/c Dr. To Consignment A/c	No entry
Abnormal Loss of goods [in Transit/ in consignee's place]		
At Cost:	Abnormal Loss A/c Dr. To Consignment A/c	No entry
At IP:	Abnormal Loss A/c Dr. To Consignment A/c [**Note**: Load to be cancelled]	No entry
Cancellation of loading of abnormal goods [If goods sent at IP]		
	Consignment A/c Dr. To Abnormal Loss A/c	No entry
Insurance claim received/ admitted against Abnormal Loss		
	Bank A/c (Amount received) Dr. Insurance Claim A/c Dr. (Amount admitted but not realised) Consignee A/c Dr. (Amount received by consignee) P/L A/c (Net Loss) Dr. To Abnormal Loss A/c	Bank A/c Dr. To Consignor A/c [Amount received from Insurance Co. on behalf of the consignor]
Closing Stock on Consignment		
If goods were Sent at Cost:	Consignment Stock A/c Dr. To Consignment A/c	No entry
If goods were Sent at IP:	Consignment Stock A/c Dr. To Consignment A/c [**Note**: Load to be cancelled]	

	Books of Consignor	Books of Consignee
Cancellation of loading on goods sent [If goods sent at IP]		
	Consignment A/c Dr. To Stock Reserve A/c	No entry
Closing of Goods sent on Consignment A/c		
	Goods sent on Consignment A/c Dr. To Purchases/ Trading A/c	No entry
Profit/Loss on Consignment		
In case of Profit	Consignment A/c Dr. To P/L A/c	No entry
In case of Loss	P/L A/c Dr. To Consignment A/c	
Final Remittance received by consignor from consignee		
	Bank A/c / Bills Receivable A/c Dr. To Consignee A/c	Consignor A/c Dr. To Bank A/c / Bills Payable A/c

Illustration 10

Agarwal of Agra sent on consignment goods valued ₹1,00,000 to Biyani of Bhagalpur on March 1, 2022. He incurred an expenditure of ₹12,000 on Freight and Insurance. Biyani was entitled to a commission of 5% on gross sales plus a del-credere commission of 3%. Biyani took delivery of the consignment by incurring expenses of ₹3,000 for goods consigned.

On Dec. 31, 2022, Biyani informed on phone that he had sold all the goods for ₹1,50,000 by incurring selling expenses of ₹2,000. He further informed that only ₹1,48,000 had been realised and rest was considered irrecoverable, and would be sending the cheque in a day or so for the amount due along with the accounts sale. The consignor closes his books on Dec. 31 each year.

On Jan. 5, 2023; Agarwal received the cheque for the amount due from Biyani and incurred bank charges of ₹260 for collecting the cheque. The amount was credited by the bank on Jan. 9, 2023.

Prepare the Consignment A/c finding out the profit/loss on the consignment, Biyani A/c, Provision for Expenses A/c and Bank A/c in the books of the consignor, recording the transactions upto the receipt and collection of the cheque.

Solution:

Books of Agarwal

Dr. Consignment to Bhagalpur Account Cr.

Particulars		(₹)	Particulars	(₹)
To Goods sent on Consignment A/c		1,00,000	By Biyani A/c [Sale]	1,50,000
To Bank A/c [Expenses incurred]		12,000		
- Freight and Insurance				
To Biyani A/c [Expenses paid by consignee]				
- Delivery Charges	3,000			
- Selling Expenses	2,000	5,000		
To Biyani A/c [Commission due]				
- Ordinary Commission [1,50,000 × 5%]	7,500			
Del credere Commission [1,50,000 × 3%]	4,500	12,000		
To Provision for Expenses A/c		260		
[Provision created for collection charges]				
To P/L A/c [Profit on consignment transferred]		20,740		
		1,50,000		**1,50,000**

Dr. Biyani Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.22	To Consignment to Bhagalpur A/c [Sales]	1,50,000	31.12.22	By Consignment to Bhagalpur A/c [Expenses paid by consignee]	5,000
			31.12.22	By Consignment to Bhagalpur A/c [Commission due]	12,000
			31.12.22	By Balance c/d [Balance due: : B/Fig.	1,33,000
		1,50,000			1,50,000
1.1.23	To Balance b/d	1,33,000	5.1.23	By Cheque for Collection A/c [Final remittance]	1,33,000
		1,33,000			**1,33,000**

Dr. **Provision for Expenses Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
9.1.23	To Cheque for Collection A/c [Bank charges deducted]	260	31.12.22	By Consignment to Bhagalpur A/c	260
		260			**260**

Dr. **Bank Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
9.1.23	To Cheque for Collection A/c [1,33,000 – 260]	1,32,740	9.1.23	By Balance c/f	1,32,740
		1,32,740			**1,32,740**

Illustration 11

M/s Singha Traders of Surat consigned 5,000 litres of edible oil costing ₹32 each to M Ltd. of Mumbai on 1.2.2023. S Ltd. paid ₹5,000 as freight and insurance charges. During transit 200 litres were destroyed for which the insurance company agreed to pay ₹5,000 in full settlement.

M Ltd. paid clearing charges ₹6,100; godown rent ₹300 and Salesman's salary ₹900. It was entitled to 6% ordinary commission and 4% del credere commission on sales.

On 30.6.2023, M Ltd. reported that 4,000 litres were sold at ₹1,65,000 and 100 litres were lost due to evaporation. A customer who bought oil for ₹1,500 could pay only 40% of his amount. M Ltd. paid its balance due by a cheque.

Show the Consignment Account in the books of M/s Singha Traders.

Solution:

Books of M/s Singha Traders

Dr. **Consignment to Mumbai Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Goods Sent on Consignment A/c [5,000 × ₹32]		1,60,000	By M. Ltd. A/c [Sale]	1,65,000
To Bank A/c [Expenses incurred by consignor]			By Goods Destroyed-in-Transit A/c [WN:1]	6,600
- Freight and Insurance Charges		5,000		
To M. Ltd. A/c [Expenses incurred by consignee]				
- Clearing Charges	6,100		By Consignment Stock A/c [WN:1]	24,500
- Godown Rent	300			
- Salesman's Salaries	900	7,300		
To M. Ltd. A/c [Commission due]				

- Ordinary Commission [1,65,000 × 6%]	9,900			
- Del credere Commission [1,65,000 × 4%]	6,600	16,500		
To P/L A/c [Profit on consignment – transferred]		7,300		
		1,96,100		**1,96,100**

Workings Note:

Value of Goods Destroyed-in-transit & Unsold Stock

	Litres	(₹)
Cost of goods sent [5,000 × ₹32]	5,000	1,60,000
Add: Consignor's expenses (being, freight and insurance charges)	-	5,000
	5,000	1,65,000
Less: Goods destroyed -in-transit [₹1,65,000 × 200/5,000]	200	6,600
Goods received by consignee	4,800	1,58,400
Add: Non-recurring expenses incurred by consignee (being, clearing charges)	-	6,100
	4,800	1,64,500
Less: Normal loss	100	-
	4,700	1,64,500
Unsold Stock = [5,000 – 200 – 100 – 4,000] = 700 litres ∴ Value of 700 litres	₹1,64,500 × $\frac{700}{4700}$ = ₹24,500	

Illustration 12

B consigned 100 calculators to A. Cost of each calculator was ₹190. B incurred expenses of ₹500 on despatch of such goods. A informed B that he had sold 68 calculators @ ₹280 each and 11 calculators @ ₹270 each and had spent ₹1,520 on behalf of the consignor. One damaged calculator was sold for ₹50 according to the instructions of consignor. A was entitled to a commission of 6% on gross sales and it includes del-credere commission. A could recover only ₹250 from a customer to whom one calculator had been sold on credit basis for ₹280. All other sales were made on cash basis.

Show the ledger accounts in the books of both the parties. Calculations may be made to the nearest rupee and assume that the expenses of consignee are recurring in nature.

Solution:

Books of B

Dr. Consignment Account Cr.

Particulars	(₹)	Particulars		(₹)
To Goods sent on Consignment A/c	19,000	By A A/c [Sale]		
[100 × ₹ 190]		[68 × ₹ 280]	19,040	
To Bank A/c [Expenses incurred]	500	[11 × ₹ 270]	2,970	22,010
To A A/c [Expenses paid by consignee]	1,520	By Goods Damaged A/c [WN: 1]		195
To A A/c [Commission due: ₹ 22,010 × 6%]	1,321	By Consignment Stock A/c [WN: 1]		3,900
To P/L A/c [Profit on consignment transferred]	3,764			
	26,105			**26,105**

Dr. Goods Damaged Account Cr.

Particulars	(₹)	Particulars	(₹)
To Consignment A/c	195	By A A/c [Sale of damaged calculator]	50
To A A/c [Commission on sale of damaged goods: ₹ 50 × 6%]	3	By P/L A/c [Net loss transferred – B/Fig.]	148
	198		**198**

N.B. As the commission is allowed on gross sales, consignee is also entitled to get commission on sale of damaged goods also.

Dr. A Account Cr.

Particulars	(₹)	Particulars	(₹)
To Consignment A/c [Sale]	22,010	By Consignment A/c [Expenses incurred]	1,520
To Goods Damaged A/c	50	By Consignment A/c [Commission due]	1,321
		By Goods Damaged A/c [Commission on sale of damaged goods]	3
		By Balance c/f	19,216
	22,060		**22,060**

Dr. Goods Sent on Consignment Account Cr.

Particulars	(₹)	Particulars	(₹)
To Purchases/ Trading A/c [Transfer]	19,000	By Consignment A/c	19,000

Books of A

B Account

Dr. Particulars	(₹)	Cr. Particulars	(₹)
To Bank A/c [Expenses paid]	1,520	By Bank A/c [Cash Sales: (₹22,010 – ₹ 280)]	21,730
To Commission A/c [Commission earned]	1,324	By Consignment Debtors A/c [Credit Sales]	280
To Balance c/f [Balance due: B/Fig.]	19,216	By Bank A/c [Sale of damaged calculator]	50
	22,060		**22,060**

Consignment Debtors Account

Dr. Particulars	(₹)	Cr. Particulars	(₹)
To B A/c [Credit sales]	280	By Bank A/c [Collection]	250
		By Commission A/c [Bad debts written-off]	30
	280		**280**

Commission Account

Dr. Particulars	(₹)	Cr. Particulars	(₹)
To Consignment Debtors A/c [₹280 – ₹250]	30	By B A/c	1,324
To P/L A/c [B/Fig.]	1,294		
	1,324		**1,324**

Workings Note:

1. Value of goods damaged & unsold stock

	Units	(₹)
Cost of goods sent	100	19,000
Add: Consignor's expenses	--	500
	100	19,500
Less: Goods damaged [₹19,500 × 1/100]	1	195
	99	19,305
Unsold stock = [100 – (68 + 11) - 1] = 20 units ∴ Value of 20 units	$₹19,305 \times \frac{20}{99} = ₹3,900$	

Illustration 13

RG Cellular of Kolkata consigned 100 mobile handsets to Techno Traders of Durgapur. The cost of each handset was ₹25,000. The consignor paid insurance ₹15,000, freight ₹8,000. An account sale was received from Pluto, showing gross sale proceeds of 80 units at ₹30,000 each.

The expenses paid and deducted by him were: Carriage ₹ 2,000; Establishment expenses ₹10,300; Insurance ₹24,000; Commission ₹85,000. The handsets lying unsold with Pluto were valued at ₹5,05,000

Pass the journal entries in the books of Techno Traders given that maintains Consignment Inward A/c.

Solution:

Books of Techno Traders

Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Consignment Inward A/c [100 × ₹25,000]	Dr.		25,00,000	
	To RG Cellular A/c				25,00,000
	(Being goods received from Jupiter)				
	Consignment Inward A/c	Dr.		36,300	
	To Bank A/c (₹ 2,000 + ₹10,300 + ₹24,000)				36,300
	(Being expenses paid for consignment)				
	Bank A/c	Dr.		24,00,000	
	To Consignment Inward A/c (80 × ₹30,000)				24,00,000
	(Being goods received on consignment sold)				
	Consignment Inward A/c	Dr.		85,000	
	To Commission A/c				85,000
	(Being commission due from Jupiter)				
	RG Cellular A/c	Dr.		5,05,000	
	To Consignment Inward A/c				5,05,000
	(Being stock lying unsold)				
	Consignment Inward A/c	Dr.		2,83,700	
	To RG Cellular A/c				2,83,700
	(Being balance of Consignment Inward A/c transferred to Jupiter account)				
	RG Cellular A/c	Dr.		22,78,700	
	To Bank A/c				22,78,700
	(Being payment made for balance due to consignor)				

Illustration 14

On Jan. 1, 2022 goods costing ₹ 1,32,000 were consigned by Shri G of Chennai to his agent Shri H in Amritsar at a pro-forma invoice price of 20% above cost. Shri G paid freight and other forwarding charges amounting to ₹ 4,000. The consignee was allowed ₹ 2,000 p.a. towards establishment costs, 5% commission on gross sales. Shri H paid ₹ 1,000 as godown rent and insurance for three months ended Mar. 31, 2023.

Three-fourths of the goods were sold at $33^1/_3$% profit on cost, half of which were credit sales. Balance stock was valued at pro-forma invoice price. Consignee reported that a customer who purchased goods worth ₹ 10,000 was untraceable and his balance was considered to be unrealisable. All other the debtors cleared their dues. Shri H cleared his dues by sending a bank draft on Mar. 31, 2023.

Prepare necessary accounts in the books of Consignor, for 3 months ending on Mar. 31, 2023.

Solution:

Books of Shri G

Dr. Consignment to Amritsar Account Cr.

Particulars	(₹)	Particulars	(₹)
To Goods Sent on Consignment A/c [₹ 1,32,000 + 20% there off]	1,58,400	By Shri H A/c [Cash Sales – WN:1]	66,000
To Bank A/c [Expenses incurred]		By Consignment Debtors A/c [Credit sales – WN:1]	66,000
- Freight and other Forwarding Charges	4,000		
To Shri H A/c [Expenses paid by consignee]		By Goods sent on Consignment A/c	26,400
- Establishment Charges [2,000 × 3/12] 500		[Loading on goods sent: ₹ 1,32,000 × 20%]	
- Godown Rent and Insurance 1,000	1,500		
To Shri H A/c [Commission due: 1,32,000 × 5%]	6,600	By Consignment Stock A/c [WN: 2]	40,600
To Consignment Debtors A/c [Bad debt written off]	10,000		
To Stock Reserve A/c [WN:2]	6,600		
To P/L A/c [Profit on consignment transferred]	11,900		
	1,99,000		**1,99,000**

Dr. **Shri H Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Consignment to Amritsar A/c [Sales]	66,000	By Consignment to Amritsar A/c [Expenses incurred]	1,500
To Consignment Debtors A/c [Collection made by consignee: (₹66,000 – 10,000)]	56,000	By Consignment to Amritsar A/c [Commission due]	6,600
		By Bank A/c [Final remittance - B/Fig.]	1,13,900
	1,22,000		**1,22,000**

Dr. **Consignment Debtors Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Consignment to Amritsar A/c [Sales]	66,000	By Shri H A/c [Amount recovered by consignee]	56,000
		By Consignment to Amritsar A/c [Bad debt written off]	10,000
	66,000		**66,000**

Dr. **Goods sent on Consignment Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Consignment to Amritsar A/c [Loading on goods sent]	26,400	By Consignment to Amritsar A/c [Invoice price of goods sent]	1,58,400
To Purchases/Trading A/c [Transfer]	1,32,000		
	1,58,400		**1,58,400**

Workings Note:

1. Cash & credit sales made by consignee

	(₹)
Cost price of goods sent	1,32,000
Cost price of goods sold [₹ 1,32,000 × 3/4]	99,000
Add: Profit @ 33 1/3 % on Cost [₹ 99,000 × $33^1/_3$ %]	33,000
Total Sales	1,32,000
∴ Cash Sales [₹ 1,32,000 × 1/2]	66,000
∴ Credit Sales [₹ 1,32,000 × 1/2]	66,000

2. Value of unsold stock

	(₹)
Invoice Price of goods sent	1,58,400
Add: Consignor's expenses [Being, freight and other forwarding charges]	4,000
	1,62,400
Unsold Stock [1/4th of the total goods = 1/4th × ₹ 1,62,400]	40,600
Loading on stock on consignment = Load on goods sent × ¼ = ₹ 26,400 × ¼	6,600

Illustration 15

Kunal of Kolkata consigned goods costing ₹ 45,000 to Quereshi of Meerut. The invoice price was made so as to show a profit of $33^1/_3$% on cost. Kunal paid ₹ 300 as carriage and ₹ 1,200 as freight & insurance, Goods costing ₹ 5,000 were destroyed while in-transit and the insurance company admitted the full claim. In Meerut, Quereshi paid ₹ 40 as carriage and ₹ 600 as godown rent. 2/3 rd of the goods received by Quereshi were sold by him. Quereshi sent a cheque to Kunal for the sale proceeds after deducting the expenses incurred by him and the commission due to him: ordinary @ 5% and del credere @ $2^1/_2$%.

Show the Consignment to Meerut A/c and Q's A/c in Kunal's Ledger.

Solution:

Books of Kunal

Dr. Consignment to Meerut Account Cr.

Particulars		(₹)	Particulars	(₹)
To Goods sent on Consignment A/c [₹ 45,000 + $33^1/_3$% thereof]		60,000	By Quereshi A/c [Sale – WN :2]	35,556
To Bank A/c [Expenses incurred]			By Goods Destroyed-in-Transit A/c [WN:1]	6,833
- Carriage	300		By Goods Sent on Consignment A/c	15,000
- Freight & Insurance	1,200	1,500	[Load on goods sent: 45,000 × $^1/_3$]	
To Quereshi A/c [Expenses paid by consignee]			By Consignment Stock A/c [WN: 1]	18,302
- Carriage	240			
- Godown Rent	600	840		
To Quereshi A/c [Commission due]				
- Ordinary Commission [35,556 × 5%]	1,778			
- Del credere Commission [35,556 × $2^1/_2$%]	889	2,667		

To Goods Destroyed-in-Transit A/c [loading on goods destroyed –WN: 1]	1,667		
To Stock Reserve A/c [Loading on unsold stock – WN: 1]	4,444		
To P/L A/c [Profit on consignment transferred]	4,573		
	75,691		**75,691**

NB: Discount on bill being purely a finance charge, would be recorded in debit side of P/L A/c.

Dr. **Quereshi Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Consignment to Meerut A/c [Sales]	35,556	By Consignment A/c [Expenses incurred]	840
		By Consignment A/c [Commission due]	2,667
		By Bank A/c [Final remittance: B/Fig.]	32,049
	35,556		**35,556**

Workings Note:

1. Value of goods destroyed-in-transit and unsold stock

	Invoice Price (₹)	Load (₹)
Goods sent	60,000	15,000 [45,000 × 1/3]
Add: Consignor's expenses [being, Carriage and Freight & Insurance]	1,500	-
	61,500	15,000
Less: Goods destroyed-in-transit [Goods costing ₹ 5,000 were destroyed i.e. ₹ 5,000/ ₹ 45,000 = 1/9th of goods sent] ∴ Load on goods destroyed-in-transit = [₹ 15,000 × 1/9] = ₹ 1,667	6,833	1,667
	54,667	13,333
Add: Non-recurring expenses incurred by consignee [being, carriage]	240	-
	54,907	13,333
∴ Unsold stock = 1/3rd of goods received [See note] ∴ Value unsold stock ∴ Load on goods unsold stock = [₹ 13,333 × 1/3] = ₹ 4,444	54,907 × 1/3 = 18,302	

2. Sales made by Quereshi

	(₹)
Cost of goods sent by consignor	45,000
Less: Cost of goods lost in transit	5,000
∴ Cost of goods received by consignee	40,000
Cost of goods sold by consignor [₹ 40,000 × $^2/_3$]	26,667
Add: Profit @ $33^1/_3$% on Cost	8,889
∴ Sale made by Quereshi	35,556

Illustration 16

Veemal of Delhi sends a consignment of wall clocks to Anand of Kolkata and charges proforma invoice price so as to show a profit of 25% on cost. The agent received commission @ 5% on all sales plus 3% del credere commission on credit sales made by him. Stock of goods with the agent at the beginning of the year: 40 clocks at proforma invoice price ₹ 25,000. During the year ended 31st December 2023, Veemal had the following transactions with Anand:

(a) Proforma invoice price of 200 Clocks consigned to Anand: ₹ 1,25,000

(b) Railway charges and insurance on the consignment paid by Veemal: ₹ 3,500

(c) Advance received from Anand : ₹ 37,500

(d) Sales made by Anand;

  (i) 80 clocks for cash : ₹ 53,750

  (ii) 100 clocks on credit: ₹ 70,000

(e) Selling expenses made by agent: ₹ 6,250 and discount allowed by him ₹ 2,500.

(f) 30 clocks were damaged by the railway for which Anand recovered ₹ 6,750. The damaged clocks were sold on cash by Anand at ₹ 5,750.

(g) Out of the clock sold on credit, ₹ 5,000 was irrecoverable and considered bad by the agent.

(h) The agent remitted the balance due by him by a bank draft.

Show necessary Ledger Accounts in the books of Veemal.

Solution:

Books of Veemal

Dr. **Consignment to Kolkata Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Consignment Stock A/c [Unsold stock]	25,000	By Stock Reserve A/c	5,000
To Goods sent on Consignment A/c [sent at IP]	1,25,000	[Load on opening stock : 25,000 × 25/125]	
To Bank A/c [Expenses incurred]		By Anand A/c [Sale: ₹ 53,750 + ₹ 70,000]	1,23,750
- Railway charges & Insurance	3,500		

Particulars		(₹)	Particulars	(₹)
To Anand A/c [Expenses paid by consignee]			By Goods Sent on Consignment A/c [load on goods sent: ₹ 1,25,000 × 25/125]	25,000
- Selling expenses	6,250			
- Discount Allowed	2,500	8,750	By Goods Damaged-in-Transit A/c [WN: 1]	19,275
To Anand A/c [Commission due]			By Consignment Stock A/c [WN: 1]	19,275
- Ordinary Commission [1,23,750 × 5%]	6,188			
- Del credere Commission [70,000 × 3%]	2,100	8,288		
To Goods Damaged-in-Transit A/c [Load - WN: 1]		3,750		
To Stock Reserve A/c [Load on unsold stock – WN: 1]		3,750		
To P/L A/c [Profit on consignment transferred]		14,262		
		1,92,300		**1,92,300**

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

Particulars	(₹)	Particulars	(₹)
To Consignment A/c [Sales]	1,23,750	By Bank A/c [Advance]	37,500
To Goods Damaged-in-Transit A/c [Insurance claim received]	6,750	By Consignment A/c [Expenses incurred]	8,750
To Goods Damaged-in-Transit A/c [Sale of damaged goods]	5,750	By Consignment A/c [Commission due]	8,288
		By Goods Damaged-in-Transit A/c [Commission on sale of damaged goods]	288
		By Bank A/c [Final remittance – B/Fig.]	81,424
	1,36,250		**1,36,250**

Dr. **Goods Damaged-in-Transit Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Consignment A/c [Goods damaged]	19,275	By Consignment A/c [Load on goods damaged]	3,750
To Anand A/c	288	By Anand A/c [Insurance claim received]	6,750

[Commission on sale of damaged goods – ₹ 5,750 × 5%]		By Anand A/c [Sale of damaged goods] By P/L A/c [Net loss – B/Fig.]	5,750 3,313
	19,563		**19,563**

Workings Note:

1. Value of Goods Damaged in Transit & Unsold Stock

	Units	(₹)
IP of goods sent	200	1,25,000
Add: Consignor's expenses [being, Railway charges & Insurance]	-	3,500
Less: Goods Damaged-in-Transit [1,28,500 × 30/200]	200	1,28,500
Load on Goods Damaged-in-Transit: Total load × 30/200 = ₹ 25,000 × 30/200 = ₹ 3,750	30	19,275
∴ Value of goods received by consignee	170	1,09,225
Unsold Stock = [40 + 200 – 30 – (80 + 100)] = 30 units		
∴ Value of unsold stock of 30 units	₹ 1,09,225 × $\frac{30}{170}$ = ₹ 19,275	
Load on unsold stock: Total load × 30/200 = ₹ 25,000 × 30/200 = ₹ 3,750		

Illustration 17

The Account Sales received from an agent disclosed that the total sales effected by him during 2022-23 amounted to ₹ 4,50,000. This included ₹ 3,12,500 for sales made at invoice price which is cost plus 25% and the balance at 10% above the invoice price. He incurred expenses to the tune of ₹ 5,000 out of which a sum of ₹1,800 is recurring in nature. Forwarding expenses of the Consignor totalled ₹ 2,400. The Agent had remitted the balance due from him through Bank Draft after deducting the expenses. 5% commission on gross sales, bad debts ₹ 850 and a Bills payable accepted by him for ₹ 10,000.

The value of unsold stock at original cost lying with the Agent as on 31st March, 2023 amounted to ₹ 50.000.

You are required to prepare the Consignment Account and the Consignee's Account in the Books of the Consignor.

Solution:

Books of Consignor

Dr. **Consignment Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Goods sent on Consignment A/c [WN:1]	5,00,000	By Consignment Debtors A/c [Sale]	4,50,000
To Bank A/c [Expenses incurred]			

Particulars		(₹)	Particulars	(₹)
- Forwarding Expenses		2,400	By Goods sent on Consignment A/c [Load on goods sent – WN:1]	1,00,000
To, Consignee A/c [Expenses paid by consignee]			By Consignment Stock A/c [WN:2]	63,200
- Non-recurring Expenses [5,000 – 1,800]	3,200			
- Recurring Expenses	1,800	5,000		
To Consignee A/c [Commission due: ₹4,50,000 × 5%]		22,500		
To Consignment Debtors A/c [Bad debt]		850		
To Stock Reserve A/c [Load on unsold stock – WN: 2]		12,500		
To P/L A/c [Profit on consignment transferred]		69,950		
		6,13,200		**6,13,200**

Dr. **Consignee Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Consignment Debtors A/c [Collection from debtors: ₹4,50,000 – ₹850]	4,49,150	By Bills Receivable A/c	10,000
		By Consignment A/c [Expenses incurred]	5,000
		By Consignment A/c [Commission due]	22,500
		By Bank A/c [Final remittance - B/Fig.]	4,11,650
	4,49,150		**4,49,150**

Workings Note:

1. Goods sent on consignment

	(₹)
Total sales	4,50,000
Less: Sales made at invoice price	3,12,500
∴ Sales made at invoice price plus 10%	1,37,500
∴ Total sales at invoice price [₹3,12,500 + (₹1,37,500 × 100/110)]	4,37,500

Less: Loading on above [₹4,37,500 × 25/125]	87,500
∴ Cost of Goods sold	3,50,000
Add: Unsold stock	50,000
∴ Cost of goods sent on consignment	4,00,000
Add: Loading @ 25%	1,00,000
Goods sent on consignment [at IP]	5,00,000

2. Value of unsold stock

	(₹)
Original cost of unsold stock (given)	50,000
Add: Loading [₹50,000 × 25%]	12,500
	62,500
Add: Proportionate expenses of consignor [₹2,400 × 62,500 / 5,00,000]	300
Proportionate non-recurring expenses paid by consignee [₹3,200 × 62,500 / 5,00,000]	400
∴ Value of unsold stock	63,200

Illustration 18

Mr. P consigned goods to Mr. D, his agent at Dhanbad, at cost price of ₹40,000. Mr. P's accountant at the end of the year drew up the agent is account as below:

Dr. **Mr. D Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Goods	40,000	By Cash	25,000
To Cash-Freight	3,000	By Balance	19,300
To P/L A/c	1,300		
	44,300		**44,300**

Mr. D sold part of the goods for ₹45,000, which exceeded by ₹9,000 their cost price. He collected ₹38,000 after allowing discount of ₹2,000 to customers. Bad Debts came to ₹1,000 and his expenses to ₹800 (including ₹200 for loading and cartage). Mr. D was entitled to a 5% commission on cash collected.

From the above information draw up Consignment A/c, Consignment Debtors A/c and Mr. D A/c in the books of Mr. P.

Solution:

Books of Mr. P

Dr. Consignment to Dhanbad Account Cr.

Particulars		(₹)	Particulars	(₹)
To Goods sent on Consignment A/c [Rectification - WN:1]		40,000	By Consignment Debtors A/c [Credit Sale]	45,000
To Mr. D's A/c [Consignor's expenses - rectified]			By Consignment Stock A/c [WN: 2]	4,320
- Freight		3,000		
To Mr. D A/c [Expenses paid by consignee]				
- Loading & Cartage	200			
- Other Expenses [₹800 – ₹200]	600	800		
To Mr. D A/c [Commission due: 5% on ₹38,000]		1,900		
To Consignment Debtors A/c				
- Discount Allowed	2,000			
- Bad debt	1,000	3,000		
To P/L A/c [Profit on consignment transferred]		620		
		49,320		**49,320**

Dr. Mr. D Account Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/f	19,300	By Goods A/c [Rectification – WN: 1]	40,000
To Consignment Debtors A/c [Collection from Debtors]	38,000	By Consignment A/c [Expenses of consignor – rectified]	3,000
		By P/L A/c [Profit wrongly included - rectified]	1,300
		By Consignment A/c [Commission due]	1,900
		By Consignment A/c [Expenses paid]	800
		By Balance c/f [Balance due: B/Fig.]	10,300
	57,300		**57,300**

Dr. **Consignment Debtors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Consignment A/c [Sales]	45,000	By D A/c [Amount collected]	38,000
		By Consignment A/c [Discount Allowed]	2,000
		By Consignment A/c [Bad debt]	1,000
		By Balance c/f [B/Fig.]	4,000
	45,000		**45,000**

Workings Note:

1. Rectification of errors

Transaction	Rectification Entry		
Goods sent on consignment	Consignment A/c	Dr.	40,000
	To Goods Sent on Consignment A/c		40,000
	Goods A/c	Dr.	40,000
	To Mr. D A/c		40,000
Expenses paid by P	Consignment A/c	Dr.	3,000
	To Mr. D A/c		3,000
Cash received from Mr. D	No Rectification Entry is needed		
Profit	P/L A/c	Dr.	1,300
	To Mr. D A/c		1,300

2. Cost price of unsold stock

	(₹)	(₹)
Cost of goods sent		40,000
Less: Cost of goods sold:		
Sales	45,000	
Less: Margin over Cost Price	9,000	36,000
∴ Cost of unsold stock		4,000

3. Value of Unsold Stock

	(₹)
Cost of unsold goods [WN:2]	4,000
Add: Proportionate expenses of consignor [₹3,000 × 4,000/ 40,000]	300
Add: Proportionate expenses of consignee [₹200 × 4,000 / 40,000]	20
	4,320

Illustration 19

The account sales received from an agent disclosed that the sales made at 10% above the price was 44% of the sales made at invoice price which is cost plus 25%. All the sales are made on credit basis. He incurred expenses to the tune of ₹ 5,000, out of which a sum of ₹ 1,800 is recurring in nature. Forwarding expenses of the consignor ₹ 2,400. The agent had remitted the balance due from him through bank draft of ₹ 4,11,650 after deducting the expenses, 5% commission on gross sales, bad debts ₹ 850 and a bill payable accepted by him for ₹ 10,000. The value of unsold stock at original cost lying with the agent amounted to ₹ 50,000. You are required prepare Consignment Account and the Agents' Account in the books of the consignor.

Solution:

Books of Consignor

Dr. **Consignment Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Goods sent on Consignment A/c - Goods sent at IP [WN:2]		5,00,000	By Consignment Debtors A/c [Credit Sale: WN:1]	4,50,000
To Bank A/c [Expenses incurred] - Forwarding Expenses		2,400	By Goods sent on Consignment A/c [Loading on unsold stock – WN:2]	1,00,000
To Agent A/c [Expenses paid by consignee]			By Consignment Stock A/c [WN:3]	63,200
- Non-recurring Expenses [5,000 – 1,800]	3,200			
- Recurring Expenses	1,800	5,000		
To Agent A/c [Commission due: WN:1]		22,500		
To Consignment Debtors A/c [Bad debt]		850		
To Stock Reserve A/c [loading on unsold stock – WN:3]		12,500		
To P/L A/c [Profit on consignment transferred]		69,950		
		6,13,200		**6,13,200**

Dr. **Agent Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Consignment Debtors A/c [Collection from credit Sales: 4,50,000 - 850]	4,49,150	By Bills Receivable A/c [Advance received]	10,000
		By Consignment A/c [Expenses incurred]	5,000
		By Consignment A/c [Commission due – WN:1]	22,500
		By Bank A/c [Final remittance]	4,11,650
	4,49,150		**4,49,150**

Workings Note:

1. Calculation of sales and commission due to consignee:

Let total sales be ₹ X.

∴ Commission = 5% of X = 0.05 X.

Now from Consignee A/c:

Final remittance from consignee	=	Collection from Consignment Debtors	–	B/R received (as advance)	–	Expenses incurred by consignee	–	Commission due

Or, 4,11,650 = (X – ₹ 850) – 10,000 – 5,000 – 0.05 X

Or, 4,11,650 = 0.95X – ₹ 15,850

Or, 0.95X = ₹ 4,27,500

Or, X = ₹ 4,50,000

∴ 0.05X = ₹ 4,50,000 × 5%

= ₹ 22,500

2. Goods sent on consignment:

According to the problem:

Total Sales = Sales made at invoice price + Sales made at invoice price plus 10%

Let, sales made at invoice price = Y

∴ Sales made at invoice price plus 10% = 0.44Y

Now, total sales = ₹ 4,50,000 (Computed in WN:1)

∴ ₹ 4,50,000 = Y + 0.44Y

Or, Y = ₹ 4,50,000/ 1.44 = ₹ 3,12,500 (i.e. Sales made at invoice price)

∴ 0.44Y = ₹ 1,37,500 (i.e. Sales made at invoice price plus 10%)

Now, the invoice price of the goods which is sold at a higher rate [i.e. IP + 10% thereof]

= ₹ 1,37,500 × 100/ 110

= ₹ 1,25,000

∴ Invoice price of goods sold = ₹ 3,12,500 + ₹ 1,25,000

= ₹ 4,37,500

∴ Cost of goods sold = ₹ 4,37,500 × 100/125

= ₹ 3,50,000

∴ Goods sent on consignment (at cost) = Cost of goods sold + unsold stock

= ₹ 3,50,000 + ₹ 50,000

= ₹ 4,00,000

∴ Goods sent on consignment (at invoice price) = Cost of goods sent + Loading @ 25%

= ₹ 4,00,000 + 25% thereof

= ₹ 5,00,000

3. Valuation of unsold stock:

	(₹)
Cost of unsold stock	50,000
Add: Load [₹ 50,000 × 25%]	12,500
∴ IP of unsold stock	62,500
Add: Consignor's proportionate expenses [₹ 2,400 × 62,500/ 5,00,000]	300
Consignee's proportionate non-recurring expenses [₹ 3,200 × 62,500/ 5,00,000]	400
∴ Value of unsold stock	63,200

Accounting for Joint Venture 2.3

Joint venture is a short term business undertaking jointly by two or more persons who share the profits and losses in an agreed ratio. Joint Venture is a temporary form of business organization. There are certain business activities or projects that may involve higher risks; higher investments and even they demand multi-skills. In such cases, an individual person may not be able to muster all resources. Hence two or more people having requisite skill sets come together to form a temporary partnership. This is called a Joint Venture. There is a Memorandum of Undertaking (MOU) signed for this purpose.

Concept

A joint venture (JV) is a business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task. This task can be a new project or any other business activity.

Characteristics of Joint Venture

Following are the salient features of a joint venture form of business:

- There is an agreement between two or more persons.
- Joint venture is made for the specific execution of a business plan/project.
- It is a temporary partnership without the use of a firm name.
- Profit & Share are shared on the same terms and conditions agreed upon. However, in the absence of any agreement, profit & share will be divided equally.
- The terms of the joint ventures are executed on a written agreement signed by all parties involved. This document will state that the parties are willingly assisting each other and will contain other terms as such durations, model of association, liabilities etc.
- Joint ventures are of short duration. Such associations are temporary and comes to an end when the purpose of the agreement is served.

Parties in a Joint Venture

The parties who have agreed to undertake the joint venture are called Co-venturers or Joint venturers. It is exactly same as partnership, with the exception that it is one of the business that is to be terminated after the venture period is over, counting from the time from when it has started. Since it is to be terminated after the period of completion of the venture, the firm name is not generally used. It is a temporary partnership with or without firm name. If there is no agreement concerning the sharing of profits or losses between the co-venturers, it is shared equally by all the parties.

Difference between Joint Venture and Partnership

There are following differences between partnership and joint venture –

- Partnership always carried on with firm's name, but for the joint venture, no such firm's name is required.
- The persons who run the business on partnership are called as partners and the persons who agreed to take the project as joint venture are called as co-venturers.
- Normally, a partnership is constituted for a long period (including various projects), whereas joint venture is formed to complete a specific job/project.
- Partnership is governed under the Partnership Act, 1932, whereas there is no enactment of such kind for the joint ventures. However, as a matter of fact in law, a joint venture is treated as a partnership.
- There is no limit specified for the numbers of co-venturers, but the number of partners is limited to 10 under banking business and 20 for any other trade or business.
- Liability of a partner is unlimited and may extent to his business and personal estate, whereas under joint venture, liabilities of co-venturers are limited to the particular assignment or project agreed upon.

Difference between Joint Venture and Consignment

Major differences between joint venture and consignment may be summarized as –

- **Relationship** – The co-venturers of a Joint venture are the owners of a Joint venture, whereas relationship of a consignor and consignee is of owner and agent.
- **Sharing of Profits** – There is no distribution of profit between a consignor and consignee, consignee only gets commission on sale made by him. On the other hand, the co-venturers of a joint venture share profits as per the agreed profit sharing ratio.
- **Ownership of Goods** – Ownership of the goods remains with the consignor. Consignor transfers only possession to the consignee, but every co-venturer of a joint venture is the co-owner of the goods/project.
- **Contribution of Funds** – Investment is done by the consignor only. On the other hand, funds are contributed by all co-ventures in a certain agreed proportion.
- **Continuity of Business** – In case of a joint venture, there is no continuity of the business once project is completed. On the other hand, if, everything goes smooth, consignment is a continuous process.

Illustration 20

A and B enter into a joint venture sharing profits and losses in the ratio 3:2. A purchased goods costing ₹ 200000. B sold 95% of goods for ₹ 2,50,000. A is entitled to get 1 % commission on purchase and B is entitled to get 5 % commission on sales. A drew a bill on B for an amount equivalent to 80% of original cost of goods. A got it discounted at ₹ 1,50,000. Calculate B's share of profit.

Solution:

Statement showing calculation of profit on joint venture

	(₹)	(₹)
Sales		2,50,000
Closing stock (5% of ₹2,00,000)		10,000
		2,60,000

	(₹)	(₹)
Less: Purchase	2,00,000	
A's commission (₹2,00,000 × 1%)	2,000	
B's commission (₹2,50,000 × 5%)	12,500	
Discount charges (₹2,00,000 × 80%) – ₹1,50,000	10,000	2,24,500
Net Profit		35,500

B's share of Profit (₹ 35,500 × 2/5) = ₹ 14,200.

Accounting of Joint Venture

There are different methods of recording joint venture transactions. They can be broadly classified into two following methods:

I. When separate set of books are maintained

II. When separate set of books are not maintained.

Method I: When Separate Set Books are Maintained for the Joint Venture

As the business duration is short, the books of accounts are not very comprehensive. The basic purpose is to ascertain the profit or loss on account of the joint venture. Generally under this approach, the following accounts are maintained:

(a) Joint Venture account;

(b) Joint Bank account; and

(c) Co-venturers account.

(a) Joint Venture account: It is a Nominal Account, in this account, in the debit side all expenses (paid personally by the co venturers or out of join bank) irrespective of its nature (i.e capital or revenue) are recorded. In the credit side, all sales (to outsiders as well as to the co-venturers) are recorded. It records all transactions related to the activities carried out. The net result of this account will be either profit or loss.

(b) Joint Bank account: To record cash/bank transactions a Joint Bank A/c is maintained. This is basically the cash book of the business. This could take a form of cash book with cash and bank column. It will record, the initial contributions made by each co-venturer, proceeds of sales, expenses and distribution of net balances among co-venturers on dissolution: of the venture. All cash inflows are recorded in the debit side and the outflows are recorded in the credit side. Final settlement of the co venturers are lastly put into this account so that it tallies..

(c) Co-venturers account: Co-Venturer's personal Accounts are maintained to record transaction related to co-venturers. It is like the capital account in the partnership business. Balance in this account refer to the claim of a co venture to / from the business and is settled through the joint bank account.

The accounting entries are normally as follows:

1. Contribution made by the co Ventures

Joint Bank A/c Dr.

To Co-Venturer A/c

2. Expenses paid through Joint Bank Account

    Joint Venture A/c Dr.

    To Joint Bank A/c

3. Expenses paid or goods supplied by the co-venturers from private account

    Joint Venture A/c Dr.

    To Co-Venturer A/c

4. Sale proceeds or collections

    Joint Bank A/c Dr.

    To Joint Venture A/c

5. Collections received by co-venturer

    Co-Venturer A/c Dr.

    To Joint Venture A/c

6. Assets taken over by the co-venturer

    Co-Venturer A/c Dr.

    To Joint Venture A/c

7. Liabilities taken over by the coventurers

    Joint Venture A/c Dr.

    To Co-Venturer A/c

8. Profit on joint venture

    Joint Venture A/c Dr.

    To Co-Venturer A/c

9. Loss on joint venture

    Co-Venturer A/c Dr.

    To Joint Venture A/c

10. Final settlement made to co-venturer

    Co-Venturer A/c Dr.

    To Joint Bank A/c

Illustration 21

Sagar and Pakhi entered into Joint Venture and undertook building construction of P & Co. Ltd., Mumbai for ₹5,00,000. The following information are available for the undertaking business:

- Sagar supplied materials of ₹35,000 and Pakhi paid ₹20,000 his architect fees.
- Sagar contributed ₹1,25,000 and Pakhi contributed ₹75,000 and deposited the same amount in the Joint Bank Account.
- They paid from Joint Bank Account for materials ₹2,80,000 and wages ₹1,20,000.
- On completion of the venture they received contract price as per the terms.
- Pakhi took over the unused materials for ₹15,000.
- Profit/Loss on Joint Venture will be shared by Sagar and Pakhi equally.

Prepare Joint Venture A/c, Co-Venturers A/c and Joint Bank A/c.

Solution:

Dr. **Joint Venture Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Sagar A/c (Material)		35,000	By Joint Bank A/c	5,00,000
To Pakhi A/c:			By Pakhi A/c	
Architect fees		20,000	Unused materials	15,000
To Joint Bank A/c				
Materials	2,80,000			
Wages	1,20,000	4,00,000		
To Profit on Joint Venture				
Sagar	30,000			
Pakhi	30,000	60,000		
		5,15,000		**5,15,000**

Dr. **Co-Venturers Account** **Cr.**

Particulars	Sagar (₹)	Pakhi (₹)	Particulars	Sagar (₹)	Pakhi (₹)
To Joint Venture A/c	-	15,000	By Joint Bank A/c	1,25,000	75,000
To Joint Bank A/c	1,90,000	1,10,000	By Joint Venture A/c	35,000	20,000
			By Joint Venture A/c	30,000	30,000
	1,90,000	**1,25,000**		**1,90,000**	**1,25,000**

Dr. **Joint Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Sagar	1,25,000	By Joint Venture A/c	4,00,000
To Pakhi	75,000	By Sagar	1,90,000
To Joint Venture	5,00,000	By Pakhi	1,10,000
	7,00,000		**7,00,000**

Illustration 22

X and Y entered into a joint venture for purchase and sale of some household items. They agreed to share profits and losses in the ratio of their respective contributions. X contributed ₹10,000 in cash and Y ₹13,000. The whole amount was placed in a Joint Bank A/c. Goods were purchased by X for ₹10,000 and expenses paid by Y amounted to ₹2,000. They also purchased good for ₹15,000 through the Joint Bank A/c. The expenses on purchase and sale of the articles amounted to ₹6,000 (those made by Y). Goods costing ₹20000 were sold for ₹45,000 and the balance were lost by fire. Prepare Joint Venture A/c, Joint Bank A/c and Joint Venturers A/c closing the venture.

Solution:

Dr. **Joint Venture Account** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)
To X (goods)		10,000	By Joint Bank A/c (sales)	45,000
To Y (expenses)		2,000		
To Joint Bank A/c (goods)		15,000		
To Joint Bank A/c (expenses)		4,000		
To Profit on Joint Venture transferred to:				
X (4/7 share)	8,000			
Y (3/7 share)	6,000	14,000		
		45,000		**45,000**

Profit on joint venture is to be divided in proportion to the contributions of X and Y. Their contributions are:

	X's contribution (₹)	Y's contribution (₹)
Amount contributed in cash	10,000	13,000
Expenses paid by Y		2,000
Goods purchased by X	10,000	
	20,000	**15,000**

Thus, profit sharing ratio between X and Y is 20,000 : 15,000 i.e. 4:3 or 4/7 and 3/7 respectively.

Dr. **Joint Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To X	10,000	By Joint Venture A/c (expenses)	4,000
To Y	13,000	By Joint Venture A/c (goods)	15,000
To Joint Venture A/c (sales)	45,000	By X	28,000
		By Y	21,000
	68,000		**68,000**

Dr. **X Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Joint Bank A/c	28,000	By Joint Bank A/c	10,000
		By Joint Venture A/c (goods)	10,000
		By Joint Venture A/c (profit)	8,000
	28,000		**28,000**

Dr. **Y Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Joint Bank A/c	21,000	By Joint Bank A/c	13,000
		By Joint Venture A/c (expenses)	2,000
		By Joint Venture A/c (profit)	6,000
	21,000		**21,000**

Method II: When Separate Set of Books are Not Maintained for the Joint Venture

The co-venturers may decide not to keep separate books of account for the venture if it is for a very short period of time. In this case, all co-venturers will have account for the transactions in their own books. Here no Joint Bank A/c is opened and the co-venturers do not contribute in cash. Goods are supplied by them from out of their stocks and expenses for the venture are also settled the same way.

Each co-venturer will prepare a Joint Venture A/c and the other Co-Venturer's A/c in his books. Naturally, the profit or loss is separately calculated by each co-venturer. Each co-venturer will take into A/c all transactions i.e. done by himself and by his co-venturer as well.

This method is generally applicable when the size of the business is small and co-venturers are operating from distant places.

(a) When each co-venturer keeps record of all transactions

Each co-venturer will prepare a Joint Venture A/c and the other Co-Venturer's A/c in his books. Naturally, the profit or loss is separately calculated by each co-venturer. Each co-venturer will take into account all transactions i.e. done by himself and by his co-venturer as well.

The accounting entries (considering two co-venturers – A and B) are presented as under:

In books of co-venturer A		In books of co-venturer B	
When goods are supplied and expenses paid by A			
Joint Venture A/c	Dr.	Joint Venture A/c	Dr.
To Purchases A/c		To A's A/c	
To Cash / Bank A/c			
When goods are supplied by B and expenses paid by B			
Joint Venture A/c	Dr.	Joint Venture A/c	Dr.
To B's A/c		To Purchases A/c	
		To Cash / Bank A/c	
When advance is given by A to B or bill accepted by A			
B's A/c	Dr.	Cash / Bank A/c	Dr.
To Cash / Bank A/c		B/R A/c	Dr.
To B/P A/c		To A's A/c	

When sale proceeds are received by A	
Cash / Bank A/c Dr. To Joint Venture A/c	A's A/c Dr. To Joint Venture A/c
When sale proceeds are received by B	
B's A/c Dr. To Joint Venture A/c	Cash / Bank A/c Dr. To Joint Venture A/c
For unsold goods taken over by A	
Goods A/c Dr. To Joint Venture A/c	A's A/c Dr. To Joint Venture A/c
For unsold goods taken over by B	
B's A/c Dr. To Joint Venture A/c	Goods A/c Dr. To Joint Venture A/c
For profit on joint venture business	
Joint Venture A/c Dr. To B's A/c To P & L A/c	Joint Venture A/c Dr. To A's A/c To P & L A/c
For loss on joint venture business	
B's A/c Dr. P&L A/c Dr. To Joint Venture A/c	A's A/c Dr. P&L A/c Dr. To Joint Venture A/c

After closure the business of joint venture, the co-venturer who has received surplus cash will remit it to the other co-venturer.

Illustration 23

Anil and Mukesh enter into a venture to take a job for ₹2,40,000. They provide the following information regarding the expenditure incurred by them:

	Anil (₹)	Mukesh (₹)
Materials	68,000	50,000
Cement	13,000	17,000
Wages	-	27,000
Architects fees	10,000	-
License fees	-	5,000
Plant	-	20,000

Plant was valued at ₹10,000 at the end of the contract and Mukesh agreed to take it at that value. Contract amount was received by Anil. You are required to prepare:

(a) Joint Venture Account and Mukesh Account in the books of Anil; and

(b) Joint Venture Account and Anil Account in the books of Mukesh.

Solution:

(a) In the books of Anil

Dr. Joint Venture Account Cr.

Particulars	(₹)	Particulars	(₹)
To Bank A/c:		By Bank A/c : Contract price	2,40,000
Materials	68,000	By Mukesh A/c : Plant taken over	10,000
Cement	13,000		
Architects Fees	10,000		
To Mukesh A/c:			
Materials	50,000		
Cement	17,000		
Wages	27,000		
License Fees	5,000		
Plant	20,000		
To Mukesh A/c: Share of Profit	20,000		
To P/L A/c : Share of Profit	20,000		
	2,50,000		**2,50,000**

Dr. **Mukesh's Account (Co-venturer)** Cr.

Particulars	(₹)	Particulars	(₹)
To Joint Venture A/c	10,000	By Joint venture A/c	1,19,000
To Balance c/d	1,29,000	By Plant A/c	20,000
	1,39,000		**1,39,000**

(b) In the books of Mukesh

Dr. Joint Venture Account Cr.

Particulars	(₹)	Particulars	(₹)
To Anil A/c:		By Anil A/c : Contract Price	2,40,000
Materials	68,000	By Plant A/c : Plant taken over	10,000
Cement	13,000		
Architects Fees	10,000		
To Bank A/c:			
Materials	50,000		
Cement	17,000		

Particulars	(₹)	Particulars	(₹)
Wages	27,000		
License Fees	5,000		
Plant	20,000		
To P/L A/c: Share of Profit	20,000		
To Anil A/c : Share of Profit	20,000		
	2,50,000		**2,50,000**

Dr. **Anil Account (Co-venturer)** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Joint Venture A/c	2,40,000	By Joint Venture A/c	91,000
		By Joint Venture A/c	20,000
		By Balance C/d	1,29,000
	2,40,000		**2,40,000**

Illustration 24

Sahani and Sahu entered into a joint venture to sale 800 bags of food grains. The business risks are to be shared in the ratio of 3:2 between them. Sahani supplied 400 bags at ₹ 800 per bag and paid freight ₹ 8,000 and insurance ₹ 2,000. Sahu sent 400 bags at ₹ 1,000 per bag. He paid ₹ 2,500 as freight, Insurance ₹ 8,000 and sundry expenses as ₹ 500. Sahani paid ₹ 50,000 as advance to Sahu.

They appointed Sandeep as agent for sale of grains. Sandeep sold all bags at ₹ 1,200 per bag. He deducted ₹ 21,000 as his expenses and commission of 5% on sales. He remitted ₹ 6,00,000 by cheque to Sahani and the balance to Sahu by way of a bill of exchange. The co-venturers settled their accounts. Prepare Joint Venture A/c, Sahu's A/c and Sandeep's A/c in the books of Mr. Sahani.

Solution:

Books of Sahani

Dr. **Joint Venture Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Food grains A/c (400 × 800)	3,20,000	By Sandeep A/c - Sales (800 × 1200)	9,60,000
To Bank A/c - freight & insurance	10,000		
To Sahu A/c -food grains (400 × 1000)	4,00,000		
To Sahu A/c - expenses (8,000 + 2,500 + 500)	11,000		
To Sandeep A/c - Expenses	21,000		
To Sandeep A/c - Commission 5%	48,000		

Particulars	(₹)	Particulars	(₹)
To Profit & Loss A/c (3/5th share)	90,000		
To Sahu A/c (2/5th share)	60,000		
	9,60,000		**9,60,000**

Dr. Sahu's Account (Co-venturer) Cr.

Particulars	(₹)	Particulars	(₹)
To Bank A/c - advance	50,000	By Joint Venture A/c - grains	4,00,000
To Sandeep A/c - bill	2,91,000	By Joint Venture A/c - expenses (₹8,000 + 2,500 +500)	11,000
To Bank A/c - final balance	1,30,000	By Joint Venture A/c - profit share	60,000
	4,71,000		**4,71,000**

Dr. Sandeep's Account (Co-venturer) Cr.

Particulars	(₹)	Particulars	(₹)
To Joint Venture A/c - sales	9,60,000	By Joint Venture A/c - expenses	21,000
		By Joint Venture A/c - commission	48,000
		By Bank A/c - cheque received	6,00,000
		By Sahu A/c - Bill	2,91,000
	9,60,000		**9,60,000**

(b) When each co-venturer keeps record of its own transactions (Memorandum method)

As a variation from this system, the co-venturers may decide to maintain a separate 'Memorandum Joint Venture A/c' in joint books. In this transactions made by each co-venturer is shown against their name. This account will reflect the profit or loss of the joint venture. The co-venturers will keep an account called "Joint venture with co-venturer A/c" wherein all transactions done by him only are recorded.

Each co-venturer sends a periodic statement of transactions effected by him for the joint venture to the other co-venturer. On the receipt of the above statement, each co-venturer prepares Memorandum Joint Venture Account for determining the profit/ loss from the joint venture. This account is not a double entry account by nature.

The journal entries which are required to be passed are as follows:

Amount received from co-venturer in cash / cheque or B/R	
Cash/ Bank/ B/R A/c	Dr.
To Joint Venture with Co-Venture's A/c	
Discounting of Bills Receivable	
Bank A/c	Dr.
Joint Venture with Co-venturer …. A/c (Discount)	Dr.
To B/R A/c	

Purchase of goods		
Joint Venture with Co-venturer …. A/c	Dr.	
To Cash/ Bank A/c		
To JV Creditors A/c		
Making payment to Creditors (including discount received)		
JV Creditors A/c	Dr.	
To Cash/ Bank/ B/P A/c		
To Joint Venture with Co-venturer…. A/c		(Discount received)
Goods supplied by co-venturer from own stock		
Joint Venture with Co-venturer…. A/c	Dr.	
To Purchases A/c/ Goods sent to JV A/c		
Payment of expenses		
Joint Venture with Co-venturer…. A/c	Dr.	
To Cash/ Bank A/c		
Sale of goods		
Cash/ Bank/ JV Debtors A/c	Dr.	
To Joint Venture with Co-venturer…. A/c		
Collection from customer (including bad debts discount allowed)		
Cash/ Bank A/c	Dr.	
Joint Venture with Co-venturer…. A/c	Dr.	(Amount of bad debts and discount allowed)
To JV Debtors A/c		
Taking away of unsold goods		
Goods sent to JV A/c	Dr.	
To Joint Venture with Co-venturer…. A/c		
Co-venturer entitled to commission/ salary etc.		
Joint Venture with Co-venturer…. A/c	Dr.	
To Commission/ Salary A/c		
Share of profit on joint venture		
Joint Venture with Co-venturer…. A/c	Dr.	
To Profit & Loss A/c		

Share of loss on joint venture	
Profit & Loss A/c	Dr.
To Joint Venture with Co-venturer…. A/c	
Settlement of balance of JV with …. A/c	
In case of debit balance	
Cash/ Bank A/c	Dr.
To Joint Venture with Co-venturer…. A/c	
In case of credit balance	
Joint Venture with Co-venturer…. A/c	Dr.
To Cash/ Bank A/c	

Points to note: The following transactions are not recorded in the books of either co-venturer:

- Transactions effected by other co-venturer; and
- Transactions not involving cash receipt or cash payment.

Illustration 25

Hari and Om agreed for purchasing and selling furniture in a joint venture, their profit sharing ratio being 3:2 respectively. Hari purchased 10 sofas at ₹ 10,000 per sofa. He sent those sofas to Om for sale after spending ₹ 1,000 per sofa on insurance and transportation. He drew a bill of ₹ 50,000 on Om and this bill was discounted at a discount of ₹ 5,000 after acceptance. Om incurred further expenses of ₹ 2,000 on these sofas before sale. He sold all the sofas @ ₹ 15,000 per sofa, giving 5% commission to the dealer.

Prepare Joint Venture with Om Account in the books of Hari. Also show the Memorandum Joint Venture Account.

Solution:

In the Books of Hari
Memorandum Joint Venture Account

Particulars		(₹)	Particulars	(₹)
To Bank A/c [Purchase] (10,000 × 10)		1,00,000	By Om A/c [Sales] (₹15,000 × 10)	1,50,000
To Bank A/c [Expense] (1,000 × 10)		10,000		
To Discount A/c (Bill discounted)		5,000		
To Om A/c [Expenses]		2,000		
To Om A/c [Commission] (1,50,000 × 5%)		7,500		
To P/L A/c:				
Hari	15,300			
Om	10,200	25,500		
		1,50,000		**1,50,000**

Dr. Joint Venture with Om Account Cr.

Particulars	(₹)	Particulars	(₹)
To Bank A/c [Purchase]	1,00,000	By Bills Receivable A/c	50,000
To Bank A/c [Expense]	10,000	By Balance c/d	80,300
To Discount on Bill A/c	5,000		
To P/L A/c [Share of profit]	15,300		
	1,30,300		**1,30,300**

Illustration 26

Jiban and Mitrik decided to work in joint venture with the following scheme, agreeing to share profits in the ratio of 2/3 and 1/3. They guaranteed the subscription at par of 50 lakhs shares of ₹ 10 each in Rainbow Ltd. and to pay all expenses up to allotment in consideration of Rainbow Ltd. issuing to them 3 lakhs other shares of ₹ 10 each fully paid together with a commission @ 5% in cash which will be taken by Jiban and Mitrik in 3:2.

Co-ventures introduced cash as follows:

		(₹)
Jiban	Stamp charges etc.	1,65,000
	Advertising charges	1,35,000
	Car expenses	1,54,000
	Printing Charges	1,88,000
Mitrik	Rent	1,30,000
	Solicitors' charges	80,000

Application fell short of the 50 lakhs shares by 1,20,000 shares and Mitrik introduced ₹ 12 lakhs for the purchase of those shares.

The guarantee having been fulfilled, Rainbow Ltd. handed over to the venturers 3 lakhs shares and also paid Commission in cash. All their holdings were subsequently sold by the venturer Mitrik receiving ₹ 12,50,000 and Jiban ₹ 25 lakhs.

You are required to prepare:

(a) Memorandum Joint Venture A/c

(b) Joint Venture A/c with Mitrik in the books of Jiban

Solution:

Memorandum Joint Venture Account

Particulars	(₹)	Particulars	(₹)
To Mitrik:		By Jiban	
Cost of shares	12,00,000	Commission (3/5)	15,00,000

To Jiban:		By Mitrik	
Stamp charges	1,65,000	Commission (2/5)	10,00,000
Advertising charges	1,35,000		
Printing charges	1,88,000		
Car expenses	1,54,000		
To Mitrik:		By Jiban	
Rent	1,30,000	Sale proceeds of shares	25,00,000
Solicitor's charges	80,000		
To Profit on venture :		By Mitrik	
Jiban (2/3)	27,98,667	Sale proceeds of shares	12,50,000
Mitrik (1/3)	13,99,333		
	62,50,000		**62,50,000**

In the books of Jiban

Dr. **Joint Venture with Mitrik Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Bank:		By Bank (commission)	15,00,000
(Stamp charges, advertising charges, car expenses and printing charges)	6,42,000		
To Share of profit	27,98,667	By Bank (Sale proceeds of shares)	25,00,000
To Bank (Remittance)	5,59,333		
	40,00,000		**40,00,000**

Conversion of Consignment into Joint Venture

A variation could be that an ongoing consignment arrangement may get converted into a joint venture arrangement. In such a case, normal accounting for consignment business is done till the conversion. Upon the conversion, the balance stock on consignment is transferred to the Joint Venture A/c and from that day onwards, accounting is done on the basis of principles followed for joint venture.

Illustration 27

Daga of Kolkata sent to Lodha of Kanpur goods costing ₹40,000 on consignment at a commission of 5% on gross sales. The packaging and forwarding charges incurred by consignor amounted to ₹4,000. The consignee paid freight and carriage of ₹1,000 at Kanpur. Three-fourth of the goods were sold for ₹48,000. Then the consignee remitted the amount due from him to consignor along with the account sale, but he desired to return the goods still lying unsold with him as he was not agreeable to continue the arrangement of consignment. He was then persuaded to continue on joint venture basis sharing profit or loss as Daga 3/5th and Lodha 2/5th.

Daga then supplied another lot of goods of ₹20,000 and Lodha sold out all the goods in his hand for ₹50,000 (gross). Daga paid expenses ₹2,000 and Lodha ₹1,700 for the second lot of goods.

Show necessary ledger account in the books of both parties. No final settlement of balance due is yet made.

Solution:

Books of Daga

Dr. **Consignment to Lodha Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Goods Sent on Consignment A/c	40,000	By Lodha's A/c (sales)	48,000
To Bank A/c (packing & dispatching)	4,000	By Joint Venture with Lodha A/c	11,250
To Lodha's A/c :		(stock transferred on conversion to JV)	
Freight & Carriage	1,000		
Commission	2,400		
To P & L A/c	11,850		
	59,250		**59,250**

Dr. **Lodha's Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Consignment A/c - sales	48,000	By Consignment A/c- expenses	1,000
		By Consignment A/c - commission	2,400
		By Cash A/c	44,600
	48,000		**48,000**

Dr. **Joint Venture with Lodha Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Consignment to Lodha A/c	11,250	By Balance c/d	42,280
To Purchase A/c	20,000		
To Bank A/c - expenses	2,000		
To P & L A/c (profit)	9,030		
	42,280		**42,280**

Books of Lodha

Dr. **Daga's Account (as consignor)** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Cash A/c- expenses	1,000	By Bank A/c – sales	48,000
To Commission A/c	2,400		
To Bank A/c - remittance	44,600		
	48,000		**48,000**

Dr. **Joint Venture with Daga Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Cash A/c - expenses	1,700	By Bank A/c – sales	50,000
To P & L A/c (profit)	6,020		
To Balance c/d	42,280		
	50,000		**50,000**

Working note:

Memorandum Joint Venture Account

Particulars	(₹)	Particulars	(₹)
To Daga A/c - goods	11,250	By Lodha A/c – sales	50,000
To Daga A/c- goods	20,000		
To Daga A/c- expenses	2,000		
To Lodha A/c- expenses	1,700		
To Net Profit :			
Daga 3/5th Share	9,030		
Lodha 2/5th share	6,020		
	50,000		**50,000**

Joint Ventures Running for More than One Accounting Period

If a joint venture runs for more than one accounting period, it poses a special problem of calculation of the closing stock. The stock should be valued on the basis of basic cost plus proportionate non-recurring expenses and it should be shown in the memorandum joint venture account on the credit side at the end of the year and on the debit side of the memorandum joint venture account of the next year. The other accounts should be made in the usual manner. However, if the co-ventures are interested in an interim settlement at the end of the first year, they should bring in their proportionate share in the value of the closing stock in their respective 'Joint Venture with Co- Venturer Account' and finally settle their account. The share of stock should be carried forward and shown on the debit side of the 'Joint Venture with Co-venturer Account.

Solved Case

1. Hyder is a producer of sandalwood miniature handicraft items having his business at the city of Mysore, Karnataka. He has gathered that even though Mysore is a popular tourist destination in South India, Agra happens to be the most popular destination, especially for foreign tourists in India. He was interested in selling his handcrafted items in Agra, but lacked the resources to open a full-fledged store in Agra. So, the only viable option available to him was to appoint an agent who would sell the handicraft items on his behalf for a commission. With this objective in mind, he searched for a reliable agent in Agra and got the reference of a popular business agent in Agra named Jalal from Yasin, one of his long-term business partner. After a few formal meeting and negotiations, Jalal was officially appointed as Hyder's agent who would receive goods from Hyder on consignment basis and sell them to customers in Agra.

   On April 1, 2022, Hyder sent goods to Jalal of Agra. However, Hyder lost all the documents that recorded the details of the goods sent on consignment. The only information available from his office is that the forwarding expenses incurred by of him for sending the goods to Agra was ₹ 12,000. Hyder gathered the following information from Jalal in relation to this consignment:

   - He incurred expenses to the tune of ₹ 25,000 out of which a sum of ₹ 9,000 is recurring in nature.
   - The Jalal had remitted the balance due from him through Bank Draft after deducting the expenses, 5% commission on gross sales, bad debts ₹ 4,250 and a Bills payable accepted by him for ₹ 50,000.
   - The value of unsold stock at original cost lying with Jalal as on March 31, 2023 amounted to ₹ 2,50,000.
   - Jalal sent an Account Sales reflecting the total sales effected by him during 2022-23 of ₹ 22,50,000. This included ₹ 15,62,500 for sales made at invoice price which is cost plus 25% and the balance at 10% above the invoice price.

i. What is the amount of goods sent on consignment by Hyder to Jalal?

ii. Ascertain the amount of profit or loss made by Hyder out of this consignment to Agra. Show by drafting the relevant ledger account.

iii. Determine the amount of final remittance made by Jalal to Hyder by drafting Jalal Account in the books of Hyder.

Solution:

i. Calculation of Goods Sent on Consignment by Hyder to Jalal

Particulars	(₹)
Total sales	22,50,000
Less: Sales made at invoice price	15,62,500
Sales made at invoice price plus 10%	6,87,500
Total sales at invoice price [₹ 15,62,500 + (₹ 6,87,500 × 100/110)]	21,87,500
Less: Loading on above [₹ 21,87,500 × 25/125]	4,37,500
Cost of Goods sold	17,50,000
Add: Unsold stock	2,50,000
Cost of goods sent on consignment	20,00,000
Add: Loading @ 25%	5,00,000
Goods sent on consignment [at IP]	25,00,000

ii. Profit on consignment is ₹3,49,750.

Dr. **Consignment to Agra Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Goods sent on Consignment A/c		25,00,000	By Consignment Debtors A/c [Sale]	22,50,000
To Bank A/c [Expenses incurred]			By Goods sent on Consignment A/c	5,00,000
- Forwarding Expenses		12,000	[Load on goods sent]	
To Consignee A/c [Expenses paid by consignee]			By Consignment Stock A/c [WN]	3,16,000
- Non-recurring Expense				
[25,000 – 9,000]	16,000			
- Recurring Expenses	9,000	25,000		
To Consignee A/c				
[Commission due: ₹ 22,50,000 × 5%]		1,12,500		
To Consignment Debtors A/c [Bad debt]		4,250		
To Stock Reserve A/c		62,500		
[Load on unsold stock – WN]				
To P/L A/c [Profit on consignment transferred] (Bal. fig.)		3,49,750		
		30,66,000		**30,66,000**

iii. Amount of final remittance made by Jalal to Hyder is - ₹20,58,250.

Jalal Account

Particulars	(₹)	Particulars	(₹)
To Consignment Debtors A/c [Collection from debtors: 22,50,000 – 4,250]	22,45,750	By Bills Receivable A/c	50,000
		By Consignment A/c [Expenses incurred]	25,000
		By Consignment A/c [Commission due]	1,12,500
		By Bank A/c [Final remittance – Bal. Fig.]	20,58,250
	22,45,750		22,45,750

Working Note:

Statement showing valuation of Unsold Stock:

Particulars	(₹)
Original cost of unsold stock (given)	2,50,000
Add: Loading [₹ 50,000 × 25%]	62,500
	3,12,500
Add: Proportionate expenses of consignor [₹ 12,000 × 3,12,500/25,00,000]	1,500
Proportionate non-recurring expenses paid by consignee [₹ 16,000 × 3,12,500 / 25,00,000]	2000
Value of unsold stock	3,16,000

EXERCISE

A. Theoretical Questions:

Multiple Choice Questions

1. Which class of account is Consignment Account?
   (a) Personal Account
   (b) Real Account
   (c) Representative Personal Account
   (d) Nominal Account

2. Memorandum Joint Venture Account is prepared _______.
   (a) for determining the amount due to co-venturer
   (b) for determining the amount due from co-venturer
   (c) for ascertaining the profit/ loss on venture
   (d) None of the above

3. On dishonor of a bill of exchange that has been discounted, noting charges are initially paid by _______.
   (a) Bank
   (b) Drawer
   (c) Drawee
   (d) Acceptor

4. The share of profit of a co-venturer maintaining only her/ his own transactions is _______.
   (a) Debited to Joint Venture Account
   (b) Debited to other co-venturer's personal account
   (c) Debited to Profit & Loss Account
   (d) None of the above

5. If any stock is taken by a co-venturer, it will be treated as _______.
   (a) an income of the joint venture.
   (b) an expense of the joint venture.
   (c) to be ignored from joint venture.
   (d) it will be treated in the personal books of the co-venturer.

6. The balance in consignment account shows _______.
   (a) Amount receivable from consignee
   (b) Amount payable to consignee
   (c) Profit/ loss on consignment
   (d) Closing stock with consignee

7. Shyam and Ramya are entered in the business of buy and sale of food grain for a period of one year and sharing the profit in the ratio of 2 :4 , this agreement is a:
   (a) Partnership
   (b) Consignment
   (c) Joint-venture
   (d) Lease
8. Memorandum Joint Venture Account is prepared when
   (a) the separate set of books is maintained for Joint Venture.
   (b) the each Co-venturer keeps records of all transactions.
   (c) the each Co-venturer keeps records of their own transactions only.
   (d) All of the above cases
9. Which of the following commission is allowed by the consignor to the consignee to encourage the consignee for putting-up hard work in introducing new product in the market?
   (a) Del-credere Commission
   (b) Over-riding Commission
   (c) Hard work Commission
   (d) Ordinary Commission
10. If Kaveri's acceptance which was endorsed by us in favour of Saleem is dishonoured, then the amount will be debited in our books to:
   (a) Saleem
   (b) Kaveri
   (c) Bills Receivable Account
   (d) None of the above

Answer:

1	**d**	**2**	**c**	**3**	**a**	**4**	**b**	**5**	**a**
6	**c**	**7**	**c**	**8**	**c**	**9**	**b**	**10**	**b**

- **State True or False:**

1. A joint venture has a definite life.
2. An Inland Bill is payable only in one country and not in any other foreign country.
3. Consignment Debtors Account is always maintained in the books of the consignor.
4. Proforma Invoice is a document sent by the consignor to the consignee.
5. Discount at the time of retirement of a bill of exchange is a gain for the drawer.

Answer:

1	**True**	**2**	**True**	**3**	**False**	**4**	**True**	**5**	**False**

Fill in the Blanks

1. A bill of exchange drawn on April 12, 2022 as payable 3 months after sight was accepted on April 13, 2022. The bill's date of maturity will be _________.
2. When separate sets of books are maintained for a joint venture, goods are taken-over by a co-venturer is credited to ________ account.
3. Partners in a joint venture business are called ________.
4. The party who sends the goods on consignment basis is referred to as the __________.
5. Commission is due to the consignee from the consignor for rendering of regular activities associated with the consignment business is called __________ commission.
6. If cash sales are ₹25,000, credit sales are ₹75,000 and consignee's del credre commission is 10%, the amount of del creder commission will be _____________.
7. _____________ expenses are included while computing the value of stock on consignment.
8. At the time of goods sent to consignee, the proforma invoice is prepared by_____________.
9. The relation between Consignee and Consignor is that of _____________.
10. _____________ can be made payable to the bearer.

Answer:

1	**July 16, 2022**	2	**Joint Venture**
3	**Co-venturers**	4	**Consignor**
5	**Ordinary**	6	**₹10,000**
7	**Non-recurring**	8	**Consignor**
9	**Agent and Principal**	10	**Bills Receivable**

Short Essay Type Questions

1. State any four essential elements of bill of exchange.
2. What is meant by Retirement of Bill?
3. State any four points of difference between consignment and ordinary sales.
4. What is meant by Account Sales in the context of consignment business?
5. Mention any four features of joint venture.

Essay Type Questions

1. Explain the procedure of calculating the date of maturity of a bill of exchange? Give example.
2. What do you mean by Accommodation Bill? Differentiate between Trade Bill and Accommodation Bill.
3. What is consignment? Discuss its salient features.
4. Distinguish between Joint Venture and Partnership.
5. Discuss the Memorandum method of accounting for joint venture transactions.

B. Numerical Questions

Multiple Choice Questions

1. X draws a bill on Y for ₹ 1,80,000 for mutual accommodation in the ratio of 2:1. X got it discounted for ₹ 1,69,200 and remitted 1/3rd of the proceeds to Y. How much money should be remitted by X to Y at the time of maturity so as to enable Y to honour the bill?
   (a) ₹ 1,20,000
   (b) ₹ 1,15,200
   (c) ₹ 1,16,800
   (d) ₹ 1,20,400
2. Raju draws a bill on Sampat on 25th October, 2023 for 90 days, the maturity date of the bill will be
   (a) 27th January, 2024
   (b) 26th January, 2024
   (c) 25th January, 2024
   (d) 28th January, 2024
3. P and Q enter into a joint venture sharing profit and losses in the ratio of 3:2. P purchased goods costing ₹ 2,00,000. Q sold 95% goods for ₹ 2,50,000. P is entitled to get 1% commission on purchase and Q is entitled to get 5% commission on sales. P drew a bill on Q for an amount equivalent to 80% of original cost of goods. P got it discounted at ₹ 1,50,000. What is P's share of profit?
   (a) ₹ 15,300
   (b) ₹ 21,300
   (c) ₹ 18,900
   (d) None of the above

Answer:

1	**a**	**2**	**d**	**3**	**b**

Comprehensive Numerical Problems

1. On 1.1.2023, X sold goods to Y valuing ₹ 30,000. On 4.1.2023 X received from Y a cheque of ₹ 10,000 and drew a bill payable 3 months after date for the balance. On the same date, X endorsed the accepted bill to Z for full settlement of a debt of ₹ 21,000. On the due date, the bill was dishonoured and Y having become insolvent, met on 12.4.2023, 80% of his acceptance as full and final dividend. You are required to pass journal entries to record the above transactions.

2. On 1st July, 2023 A drew a bill for ₹ 8,00,000 for 3 months on B for mutual accommodation. He accepts the bill of exchange. He purchased goods worth ₹ 1,81,000 from C on the same date. A endorsed B's acceptance to C in full settlement. On 1st September 2023, C purchased goods worth ₹1,90,000 from B. C endorsed the bill of exchange received from A to B and paid ₹9,000 in full settlement of the amount due to B.

   On 1st October 2023 B purchased Goods worth ₹ 1,00,000 from A. He paid the amount due to A by Cheque.

   Pass necessary journal entries in the books of B.

3. Hardik consigned to Jamal of Jabalpur 400 boxes of goods at a cost of ₹5,000 per box and incured the following expenses in connection with the same – Carriage ₹9,400, Freight ₹34,800 and Insurance ₹1,25,000. On arrival of the boxes at Jabalpur, Jamal paid Clearing charges ₹31,200, Cartage ₹9,600 and Godown rent ₹2,000. On arrival of the goods at the godown, 60 boxes were found to be damaged and a sum of ₹3,00,000 was realized from the insurance company by way of compensation. 240 of the remaining boxes were sold at a total price of ₹22,00,000.

   Jamal is entitled to an ordinary commission of 5% and 2% del-credere commission on sales in addition to reimbursement of expenses incurred. He sent to Hardik an Account Sales together with a bank draft for the balance due to Hardik.

   You are required to prepare Consignment Account in the books of Hardik and pass journal entries in the books of Jamal.

   [**Answer:** In the books of Hardik, Profit on Consignment ₹7,13,680; In the books of Jamal, Final Balance paid to Hardik ₹20,03,200]

4. Azad and Arjun entered into a joint venture and opened a fast food shop during Durga Puja festival at Maddox Square in Kolkata. Their profit sharing ratio is 1:1. Azad delivers stock of ₹50,000. He also paid carriage charges amounting to ₹2,500. Arjun incurred expenses on carriage and electricity charges for ₹6,500 and receives cash from sales ₹30,000. Arjun took over stock at an agreed value of ₹10,000 for his personal use. At the end of the venture, Azad took over the remaining stock which was valued at ₹11,000.

   You are required to prepare Memorandum Joint Venture Account and also other necessary ledger accounts in the books of Azad and Arjun.

Unsolved Case

Mr. Sudheer Kapoor is an executive in a multi-national financial consultancy firm and is presently working at Pune, Maharashtra. He belongs to a well-to-do family who were erstwhile landlords at Hisar district of Haryana. He inherited large plots of land as a result of his family lineage. During the end of 2023, Mr. Kapoor decided to develop a part of the inherited land and for this purpose entered into a joint venture with Mr. Harmeet Singh of Ludhiana to develop some building sites and sell them. They agreed amongst themselves that the operating results will be shared between them in 4:5 ratio. It was further agreed between them that any cash investment made by the co-venturers in the venture would entitle them to interest at 10% p.a.

Mr. Kapoor decided to use five-bigha (1 bigha = 20 katthas) plot for this purpose and it was purchased by the venture for ₹ 60 lakhs. Mr. Kapoor and Mr. Singh approached Bank of Baroda, a nationalized book for financing the venture. The bank, after due consideration of the case, agreed to finance them to the extent of 80% of the cost at 16% rate of interest p.a. The buying agreements were finalized by the advocate of Mr. Kapoor and Mr. Singh on January 1, 2024 and the payment was made on the same day. Mr. Singh agreed to pay the balance of the purchase consideration and registration expenses amounting to ₹ 48 lakhs was also met by him.

Mr. Kapoor approached Mrs. Kulwinder Kaur, his school friend, who is a practicing architect. Mrs. Kaur provided the following detailed plan relating to the plot:

- 10% of the total area is to be left for roads, parks etc.;
- Three types of buildings were to be developed – Regular (1.5 katthas), Deluxe (2.5 katthas) and Executive (3 katthas).
- 12 buildings of each type i.e. Regular, Deluxe and Executive will be developed;
- The sale price of each type were determined as follows:
- Regular – Cost plus 50% premium, Deluxe – Cost plus 40% premium, and Executive – Cost plus 25% premium,
- The balance area will be taken equally by the co-venturers at cost.

Advertisements of the project were given in local newspapers and other media on February 1, 2021 and the following expenses took place in relation to this project:

- Levelling and ground preparation expenses ₹ 12,000 per kattha;
- Engineering expenses ₹ 28,000 per kattha
- Construction expenses ₹ 22,000 per kattha;
- Municipal taxes ₹ 3,000 per kattha;
- Advertisement expenses incurred ₹ 15 lakhs;
- Office and administrative expenses ₹ 6,50,000;
- Site expenses ₹ 2,70,000;
- Sundry expenses ₹ 80,000.

Mr. Kapoor met all these afore-mentioned expenses. Moreover, it was Mr. Kapoor who took the sole responsibility of the sale of the plots for which he was entitled to receive 8% of the sale proceeds. The entire business was over by December 31, 2023 and all the remaining transactions were settled on that date. You, being a professional accountant and colleague-cum-friend of Mr. Kapoor have been approached by him to do the accounts of this joint venture.

1. What is the cost per kattha of land?
2. Calculate the sale price of each type of building.
3. Calculate the amount of interest due to each of the co-venturers.
4. Determine how much profit, if any, has been earned by Mr. Kapoor and Mr. Singh.
5. Ascertain the amount that had to be transacted for the final settlement of the accounts.

SECTION-C

Preparation of Financial Statements

Preparation of Final Accounts of Commercial Organisations, Not-for-Profit Organisations and from Incomplete Records

3

This Module Includes

Preparation of Final Accounts of Commercial Organisations, Not-for-Profit Organisations and from Incomplete Records

SLOB Mapped against the Module

To develop application-oriented knowledge to prepare financial statements of profit seeking and not-for-profit entities and from incomplete records. (CMLO 3a and 4c)

Module Learning Objectives:

After studying this module, the students will be able to:

- Understand the different components of financial statements of non-commercial organizations, and learn thoroughly the drafting of the Income Statement and Balance Sheet;
- Prepare financial statements of non-profit making organization, specifically drafting of Receipts and Payments Account, Income and Expenditure Account and Balance Sheet;
- Also understand the process of preparingthe financial statements form incomplete records;

Preparation of Financial Statements of Commercial Organisations

3.1

In addition to recording keeping, a major objective of accounting is determination of operating results and disclosure of the financial position. The determination of operating result of commercial form of organisations happen to be the ascertainment of the profit earned during a period or the amount of loss suffered. This requires the preparation of specific statements which are technically referred to as Financial Statements.

The financial statements of a non-corporate commercial organisation broadly includes the Income Statement, Balance Sheet, and Cash Flow Statement. However, discussion on Cash Flow Statement is beyond the scope of this chapter. Thus, traditionally the term 'Financial Statements' includes only three basic statements – Income Statement and Balance Sheet.

3.1.1 Income Statement

The term 'Income Statements' is a generic term which refers to those components of financial states which are associated with determination of operating result i.e. ascertainment or profit earned or loss suffered. For non-corporate commercial organisations (i.e. proprietorship businesses, partnership firms etc.) the income statements include Trading Account, Profit & Loss Account (P/L A/c) and Profit & Loss Appropriation Account. To be specific, the income statements of different forms of business organisation are as under:

Form of Non-Corporate Commercial Organisation	Components of Income Statement
Proprietary organisation	Trading A/c, P/L A/c
Partnership organisation	Trading A/c, P/L A/c, P/L Appropriation A/c

The components of income statements of non-corporate commercial organisations are discussed hereunder:

1. **Trading Account:** This is the first income statement prepared by a non-corporate trading business entity. It is prepared to determine the gross operating results (i.e. Gross Profit or Gross Loss). Its principle involves matching of the Cost of Goods Sold (COGS) of an accounting period against the corresponding Sales. It considers only the direct costs and direct income (i.e. Sales) for determination of Gross Profit/ Gross Loss. It is a nominal account, and is closed by transfer of the Gross Profit/ Gross Loss to the Profit and Loss A/c. The following items will appear in the debit side of the Trading Account:

    (i) **Opening Stock:** In case of trading concern, the opening stock means the finished goods only. The amount of opening stock should be taken from Trial Balance.

    (ii) **Purchases:** The amount of purchases made during the year. Purchases include cash as well as credit purchase. The deductions can be made from purchases, such as, purchase return, goods withdrawn by the proprietor, goods distributed as free sample etc.

(iii) Other Direct expenses: It means all those expenses which are incurred from the time of purchases to making the goods in suitable condition. This expenses includes freight inward, octroi, wages etc.

(iv) Gross profit: If the credit side of Trading A/c is greater than debit side of Trading A/c gross profit will arise.

The following items will appear in the credit side of Trading Account:

(i) Sales Revenue: The sales revenue denotes income earned from the main business activity or activities. The income is earned when goods or services are sold to customers. If there is any return, it should be deducted from the sales value. As per the accrual concept, income should be recognized as soon as it is accrued and not necessarily only when the cash is paid for.

(ii) Closing Stocks/Inventries: In case of trading business, there will be closing stocks of finished goods only. According to convention of conservatism, stock is valued at cost or net realizable value whichever is lower.

(iii) Gross Loss: When debit side of trading account is greater than credit side of trading account, gross loss will appear.

The proforma of Trading Account is as follows:

Trading Account

Dr. **for the year ended ….** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Opening Stock		By Sales	
To Purchases		Less: Sales Returns	
Less: Purchase returns		By Closing Stock	
To Wages		By Profit and Loss A/c	
To Other Direct expenses		(Gross Loss transferred)	
To Profit and Loss A/c			
(Gross Profit transferred)			

2. Profit & Loss Account: The second income statement is the Profit & Loss Account. It is drafted after the determination of Gross operating result i.e. Gross Profit or Gross Loss. This account determines the Net Profit or Net Loss of an organisation for a particular accounting period. It is prepared by charging the indirect expenses and losses against the Gross Profit and other indirect incomes. It is closed by transfer of the Net Profit or Net Loss to the Capital Account(s) of the proprietor or partners.

The following items will appear in the debit side of the Profit & Loss A/c:

(i) Cost of Sales: This term refers to the cost of goods sold. The goods could be manufactured and sold or can be directly identified with goods.

(ii) Other Expenses: All expenses which are not directly related to main business activity will be reflected in the P & L component. These are mainly the Administrative, Selling and distribution expenses. Examples are salary to office staff, salesmen commission, insurance, legal charges, audit fees, advertising, free samples, bad debts etc. It will also include items like loss on sale of fixed assets, interest and provisions. Students should be careful to include accrued expenses as well.

(iii) Abnormal Losses: All abnormal losses are charged against Profit & Loss Account. It includes stock destroyed by fire, goods lost in transit etc.

The following items will appear in the credit side of Profit & Loss A/c:

(i) Revenue Incomes: These incomes arise in the ordinary course of business, which includes commission received, discount received etc.

(ii) Other Incomes: The business will generate incomes other than from its main activity. These are purely incidental. It will include items like interest received, dividend received, etc .The end result of one component of the P & L A/c is transferred over to the next component and the net result will be transferred to the balance sheet as addition in owners' equity. The profits actually belong to owners of business. In case of company organizations, where ownership is widely distributed, the profit figure is separately shown in balance sheet.

The proforma of Profit & Loss Account is as follows:

Profit & Loss Account

Dr. **for the year ended ….** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Trading A/c		By Trading A/c	
(Gross Loss transferred)		(Gross Profit transferred)	
To Administrative expenses		By Other Income	
To Office salaries		By Interest received	
To Communication		By Commission received	
To Travel & Conveyance		By Profit on sale of assets	
To Office rent		By Rent received	
To Advertising		By Capital A/c	
To Audit fees		(Net loss transferred)	
To Insurance			
To Repairs & maintenance			
To Selling & Distribution expenses			
To Bad debts			
To Salesmen commission			
To Interest on loans			
To Depreciation and Amortisation			
To Financial expenses			
To Bank charges			
To Loss on sale of assets			
To Capital A/c			
(Net profit transferred)			

3. **Profit & Loss Appropriation Account:** This component of income statement shows the appropriation of the net profit among the partners of a partnership business. Sole proprietorship businesses are not required to prepare the P/L Appropriation account. The net profit may be used by the business to distribute dividends, to create reserves etc. In order to show these adjustments, a P & L Appropriation A/c is maintained. Distribution of profits is only appropriation and does not mean expenses. After passing such distribution entries, the remaining surplus is added in owner's equity.

   The format of P & L Appropriation A/c is given below

Profit and Loss Appropriation Account

Dr. **for the year ended......** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Proposed dividend To Reserves (Transfer) To Capital A/c		By P/L A/c (Net profit transferred)	

The above Accounts are prepared to know the operating results in case of a Trading concern who purchases goods and sells it. But some proprietorship and partnerships organizations are there who produce goods and sells in the market. In that case they prepare Manufacturing Accounts in addition to Trading and Profit Loss Account. This account is an extension of Trading Account. The format of Manufacturing and Trading Accounts are given below.

Manufacturing Account

Dr. **for the year ended ….** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Opening Stock of Raw Materials and WIP To Purchase of Raw Materials Less: Purchase returns To Wages To Other Direct expenses		By Closing Stock of Raw Materials and WIP By Cost of Goods manufactured transferred to Trading Account	

Trading Account

Dr. **for the year ended ….** **Cr.**

Particulars	(₹)	Particulars	(₹)
To opening stock of Finished goods To Cost of goods manufactured (transferred from Manufacturing Account)		By Sales Less: Sales Returns By Closing stock of Finished Goods By Profit and Loss A/c	

Particulars	(₹)	Particulars	(₹)
To Profit and Loss A/c (Gross Profit transferred)		(Gross Loss transferred)	

3.1.2 Balance Sheet

Balance Sheet is the financial statement that is prepared to show the financial position of the organisation on a specific date. It is prepared after drafting Income Statements i.e. Trading Account and P/L Account. It reflects the assets and liabilities of a concern at a particular point of time. The Balance Sheet may be drafted either in Horizontal format or in Vertical format. In the horizontal format, the Liabilities appear on the left-hand side, while the Assets appear on the right-hand side of the Balance Sheet. This is the traditional format followed by non-corporate commercial organisations. In the vertical format, the liabilities and assets appear in a top-down order.

The various items should appear in the Balance Sheet in a specific order which is known as Marshalling. When the assets which are most permanent in nature appear at the top, and the current assets appear below them, and for liabilities, the capital and long-term liabilities appear above the short-term liabilities, it is known as marshalling under Rigidity Order or Permanence Order. When the reverse ordering is followed as regards the assets and liabilities, it is known as marshalling under Liquidity Preference Order or Realisability Order.

Preparation of Final Accounts

Final accounts of an organisation are prepared from the ledger balances. Each of the ledger accounts should be posted to any of the income statements (viz. Manufacturing A/c, Trading A/c or Profit & Loss A/c) or the Balance Sheet depending on its nature.

In addition to these, some adjustments may be required to be made for honouring the accounting principles, or rectifying some of the existing errors in the books, for which either adjustment entries or rectification entries may be required to be passed. Effect of these adjustments/ rectifications would be 'double' and get reflected either in the income statements and/ or Balance Sheet.

Some of the important adjustments include:

- Closing stock
- Outstanding expenses or Accrued expenses
- Prepaid expenses
- Accrued income
- Income received in advance
- Goods sold on approval basis
- Goods distributed as free samples
- Goods withdrawn by proprietor/ partner for personal use
- Depreciation and Amortisation
- Bad debts

- Provision for doubtful debts
- Provision for discount on debtors
- Abnormal loss of stock
- Interest on capital
- Interest on drawings etc.
- Asset recorded as expenses or vice versa

The different components of financial statements are prepared in a sequential order, as follows:

Firstly, the Trading Account is prepared and its balance (reflecting Gross Profit or Gross Loss) gets transferred to Profit & Loss Account.

Thereafter, the Profit & Loss Account is prepared and its balance (reflecting Net Profit or Net Loss) is transferred to Capital Account (after drafting Profit & Loss Appropriation Account in case of partnership firms).

Finally, the Balance Sheet is drafted considering a ledger balances reflecting assets, liabilities and capital.

Illustration 1

Following are the ledger balances presented by M/s. P. Sen as on 31st March 2023:

Particulars	(₹)	Particulars	(₹)
Stock (1.4.2022)	10,000	Sales	3,00,000
Purchase	1,60,000	Return Inward	16,000
Carriage Inwards	10,000	Return Outward	10,000
Wages	30,000	Royalty on Production	6,000
Freight	8,000	Gas and Fuel	2,000

Additional Information:

(1) Stock on 31.3.2023: (i) Market Price ₹ 24,000; (ii) Cost Price ₹ 20,000;

(2) Stock valued ₹ 10,000 were destroyed by fire and insurance company admitted the claim to the extent of ₹ 6,000.

(3) Goods purchased for ₹ 6,000 on 29th March, 2023, but still lying in-transit, not at all recorded in the books.

(4) Goods taken for the proprietor for his own use for ₹ 3,000.

(5) Outstanding wages amounted to ₹ 4,000.

(6) Freight was paid in advance for ₹ 1,000.

Solution:

M/s P. Sen
Trading Account
Dr. **for the year ended 31st March, 2023.** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		10,000	By Sales	3,00,000	
To Purchase	1,60,000		Less: Return Inward	16,000	2,84,000
Less: Return Outward	10,000				
	1,50,000		By Closing Stock		20,000
Less: Goods taken by Proprietor	3,000		By Stock Destroyed (Abnormal Loss)		10,000
	1,47,000				
Add: Goods-in-transit	6,000	1,53,000	By Goods-in-Transit		6,000
To Wages	30,000				
Add: Outstanding	4,000	34,000			
To Carriage Inwards		10,000			
To Freight	8,000				
Less: Prepaid	1,000	7,000			
To Royalty on production		6,000			
To Gas & fuel		2,000			
To Profit & Loss A/c		98,000			
(Gross profit transferred)					
		3,20,000			**3,20,000**

Note: (a) Stock should be valued as per cost price or net realizable value whichever is lower.

(b) The claim which was admitted by insurance company and the loss of stock, will not appear in Trading Account.

Illustration 2

From the following particulars presented by Mr. Shankar for the year ended 31st March 2023, prepare Profit and Loss Account after taking into consideration the given details:

Gross Profit ₹ 1,00,000, Rent ₹ 22,000; Salaries, ₹ 10,000; Commission (Cr.) ₹ 12,000; Insurance ₹ 8,000; Interest (Cr.) ₹ 6,000; Bad Debts ₹ 2,000; Provision for Bad Debts (1.4.2021) ₹ 4,000; Sundry Debtors ₹ 40,000; Discount

Received ₹ 2,000; Plant & Machinery ₹ 80,000.

Adjustments:

(a) Outstanding salaries amounted to ₹ 4,000;

(b) Rent paid for 11 months;

(c) Interest due but not received amounted to ₹ 2,000

(d) Prepaid Insurance amounted to ₹ 2,000;

(e) Depreciate Plant and Machinery by 10% p.a.

(f) Further Bad Debts amounted to ₹ 2,000 and make a provision for Bad Debts @5% on Sundry Debtors.

(g) Commissions received in advance amounted to ₹ 2,000.

Solution:

Mr. Shankar

Profit and Loss Account

Dr. for the year ended 31st March 2023 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Rent	22,000		By Trading A/c.		1,00,000
Add: Outstanding	2,000	24,000	-Gross Profit		
” Salaries	10,000		” Commission	12,000	
Add: Outstanding	4,000	14,000	Less: Received in advance	2,000	10,000
” Insurance	8,000		” Interest	6,000	
Less: Prepaid	2,000	6,000	Add: Accrued Interest	2,000	8,000
” Bad Debts	2,000				
Add: further Bad Debts	2,000	4,000	” Discount received		2,000
” Depreciation on Plant & Machinery @10% on ₹80,000		8,000	” Provisions for Bad Debts	4,000	
” Capital A/c (Net Profit Transferred)		66,100	Less: New Provision @ 5% on (₹40,000 – ₹2,000)	1,900	2,100

		1,22,100			**1,22,100**

Illustration 3

X,Y and Z are three Partners sharing profit and Losses equally. Their capital as on 01.04.2022 were: X ₹ 80,000 ; Y ₹ 60,000 and Z ₹ 50,000.

They mutually agreed on the following points (as per partnership deed):

(a) Interest on capital to be allowed @ 5% P.a.

(b) X to be received a salary @ ₹ 500 p.m.

(c) Y to be received a commission @ 4% on net profit after charging such commission.

(d) After charging all other items 10% of the net profit to be transferred General Reserve.

Profit from Profit and Loss Account amounted to ₹ 66,720.

Prepare a Profit and Loss Appropriation Account for the year ended 31st March, 2023.

Solution:

Profit & Loss Appropriation A/c

Dr. **for the year ended 31st March, 2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Interest on Capital:			By Profit and Loss A/c		66,720
X	4,000		(Net profit transferred)		
Y	3,000				
Z	2,500	9,500			
" Salaries					
X : (₹ 500 × 12)		6,000			
" Commission		1970			
Y [WN: 1]					
" General Reserve [WN: 2]		4,925			
" Partners' Capital A/c:					
(Net Divisible Profit)					
X	14,775				
Y	14,775				
Z	14,775	44,325			
		66,720			**66,720**

Working Note:

1. Net Profit before charging Y's Commission = ₹ [66,720 – (9,500 + 6,000)] = ₹ 51,220

   Less: Y's Commission @ 4% = $\left(\frac{4}{104} \times ₹\ 51,220\right)$ = ₹ 1,970

			49,250
2. Transfer to General Reserve	= ₹ 49,250 × 10%	=	₹ 4,925

Illustrations 4

From the following Trial Balance of M/s BJ & Sons, prepare the final accounts for the year ended on 31st March 2023, and also the Balance sheet as on that date:

Particulars	Debit (₹)	Credit (₹)
Stock as on 01.04.2022: Finished goods	2,00,000	
Purchases and Sales	22,00,000	35,00,000
Bills receivables	50,000	
Returns	1,00,000	50,000
Carriage Inwards	50,000	
Debtors and Creditors	2,00,000	4,00,000
Carriage Outwards	40,000	
Discounts	5,000	5,000
Salaries and wages	2,20,000	
Insurance	60,000	
Rent	60,000	
Wages and salaries	80,000	
Bad debts	10,000	
Furniture	4,00,000	
BJ's capital		5,00,000
BJ's drawing	70,000	
Loose tools	1,00,000	
Printing & stationery	30,000	
Advertising	50,000	
Cash in hand	45,000	
Cash at bank	2,00,000	
Petty Cash	5,000	
Machinery	3,00,000	
Commis sion	10,000	30,000
Total	**44,85,000**	**44,85,000**

Adjustments:

(i) Finished goods stock: Stock on 31st March was valued at Cost price ₹ 4,20,000 and Market price ₹ 400,000.

(ii) Depreciate furniture @ 10% p.a. and machinery @ 20% p.a. on reducing balance method.

(iii) Rent of ₹ 5,000 was paid in advance.

(iv) Salaries & wages due but not paid ₹ 30,000.

(v) Make a provision for doubtful debts @ 5% on debtors.

(vi) Commission receivable ₹ 5,000.

Solution :

M/s BJ & Sons

Dr. Trading Account for the year ended 31st March 2023 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock :			By Sales	35,00,000	
Finished Goods		2,00,000	Less: Sales Returns	1,00,000	34,00,000
To Purchases	22,00,000				
Less: Purchases Returns	50,000	21,50,000	By Closing Stock		
To Carriage Inwards		50,000	Finished Goods		4,00,000
To Wages & Salaries		80,000			
To P/L A/c		13,20,000			
(Gross Profit transferred)					
		38,00,000			**38,00,000**

Dr. Profit & Loss Account for the year ended 31st March 2023 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Administrative expenses	-		Gross Profit b/d		13,20,000
To Salaries & wages	2,20,000		Discount received		5,000
Add: Outstanding	30,000	2,50,000	Commission received	30,000	
To Depreciation: on Furniture		40,000	Add : Receivable	5,000	35,000
on Machinery		60,000			
To Insurance		60,000			
To Rent	60,000				
Less: Paid in Advance	5,000	55,000			
To Printing & Stationery		30,000			
To Advertising		50,000			
To Carriage Outwards		40,000			
To Discounts		5,000			

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Bad debts		10,000			
To Commission		10,000			
To Provision for Doubtful Debts		10,000			
To BJ's Capital A/c (Net Profit transferred)		740,000			
		13,60,000			**13,60,000**

Dr. **Balance Sheet as on 31st March 2023** **Cr.**

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
BJ's Capital	5,00,000		Fixed Assets:		
Less : Drawings	70,000		Furniture	400,000	
Add : Net Profit for the year	7,40,000	11,70,000	Less: Depreciation	40,000	3,60,000
Long Term Liabilities:		-	Machinery	300,000	
			Less: Depreciation	60,000	2,40,000
Current Liabilities:			Loose Tools		1,00,000
Sundry Creditors		4,00,000			
Outstanding Salaries & Wages		30,000	Current Assets:		
			Stocks		4,00,000
			Sundry Debtors	200,000	
			Less: Provision for Doubtful Debts	10,000	1,90,000
			Bills Receivables		50,000
			Cash in Hand		45,000
			Cash at Bank		2,00,000
			Petty Cash		5,000
			Prepaid Rent		5,000
			Commission Receivable		5,000
		16,00,000			**16,00,000**

Notes :

(1) Closing stock is valued at market price here as it is less than cost price (conservatism concept)

Illustrations 5

Mr. Arvind Kumar has a small business enterprise. He has given the trial balance as at 31st March 2023

Particulars	Debit (₹)	Credit (₹)
Mr. Arvind Kumar's Capital		1,00,000
Machinery	36,000	
Depreciation on Machinery	4,000	
Repairs to Machinery	5,200	
Wages	54,000	
Salaries	21,000	
Income Tax of Mr. Arvind Kumar	1,000	
Cash in Hand	4,000	
Land & Building	1,49,000	
Depreciation on Building	5,000	
Purchases	2,50,000	
Purchase Returns		3,000
Sales		4,98,000
CC Bank		7,600
Accrued Income	3,000	
Salaries Outstanding		4,000
Bills Receivables	30,000	
Provision for Doubtful Debts		10,000
Bills Payable		16,000
Bad Debts	2,000	
Discount on Purchases		7,080
Debtors	70,000	
Creditors		62,520
Opening Stock (01.04.2021)	74,000	
Total	**7,08,200**	**7,08,200**

Additional information:

(1) Stock as on 31st March 2023 was valued at ₹ 60,000

(2) Write off further ₹ 6,000 as bad debt and maintain a provision of 5% for doubtful debt.

(3) Goods costing ₹ 10,000 were sent on approval basis to a customer for ₹ 12,000 on 30th March, 2022. This was recorded as actual sales.

(4) ₹ 2,400 paid as rent for office was debited to Landlord's A/c and was included in debtors.

(5) General Manager is to be given commission at 10% of net profits after charging his commission.

(6) Works manager is to be given a commission at 12% of net profit before charging General Manager's commission and his own.

You are required to prepare final accounts in the books of Mr. Arvind Kumar, and also the Balance Sheet as on that date.

Solution :

Mr. Arvind Kumar

Dr. **Trading Account for the year ended 31st March 2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening stock:			By Sales A/c	4,98,000	
Finished goods		74,000	Less: Sent on Approval	(12,000)	4,86,000
To Purchases:	2,50,000				
Less: Purchases returns	(3,000)	2,47,000	By Closing stock A/c		
			Finished goods	60,000	
To Wages:		54,000	Add Sent on Approval	10,000	70,000
To P/L A/c		181,000			
(Gross Profit transferred)					
		5,56,000			**5,56,000**

Dr. **Profit and Loss Account for the year ended 31st March 2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Salaries		21,000	By Trading A/c		
To Repairs to Machinery		5,200	(Gross Profit transferred)		1,81,000
To Depreciation: on Machinery		4,000	By Discount Received		7,080
on Building		5,000			
To Rent		2,400			
To Bad Debts	2,000				
Add: Further Bad Debts	6,000				
Provision for Doubtful Debts	2,480				
Less: Provision Opening	(10,000)	480			

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Commission to Works Manager		18,000			
To Commission to General Manager		12,000			
To Capital A/c (Net Profit transferred)		1,20,000			
		1,88,080			**1,88,080**

Balance Sheet as on 31st March 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Arvind Kumar's Capital	1,00,000		Fixed Assets:		
Less: Drawings (income tax)	(1,000)		Land & Building		1,49,000
Add: Net Profit for the year	1,20,000	2,19,000	Machinery		36,000
Long term Liabilities:		-	Current Assets:		
Current Liabilities:			Stocks	60,000	
Sundry Creditors		62,520	Add: Sent on Approval	10,000	70,000
Outstanding Salaries		4,000	Sundry Debtors	70,000	
			Less: Goods on Approval	(12,000)	
CC Bank's Overdraft		7,600	Less: Bad Debts	(6,000)	
Bills Payable		16,000	Less: Related to Landlord	(2,400)	
Commission Payable		30,000	Less: Provision for Doubtful Debts	(2,480)	47,120
			Bills Receivable		30,000
			Cash in Hand		4,000
			Accrued Income		3,000
		3,39,120			**3,39,120**

Working Notes:

(1) Commission payable to works manager & general manager is computed as below:

	(₹)
Profit before charging any commission	1,50,000
Commission to works manager @ 12% on 1,50,000	18,000
Profit after works manager's commission	1,32,000

Commission to General Manager (1,32,000/110 × 10) 12,000

Illustrations 6

Mr. Abhay runs a small shop and deals in various goods. He has not been able to tally his trial balance and has closed it by taking the difference to Suspense A/c. It is given below:

Particulars (as on 31st March 2023)	Debit (₹)	Credit (₹)
Abhay's Capital		1,50,000
Drawings	75,000	
Fixed Assets	1,35,000	
Opening Stock (01.04.2021)	36,500	
Purchases & Returns	6,75,000	13,500
Sales & returns	34,000	8,50,000
Due from Customer & to Creditors	95,000	3,25,000
Expenses	45,750	
Cash		3,000
Bank Deposits & Interest Earned	55,000	5,750
Suspense A/c		4,000
Advertising	2,00,000	
Total	**13,51,250**	**13,51,250**

Mr. Abhay has requested you to help him in tallying his trial balance and also prepare his final accounts. On investigation of his books you get the following information:

(i) Closing Stock on 31st March 2023 was ₹ 45,000 at cost and could sell over this value.

(ii) Depreciation of ₹ 13,500 needs to be provided for the year.

(iii) A withdrawal slip indicated a cash withdrawal of ₹ 15,000 which was charged as drawing. However, it was noticed that ₹ 11,000 was used for business purpose only and was entered as expenses in cash book.

(iv) Goods worth ₹ 19,000 were purchased on 24th March 2023 and sold on 29th March 2023 for ₹ 23,750. Sales were recorded correctly, but purchase invoice was missed out.

(v) Purchase returns of ₹ 1,500 were routed through sales return. Party's A/c was correctly posted.

(vi) Expenses include ₹ 3,750 related to the period after 31st March 2023.

(vii) Purchase book was over-cast by ₹ 1,000. Posting to suppliers' A/c is correct.

(viii) Advertising will be useful for generating revenue for 5 years.

Solution: Rectification of Errors:

(a) Cash withdrawn was recorded as

Cash A/c Dr ₹15,000

To Bank A/c ₹15,000

But it was charged to drawing and ₹11,000 was recorded as expenses as well i.e.

Drawings A/c Dr ₹15,000

Expenses A/c Dr ₹11,000

To Cash A/c ₹26,000

This resulted in negative cash of ₹11,000. The rectification entry to be passed is

Cash A/c Dr ₹11,000

To Drawings A/c ₹11,000

(b) Omitted transaction to be recorded

Purchases A/c Dr ₹19,000

To Suppliers' A/c ₹19,000

(c) Incorrect recording of purchase returns corrected by

Suspense A/c Dr ₹3,000

To Purchase return A/c ₹1,500

To sales return A/c ₹1,500

(d) Incorrect expenses rectified by

Prepaid expenses A/c Dr ₹3,750

To Expenses A/c ₹3,750

(e) Over-casting of purchase book rectified by

Suspense A/c Dr ₹1,000

To Purchases A/c ₹1,000

Based on these rectifications we can now proceed to complete the final accounts.

Mr. Abhay

Dr. **Trading Account for the year ended 31st March, 2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock	-	36,500	By Sales	8,50,000	
To Purchases	6,75,000		Less: Returns	(34,000)	
Less: Returns	(13,500)		Add: Rectification	1,500	8,17,500
Less: Additional returns	(1,500)		By Closing stock		45,000
Add: Purchases missed out	19,000				
Less: Over-casting rectified	(1,000)	6,78,000			

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Gross Profit c/d		1,48,000			
		8,62,500			**8,62,500**

Dr. Profit and Loss Account for the year ended 31st March, 2023 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Expenses	45,750		By Gross Profit b/d		1,48,000
Less : Prepaid	3,750	42,000			
To Depreciation		13,500	By Interest on Bank deposits		5,750
To Advertising		2,00,000	By Net Loss		1,01,750
		2,55,500			**2,55,500**

Balance Sheet as on 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Mr. Abhay's Capital	1,50,000		Fixed Assets		
Add: Wrong charge to drawing	11,000		Gross Block	1,35,000	
	1,61,000		Less: Depreciation	13,500	1,21,500
Less: Drawings	75,000	86,000	Current Assets:		
			Stocks		45,000
Current Liabilities:			Sundry Debtors		95,000
Sundry Creditors	3,25,000		Cash in hand	(3,000)	
Add: Missed out purchase	19,000	3,44,000	Add: Rectification	11,000	8,000
			Fixed deposit with Bank		55,000
			Prepaid expenses		3,750
			Miscellaneous Expenditure:		
			Profit & Loss (Dr.)		1,01,750
		4,30,000			**4,30,000**

Note : The expenditure incurred on intangible items after the date AS 26 became/becomes mandatory (01.04.2003 or 01.04.2004, as the case may be) would have to be expensed when incurred since these do not meet the definition of an 'asset' as per AS 26. Hence, full amount of Advertisement expense is charged to Profit & Loss Account.

It may be mentioned here that students might be thinking that since Advertisement benefit spread over five years, hence 1/5th to be shown in P/L Account and rest 4/5 will be shown in Balance sheet. But to be an Asset

(Tangible /intangible) , Asset recognition criteria must be fulfilled as per AS-10 and AS-26 as the case may be i.e. Future economic Benefit flow into the organisation and it can be reliably measured. The 1st condition of future economic benefit fulfills but the second condition i.e. reliable measurement of revenue is absent. It cannot be measured reliably asd to how much revenue can be generated each year with this expenses. Hence, the entire amount has been charged against profit in the year of expenditure.

Illustration 7

Mr. O maintains his accounts on Mercantile basis. The following Trial Balance has been prepared from his books as at 31st March, 2023 after making necessary adjustments for outstanding and accrued items as well as depreciation:

Trial Balance
as at 31st March, 2023

Particulars	Debit (₹)	Credit (₹)
Plant and Machinery	2,12,500	
Sundry Creditors		2,64,000
Sales		6,50,000
Purchases	4,20,000	
Salaries	40,000	
Prepaid Insurance	370	
Advance Rent	2,000	
Outstanding Salary		6,000
Advance Salary	2,500	
Electricity Charges	2,650	
Furniture and Fixtures	72,000	
Opening Stock (01.04.2022)	50,000	
Outstanding Electricity Charges		450
Insurance	1,200	
Rent	10,000	
Miscellaneous Expenses	14,000	
Cash in Hand	3,000	
Investments	80,000	
Drawings	24,000	
Dividend from Investments		8,000
Accrued Dividend from Investments	1,500	

Particulars	Debit (₹)	Credit (₹)
Depreciation on Plant and Machinery	37,500	
Depreciation on Furniture	8,000	
Capital Account		2,11,970
Telephone Charges	6,000	
Sundry Debtors	1,70,500	
Stationery and Printing	1,200	
Cash at Bank	65,000	
Interest on Loan	8,000	
Interest Due but Not Paid on Loan		1,500
Loan Account		90,000
	12,31,920	**12,31,920**

Additional Information:

(i) Salaries include ₹10,000 towards renovation of Proprietor's residence.

(ii) Closing Stock amounted to ₹75,000.

Mr. O, however, request you to prepare a Trading and Profit & Loss Account for the year ended 31st March, 2023 and a Balance Sheet as on that date following cash basis of accounting.

Solution:

Mr. O

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2023 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		50,000	By Sales		6,50,000
To Purchases		4,20,000	By Closing Stock		75,000
To Profit & Loss A/c.					
– Gross Profit transferred		2,55,000			
		7,25,000			7,25,000
To Salaries	40,000		By Trading A/c.		
– Less: Outstanding	6,000		-Gross Profit transferred		2,55,000
Salaries	34,000		By Dividend	8,000	
– Add: Advance Salary	2,500		Less: Accrued Dividend	1,500	6,500
	36,500				
– Less: Renovation (Drawings)	10,000	26,500			

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Insurance	1,200				
– Add: Prepaid	370	1,570			
To Rent	10,000				
– Add: Advance Rent	2,000	12,000			
To Electricity Charges	2,650				
– Less: Outstanding	450	2,200			
To Miscellaneous Expenses		14,000			
To Stationery & Printing		1,200			
To Depreciation:					
– Plant & Machinery	37,500				
– Furniture & Fixtures	8,000	45,500			
To Interest on Loan	8,000				
– Less: Outstanding	1,500	6,500			
To Telephone Charges		6,000			
To Capital Account					
– Net Profit transferred		1,46,030			
		2,61,500			**2,61,500**

Balance Sheet as at 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Account	2,11,970		Plant and Machinery (at cost less depreciation)		2,12,500
Add: Net Profit	1,46,030		Furniture & Fixtures (at cost less depreciation)		72,000
	3,58,000		Investments		80,000
Less: Drawings (₹24,000 + ₹10,000)	34,000	3,24,000	Stock-in-Trade		75,000
			Debtors		1,70,500
Loan Account		90,000	Cash at Bank		65,000
Sundry Creditors		2,64,000	Cash in hand		3,000
		6,78,000			**6,78,000**

Illustration 8

The following Trial Balance has been prepared from the books of Mrs. Sexena as on 31st March, 2023 after making necessary adjustments for depreciation on Fixed Assets, outstanding and accrued items and difference under Suspense Account.

Trial Balance as at 31st March, 2023

Particulars	Debit (₹)	Particulars	Credit (₹)
Machineries	1,70,000	Sundry Creditors	82,000
Furniture	49,500	Capital Account	2,45,750
Sundry Debtors	38,000	Outstanding Expenses:	
Drawings	28,000	Salaries	1,500
Travelling Expenses	6,500	Printing	600
Insurance	1,500	Audit Fees	1,000
Audit Fees	1,000	Bank Interest	1,200
Salaries	49,000	Discounts	1,800
Rent	5,000	Sales (Less Return)	6,80,000
Cash in Hand	7,800		
Cash at Bank	18,500		
Stock-in-Trade (01.04.2021)	80,000		
Prepaid Insurance	250		
Miscellaneous Expenses	21,200		
Discounts	1,200		
Printing & Stationery	1,500		
Purchase (Less Returns)	4,60,000		
Depreciation:			
Machineries	30,000		
Furniture	5,500		
Suspense Account	39,400		
	10,13,850		**10,13,850**

On the subsequent scrutiny following mistakes were noticed:

(i) A new machinery was purchase for ₹ 50,000 but the amount was wrongly posted to Furniture Account as ₹ 5,000.

(ii) Cash received from Debtors ₹ 5,600 was omitted to be posted in the ledger.

(iii) Goods withdrawn by the proprietor for personal use but no entry was passed ₹ 5,000.

(iv) Sales included ₹ 30,000 as goods sold cash on behalf of Mr. Thakurlal who allowed 15% commission on such sales for which effect is to be given.

You are further told that:

(a) Closing stock on physical verification amounted to ₹ 47,500.

(b) Depreciation on Machineries and Furniture has been provided @ 15% and 10%, respectively, on reducing balancing system.

Full year's depreciation is provided on addition.

You are requested to prepare a Trading and Profit & Loss Account for the year ended 31st March 2023 and a Balance Sheet as on that date so as to represent a True and Correct picture.

Solution:

Mrs. Sexena

Trading and Profit and Loss Account

Dr. for the year ended 31st March, 2023 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		80,000	By Sales		
			(₹ 6,80,000 - ₹ 30,000)		6,50,000
To Purchases	4,60,000		By Closing Stock		47,500
Less: Drawings	5,000	4,55,000			
To Profit & Loss A/c.					
Gross Profit transferred		1,62,500			
		6,97,500			6,97,500
To Salaries:		49,000	By Trading A/c.		1,62,500
			(Gross Profit)		
To Rent		5,000	By Bank Interest		1,200
To Insurance		1,500	By Selling Commission		
To Audit Fees		1,000	(15% on ₹ 30,000)		4,500
To Printing & Stationery		1,500	By Discount Received		1,800
To Miscellaneous Expenses		21,200			
To Discount Allowed		1,200			
To Travelling Expenses		6,500			
To Depreciation:					
Machinery	37,500				
Furniture	5,000	42,500			
To Capital Account					
(Net Profit transferred)		40,600			
		1,70,000			**1,70,000**

Balance Sheet
as at 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Account	2,45,750		Machinery	2,50,000[1]	
Add: Net Profit	40,600		Less: Depreciation	37,500	2,12,500
	2,86,350				
Less: Drawings			Furniture	50,000[2]	
(28,000+5,000)	33,000	2,53,350			
			Less: Depreciation	5,000	45,000
Sundry Creditors		82,000	Stock		47,500
Outstanding Liabilities:			Debtors (₹38,000 - ₹5,600)		32,400
Salaries	1,500		Cash		7,800
Audit Fees	1,000		Bank		18,500
Printing	600	3,100	Prepaid Insurance		250
Thakurlal's A/c.					
(₹30,000 – ₹4,500)		25,500			
		3,63,950			**3,63,950**

Notes:

		(₹)
1.	Machinery as per Trial Balance	1,70,000
	Add: Depreciation	30,000
		2,00,000
	Additions	50,000
		2,50,000
2.	Furniture	49,500
	Add: Depreciation	5,500
		55,000
	Less: Wrong Debit	5,000
3.	Suspense A/c is eliminated by item	50,000

(i) ₹ 45,000 (₹50,000 – ₹5,000) and item
(ii) by ₹5,600 (debited), respectively.

Illustration 9

The following Trial Balance has been extracted from the books of Mr. Agarwal as on 31.3.2023:

Trial Balance as on 31.3.2023

Particulars		Dr. (₹)	Particulars	Cr. (₹)
Purchase		6,80,000	Sales	8,38,200
Sundry Debtors		96,000	Capital Account	1,97,000
Drawings		36,000	Sundry Creditors	1,14,000
Bad Debts		2,000	Outstanding Salary	2,500
Furniture & Fixtures		81,000	Sale of Old Papers	1,500
Office Equipments		54,000	Bank Overdraft (PP Bank)	60,000
Salaries		24,000		
Advanced Salary		1,500		
Carriage Inward		6,500		
Miscellaneous Expenses		12,000		
Travelling Expenses		6,500		
Stationery & Printing		1,500		
Rent		18,000		
Electricity & Telephone		6,800		
Cash In Hand		5,900		
Cash at Bank (SBI)		53,000		
Stock (1.4.2021)		50,000		
Repairs		7,500		
Motor Car		56,000		
Depreciation:				
Furniture	9,000			
Office Equipment	6,000	15,000		
		12,13,200		**12,13,200**

Additional Information:

(i) Sales includes ₹ 60,000 towards goods for cash on account of a joint venture with Mr. Reddy who incurred ₹ 800 as forwarding expenses. The joint venture earned a profit of ₹ 15,000 to which Mr. Reddy is entitled to 60%

(ii) The motor car account represents an old motor car which was replaced on 1.4.2022 by a new motor car costing ₹ 1,20,000 with an additional cash payment of ₹ 40,000 laying debited to Purchase Account.

(iii) PP Bank has allowed an overdraft limit against hypothecation of stocks keeping a margin of 20%. The present balance is the maximum as permitted by the Bank.

(iv) Sundry Debtors include ₹ 4,000 as due from Mr. Trivedi and Sundry Creditors include ₹ 7,000 as payable to him.

(v) On 31.3.2023 outstanding rent amounted to ₹ 6,000 and you are informed that 50% of the total rent is attributable towards Agarwal's resident.

(vi) Depreciation to be provided on motor car @ 20% (excluding sold item).

Mr. Agarwal requests you to prepare a Trading and Profit & Loss Account for the year ended 31.3.2023 and a Balance Sheet as on that date.

Solution:

Mr. Agarwal
Trading and Profit and Loss Account
Dr. for the year ended 31st March, 2023 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		50,000	By Sales	8,38,200	
To Purchases	6,80,000		– Less: Sale on account of Joint Venture	60,000	7,78,200
– Less: Motor Car	40,000	6,40,000			
			`` Closing Stock (W.N. 1)		75,000
To Carriage Inward		6,500			
To Profit & Loss A/c -Gross Profit transferred		1,56,700			
		8,53,200			8,53,200
To Salaries		24,000	By Trading A/c. - Gross Profit transferred		1,56,700
To Travelling Expenses		6,500	`` Sale of old papers		1,500
To Printing & Stationery		1,500	`` Profit on Joint Venture (40% of ₹15,000)		6,000
`` Electricity & Telephone		6,800	`` Profit on replacement of Motor Car (W. N. 2) [(₹1,20,000 –(₹56,000 + ₹40,000)]		24,000
`` Rent	18,000				
– Add: Outstanding	6,000				
	24,000				
– Less: Drawings	12,000	12,000			
`` Bad Debts		2,000			
`` Miscellaneous Expenses		12,000			
`` Repairs		7,500			

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
`` Depreciation on:					
– Furniture	9,000				
– Office Equipment	6,000				
– Motor Car (W.N. 3)	24,000	39,000			
`` Capital Account					
- Net Profit transferred		76,900			
		1,88,200			**1,88,200**

Balance Sheet
as at 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Account	1,97,000		Furniture & Fixtures	90,000	
Add: Net Profit	76,900		Less: Depreciation	9,000	
	2,73,900				81,000
Less: Drawings (36,000 + 12,000)	48,000		Office Equipment	60,000	
		2,25,900	Less: Depreciation	6,000	
Bank Overdraft		60,000			54,000
Creditors	1,14,000		Motor Car	56,000	
Less: Due to Trivedi	4,000	1,10,000	Additions	1,20,000	
				1,76,000	
			Less: Sold	56,000	
Amount payable to Reddy		54,000		1,20,000	
(₹60,000 – ₹6,000)			Less: Depreciation	24,000	96,000
Outstanding Liabilities:			Stock		75,000
Salaries	2,500		Debtors	96,000	
Rent	6,000	8,500	Less: Due from Trivedi	4,000	92,000
			Cash		5,900
			Bank		53,000
			Prepaid Salary		1,500
		4,58,400			**4,58,400**

Working Notes:

1. Depreciation on Motor Car

on new motor car i.e., @ 20% on ₹ 1,20,000 = ₹ 24,000

2. Profit on Replacement of Motor Car

	(₹)	(₹)
Cost of new Motor Car		1,20,000
Less: Exchange Value	56,000	
Cash Payment	40,000	96,000
Profit on replacement		24,000

3. Closing Stock

Maximum allowable limit (100 – 20)% = 80% of stock.

Overdraft is ₹ 60,000 which is equal to 80%.

So, closing stock $= ₹\ 60{,}000 \times \frac{100}{80}$

$= ₹\ 75{,}000.$

Final Accounts of Partnership Firm

Illustration 10

From the following particulars prepare a Final Accounts of M/s. X & Y for the year ended 31st March 2023.

Particulars	(₹)	Particulars	(₹)
Sales	8,20,000	Land	11,000
Opening Stock	3,00,000	Purchase	3,80,000
Loan (Dr.)	20,000	Interest (Cr.)	1,000
Wages	60,000	Salaries	40,000
Carriage Inwards	4,000	Carriage Outward	2,000
Returns inward	4,000	Returns Outwards	3,000
Furniture	10,000	Trade charges	8,000
Drawings		Capital	
X	12,000	X	24,000
Y	10,000	Y	16,000
Cash	3,000		

Additional Information:

(i) Closing Stock amounted to ₹ 1,20,000;

(ii) Provide Interest on drawings (on an average 6 months) and interest on capital @ 6% and 4% respectively.

(iii) Y is to get a salary of ₹ 400 p.m.

(iv) X is to get a commissions @ 2% on gross sales

(v) 50% of the profit is to be transferred to Reserve Fund.

(vi) Depreciations on furniture @ 10% p.a.

The partners share profit and loss equally.

Solution:

M/s X & Y

Dr. Trading and Profit and Loss Account for the year ended 31st March, 2023 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		3,00,000	By Sales	8,20,000	
`` Purchases	3,80,000		Less: Return Inwards	4,000	8,16,000
Less: Returns Outwards	3,000	3,77,000	`` Closing Stock		1,20,000
`` Wages		60,000			
`` Carriage Inward		4,000			
`` Profit & Loss A/c					
-Gross Profit transferred		1,95,000			
		9,36,000			9,36,000
To Salaries		40,000	By Trading A/c.		
`` Carriage Outward		2,000	- Gross Profit		1,95,000
`` Trade Charges		8,000	`` Interest		1,000
`` Depreciation on:					
- Furniture		1,000			
To P&L Appropriation A/c.					
- Net Profit transferred		1,45,000			
		1,96,000			**1,96,000**

Profit and Loss Appropriation Account

Dr. for the year ended 31st March, 2023 Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Interest on Capital			By Profit and Loss A/c		1,45,000
X	960		-Net Profit		
Y	640	1,600	By Interest on Drawings:		
To Salary			X	360	

Y:		4,800	Y	300	660
To Commission – X		16,400			
`` Reserve Fund (50%)		61,430			
To Partner's Capital A/c					
`` Net Divisible Profit					
X	30,715				
Y	30,715				
		61,430			
		1,45,660			**1,45,660**

Dr. **Partners' Capital Account** **Cr.**

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Drawings	12,000	10,000	By Balance b/d.	24,000	16,000
`` Interest on Drawings	360	300	`` Interest on Capital	960	640
`` Balance c/d.	59,715	41,855	`` Salary	---	4,800
			`` Commission	16,400	---
			`` Share of Profit	30,715	30,715
	72,075	**52,155**		**72,075**	**52,155**

Balance Sheet
as at 31st March, 2023

Liabilities	(₹)	Assets	(₹)	(₹)
Capital :		Land		11,000
X	59,715	Furniture	10,000	
Y	41,855	Less: Depreciation	1,000	9,000
Reserve Fund	61,430			
		Loan		20,000
		Closing Stock		1,20,000
		Cash		3,000
	1,63,000			**1,63,000**

Illustration 11

From the following balances extracted from the books of Mr. S on December 31, 2023, prepare a Trading and Profit and Loss Account for the year ended on that date and also a Balance Sheet as on the same date:

Trial Balance as on 31.12.2023

Particulars	Dr. (₹)	Particulaes	Cr. (₹)
Salaries	18,000	Sales	2,43,000
Debtors	1,26,000	8% Loan from Mr. Kumar (taken on 1.7.22)	60,000
Stock on 01.01.2022	30,000	Provision for Bad Debts	8,000
Machinery	2,00,000	Bills Payable	11,000
Furniture	85,000	Outstanding Salaries	3,000
Bad Debts	4,000	Capital Account	3,30,000
Purchases	1,50,000	Creditors	90,000
Printing & Stationery	5,300		
Postage & Telephone	3,200		
Rent	4,500		
Cash in Hand	2,500		
Bank Balance	72,500		
Insurance	4,800		
Bills Receivable	15,000		
General Expenses	9,200		
Drawings	10,000		
Interest on loan	2,000		
Wages	3,000		
	7,45,000		**7,45,000**

Additional Information:

a. Closing Stock (as on 31.12.2023): Cost Price ₹ 50,000; Market Value ₹ 40,000.

b. An old furniture which stood at ₹ 12,000 in the books on Jan 1, 2023 was disposed of at ₹ 5,800 on June 30, 2023, in part exchange of a new furniture costing ₹ 10,400. A net invoice of ₹ 4,600 was passed through the Purchase Day Book.

c. Sales include ₹ 36,000 hire-purchase sales. Hire-purchase sales prices are determined after adding 25% on Hire-Purchase price. 30% of the installments have not fallen due yet. Profit or loss on hire-purchase sales is to be shown in the Profit and Loss Account.

d. Debtors include ₹ 7,500 due from Mr. M and Creditors include ₹ 6,000 due to him.

e. Annual Insurance premium up to 31.03.23.

f. Depreciate the fixed assets as follow: Machinery @ 15% p.a. and Furniture @ 10% p.a.

g. Provide 5% for bad debts on debtors (excluding hire-purchase debtors).

Solution:

Mr. S

Dr. **Trading and Profit & Loss Account for the year ended 31.12.2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		30,000	By Sales	2,43,000	
To Purchases	1,50,000		Less: Sales on Hire Purchase basis	36,000	2,07,000
Less: Exchange of Furniture [WN: 2]	4,600	1,45,400	By Goods Sent on Hire Purchases [₹36,000 × 75%]		27,000
To Wages		3,000			
To Gross Profit		95,600	By Closing Stock [WN: 1]		40,000
		2,74,000			**2,74,000**
To Salaries		18,000	By Gross Profit		95,600
To Bad Debts		4,000	By Provision for Bad Debts (Old)		8,000
To Printing & Stationery		5,300	By Profit on Hire Purchase [WN: 3]		6,300
To Postage & Telephone		3,200			
To Rent		4,500			
To Insurance	4,800				
Less: Prepaid Insurance [4,800 × 3/12]	1,200	3,600			
To General Expenses		9,200			
To Interest on Loan	2,000				
Add: Outstanding interest on loan	400	2,400			
[(₹60,000 × 8% × 6/12) – 2,000]					
To Loss on Exchange [WN: 2]		5,600			
To Depreciation:					
Machinery	30,000				
Furniture [₹7,820 (WN: 4) + ₹600 (WN: 2)]	8,420	38,420			
To Provision for Bad debt (New)		5,460			
To Capital A/c [Net Profit transferred]		10,220			
		1,09,900			**1,09,900**

Balance Sheet as on 31.12.2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital	3,30,000		Machinery	2,00,000	
Add: Net profit	10,220		Less: Depreciation @15%	30,000	1,70,000
	3,40,220				
Less: Drawings	10,000	3,30,220	Furniture	85,000	
			Less: Net Exchange [WN: 2]	1,600	
8% Loan from Mr. Kumar		60,000		83,400	
			Less : Depreciation [WN: 4]	7,820	75,580
Creditors	90,000		Stock-in-Trade [WN: 1]		40,000
Less: Creditors for Furniture [WN: 2]	4,600		Hire Purchase Stock [WN: 3]		8,100
	85,400		Debtors	1,26,000	
Less: Set-off	6,000	79,400	Less: Hire Purchase Debtors	10,800	
			[₹36,000 × 30%]	1,15,200	
Creditors for Furniture [WN: 2]		4,600	Less: Set-off	6,000	
Bills Payable		11,000		1,09,200	
Outstanding Salaries		3,000	Less : Provision for Bad Debt	5,460	1,03,740
Outstanding Interest on Loan		400			
			Bills Receivable		15,000
			Prepaid Insurance		1,200
			Bank Balance		72,500
			Cash in hand		2,500
		4,88,620			**4,88,620**

Working Notes:

1. Exchange of Furniture - Rectification Entry

		(₹)	(₹)
Creditors A/c	Dr.	4,600	
Depreciation A/c	Dr.	600	
Loss on Exchange A/c	Dr.	5,600	
(New) Furniture A/C	Dr.	10400	
To (Old) Furniture A/c			12000
To Creditors for Furniture A/c			4600
To Purchases A/c			4600

2. Goods sent and sold on Hire-purchase

Dr. HP Trading A/c ✓ Cr.

Particulars	(₹)	Particulars	(₹)
To Goods sent on HP A/c [₹36,000 × 75%]	27,000	By HP Sales A/c [Matured Installment]	25,200
		By Stock with H. P. [₹36,000 × 30% × 75%]	8,100
To P/L A/c	6,300		
	33,300		**33,300**

Dr. HP Sales A/c ✓ Cr.

Particulars	(₹)	Particulars	(₹)
To HP Trading A/c [₹36,000 × 75%]	25,200	By Sales A/c	36,000
To Balance c/f	10,800		
	36,000		**36,000**

Dr. HP Debtors A/c Cr.

Particulars	(₹)	Particulars	(₹)
To Debtors A/c	10,800	By Balance c/f	10,800
	10,800		**10,800**

3. Depreciation on Furniture [to be deducted from Furniture in Balance Sheet]

	(₹)
On Old Furniture [₹85,000 – 12,000] × 10%	7,300
On Sold old Furniture (12,000 × 10% × 6/12)	600
On Furniture acquired during the year [₹10,400 × 10% × 6/12]	520
	8,420

Illustration 12

Mrs. Joshi has presented you the following Trial Balance as on 31st December 2023:

Dr. Trial Balance as on 31.12.2023 Cr.

Particulars	(₹)	Particulars	(₹)
Purchases	1,75,000	Sales	3,25,000
Interest	8,000	10 % Loan from UBI	1,00,000
Debtors	1,04,000	Bills Payable	86,000
Suspense A/c	8,000	Capital	4,87,000
Rent	6,600	Sundry Creditors	1,02,500
Plant & Machinery	5,30,000	Apprenticeship Premium Received	2,000
Furniture & Fixture	85,000	Purchase Return	1,500
Salaries	7,000		
Wages	2,500		
GST	6,000		
Motor Car	70,000		
Octroi	500		

Particulars	(₹)	Particulars	(₹)
Insurance	10,000		
Unexpired insurance	2,300		
Factory Shed	30,000		
Bills Receivable	25,000		
Patent	32,100		
Sales Return	2,000		
	11,04,000		**11,04,000**

You are required to prepare a Trading and Profit & Loss account and a Balance Sheet as on 31st Dec 2022 after considering the following adjustment:

1. A sale of ₹25,000 made for cash had been credited to Purchase A/c.
2. Private purchase amounting to ₹600 had been included in Purchase Day Book.
3. The loan account in the books of proprietor appeared as follows:

Dr. **10% Loan from UBI Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.23	To Balanced c/f	1,00,000	1.1.23	By Balance b/f	50,000
			31.12.23	By Bank A/c	50,000
		1,00,000			**1,00,000**

Interest paid includes ₹3,000 interest paid to UBI Bank.

4. During the year goods worth ₹1,00,000 were invoiced on 'sale on approval basis' at cost plus 25%. Out of these, goods worth ₹20,000 accepted by the customers, ₹40,000 worth of goods were rejected and properly accounted for but no intimation has been obtained for the balance of the goods and its period is yet to expire.
5. Debtors were shown after deduction of Provision for Doubtful Debt of ₹2,000. It was decided that this debt was considered to be bad and should be written off and a provision of ₹1,000 should be made which was considered doubtful.
6. Suspense account represents money advanced to sales manager who was sent to Mumbai in August, 2023 for sales promotion. On returning to Kolkata submitted a statement disclosing that ₹2,000 was incurred for travelling, ₹1,200 for legal expenses and ₹1,800 for miscellaneous expenses. The balance lying with him is yet to be refunded.
7. Business is carried on in a two-storied rented house. The ground floor, being 50 per cent of the accommodation, is used for business. Mrs. Joshi lives with her family on the first floor.
8. The Furniture account represents old furniture which was replaced on 1.1.2023 by a new one, costing ₹1,20,000 with an additional cash payment of ₹80,000 lying debited to purchases account. However, the assets were put to use on 1.4.2023.
9. Depreciation is to be charged on Furniture @ 10% p.a., Plant & Machinery @ 5% p.a., Motor Car @ 5% p.a.
10. The General manager is entitled to commission based on a percentage of net profit (such commission being charged to profit and loss account before ascertaining the net profits), calculated in the following manner :

On the first ₹ 30,000 of net profit	Nil
On the next ₹ 30,000 of net profit	10%
On the next ₹ 30,000 of net profit	20%
And on the balance of net profit	30%

11. Closing Stock was 31.12.2023 was 22,000.

Solution:

Mrs. Joshi

Dr. **Trading and Profit & Loss Account for the year ended 31.12.2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Purchases	1,75,000		By Sales	3,25,000	
Less : Purchase Return	1,500		Less : Sales Return	2,000	
	1,73,500			3,23,000	
Add: Sales wrongly credited in Purchase	25,000		Add : Sales wrongly credited to Purchase	25,000	
	1,98,500			3,48,000	
Less : Private purchase	600		Less : Sale on approval basis	40,000	3,08,000
	1,97,900		By Closing Stock		
Less : Payment for Furniture [WN: 2]	80,000	1,17,900	In hand	22,000	
To Wages		2,500	With Customer [WN: 1]	32,000	54,000
To Octroi		500			
To Gross Profit c/d		2,41,100			
		3,62,000			3,62,000
To Rent	6,600		By Gross Profit b/d		2,41,100
Less: Rent of Personal portion (50%)	3,300	3,300	By Apprenticeship Premium		2,000
To Salaries		7,000	By Provision for Bad Debt		2,000
To GST		6,000			
To Insurance		10,000			
To Interest	8,000				
Add : Outstanding	2,000	10,000			
[(50,000 × 10%) – 3,000]					

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Bad Debt		2,000			
To Provision for Bad Debts		1,000			
To Depreciation:					
Furniture	12,000				
Plant & Machinery	26,500				
Motor Car	3,500	42,000			
To Loss on Exchange [WN: 2]		45,000			
To Sales Promotion Expenses:					
Travelling	2,000				
Legal Expenses	1,200				
Misc. Expenses	1,800	5,000			
To General Manager's Commission [WN:3]		16,140			
To Capital A/c [Net Profit transferred]		97,660			
		2,45,100			2,45,100

Balance Sheet as on 31.12.2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
			Patent		32,100
			Factory Shed		30,000
Capital	4,87,000		Plant & Machinery	5,30,000	
Add : Net Profit	97,660		Less : Depreciation @ 5%	26,500	5,03,500
	5,84,660				
Less : Drawings [Rent of Personal Accommodation]	3,300	5,81,360	Furniture & Fixture	85,000	
			Add: Net Exchange	35,000	
				1,20,000	
10 % Loan from UBI		1,00,000	Less : Depreciation @10%	12,000	1,08,000
Bills Payable		86,000			
Sundry Creditors	1,02,500		Motor Car	70,000	
Less : Private purchase	600	1,01,900	Less : Depreciation @ 5%	3,500	66,500

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Outstanding Interest		2,000	Stock-in-Trade:		
Outstanding Manger's Commission		16,140	In hand	22,000	
			With Customers [WN: 1]	32,000	54,000
			Debtors [1,04,000 + 2,000]	1,06,000	
			Less : Sale on Approval basis [WN:1]	40,000	
				66,000	
			Less : Bad debt	2,000	
				64,000	
			Less : Provision for Bad Debts	1,000	63,000
			Bills Receivable		25,000
			Unexpired insurance		2,300
			Due from Sales Manager [8,000 – 5,000]		3,000
		8,87,400			**8,87,400**

Working Notes:

1. Unexpired goods on Sale on approval basis

	(₹)
Invoice price of goods sent	1,00,000
Less: Goods accepted	(20,000)
Goods returned	(40,000)
∴ Invoice Vale of goods lying in the hands of customer	40,000
∴ Cost price of goods waiting approval = ₹ 40,000 × 100/125 = ₹ 32,000	

2. Exchange of Furniture

	(₹)
Original Cost of new Furniture	1,20,000
Less: Payment made	80,000
∴ Exchange Value	40,000

∴ WDV of old Furniture	85,000
∴ Loss on Exchange	45,000

Rectification Entry		(₹)	(₹)
Furniture A/c	Dr.	35,000	
Loss on Exchange A/c	Dr.	45,000	
To Purchases A/c			80,000

3. General manager's Commission

Net Profit before manager's commission = ₹ 241,100 – ₹ 1,27,300 = ₹ 1,13,800

Net Profit	Rate of Commission	Commission (₹)	
On first ₹ 30,000	-	-	
On Next ₹ 30,000	10%	3,000	[30,000 × 10%]
On Next ₹ 30,000	20%	6,000	[30,000 × 20%]
On balance	30%	7,140	[1,13,800 – 90,000] × 30%
∴ Commission payable to General Manager		16,140	

Preparation of Financial Statements of Not-for-Profit Organisation

3.2

Some of the organizations or institutions are constituted to provide valuable services to the society and not with the primary objective of earning profit.

Non-profit Organisations

The organizations which are primarily formed with the objective of offering some specific services to the society and not with profit motive only are referred to as Non-profit Organisations. Such organisations include educational institutions, public medical organisations, social clubs, charitable trusts, trade unions, Cultural clubs like Rotary or Lions club Religious institutions etc. Their main objective is to operate for adding value to different sections of the society.

Features of Non-profit Organisations

The salient features of such non-trading estitis are:

- This organization is governed by elected body or trustee board.
- Its operation is not driven by any profit motive unlike trading concerns.
- Main purpose of the organization is to provide social service.
- Main source of their income comes from donation and membership subscription.
- The funds are utilized maximum for the benefits of the society.
- The membership process for this concern is non-transferable.
- The method of accounting that is followed here is entity concept.

Items of incomes and expenses of Non-profit Organisations

These organisations get their funds in the form of contributions by way of entrance fees, life membership fees, annual subscriptions, donations, grants, legacies etc. The accounting of such organisations is based on similar principles followed by the other organisations. Given the nature of these institutions, there are certain items of revenue and expenses that need special understanding so that accounting treatment could be correctly decided.

There are certain items of income and expenditures which are unique for the non-trading entities. They could be listed as:

Income items	Expenditure items
Donations	Upkeep of grounds
Entrance fees	Tournament expenses
Subscriptions	Prizes
Grants received	Events

The accounting treatment of some of these items of inflows are as follows:

(a) Entrance Fees – These are received at the time of admission of a new member and thus are one-time fees. They are non-recurring in nature. It could be either capitalized as they are non-recurring or taken as revenue as per the rules of the institution. There's a view that addition of member is an ongoing activity and thus every year the institute will get entrance fees. So it may be taken as a normal revenue receipt.

(b) Donations – They could be used for meeting capital or revenue expenses. If donations are received for a special purpose, the amount is credited to a fund from which the amounts are disbursed. The fund may be invested in specified securities. Income from such investments is credited to the fund A/c only. Small donation amounts which are not earmarked for any specific purpose may be treated as revenue receipts.

(c) Legacy – Many times trusts are formed in the memory of certain persons by their will. In such case after the demise of the person, the funds pass on to the institution. Such legacies are of course one-time and therefore should be taken to the capital fund.

(d) Endowments – Sometimes, donations are also in the form of endowments to be used as per instructions of the donor. These are to be treated as capital receipts.

(e) Life membership fees – These could be taken as capital receipts and every year a charge is debited based on some logic. In other words, when received, it could be treated as deferred receipt in the balance sheet and every year a specific amount is credited to Income & Expenditure A/c.

(f) Subscriptions – These are annual receipts and therefore taken as revenue receipts. These must be recognised as revenue on the accrual concept.

Financial Statements of Non-profit Organisations

The different components of the financial statements of non-profit organisations are:

- Receipts & Payments Account;
- Income & Expenditure Account; and
- Balance Sheet.

3.2.1 Preparation of Receipts and Payments Account

This is the summarized form of the cash book of a non-profit organisation. Entries are made on cash basis and items pertaining to previous year or current year or subsequent years are also recorded. It is a memorandum account in which the receipts are shown on left side and payments are shown on the right side. Capital as well as revenue items are entered in the Receipts and Payments Account. This account is real account in nature. No provisions are recorded in this account. The account begins with the opening balance of cash and bank and ends with the closing balance of cash and bank.

The proforma of a typical Receipts and Payments Account is as under:

Receipt and Payment Account

Receipts	(₹)	Payments	(₹)
Starts with opening balance			
All receipts - capital or revenue		All payments - Capital or revenue	
May be related to any period previous, current or subsequent.		May be related to any period previous, current or subsequent.	

Receipts	(₹)	Payments	(₹)
		Ends with closing balance	

Features of Receipts and Payments Account

1. It is an account which contains all Cash and Bank transactions made by a nonprofit organization during a particular financial period.
2. It is a memorandum account.
3. It is Real Account by nature.
4. It starts with the opening balances of Cash and Bank.
5. It is a summary of Cash Book. Summary of all Cash Receipts both capital & revenue during the period are debited to it. All Cash Payments both capital & revenue during the period are credited to this Account. It ends with the closing Cash and Bank Balances.
6. While recording the Cash and Bank transactions all entries are made on Cash Basis.

3.2.2 Preparation of Income and Expenditure Account

This is the income statement of the non-profit organisation. As the name suggests only revenue items i.e. revenue incomes and revenue expenditures are recorded herein. Incomes are recorded on the credit side, while the expenses are recorded in the debit side. Both incomes and expenses must be taken on the basis of accrual concept. This account should reflect only items that are pertaining to current period. The balance of this account shows either a surplus or deficit. Excess of income over expenditure is called surplus and excess of expenditure over income is called as deficit.

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

Expenses	(₹)	Income	(₹)
Only revenue expenses		Only revenue receipts	
Only related to current period		Only related to current period	
Shows either surplus		Or shows deficit	

Features of Income and Expenditure Account

1. It is by nature Nominal Account.
2. All expenditures of revenue nature for the particular period are debited to this account on accrual basis.
3. All revenue incomes related to the particular period are credited to this account on accrual basis.
4. All Capital incomes and expenditures are excluded.
5. Only current year's incomes and expenses are recorded. Amounts related to other periods are deducted. Amounts outstanding for the current year are added.
6. Profit on Sale of Asset is credited. Loss on Sale of Asset is debited. Annual Depreciation on Assets is also debited.
7. If income is more than expenditure, it is called a Surplus, and is added with Capital or General Fund etc. in the Balance Sheet.
8. If expenditure is more than income, it is a deficit, and is deducted from Capital or General Fund etc. in the Balance Sheet.

3.2.3 Preparation of Balance Sheet

It is prepared as on the last day of the accounting period. It also has assets and liabilities and prepared based on accounting equation. But, there's no capital account. Instead there is a capital fund. The surplus or deficit from Income & Expenditure A/c is adjusted against this capital fund at the end of the year.

Difference between Receipts and Payments Account and Income and Expenditure Account

Receipts & Payments Account	Income & Expenditure Account
1. It is a summarised Cash Book	1. It closely resembles the Profit & Loss Account of a Trading concern.
2. Receipts are debited and Payments are credited.	2. Incomes are credited and Expenditures are debited.
3. Transactions are recorded on Cash basis.	3. Transactions are recorded on Accrual Basis
4. Amounts related to previous period or future period may remain included. Outstanding amount for current year is excluded.	4. Transactions are recorded on accrual basis. All amounts not related to the current period are excluded. Outstanding amounts of current period are added.
5. It records both Capital and Revenue transactions.	5. It records Revenue transactions only.
6. It serves the purpose of a Real Account.	6. It serves the purpose of a Nominal Account.
7. It starts with opening Cash and Bank Balances and ends with closing Cash and Bank Balances.	7. It does not record such balances, rather its final balance shows a surplus or a deficit for the period.
8. It does not record notional loss or noncash expenses like bad debts, depreciations etc.	8. It considers all such expenses for matching against revenues
9. Its closing balance is carried forward to the same account of the next accounting Period.	9. Its closing balance is transferred to Capital Fund or General Fund or Accumulated Fund in the same period's Balance Sheet.
10. It helps to prepare an Income & Expenditure A/c.	10. It helps to prepare a Balance Sheet.

Fund Asset Accounting and its peculiarities:

Following are the concepts of some funds which are generally maintained by non-profit organizations:

(i) Capital Fund : It is also called "General Fund" or "Accumulated Fund." It is actually the Capital of a non-profit concern. It may be found out as the excess of assets over liabilities. Usually "Surplus" or "Deficit" during a period is added with or deducted from it. A portion of capitalised incomes like donations may be added with it.

(ii) Special Fund: It may be created out of special donation or subscription or out of a portion of the "Surplus". For example a club may have a "Building Fund". It may be used for meeting some specific expenses or for acquiring an asset. If any income is derived out of investments made against this fund or if any profit or loss occurs due to sale of such investments, such income or profit or loss is transferred to this fund.

If the Special Fund is used to meet an expense, the following entry is passed:

Special Fund A/c   Dr.

To Bank A/c (amt. of expense)

NB: The balance of the Fund is shown as a liability in the Balance Sheet.

Finally, when the balance is transferred to Capital Fund, the entry will be:

Special Fund A/c Dr.

To Capital Fund A/c (Balance of Special Fund)

If the Special Fund is used to purchase an asset

Asset A/c Dr.

To Bank A/c (Cost of the asset)

Special Fund A/c Dr.

To Capital Fund A/c (Special Fund closed)

(iii) Donations

(a) Donation received for a particular purpose should be credited to Special Fund. For example, Donation received for Building should be credited to Building Fund A/c.

(b) For other donations received the by-laws or rules of the concern should be followed.

(c) If there is no such rule, donations received of non-recurring nature should be credited to Capital Fund. Recurring donations received should be credited to Income & Expenditure Account.

(d) Donation paid by the concern should be debited to Income & Expenditure Account.

(iv) Legacy received

It is to be directly added with Capital Fund after deduction of tax,(if any). It is a kind of donation received according to the will made by a deceased person.

(v) Entrance Fees or Admission Fees

(a) The rules or by-laws of the concern should be followed.

(b) If there is no such rule, Admission or Entrance Fees paid once by members for acquiring membership should be added with Capital Fund.

(c) If such fees are of small amounts covering the expenses of admission only, the fees may be credited to Income & Expenditure Account.

(vi) Subscriptions

(a) Annual subscriptions are credited to Income & Expenditure Account on accrual basis.

(b) Life membership subscription is usually credited to a separate account shown as a liability.

Annual Subscription apportioned out of that is credited to Income & Expenditure Account and deducted from the liability. Thus the balance is carried forward till the contribution by a member is fully exhausted. If any member dies before hand, the balance of his life Membership contribution is transferred to Capital Fund or General Fund.

Illustration 13

On 31st March 2021, a club had subscription in arrears of ₹ 28,000 and in advance ₹ 4,000. During the year ended 31st March 2022, the club received subscription of ₹ 2,08,000 of which ₹ 12,500 was related to 2022-23. On 31st March, 2022, there were 5 members who had not paid subscription for 2021-22 @ ₹ 1,600 per person. Prepare the Subscription Account for the year 2021-22.

Solution:

Dr. **Subscription Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d (arrears)	28,000	By Balance b/d (advance)	4,000
To I & E A/c (income for 2021-22)[B/fig]	1,79,500	By R & P A/c (received)	2,08,000
To Balance c/d (advance)	12,500	By Balance c/d (arrears- ₹1600 × 5)	8,000
	2,20,000		**2,20,000**

Illustration 14

The City Sports Club of Surat had received in 2022-2023 ₹ 50,000 towards subscription. Subscription for 2021-22 unpaid on 1.4.2022 were ₹ 5,000.

Subscriptions paid in advance on 31.3.2022 were ₹ 1,250 and the same on 31.3.2023 was ₹ 1,000. Subscriptions for 2022- 2023 unpaid on 31.3.2023 were ₹ 2,250.

Show a statement showing the amount of subscriptions that would appear in Income and Expenditure Account of the club for the year ended 31.03.2023.

Solution:

Particulars	(₹)
Subscriptions received during the year 2022-2023	50,000
Add : Subscription outstanding on 31.3.2023	2,250
	52,250
Less : Subscription outstanding on 1.4.22	5,000
	47,250
Add : Subscription paid in advance on 31.3.2022	1,250
	48,500
Less : Subscription received in advance on 31.3.2023	1,000
Subscription for 2022-2023	47,500

Illustration 15

The following is the Income and Expenditure Account of GB Club for the year ended 31st March. 2023:

Income and Expenditure Account of GB Club

Dr. **for the year ended 31st March, 2023** **Cr.**

Expenditure	(₹)	Income	(₹)
To Salaries	19,500	By Subscription	68,000
To Rent	4,500	By Donation	5,000

Expenditure	(₹)	Income	(₹)
To Printing	750		
To Insurance	500		
To Audit Fees	750		
To Games & Sports	3,500		
To Subscriptions written off	350		
To Miscellaneous Expenses	14,500		
To Loss on sale of Furniture	2,500		
To Depreciation:			
Sports Equipment	6,000		
Furniture	3,100		
To Excess of income over expenditure	17,050		
	73,000		**73,000**

Additional Information:

	31-03-2022 (₹)	31-03-2023 (₹)
Subscription in arrears	2,600	3,700
Advance Subscriptions	1,000	1,500
Outstanding expenses:		
Rent	500	800
Salaries	1,200	350
Audit Fee	500	750
Sports Equipment less depreciation	25,000	24,000
Furniture less depreciation	30,000	27,900
Prepaid Insurance	—	150

Book value of furniture sold is ₹ 7,000. Entrance fees capitalized ₹ 4,000. On 1st April, 2022 there was no cash in hand but Bank Overdraft was for ₹ 15,000. On 31st March, 2023 cash in hand amounted to ₹ 850 and the rest was Bank balance.

Prepare the Receipts and Payments Account of the GB Club for the year ended 31st March, 2022.

Solution:

Receipts and Payments of GB Club Account for the year ended 31.3.2023

Receipt	(₹)	Payments	(₹)	
To Subscription A/c (W.N.1)	67,050	By Balance b/d (Bank overdraft)		15,000
To Donation A/c	5,000	By Salary	19,500	
To Entrance Fees A/c	4,000	Add: Outstanding of last year	1,200	
To Furniture A/c	4,500	Less: Outstanding of this year	(350)	20,350
(Sale of furniture) (7,000 - 2,500)		By Rent	4,500	
		Add: Outstanding of last year	500	

Receipt	(₹)	Payments	(₹)	
		Less: Outstanding of this year	(800)	4,200
		By Printing		750
		By Insurance	500	
		Add: Prepaid in this year	150	650
		By Audit Fees	750	
		Add: Outstanding of last year	500	
		Less: Outstanding of this year	(750)	500
		By Games and Sports		3,500
		By Miscellaneous Expenses		14,500
		By Sports Equipment (Purchased) (W.N.2)		5,000
		By Furniture (Purchased) (W.N.3)		8,000
		By Balance c/d		
		Cash		850
		Bank (Bal. fig.)		7,250
	80,550			**80,550**

Working Notes:

1. Calculation of subscription received during the year 2022-2023

Particulars	(₹)	(₹)
Subscription as per Income and Expenditure A/c		68,000
Less: Arrears of 2022-2023	3,700	
Advance in 2021-2022	1,000	(4,700)
		63,300
Add: Arrears of 2021-2022	2,600	
Advance for 2022-2023	1,500	4,100
		67,400
Less: Written off during 2022-2023		(350)
		67,050

2. Calculation of Sports Equipment purchased during 2022-2023

Dr. Sports Equipment Account Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d To Receipts & Payments A/c (Purchases) (bal. fig.)	25,000 5,000	By Income & Expenditure A/c (Depreciation) By Balance c/d	6,000 24,000
	30,000		**30,000**

3. Calculation of Furniture purchased during 2022-2023

Dr. Furniture Account Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d To Receipts and Payments A/c (Purchases) (Bal. fig.)	30,000 8,000	By Receipts & Payments A/c By Income and Expenditure A/c (Loss on sale) By Income and Expenditure A/c (Depreciation) By Balance c/d	4,500 2,500 3,100 27,900
	38,000		**38,000**

Illustration 16

The Income and Expenditure account of an association for the year ended 31 March 2023 is as under:

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Salaries	1,20,000	By Subscription	1,70,000
To Printing and Stationery	6,000	By Entrance fee	4,000
To Telephone	1,500	By Contribution for Dinner	36,000
To Postage	500		
To General expenses	12,000		
To Interest and bank charges	5,500		
To Audit fees	2,500		
To Annual Dinner Expenses	25,000		
To Depreciation	7,000		
To Surplus	30,000		
	2,10,000		**2,10,000**

The aforesaid Income and Expenditure account has been prepared after the following adjustments: (₹)

Subscription outstanding as on 31st March 2022	16,000
Subscription outstanding as on 31st March 2023	18,000
Subscription received in advance as on 31st March 2022	13,000
Subscription 'received in advance as on 31st March 2023	8,400
Salaries outstanding as on 31st March 2022	6,000
Salaries outstanding as on 31st March 2023.	8,000
Audit fees for 2021-22 paid during 2022-23	2,000
Audit fee for 2022-23 not paid	2,500
The building owned by the association since 2022 costs	1,90,000
Equipment as on 31st March, 2022 valued at	52,000
At the end of the year after depreciation of ₹ 7,000, equipment amounted to	63,000
In 2020-21, the association raised a bank loan of which is still not paid	30,000
Cash in hand as on 31st March 2023	28,500
Cash in hand as on 31st March 2022	13,600
Capital Fund as on 31st March 2022	2,20,600

You are required to prepare Receipts and Payment Account of the association for the year ended 31st March 2023 and the Balance Sheet as at that date.

Solution:

Receipts and Payments
for the year ended 31st March, 2023

Receipts	(₹)	Payments	(₹)
To Balance b/d	13,600	By Salaries W.N. (2)	1,18,000
To Subscription (WN.3)	1,63,400	By Printing & Stationery	6,000
To Entrance Fees	4,000	By Postage	500
To Annual Dinner Contribution	36,000	By Telephone	1,500
		By General Expenses	12,000
		By Audit Fees	2,000
		By Dinner Expenses	25,000
		By Interest	5,500
		By Equipments W.N. (1)	18,000
		By Balance c/d	28,500
	2,17,000		**2,17,000**

Balance Sheet as at 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)
Capital (W.N.- 4)	2,20,600		Buildings	1,90,000
Add: Surplus	30,000	2,50,600	Equipments	63,000
Bank Loan		30,000	Cash in Hand	28,500
Creditors : Salaries		8,000	Subscription Receivable	18,000
Audit Fees O/S		2,500		
Subscription Received in Advance		8,400		
		2,99,500		**2,99,500**

Working Notes: (1)

Dr. **Equipment Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	52,000	By Depreciation	7,000
To Bank A/c (B/f)	18,000	By Balance c/d	63,000
	70,000		**70,000**

(2)

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

Particulars	(₹)	Particulars	(₹)
To Salary O/S (2021 - 22)	8,000	By Income & Expenditure A/c	1,20,000
To Bank A/c (Bal. fig.)	1,18,000	By Salary O/S (2020-21)	6,000
	1,26,000		**1,26,000**

(3)

Dr. **Subscription Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Subscription Receivable (2020-21)	16,000	By Subscription Receive in Advance (2020-21)	13,000
To Subscription Received in Advance (2022-23)	8,400	By Subscription Receivable (2021-22)	18,000
To Income & Expenditure A/c	1,70,000	By Bank A/c (Bal. fig.)	1,63,400
	1,94,400		**1,94,400**

(4)

Balance Sheet as at 31st March, 2022

Liabilities	(₹)	Assets	(₹)
Capital fund (Bal. fig.)	2,20,600	Building	1,90,000
Bank loan	30,000	Equipment	52,000
Creditors Salaries	6,000	Cash in hand	13,600
Audit Fees O/S	2,000	Subscription Receivable	16,000
Subscription Received in Advance	13,000		
	2,71,600		**2,71,600**

Illustration 17

JB Club furnishes you the Receipts and Payments Account for the year ended 31.03.2023:

Receipts	(₹)	Payments	(₹)
To Cash in hand (1.4.2022)	40,000	By Salary	20,000
To Cash at Bank (1.4.2022)	1,00,000	By Repair expenses	5,000
To Donations	50,000	By Furnitures	60,000
To Subscriptions	1,20,000	By Investments	60,000
To Entrance fee -	10,000	By Misc. Expenses	5,000
To Interest on Investments	1,000	By Insurance Premium	2,000
To Interest from Banks,	4,000	By Billiards table and other Sports Items	80,000
To Sale of Old Newspaper	1,500	By Stationery Expenses	1 ,500
To Sale of Drama Tickets	10,500	By Drama Expenses	5,000
		By Cash in Hand (31.03.2023)	26,500
		By Cash at Bank (31.03.2023)	72,000
	3,37,000		**3,37,000**

Additional information:

(a) Subscriptions in arrear for 2022-23 ₹ 9,000 and subscription in advance for the year 2023-24 ₹ 3,500.

(b) ₹ 400 was the insurance premium outstanding as on 31.03.2023.

(c) Miscellaneous expenses prepaid ₹ 900.

(d) 50% of donation is to be capitalized.

(e) Entrance fees to be treated as revenue income.

(f) 8% interest has accrued on investments for five months.

(g) Billiards table and other sports equipments costing ₹ 3,00,000 were purchased in the financial year 2021-22 and of which ₹ 80,000 was not paid 31.03.2022. There is no charge for Depreciation to, be considered.

You are required to prepare Income and Expenditure Account for the year ended 31.03.2023 and Balance sheet of the Club as at 31.03.2023.

Solution:

JB Club
Income and Expenditure Account
Dr. for the year ended 31.03.2023 Cr.

Expenditure	(₹)	Income	(₹)
To Salary	20,000	By Subscription	1,25,500
To Repair Expenses	5,000	(₹ 1,20,000 + ₹ 9,000 - ₹ 3,500)	
To Misc. Expenses	4,100	By Donation @ 50%	25,000
(5,000 – 900) (less prepaid)		By Entrance Fee	10,000
To Insurance Premium	2,000	By Sale of Old Newspaper	1,500
To Stationery Expenses	1,500	By Bank Interest	4,000
To Drama Expenses	5,000	By Interest on Investments	3,000
		(60,000 × 8% × 5/12) + 1,000	
To Excess of Income over Expenditure	1,41,900	By Sale of Drama Tickets	10,500
	1,79,500		**1,79,500**

Balance Sheet as at 01.04.2022

Liabilities	(₹)	Assets	(₹)
Capital Fund (Bal. fig)	3,60,000	Cash in Hand	40,000
Billiards Table Outstanding	80,000	Cash at Bank	1,00,000
		Billiards Table and Other Sports Equipments	3,00,000
	4,40,000		**4,40,000**

Balance Sheet as at 31.03.2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Fund	3,60,000		Cash in Hand		26,500
Add: Donations	25,000		Cash at Bank		72,000
Excess of Income over Expenditure	1,41,900	5,26,900	Investments	60,000	
			Accrued Interest	2.000	62,000
Subscriber in Advance		3,500	Furniture		60,000
			Prepaid Misc. Exp.		900
			Subscription Arrear		9,000
			Billiards Table and Other Sports Equipments		3,00,000
		5,30,400			**5,30,400**

Note: Insurance Premium Outstanding is not recorded because it is not a transaction.

Illustration 18

OB Library Society showed the following position on 31st March, 2022:

Balance Sheet as on 31st March, 2022

Liabilities	(₹)	Assets	(₹)
Capital Fund	7, 93,000	Electrical Fittings	1,50,000
Expenses Payable	7,000	Furniture	50,000
		Books	4,00,000
		Investments in Securities	1,50,000
		Cash at Bank	25,000
		Cash in Hand	25,000
	8,00,000		**8,00,000**

The Receipts and Payment Account for the year ended on 31st March, 2023 is given below:

Receipts		(₹)	Payments	(₹)
To Balance b/d			By Electric Charges	7,200
Cash at Bank	25,000		By Postage and Stationery	5,000
Cash in Hand	25,000	50,000	By Telephone Charges	5,000
To Entrance Fees		30,000	By Books Purchased (Apr, 2021)	60,000
To Membership Subscription		2,00,000	By Outstanding Expenses Paid	7,000
To Sale Proceeds of Old Papers		1,500	By Rent	88,000
To Hire of Lecture Hall		20,000	By Investment in Securities	40,000
To Interest on Securities		8,000	By Salaries	66,000
			By Balance c/d	
			Cash at Bank	20,000
			Cash in Hand	11,300
		3,09,500		**3,09,500**

You are required to prepare Income and Expenditure Account for the year ended 31st March, 2023 and a Balance Sheet as at 31st March, 2023 after making the following adjustments:

(a) Membership subscription included ₹ 10,000 received in advance.

(b) Provide for outstanding rent ₹ 4,000 and salaries ₹ 3,000.

(c) Books to be depreciated @ 10% including additions. Electrical fittings and furniture are also to be depreciated at the same rate.

(d) 75% of the entrance fees is to be capitalized.

(e) Interest on securities is to be calculated @ 5% p.a. including purchases made on 01.10.2022 for ₹ 40,000.

Solution:

Income & Expenditure Account of OB Library Society
for the year ended 31-3-2023

Dr. **Cr.**

Particulars		(₹)	Particulars		(₹)
To Electricity Charges		7,200	By Entrance Fees (30,000 × 25%)		7,500
To Postage & Stationery		5,000	By Membership Subscription	2,00,000	
To Telephone Charges		5,000	Less: Advance	10,000	1,90,000
To Rent	88,000		By Sale of Old Papers		1,500
Add: Outstanding	4,000	92,000	By Hire of Lecture Hall		20,000
To Salaries	66,000		By Interest on Securities	8,000	
Add: Outstanding	3,000	69,000	Add. Accrued Interest	500	8,500
To Depreciation on:					
Books (10% on 4,60,000)		46,000	[5% on 1,50,000 + (5% on 40,000) × $\frac{1}{2}$ - 8,000]		
Electrical fittings (10% on 1,50,000)		15,000			
Furniture (10% on 50,000)		5,000	By Deficiency		16,700
		2,44,200			**2,44,200**

Balance Sheet of OB Library as on 31.03.2023

Liabilities		(₹)	Assets	(₹)
Capital Fund	7,93,000		Electrical Fitting (1,50,000 – 15,000)	1,35,000
Add: Entrance fees	22,500		Furniture (50,000 – 5,000)	45,000
	8,15,500		Books (4,60,000 – 46,000)	4,14,000
Less: Excess of			Investment in securities (1,50,000 + 40,000)	1,90,000
Expenditure over Income	16,700	7,98,800	Accrued Interest	500
Outstanding Expenses:			Cash at Bank	20,000
Rent	4,000		Cash in Hand	11,300
Salaries	3,000	7,000		
Membership Subscription in Advance		10,000		
		8,15,800		**8,15,800**

Illustration 19

Following is the summary of Receipts and Payments of RR Clinic for the year ended 31st March, 2023:

	(₹)
Opening Cash Balance	56,000
Donation Received (including ₹50,000 for Building Fund)	1,55,000
Payment to Creditors for Medicines Supply	2,10,000
Salaries	70,000
Purchase of Medical Equipments	1 ,05,000
Medical Camp Collections	87,500
Subscription Received	3,50,000
Interest on Investments @ 9% p.a.	63,000
Honorarium to Doctors	1,90,000
Telephone Expenses	6,000
Medical Camp Expenses	10,500
Miscellaneous Expenses	7,000

Additional Information:

SI.		01.04.2022 (₹)	31.03.2023 (₹)
1.	Subscription Due	10,500	15,400
2.	Subscription Received in Advance	8,400	4,900
3.	Stock of Medicine	70,000	1,05,000
4.	Medical Equipments	1,47,000	2,14,200
5.	Building	3,50,000	315,000
6.	Creditor for Medicine Supply	63,000	91,000
7.	Investments	7,00,000	7,00,000

You are required to prepare Receipts and Payments Account and Income and Expenditure Account for the year ended 31st March, 2023 and the Balance Sheet as on 31st March, 2023.

Solution:

Receipts and Payments Account of RR Clinic
for the year ended 31.03.2023

Receipts	(₹)	Payments	(₹)
To Cash in Hand (Opening)	56,000	By Medical Supply	2,10,000
To Subscription	3,50,000	By Honorarium to doctors	1,90,000
To Donation	1,55,000	By Salaries	70,000
To Interest on Investment	63,000	By Misc. Expenses	7,000
To Medical Camp collections	87,500	By Purchase of Equipment	1,05,000
		By Telephone Expenses	6,000
		By Medical Camp Expenses	10,500
		By Cash in Hand (Closing)	1,13,000
	7,11,500		**7,11,500**

Income and Expenditure Account of RR Clinic

Dr. **for the year ended 31.03.2023** **Cr.**

Expenditure	(₹)	Income	(₹)
To Medicine Consumed	2,03,000	By Subscription	3,58,400
To Honorarium to Doctors	1,90,000	By Donation	1,05,000
To Salaries	70,000	By Interest on Investments	63,000
To Telephone Expenses	6,000	By Profit on Medical camp:	
To Misc. Expenses	7,000	Collections 87,500	
To Depreciation on:		Less: Expenses 10,500	77,000
Medical Equipment 37,800			
Building 35,000	72,800		
(3,50,000 – 3,15,000)			
To Surplus-excess of Income over Expenditure	54,600		
	6,03,400		**6,03,400**

Balance Sheet of RR Clinic as on 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Fund:			Building	3,50,000	
Opening Balance	12,62,100		Less: Depreciation	(35,000)	3,15,000
Add: Surplus	54,600	13,16,700	Medical Equipment	1,47,000	
Building Fund		50,000	Add: Purchase	1,05,000	
Subscription Received in Advance		4,900		2,52,000	
			Less: Depreciation	(37,800)	2,14,200
Creditors for Medicine Ssupply		91,000			
			Stock of Medicine		1,05,000
			Investments		7,00,000
			Subscription Receivable		15,400
			Cash in hand		1,13,000
		14,62,600			**14,62,600**

		(₹)	(₹)
1	**Subscription for the year ended 31.03.2023**		
	Subscription received during the year		3,50,000
	Less: Subscription receivable on 01.04.2022	10,500	.
	Less: Subscription received in advance on 31.03.2023	4,900	(15,400)

		(₹)	(₹)
	Add: Subscription receivable on 31.03.2023	15,400	3,34,600
	Add: Subscription received in advance on 01.04.2022	8,400	23,800
	Subscription for the year 2022-23		3,58,400
2.	**Purchase of Medicine**		
	Payment of Medicine Supply		2,10,000
	Less: Amount due for Medicine Supply 01.04.2022		(63,000)
			1,47,000
	Add: Amount due for Medicine Supply on 31.03.2023		91,000
	Purchase of Medicine during 2022-23		2,38,000
3.	**Medicine Consumed**		
	Stock of Medicine on 01.04.2022		70,000
	Add: Purchase of Medicine during the year		2,38,000
			3,08,000
	Less: Stock of Medicine on 31 03.2023		(1,05,000)
	Medicines Consumed		2,03,000
4	**Depreciation on Equipment**		
	Value of Equipment on 01.04.2022		1,47,000
	Add: Purchase of Equipment during the year		1,05,000
			2,52,000
	Less: Value of Equipment on 31.03.2023		(2,14,200)
	Depreciation on Equipment for the year		37,800

Balance Sheet of RR Clinic as on 31st March, 2022

Liability	(₹)	Assets	(₹)
Capital Fund: (balancing Figure)	12,62,100	Building	3,50,000
Subscription Received in Advance	8,400	Medical Equipment	1,47,000
Creditors for Medicine Supply	63,000	Stock of Medicine	70,000
		Investments	7,00,000
		Subscription Receivable	10,500
		Cash in Hand	56,000
	13,33,500		**13,33,500**

Illustration 20

The following information provided by the New Youth Club, Delhi for the first year ended 31st March, 2023:

(i) Donations Received for Building ₹ 25,00,000;

(ii) Other Incomes and Receipts were:

(₹ in '000)

Particulars	Capital Income	Revenue Income	Actual Receipt
	(₹)	(₹)	(₹)
Entrance Fees	—	251	251
Life Membership Fees	105	—	105
Subscription	—	1,160	1,151
Play Ground Rent	—	120	110
Refreshment Account	—	115	115
Sundry Incomes	—	62	49

(iii) Expenditures and actual payments were:

(₹ in '000)

Particulars	Capital Expenditure	Revenue Expenditure	Actual Payment
	(₹)	(₹)	(₹)
Land	800	—	800
Books	236	—	202
Furniture	345	—	315
Honorarium and Salaries	—	165	131
Maintenance of Play Ground	—	52	50
Refreshment Account	—	79	79
Insurance Premium	—	12	15
Sundry Expenses	—	70	65

Others:

Donation were utilized to the extent of ₹ 13 Lakh in construction of building, remaining balance were unutilized. In order to keep in safe, 8% Government Securities were purchased on 31st December, 2022 for ₹ 10.50 Lakh. Remaining amount was put in bank as term deposit on 31st March, 2023. During the year 2022-23, Subscription received in advance ₹ 52,000 for the year 2023-24.

Depreciation to be charged on Building and Furniture @ 10% and on Books @ 15%.

You are required to prepare the Receipts & Payments Account, Income & Expenditure Account and Balance Sheet as on 31st March, 2023.

Solution:

New Youth Club

Receipts & Payments Account (₹ in 000)

Dr. **for the year ending 31st March, 2023** **Cr.**

Receipts	(₹)	Payments	(₹)
To Donations	2,500	By Land	800
To Entrance fees	251	By Building	1,300
To life Membership fees	105	By Books	202
To Subscription	1,151	By Furniture	315
To Play Ground rent	110	By Honorarium and Salaries	131
To Refreshment account	115	By Maintenance of Play Ground	50
To Sundry incomes	49	By Refreshment Account	79
		By Insurance Premium	15
		By Sundry Expenses	65
		By Govt. Securities	1,050
		By Term Deposits	150
		By Balance c/d	124
	4,281		**4,281**

Income & Expenditure Account

Dr. **for the year ending 31st March, 2023** **Cr.** (₹ in 000)

Expenditure	(₹)	(₹)	Income	(₹)	(₹)
To Honorarium and Salaries	131		By Subscription	1,151	
Add: Outstanding	34	165	Less: Received in Advance	52	
To Maintnc. of Play Ground.	50			1,099	
Add: Outstanding	2	52	Add: Outstanding	61	1,160
To Insurance Premium	15		By Entrance Fees		251
Less: Prepaid	3	12	By Play Ground Rent	110	
To Sundry Expenses	65		Add: Outstanding	10	120
Add: Outstanding	5	70	By Prof it on Refreshment		36
To Depreciation			By Sundry Incomes	49	
On Building-10% on ₹ 13 Lakh		130	Add: Outstanding	13	62
On Fumiture-10% on ₹ 3,45,000		34.50	By Interest on Govt. Securities (Accrued)		21
On Books- 15% on ₹ 2,36000		35.40			
To Surplus		1,151.10			
		1,650			**1,650**

Balance Sheet as on 31st march, 2023

(₹ in 000)

Liabilities		(₹)	Assets	(₹)
Capital Fund			Land	800
Add: Life Membership fees	105.00		Building (₹13 Lakh- ₹1.3 Lakh)	1,170
Add: Surplus	1,151.10	1,256.10	Books (₹2,36,000 - ₹35,400)	200.6
Donations for Building		2,500	Furniture (₹3,45,000 - ₹34,500)	310.5
Creditors for Books		34	8% Govt. Securities	1,050
Creditors for Furniture		30	Out. Int. on Govt. Securities	21
Outstanding Hon. and salaries		34	Outstanding Subscription	61
Outs. Maintenance of play ground		2	Prepaid Insurance Premium	3
Outstanding Sundry expenses		5	Play Ground rent- Outstanding	10
Subscription Received in Advance		52	Sundry incomes - Outstanding	13
			Term Deposits	150
			Cash and Bank	124
		3,913.10		**3,913.10**

Working Notes:

(1) Donation received for building has been treated as capital item.

(2) Amount of Term Deposit = Donations Received – (Cost of Building + 8% Govt. Securities) ₹25 Lakh – (₹13 Lakh + ₹10.50 Lakh) = ₹1 ,50,000

(3) Profit on Refreshment = ₹1,15,000 - ₹79,000 = ₹36,000

(4) Outstanding Subscription=₹11,60,000 - (₹11,51,000 – ₹52,000) = ₹61,000

(5) Accrued Interest on Govt. Securities: ₹10,50,000 × 8% × 3/12= ₹21,000

Restaurant Trading and Bar Trading

Some clubs have Restaurant and Bar facilities for members and outsiders. Under the circumstances, Restaurant Trading or Bar Trading Account is opened to ascertain the Restaurant or Bar profit, it is just like Trading Account which is opened in case of a trading concern. The Restaurant or Bar profit so ascertained from Restaurant Trading or Bar Trading is transferred to the Income and Expenditure Account as we generally transfer the Gross Profit from Trading Account to Profit and Loss Account in case of Trading concern. Hence, the method of preparing a Restaurant or Bar Trading Account is just like the method of preparing a Trading Account.

Illustration 21

The following summary of the Cash Book has been prepared by the treasurer of a Club:

Receipts	(₹)	Payments	(₹)
To Balance b/d	4,740	By Wages – outdoor staff	13,380
To Subscriptions	29,720	By Restaurant Purchase	50,400
To Entrance Fees	3,200	By Rent – 18 months' to July 30, 2022	7,500

Receipts	(₹)	Payments	(₹)
To Restaurant Receipts	56,800	By Rates	2,700
To Games & Competition Receipts	13,640	By Secretary's Salary	3,120
To Due to Secretary for Petty expenses	80	By Lighting	7,200
		By Competition Prizes	4,000
		By Printing & Postage etc.	6,000
		By Placed in Fixed Deposit	8,000
		By Balance c/d	5,880
	1,08,180		**1,08,180**

On April 1, 2022 the club's assets were:- Furniture ₹48,000, Restaurant stock ₹2,600; Stock of prizes ₹800; ₹5,200 was owing for supplies to the restaurant.

On March, 31, 2023, the Restaurant stocks were ₹3,000 and prizes in hand were ₹500, while the club owed ₹5,600 for restaurant supplies.

It was also found that subscriptions unpaid at March 31, 2023, amounted to ₹1,000 and that the figure of ₹29,720 shown in the Cash Book included ₹700 in respect of previous year and ₹400 paid in advance for the following year.

Prepare an account showing the Profit or Loss made on the Restaurant and a General Income and Expenditure Account for the year ended 31.3.2023, together with a Balance Sheet as at that date, after writing 10% off the Furniture.

Solution:

Restaurant Trading Account

Dr. **for the year ended 31st March, 2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock A/c		2,600	By Restaurant Receipts A/c		56,800
" Purchases A/c	50,400		" Closing Stock A/c		3,000
" Add: Outstanding for 31.3.2022	5,600				
	56,000				
Less: Outstanding for 01.04.2021	5,200	50,800			
" Income & Expenditure A/c (G.P. transferred)		6,400			
		59,800			**59,800**

Balance Sheet as at 1st April, 2023

Liabilities	(₹)	Assets	(₹)
Accumulated Fund: (Bal. fig.)	50,390	Furniture and Equipment	48,000
Owing for Supplies to Restaurant	5,200	Restaurant Stock	2,600
Outstanding Rent (Jan. to March 2021)	1,250	Stock of Prize	800
		Outstanding Subscriptions	700
		Cash and Bank	4,740
	56,840		**56,840**

Income and Expenditure Account

Dr. **for the year ended 31st March, 2023** **Cr.**

Expenditure	(₹)	(₹)	Income	(₹)	(₹)
To Wages		13,380	By Subscription : Subscription already received	29,720	
" Rent	7,500		Less: Outstanding for 1.4.12	700	
" Less: Outstanding on 1.4.2021	1,250			29,020	
	6,250				
			Add: Outstanding for 2022	1,000	
" Less: Prepaid for 3 months (₹7,500 × 3/18)	1,250	5,000		30,020	
" Rates		2,700	Less: Received in advance	400	29,620
" Secretary's Salary		3,120	" Games Competition Receipts		13,640
" Lighting, Cleaning, Services		7,200	" Restaurant Trading – Gross Profit		6,400
" Competition Prize	4,000				
" Add: Opening Stock	800				
	4,800				
" Less: Closing Stock	500	4,300			
" Printing, Postage and Sundries		6,000			

Expenditure	(₹)	(₹)	Income	(₹)	(₹)
” Dep. on Furniture and Equipment @ 10%		4,800			
” Surplus – Excess of Income over Expenditure		3,160			
		49,660			**49,660**

Balance Sheet as at 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Accumulated Fund:			Furniture and Equipment	48,000	
Balance on 1.4.2021	50,390		Less: Depreciation	4,800	43,200
Add: Surplus	3,160	53,550	Restaurant Stock		3,000
Entrance Fees		3,200	Stock of Prize		500
Subscription Received in Advance		400	Outstanding Subscriptions		1,000
Owing for Supplies to Restaurant		5,600	Prepaid Rent		1,250
Outstanding Petty Expenses		80	Fixed Deposit with Bank		8,000
			Cash and Bank		5,880
		62,830			**62,830**

Preparation of opening and closing Balance Sheet from a given Receipt & Payment Account and Income & Expenditure Account

While drafting the balance sheet the follow points are to be noted:

A. While preparing opening Balance Sheet

(a) At first, take the opening balance of Cash and Bank which are given in the Receipts and Payments Account as “Balance b/d”. The same will appear in the assets side of the opening Balance Sheet.

(b) All the opening assets will appear in the assets side of the opening Balance Sheet which are given in the form of adjustments. Similarly, all the opening liabilities will also appear in the liabilities side of the opening Balance Sheet.

(c) Ascertain the difference between the assets side and the liabilities side of the opening Balance Sheet which will be treated as “Capital Fund”.

B. While preparing closing Balance Sheet

(a) At first, take the closing balance of Cash and Bank which are given in the Receipts and Payments Account as “Balance c/d”. The same will appear in the asset side of the closing Balance Sheet.

(b) All the opening fixed asset which have appeared in the asset side of the opening Balance Sheet (after charging all adjustments), if not sold or cost, including addition, if any.

(c) All the closing current liabilities including capital fund, surplus or deficit (which we get from income and Expenditure Account), other funds like, Donation, Entrance Fees etc. also appear in the liabilities side of the closing Balance Sheet.

(d) Now, each individual item of Receipts and Payments Account should be compared with each individual item of Income and Expenditure Account and the same is to be adjusted accordingly. It must be remembered that items which are appeared in the credit side of the Receipts and Payments Account must be compared with the items which is appeared in the debit side of Income and Expenditure and vice-versa.

Illustration 22

The following are the items of Receipts and Payments of the BJ Club as summarized from the books of account maintained by the Secretary:

Receipts	(₹)	Payments	(₹)
Opening Balance 1.1.2023	4,200	Manager's Salary	1,000
Entrance Fees: For 2022	1,000	Printing and Stationery	2,600
For 2023	10,000	Advertising	1,800
Subscriptions: For 2022	600	Fire Insurance	1,200
For 2024	15,000	Investments Purchased	20,000
Interest Received on Investments	3,000	Closing Balance 31.12.2023	7,600
Subscriptions 2023	400		
	34,200		**34,200**

It was ascertained from enquiry that the following represented a fair picture of the Income and Expenditure of the Club for the year 2023 for audit purpose:

Expenditure	(₹)	(₹)	Income	(₹)
Manager's Salary		1,500	Entrance Fees	10,500
Printing & Stationery	2,000		Subscription	15,600
Add: Accrued	400	2,400	Interest on Investments	4,000
Advertising (accrued Nil)		1,600		
Audit Fees		500		
Fire Insurance		1,000		
Depreciation		4,940		

Expenditure	(₹)	(₹)	Income	(₹)
Excess of Income over Expenditure		18,160		
		30,100		**30,100**

You are required to prepare the Balance Sheet of the Club as on 31.12.2022 and 31.12.2023, it being given that the values of the Fixed Assets as on 31.12.2022 were: Building ₹ 44,000, Cricket Equipment ₹ 25,000 and Furniture ₹ 4,000. The rates of depreciation are Building 5%, Cricket Equipments 10%, Furniture 6%.

Your are entitled to make assumptions as may be justified.

Solution:

BJ Club

Balance Sheet as at 31st December, 2022

Liabilities	(₹)	Assets	(₹)
Outstanding Liabilities:		Building	44,000
Advertisement (₹1,800 – ₹1,600)	200	Furniture	4,000
Printing and Stationery (₹2,600 – ₹2,000)	600	Cricket Equipment	25,000
Capital Fund (Bal. fig.)	78,000	Entrance Fees in arrear	1,000
		Subscription in arrear	600
		Cash	4,200
	78,800		**78,800**

BJ Club

Balance Sheet as at 31st December, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Fund:			Building	44,000	
Balance on 1.1.2022	78,000		Less: Depreciation 5%	2,200	41,800
Add: Excess of Income					
over Expenditure	18,160	96,160	Furniture	4,000	
Subscription Received in Advance		400	Less: Depreciation 6%	240	3,760
Outstanding Liabilities:					
Printing and Stationery		400	Cricket Equipment	25,000	
Manager's Salary:			Less: Depreciation 10%	2,500	22,500
(1,500 – 1,000)		500	Investments		20,000

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Audit Fees		500	Subscriptions in Arrear (15,600 – 15,000)		600
			Entrance Fees in Arrear (10,500 – 10,000)		500
			Accrued Interest on Investments (4,000 – 3,000)		1,000
			Prepaid Insurance (1,200 – 1,000)		200
			Cash		7,600
		97,960			**97,960**

Note: Advertisement expenses and Printing and Stationery which were paid in excess over Income and Expenditure A/c are assumed to be outstanding for the previous year.

Preparation of Financial Statements from Incomplete Records

3.3

Transactions are entered into by every organisation, and it is the primary function of accounting is to record the transactions in the books of accounts. This should be recorded in the books on a systematic and scientific manner following the double entry system. However, in many cases double entry recording is not followed. Such entities usually include the small-time traders such as grocery stores, kirana shops etc. The small entities record the transactions on a casual and sketchy manner, and thus results in incomplete recording of the transactions. This incomplete manner of recording the transactions is commonly referred to as single entry system of account keeping.

Single Entry System

Single entry system is an approach of recording transactions which does not follow the principles of double entry book-keeping system. Under this system, some transactions may be fully recorded, while some transactions get partially recorded and some other transactions may be entirely omitted to be recorded in the books of accounts. Thus, the term 'single entry' is a misnomer. It would rightly be referred to as incomplete records.

Features of Single Entry System

The salient features of single entry system are as under:

- It is an unscientific approach of recording transactions.
- It is a mixture of no entry, single entry and double entry.
- This system is usually followed by the small businesses, semi-skilled service providers and workers etc. who cannot maintain books under double entry system.
- There is no uniformity in recording of transactions.
- Usually, only the cash and personal accounts are recorded.
- In this system, the original vouchers of different transactions are kept for future references, though the relevant accounts are not prepared.

Limitations/ Defects of Single Entry system

Single entry system is a defective approach of recording transactions as it suffers from certain major limitations, which are as under:

(i) As principle of double entry is not followed, the trial balance cannot be prepared. Hence, arithmetical accuracy cannot be guaranteed.

(ii) Profit or loss can be found out only by estimates as nominal accounts are not maintained.

(iii) It is not possible to make a balance sheet in absence of real accounts.

(iv) It is very difficult to detect frauds or errors.

(v) Valuation of assets and liabilities is not proper.

(vi) The external agencies like banks cannot use financial information. A bank cannot decide whether to lend money or not.

(vii) It is quite likely that the business and personal transactions of the proprietor get mixed.

Difference between single entry system and double entry system

The distinctions between double entry system and single entry system are as follows:

(i) Single entry is a casual and unscientific approach of recording transactions, while double entry is the scientific approach of record keeping.

(ii) In double entry system, both the aspects (debit and credit) of all the transactions are recorded. But in single entry system, there is no record of some transactions. In this system, some transactions are recorded only in one of their aspects whereas some other transactions are recorded in both of their aspects.

(iii) Under double entry system, various subsidiary books such as sales book, purchases book etc. are maintained. Under single entry system, no such subsidiary books except cash book which is also considered as a part of ledger is maintained.

(iv) In the case of double entry system, there is a ledger which contains personal, real and nominal accounts. But in single entry system, the ledger contains cash account and some personal accounts only.

(v) Under double entry system, preparation of trial balance is possible, whereas it is not possible to prepare a trial balance in single entry system. Hence accuracy of work is uncertain.

(vi) Under double entry system, Trading A/c, Profit & Loss A/c and the Balance Sheet are prepared in a scientific manner. But under single entry system, only a rough estimate of Profit or Loss is made and a Statement of Affairs is prepared which resembles a Balance Sheet in appearance but which does not present an accurate picture of the financial position of the business.

(vii) The possibility of fraud and misappropriation is greater under single entry system as compared to double entry system.

(viii) Double entry system of book-keeping is usually followed by most of the concerns, while single entry is followed by the small businesses, sole traders, partnership firms and professionals who cannot afford to maintain the formal books of accounts.

Accounting from Incomplete Records & Preparation of Final Accounts

The businesses which does not follow the formal double entry system of accounting do not have any uniformity in their practices. They record the transactions as per their own wish and requirements. Such entities do not maintain the regular books of accounts, and fail to draft the trial balance and the financial statements.

However, such smaller entities are also interested in determining the operating results and financial position at the end of every accounting period. It may not be possible for such entities to determine the correct operating results and reflect the true financial position at the end of an accounting period from such partial and incomplete records.

There are two recognised approaches of preparing the financial statements from such incomplete records. They are:

1. Balance sheet approach/ net worth approach/ comparison approach
2. Conversion approach.

Approach 1: Balance Sheet Approach/ Net Worth Approach/ Comparison Approach

Under this approach, the operating result of an entity is determined by comparing the net worth capital of the entity at two different points of time. As per this approach, the balances of capital/ net worth are determined by preparing the statement of affairs Using these capitals, the operating result is determined by comparing the amounts of capital/ net worth at two points of time. Hence, this approach is known as the balance sheet approach/ net worth approach/ comparison approach.

Under this approach, three statements are prepared:

- **Statement of affairs:** It is a statement of financial position that is prepared with the balances of various assets and liabilities to ascertain the capital/ net worth at the beginning and end of the accounting period.
- **Statement of profit & loss:** This statement is prepared for determination of the profit/ loss) of the entity. Firstly, the trading profit/loss is determined by comparing the capital / net worth as at the beginning and end of the accounting period. Thereafter, effect is to be given for the necessary adjustments for determination of the net profit/ loss for the accounting period.
- **Final statement of affairs:** This statement is to be prepared at the end of the accounting period with the closing balances of the assets and liabilities after providing for the necessary adjustments viz. Depreciation, provision for bad & doubtful debts etc. It is also known as the revised statement of affairs.

Steps for preparation of Final Accounts under 'Balance Sheet/ Net Worth/ Comparison Approach'

Step 1: Preparation of 'statement of affairs' as at the beginning & end of the accounting period for determination of the amount of the opening and closing capital/ net worth.

Step 2: Preparation of 'statement of profit & loss' for determination of trading profit/ loss, and thereafter, the net profit/ loss.

Statement of profit and loss for the year ended

Particulars	(₹)	(₹)
Capital (at the end)	xx	
Less : Capital (at the beginning)	xx	xx
Add : Drawings		xx
		xx
Less : Further Capital Introduced (if any)		xx
Profit/Loss		xx
Less : Adjustments, if any say, Bad debts, Depreciation etc.		xx
Net Profit/Loss for the Period		xx

Particulars	(₹)	(₹)
Less : Appropriation Items :		
(i) Interest on Partner's Capital	xx	
(ii) Partners' Salaries etc.	xx	xx
Divisible Profit		xx

Step 3: Preparation of 'Final Statement of Affairs' as at the end of the accounting period for disclosing the financial position of the entity.

It may be mentioned here that while preparing statement of profit care should be taken to see which adjustments have been considered while preparing closing statement of affairs and which not considered. Adjustments should be taken in one place only i.e. either in closing statement of affairs or in statement of profit.

Approach 2: Conversion Approach

An entity that does not maintain its books under double entry system records only some of the total transactions that it enters into. In such case, it would not be possible to ascertain the profit/ loss and reflect its financial position through the preparation of financial statements directly as the ledger balances are not available. However, such organisation's financial statements may be prepared from such recorded data by recording them in relevant accounts under the double entry system of book keeping, and there after determining the 'missing information'. Usually, the regular accounts like Debtors A/c, Creditors A/c, Cash book, Assets A/c etc. are prepared with the data available and relevant ledger balances are calculated.There is no fixed approach towards determination of such information, and the steps to be taken depends on the data available in each case. Since, as per this approach the data kept under single entry system are converted to double entry system, it is referred to as 'Conversion Approach'.

Difference between 'Statement of Affairs' & 'Balance Sheet'

Statement of Affairs	Balance Sheet
1. It is prepared by an entity following single entry system.	1. It is prepared by an entity following double entry system.
2. It is prepared for determining the Capital or Net Worth at two different points of time.	2. It is prepared for disclosing the financial position of an entity.
3. It reflects the estimated financial position.	3. It reflects the true financial position.
4. The information contained in the Statement of Affairs is comparatively less reliable.	4. The information contained in the Balance Sheet is more reliable.
5. The balance of Capital account is taken as the 'excess of assets over liabilities'.	5. The balance of Capital account is available from regular accounting records.
6. It has no statutory format.	6. Balance Sheet format is specified under various statutes viz. Companies Act, Banking Regulations Act etc.

Difference between 'Statement of Profit & Loss' & 'Profit & Loss Account'

Statement of Profit & Loss	Profit & Loss Account
1. It is prepared by an entity following single entry system.	1. It is prepared by an entity following double entry system.
2. Profit/ loss is determined by comparing the capital/ net worth at two points of time.	2. Profit/ loss is determined by matching expenses/ losses against incomes / gains.
3. It reflects the estimated profit/ loss of an entity.	3. It reflects the true profit/ loss of an entity.
4. All items of expenses, losses, incomes and gains do not get properly disclosed.	4. All expenses, losses, incomes and gains get properly disclosed.
5. Information provided by the Statement of Profit & Loss is comparatively less reliable.	5. Information provided by the Profit & Loss Account is reliable.

Illustration 23

Mr. Prakash keeps his accounts on single entry system. He has given following information about his assets and liabilities.

Items	On 31.03.2022	On 31.03.2023
Creditors	55,200	58,500
Cash at bank	600	1500
Bills payable	26,400	28,200
Bills receivables	16,200	18,300
Debtors	45,600	56,000
Stock in trade	31,000	47,300
Machinery	66,200	78,000
Computer	18,000	17,000

During the year, Prakash brought additional ₹7,500 cash in business. He withdrew goods of ₹2,100 and cash of ₹7,200 for his personal use. Interest on opening capital is to be given at 5% and interest on drawing is to be charged at 10%.

Prepare statement of profit or loss for the year ended 31.03.2023.

Solution:

Here the information about opening and closing capital is not given. Both these figures can be computed based on statement of affairs as on 31.03.2022 and 31.03.2023.

These figures will then be used together with further information to ascertain the profit or loss for the period by drafting the Statement of Profit or Loss for the year ended 31.03.2023.

Mr. Prakash

Statement of Affairs as on 31.03.2022

Liabilities	(₹)	Assets	(₹)
Creditors	55,200	Cash at Bank	600
Bills Payable	26,400	Bills Receivables	16,200
Capital (Bal. figure.)	96,000	Debtors	45,600
		Stock in Trade	31,000
		Machinery	66,200
		Computers	18,000
	1,77,600		**1,77,600**

Statement of Affairs as on 31.03.2023

Liabilities	(₹)	Assets	(₹)
Creditors	58,500	Cash at Bank	1,500
Bills Payable	28,200	Bills Receivables	18,300
Capital (Bal. fig.)	131,400	Debtors	56,000
		Stock in Trade	47,300
		Machinery	78,000
		Computers	17,000
	2,18,100		**2,18,100**

Statement of Profit or Loss for the year ended 31.03.2023

Particulars	(₹)
Closing Capital as per Statement of Affairs as on (31.03.2023)	1,31,400
Less: Opening Capital as per Statement of Affairs as on (31.03.2022)	(96,000)
Increase or decrease in capital	35,400
Add: Drawings (Goods + Cash) [₹7,200 + ₹2,100]	9,300
Add: Interest on Drawings @ 10% (₹9,300 × 10% × $^{6}/_{12}$)	465
Less: Interest on Opening Capital @ 5% (₹96,000 × 5%)	(4,800)
Less: Fresh Capital Introduced	(7,500)
Net Profit or Loss for the year	32,865

Note: Date of Drawings is not given in question hence, interest on drawings is charged for 6 months.

Illustration 24

Mr. Kanan is running a business of readymade garments. He does not maintain his books of accounts under double entry system. While assessing the income of Mr. Kanan for the financial year 2022-23, Income Tax Officer feels that he has not disclosed the full income earned by him from his business. He provides you the following information:

On 31st March, 2022	(₹)
Sundry Assets	16,65,000
Liabilities	4,13,000
On 31st March, 2023	
Sundry Assets	28,40,000
Liabilities	5,80,000
Mr. Kanan's monthly drawings for the year 2022-23	32,000
Income declared to the Income Tax Officer	9,12,000

During the year 2022-23, one life insurance policy of Mr. Kanan was matured and amount received ₹50,000 was retained in the business.

State whether the Income Tax Officer's contention is correct. Explain by giving necessary working.

Solution:

Determination of Capital balance of Mr. Karan on 31.03.2022 and on 31.03.2023

Particulars	31.03.2022 (₹)	31.03.2023 (₹)
Assets	16,65,000	28,40,000
Less: Liabilities	4,13,000	5,80,000
Capital	12,52,000	22,60,000

Determination of Profit by applying the method of the Capital Comparison

Particulars	(₹)
Capital Balance as on 31.3.2023	22,60,000
Less. Fresh Capital Introduces(matured life insurance policy amount)	(50,000)
	22,10,000
Add: Drawings (₹32,000 × 12)	3,84,000
	25,94,000
Less: Capital Balance as on 01.04.2022	(12,52,000)
Profit	13,42,000
Income Declared	9,12,000
Suppressed Income	4,30,000

The Income Tax Officer's contention that Mr. Kanan has not declared his true income is correct. Mr. Kanan's true income is in excess of the disclosed income by ₹4,30,000.

Illustration 25

The following information is available from Mrs. Sashi who maintains books of accounts on single entry system.

Particulars	01.04.2022 (₹)	31.03.2023 (₹)
Cash and Bank	20,000	21,000
Sundry Debtors	17,000	25,000
Stock	40,000	60,000
Furniture	29,000	29,000
Creditors	32,000	22,000
10 % Loan from Mrs. Sashi	30,000	30,000

Mrs. Sashi withdrew ₹ 5,000 from the business every month for meeting her household expenses. During the year She sold investments held by her privately for ₹ 35,000 and invested the amount in her business. At the end of the year 20212-2023, it was found that full years interest t on loan from Mrs. Sashi had not been paid. Depreciation @ 10% p.a was to be provided on furniture for the full year. Shop assistant was to be given a share of 5% on the profits ascertained before charging such share. Calculate profit earned during the year ended 31.03.2023 by Mrs. Sashi.

Solution:

Statement of Affairs

Particulars	31-03-2022 (₹)	31-03-2023 (₹)	Particulars	31-03-2022 (₹)	31-03-2023 (₹)
Capital (opening & closing) (Bal. fig.)	44,000	83,000	Cash at Bank	20,000	21,000
			Debtors	17,000	25,000
Creditors	32,000	22,000	Stock	40,000	60,000
Loan from Mrs. Sashi	30,000	30,000	Furniture	29,000	29,000
	1,06,000	**1,35,000**		**1,06,000**	**1,35,000**

Statement of Profit & Loss

Dr. **for the year ended 31.03.2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
Opening Capital		44,000	Closing Capital		83,000
Further Introduction of Capital		35,000	Drawings (5,000 × 12)		60,000
Trading Profit		64,000			
		1,43,000			**1,43,000**
Depreciation (29,000 × 10%)		2,900	Trading Profit		64,000
Interest on Loan (30,000 × 10%)		3,000			
Net Profit		58,100			
		64,000			**64,000**

Particulars	31-03-2022 (₹)	31-03-2023 (₹)	Particulars	31-03-2022 (₹)	31-03-2023 (₹)
Commission to Shop Assistant (58,100 × 5%)		2,905	Net Profit		58,100
Net Profit		55,195			
		58,100			**58,100**

Statement of Affairs
for the year ended 31.03.2023

Particulars	(₹)	(₹)	Particulars	(₹)
Capital	44,000		Cash at Bank	21,000
Add: Further Capital Introduced	35,000		Debtors	25,000
Less: Drawings	(60,000)		Stock	60,000
Add: Net profit	55,195	74,195	Furniture (₹29,000 – ₹2,900)	26,100
Creditors		22,000		
Interest on Loan		3,000		
Commission to Assistant		2,905		
Loan from Mrs. Sashi		30,000		
		1,32,100		**1,32,100**

Illustration 26

Ram Prakash, a small trader does not keep his books following Double Entry System. From the following information provided by him, prepare Trading and Profit & Loss Account for the year ended 31st March, 2023 and Balance Sheet as at that date:

Particulars	31.03.2022 (₹)	31.03.2023 (₹)
Furniture	1,00,000	1,20,000
Stock of Goods-in-Trade	60,000	20,000
Sundry Debtors	1,20,000	140000
Prepaid Expenses	—	4,000
Sundry Creditors	40,000	?
Unpaid Expenses	12,000	20,000
Cash	22,000	6,000

Receipts and Payments during the year were as follows:

Particulars	(₹)
Receipts from Debtors	4,20,000
Paid to Creditors	2,00,000
Transportation	40,000
Drawings	1,20,000
Sundry Expenses	1,40,000
Furniture Purchased	20,000

Other Information: There were considerable amount of Cash Sales. Credit Purchases during the year amounted to ₹2,30,000. Provide a provision for Doubtful Debts to the extent of 10% on Debtors

Solution:

Ram Prakash

Trading and Profit and Loss Account

Dr. **for the year ended 31st March, 2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)
To Opening Stock		60,000	By Sales:	
To Purchases		2,30,000	Credit (WN 1)	4,40,000
To Transportation		40,000	Cash (WN 3)	84,000
To Gross Profit c/d		2,14,000	By Closing Stock	20,000
		5,44.000		**5,44.000**
To Sundry Exp.	1,40,000			
Less: Unpaid exp. For 2022	12,000		By Gross Profit b/d	2,14,000
	1,28,000			
Less: Prepaid Exp. 2023	4,000			
	1,24,000			
Add: Unpaid Exp. For 2023	20,000	1,44,000		
To Provision for Doubtful Debts.		14,000		
To Net Profit transferred to Capital A/c		56,000		
		2,14,000		**2,14,000**

Balance Sheet as at 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Creditors (WN 2)		70,000	Cash and balance		6,000
Unpaid Expenses		20,000	Debtors	1,40,000	
Capital (WN 4)	2,50,000		Less: Provision for	14,000	1,26,000
Add: Net Profit	56,000		Doubtful Debts		20,000
	3,06,000		Closing Stock		4,000
Less: Drawing	(120,000)	1,86,000	Prepaid Expenses		
			Furniture	1,00,000	
			Add: Additions	20,000	1,20,000
		2,76,000			**2,76,000**

Working Notes:

1. Calculation of Credit Sales:

Dr. **Total Debtors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	1,20,000	By Cash/Bank A/c	4,20,000
To Sales A/c — credit (Bal. fig.)	4,40,000	By Balance c/d	1,40,000
	5,60,000		**5,60,000**

2. Calculation of Closing Creditors Balance:

Dr. **Total Creditors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Cash/Bank A/c	2,00,000	By Balance c/d	40,000
To Balance c/d (b/f)	70,000	By Purchase A/c	2,30,000
		(Credit Purchases)	
	2,70,000		**2,70,000**

3. Calculation of Cash Sales:

Dr. **Cash Book** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	22,000	By Total creditors A/c	2,00,000
To Total Debtors A/c	4,20,000	By Drawings A/c	1,20,000
To Sales A/c (b/f)	84,000	By Sundry Exp. A/c	1,40,000
		By Transportation A/c	40,000
		By Furniture A/c	20,000
		By Balance c/d	6,000
	5,26,000		**5,26,000**

4. Calculation of Opening Capital:

Statement of Affairs as at 31st March, 2022

Particulars	(₹)	Particulars	(₹)
Creditors	40,000	Furniture A/c	1,00,000
Unpaid Expenses	12,000	Stock	60,000
Capital (B/F)	2,50,000	Debtors	1,20,000
		Cash in Hand	22,000
	3,02,000		**3,02,000**

Illustration 27

The following is the Balance Sheet of Chirag as on 31st March, 2022:

Balance Sheet as on April 1, 2022

Liabilities	(₹)	Assets	(₹)
Capital Account	48,000	Building	32,500
Loan	15,000	Furniture	5,000
Creditor	31,000	Motor Car	9,000
		Stock	20,000
		Debtors	17,000
		Cash in Hand	2,000
		Cash at Bank	8,500
	94,000		**94,000**

A riot occurred on the night of 31st March, 2023 in which all books and records were lost. The cashier had absconded with the available cash. He gives you the following information:

(a) His sales for the year ended 31st March, 2023 were 20% higher than the previous year's. He always sells his goods at cost plus 25%; 20% of the total sales for the year ended 31st March, 2023 were for cash. There were no cash purchases.

(b) On 1st April, 2022 the stock level was raised to ₹ 30,000 and stock was maintained at this new level all throughout the year.

(c) Collection from debtors amounted to ₹ 1,40,000 of which ₹ 35,000 was received in cash, business expenses amounted to ₹ 20,000 of which ₹ 5,000 was outstanding on 31st March, 2023 and ₹ 6,000 was paid by cheques.

(d) Analysis of the Pass Book revealed the Payment to Creditors ₹ 1,37,500, Personal Drawing ₹ 7,500, Cash deposited in Bank ₹ 71,500 and Cash withdrawn from Bank ₹ 12,000.

(e) Gross Profit as per last year's audited accounts was ₹ 30,000.

(f) Provide depreciation on Building and Furniture at 5% and Motor Car at 20%.

(g) The amount defalcated by the cashier may be treated as recoverable from him.

You are required to prepare the Trading and Profit and Loss Account for the year ended 31st March, 2023 and Balance Sheet as on that date.

Solution:

Chirag

Trading and Profit and Loss Account

Dr. **For the year ending on 31st March, 2023** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)
To Opening Stock		20,000	By Sales	1,80,000
To Purchase (Bal. fig.)		1,54,000	By Closing stock	30,000
To Gross Profit old (@ 20% on sales)		36,000		
		2,10,000		**2,10,000**

Particulars	(₹)	(₹)	Particulars	(₹)
To Sundry Business Expenses		20,000	By Gross Profit b/d	36,000
To Depreciation: on Building	1,625			
on Furniture	250			
on Motor	1,800	3,675		
To Net Profit transferred to Capital A/c.		12,325		
		36,000		**36,000**

Balance Sheet as at 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Account:			Building	32,500	
Opening Balance	48,000		Less: Depreciation	(1,625)	30,875
Add: Net Profit	12,325		Furniture	5,000	
	60,325		Less: Depreciation	(250)	4,750
Less: Drawings	(7,500)	52,825	Motor Car	9,000	
Loan		15,000	Less: Depreciation	(1,800)	7,200
Sundry Creditors [W.N. 2]		47,500	Stock in Trade		30,000
Outstanding expenses		5,000	Sundry Debtors [W.N. 1]		21,000
			Cash at Bank [W.N. 3]		22,000
			Sundry Advances [W.N. 3]		4,500
			(Amount recoverable from cashier)		
		1,20,325			**1,20,325**

Working Notes:

1. Total Debtors Account

Dr. **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	17,000	By Bank (₹1,40,000 – ₹35,000)	1,05,000
To Sales (80% of ₹ 1,80,000)	1,44,000	By Cash A/c	35,000
		By Balance c/d	21,000
	1,61,000		**1,61,000**

2. Total Creditors Account

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Bank	1,37,500	By Balance b/d	31,000
To Balance c/d	47,500	By Purchases	1,54,000
	1,85,000		**1,85,000**

3. Cash Book

Dr. Cr.

Particulars	Cash (₹)	Bank (₹)	Particulars	Cash (₹)	Bank (₹)
To Balance b/d	2,000	8,500	By Business Expenses	9,000	6,000
To Sales	36,000	—	By Drawings	—	7,500
To Sundry Debtors	35,000	1,05,000	By Sundry Creditors	—	1,37,500
To Cash (Contra)	—	71,500	By Bank (Contra)	71,500	—
To Bank (Contra)	12,000	—	By Cash (Contra)	—	12,000
			By Amount Recoverable from Cashier (Bal. fig.)	4,500	—
			By Balance c/d (Bal. fig.)	—	22,000
	85,000	**1,85,000**		**85,000**	**1,85,000**

(iv) Last years Total Sales = Gross Profit × 100/20 = ₹ 30,000 × 100/20 = ₹ 1,50,000

(v) Current year's Total Sales = ₹ 1,50,000 + 20% of ₹ 1,50,000 = ₹ 1,80,000

(vi) Current year's Credit Sales = ₹ 1,80,000 × 80% = ₹ 1,44,000

(vii) Cost of Goods Sold = Sales – G.P. = ₹ 1,80,000 – 36,000 = ₹ 1,44,000

(viii) Purchases = Cost of Goods Sold + Closing Stock – Opening Stock

= ₹ 1,44,000 + ₹ 30,000 – ₹ 20,000 = ₹ 1,54,000.

Illustration 28

The Statement of affairs of Mr. R on Saturday, the 31st December 2022 was as follows:

Particulars	(₹)	Particulars	(₹)
Capital	50,000	Fixed Assets	30,000
Sundry Creditors	10,000	Stock	10,000
Liability for Expenses	1,000	Debtors	15,000
		Bank	5,000
		Cash	1,000
	61,000		**61,000**

Mr. R did not maintain has books on the double entry system. But he carefully follows the following system:

(a) Every week he draws ₹200.

(b) After meeting his weekly sundry expenses (₹100 on average) and his drawings, the balance of weekly collection is banked at the commencement of. the next week.

(c) No cash purchase is made and creditors are paid by cheques.

(d) Sales are at fixed price which include 20% profit on sales.

(e) Credit sales are few and are noted in a diary. Payments are received in cheques only from such parties.

(f) Expenses other, than sundries and other special drawings are made in. cheques.

(g) All unpaid bills are kept in a file carefully.

The following are his bank transactions for 13 weeks:

Particulars	(₹)	Particulars	(₹)
Balance on Jan. 1	5,000	Creditors Paid	40,000
Cheques Deposited	2,000	Rent Paid	600
Cash Deposited	42,000	Expenses (other than Sundry Expenses)	3,000
		Balance on April 1.	5,400
	49,000		**49,000**

After 13 weeks on 1st April (Monday) the entire cash was missing when it was to be deposited in the bank. The following further facts are ascertained:

(a) Stock on that day was valued at ₹4,000;

(b) Sundry Debtors amounted to ₹20,000 as per diary;

(c) Sundry Creditors were ₹8,000 as per unpaid bills file. Find out the amount of cash missing.

Solution

Dr. **Sundry Debtors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f	15,000	By Bank A/c	2,000
To Credit Sales (Bal. fig.) A/c	7,000	By Balance c/f	20,000
	22,000		**22,000**

Dr. **Sundry Creditors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank A/c	40,000	By Balance b/f	10,000
To Balance c/f	8,000	By Credit Purchases (Bal. fig.)	38,000
	48,000		**48,000**

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

Particulars	(₹)	Particulars	(₹)
To Balance b/f	1,000	By Drawing: (13 × ₹ 200)	2,600
To Cash Sales	48,000	By Sundry Expenses: (13 × ₹ 100)	1,300
		By Bank A/c	42,000
		By Balance being cash missing	3,100
	49,000		**49,000**

Note: Calculation of Cash Sales:

Particulars	(₹)
Opening Stock	10,000
Add: Purchases	38,000
	48,000
Less: Closing Stock Cost of goods sold,	4,000
	44,000
Add: Gross Profit @ 20% on Sales i.e., 25% on cost	11,000
Total Sales	55,000
Less Credit Sales	7,000
Cash Sales	48,000

Illustration 29

Mrs. Laxmi, a retail trader needs final accounts for the year ended 31.03.2023 for the purpose of taking a bank loan. However, she informs you that principle of double entry had not been followed. With following inputs, prepare a Profit & Loss A/c for the year ended 31.03.2023 and Balance sheet as on 31.03.2023.

Details of receipts and payments:

(i) Cash deposited in bank ₹ 3,500

(ii) Dividend on personal A/c deposited into bank ₹ 250

(iii) Tuition fees of Laxmi's daughter paid by cheque ₹ 4,500

(iv) Rent for the year by cheque ₹ 9,000

(v) Cash received from debtors ₹ 52,500

(vi) Paid to creditors ₹ 40,025

(vii) Salaries & wages paid in cash ₹ 9,000

(viii) Transportation in cash ₹ 2,750

(ix) Office electricity in cash ₹ 6,600

(x) Electricity (house) in cash ₹ 7,200

(xi) General expenses in cash ₹ 890.

Opening and Closing Balances of Assets & Liabilities:

Particulars	31.03.2021	31.03.2022
Stock	42,500	22,500
Bank	55,500	20,500
Cash	10,850	10,500
Debtors	16,800	14,800
Creditors	15,600	22,800
Investments	15,000	15,000

She also informs you that she draws ₹6,000 from bank on monthly basis and some debtors deposit cheques directly in bank.

Solution:

Dr. **Stock Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	42,500	By Cost of sales (Bal. fig) A/c	90,135
To Purchases (credit) A/c	47,225	By Balance c/d	22,500
To Cash (purchases) A/c	22,910		
	1,12,635		**1,12,635**

Dr. **Bank Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	55,500	By Drawings A/c (tuition fees)	4,500
To Cash A/c	3,500	By Rent A/c	9,000
To Capital (dividend)	250	By Creditors A/c	40,025
To Debtors (Bal. fig.)	86,775	By Drawings A/c (@ ₹6,000 pm)	72,000
		By Balance c/d	20,500
	1,46,025		**1,46,025**

Dr. **Cash Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	10,850	By Bank A/c	3,500
To Debtors A/c	52,500	By Salaries & Wages A/c	9,000
		By Transportation A/c	2,750

Particulars	(₹)	Particulars	(₹)
		By Electricity A/c	6,600
		By Drawings A/c (electricity)	7,200
		By General Expenses A/c	890
		By Purchases (Bal. fig.)	22,910
		By Balance c/d	10,500
	63,350		**63,350**

Dr. **Debtors Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	16,800	By Cash A/c	52,500
To Sales A/c (credit Sales) (Bal. fig.)	1,37,275	By Bank A/c	86,775
		By Balance c/d	14,800
	1,54,075		**1,54,075**

Dr. **Creditors Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Bank A/c	40,025	By Balance b/d	15,600
To Balance c/d	22,800	By Purchases A/c (credit) (Bal. fig.)	47,225
	62,825		**62,825**

Dr. **Mrs. Laxmi's capital Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Drawings A/c (Tuition Fees)	4,500	By Balance b/d (Bal. fig.)	1,25,050
To Drawings A/c (Electricity)	7,200	By Bank A/c (Dividend)	250
To Drawings A/c (Bank)	72,000		
To Balance c/d	41,600		
	1,25,300		**1,25,300**

Dr. **Trading Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Opening Stock A/c	42,500	By Sales A/c	1,37,275
To Purchases A/c	70,135	By Closing Stock A/c	22,500

Particulars	(₹)	Particulars	(₹)
To Gross profit c/d	47,140		
	1,59,775		**1,59,775**

Dr. **Profit & Loss Account for the year ended 31st March 2023** Cr.

Particulars	(₹)	Particulars	(₹)
To Rent A/c	9,000	By Gross Profit b/d	47,140
To Salary & Wages A/c	9,000		
To Transportation A/c	2,750		
To Electricity A/c	6,600		
To General Expenses A/c	890		
To Net Profit c/d	18,900		
	47,140		**47,140**

Balance sheet as on 31st March 2022

Liabilities	(₹)	Assets	(₹)
Creditors	22,800	Stock	22,500
Capital (Bal. fig.)	41,600	Bank	20,500
Net profit	18,900	Cash	10,500
		Debtors	14,800
		Investment	15,000
	83,300		**83,300**

Solved Case

Mr. M. Raja, is a graduate in Sociology who hails from a middle-class family in Madurai, Tamil Nadu. Since his childhood, Raja intended to be a businessman like Mr. P. Nageswar, father of his best friend N. Premnath. Accordingly, he started his personal sole proprietary business trading in coconut oil in the year 2020-21. Mr. Raja, not being very conversant with accounts of the business, approaches you for helping him with the finalisation of the accounts of the financial year 2022-23. He furnishes you with the following bank summary for the year ended March 31, 2023:

	(₹)	(₹)
Balance on April 1, 2022		11,000
Add: Deposits		
Cash (out of cash sales)	1,25,000	
Collection from Credit Customers	3,50,000	
Income from personal investments	36,000	5,11,000
		5,22,000
Less: Deductions		
Cash withdrawn for personal drawings	20,000	
Shop expenses	40,000	
Cheques issued to suppliers of:		
Goods	3,50,000	
Supplies	40,000	
Cheques issued for personal purposes	55,000	
Bank charges	500	5,05,500
Balance on March 31, 2023		16,500

Mr. Raja informs you that he had the following Assets and Liabilities (in addition to the Bank Balances) on March 31, the extracts of which are as under:

	2022-23 (₹)	2021-22 (₹)
Assets:		
Cash Balance	7,000	4,000
Amounts due from Customers	37,000	27,500
Unsold Inventory at Cost	13,000	10,000
Prepaid Expenses	3,000	2,000
	60,000	**43,500**

	2022-23 (₹)	2021-22 (₹)
Liabilities:		
Creditors for Goods	23,000	28,000
Creditors for Services	2,500	1,500
	25,500	**29,500**

He also informs you the following:

(a) He uses 75% of cash sale proceeds for making cash purchases; the remaining balance being deposited in Bank.

(b) He had allowed cash discount of ₹ 5,000 to his credit customers for prompt payment; he was allowed cash discount ₹ 7,000 by his suppliers of goods for prompt payment.

(c) Collections from credit customers and payments to suppliers of goods are invariable by crossed cheques.

1. What is the balance of Mr. M. Raja's capital account as on April 1, 2022?
2. Ascertain the amounts of credit sales and credit purchases made by the business during the year 2022-23.
3. Determine the operating result of the business by preparing the Trading and Profit & Loss account for the year ended March 31, 2023.
4. Draft the Balance Sheet of the business as at March 31, 2022.

Solution:

1. Capital balance on 1.1.2022 is - ₹25,000

Balance Sheet as on 1.1.2022

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital [Opening Capital:		25,000	Inventory		10,000
Bal. Fig.]			Due from Customers		27,500
Creditors for:			Prepaid Expenses		2,000
Goods		28,000	Bank		11,000
Services		1,500	Cash		4,000
		54,500			**54,500**

2. Credit Sales is - ₹3,64,500 and Credit Purchase is - ₹3,52,000

Dr. Customers Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Balance b/f	27,500		By Bank A/c	3,50,000
	To Sales A/c [Credit Sales: Bal. Fig.]	3,64,500		By Discount Allowed A/c	5,000
				By Balance c/f	37,000
		3,92,000			**3,92,000**

Dr. **Creditors Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Bank A/c	3,50,000		By Balance b/f	28,000
	To Discount Received A/c	7,000		By Purchases A/c [Credit purchases: Bal. Fig.]	3,52,000
	To Balance c/f	23,000			
		3,80,000			**3,80,000**

3. Operating result - ₹65,000

Trading and Profit & Loss Accounts
for the year ended Dec. 31, 2023

Dr. Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		10,000	By Sales:		
To Purchases: Cash [WN:4]	3,75,000		Cash [WN:4]	5,00,000	
Credit	3,52,000	7,27,000	Credit	3,64,500	8,64,500
To Gross Profit c/d (Bal. fig.)		1,40,500	By Closing Stock at Cost		13,000
		8,77,500			**8,77,500**
To Expenses [WN:3]		77,000	By Gross Profit b/d		1,40,500
To Bank Charges		500	By Discount Received		7,000
To Discount Allowed		5,000			
To Capital A/c [Net Profit transferred] (Bal. fig.)		65,000			
		1,47,500			**1,47,500**

4. Balance Sheet as on Dec. 31, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Opening Capital	25,000		Inventory		13,000
Add: Net Profit	65,000		Due from Customers		37,000
Further Capital [income from personal investment]	36,000		Prepaid Expenses		3,000
	1,26,000		Bank		16,500
			Cash		7,000
Less: Drawings [20,000 + 55,000]	75,000	51,000			
Creditors for: Goods		23,000			
Services		2,500			
		76,500			**76,500**

Working Note:

1.

Books of Raja

Receipt and Payment Accounts for the year ended Dec. 31, 2023

Receipts	(₹)	Payments	(₹)
To Opening Balance:		By Cash Purchases [WN:4]	3,75,000
Cash	4,000	By Payment to Suppliers	3,50,000
Bank	11,000	By Payments for Services: Cash	37,000
To Cash Sales [WN:4]	5,00,000	Cheques	40,000
To Collection from Customers	3,50,000	By Bank Charges	500
Capital Introduces:		By Drawings [20,000 + 55,000]	75,000
Income from Personal Investment	36,000	By Closing Balance:	
		Cash	7,000
		Bank	16,500
	9,01,000		**9,01,000**

2. Expenses Paid during 2022-23

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

Date	Particulars	₹	Date	Particulars	₹
	To Balance b/f	4,000		By Purchases A/c [WN:4]	3,75,000
	To Sales A/c [WN:4]	5,00,000		By Bank A/c [Amount deposited]	1,25,000
	To Bank A/c [Withdrawn from bank for shop expenses]	40,000		By Expenses A/c [Expenses paid: Bal. Fig.]	37,000
				By Balance c/f	7,000
		5,44,000			**5,44,000**

3. Expenses to be transferred to Profit & Loss Accounts

Particulars	(₹)
Expenses Paid: Cash [WN:2]	37,000
Cheque	40,000
	77,000
Add: Prepaid Expenses on 31.12.2022	2,000
Outstanding Expenses on 31.12.2023	2,500
	81,500
Less: Prepaid Expenses on 31.12.2023	3,000
	78,500

Particulars	(₹)
Less: Outstanding Expenses on 31.12.2021	1,500
∴ Expenses to be debited to Profit & Loss A/c	77,000

4. **Cash Sales & Cash Purchases during 2022**

   75% of Cash Sale proceeds are used for Cash Purchases

   ∴ 25% Amount of Cash Sale proceeds deposited into Bank

   ∴ Cash Sales = Cash deposited × 100/25 = 1,25,000 × 100/25 = 5,00,000

   ∴ Cash Purchases = 75% of Cash Sale proceeds = 5,00,000 × 75% = 3,75,000

Illustration-30

Lucky does not maintain proper book of accounts. However, he maintains a record of his bank transections and also is able to give the following information from which you are requested to prepare his final accounts for the year 2022-2023:

	Opening	Closing
Debtors	1,02,500,	?
Creditors	?	46,000
Stock	50,000	62,500
Bank Balance	?	50,000
Fixed assets	7,500	9,000
Details of his bank transactions were as follows:		
Received from debtors	3,40,000	
Additional capital brought in	5,000	
Sale of fixed assets (book value ₹ 2,500)	1,750	
Paid to creditors	2,80,000	
Expenses paid	49,250	
Personal drawings	25,000	
Purchase of fixed assets	5,000	

No cash transections took place during the year. Goods was sold at cost plus 25%. Cost of goods sold was ₹2,60,000

Solution

Treading and profit and loss account
For the year ended 31st March, 2023

Dr Cr

Particulars	₹	Particulars	₹
To open stock	50,000	By Sales (₹ 2,60,000 x 125/100	3,25,000
To purchase (balancing figure)	2,72,000	By closing stock	62,500
To Gross profit c/d (2,60,000 x 25/100)	65,000		
	3,87,500		3,87,500
To Expenses	49,250,	By Gross Profit b/d	65,000
To loss on sale of fixed assets	750		
To depreciation on fixed asset (W.N.1)	1,000		
To new Profit	14,000		
	65,000		65,000

Balance sheet As AT 31st March, 2023

Liabilities		₹	Assets	₹
Capital	169,000		Fixed Assets	9,000
Add: Additional capital	5,000		Debtors	87,500
New Profit	14,000		Stock	62,500
	1,88,000		Bank Balance	50,000
Less : Drawings	25,000	1,63,000		
Creditors		46,000		
		2,09,000		2,09,000

Working Notes :

(i) Fixed Assets Account

Dr Cr.

Particulars	₹	Particulars	₹
To Balance b/d	7,500	By Bank (Sale)	1,750
To Bank	5,000	By Loss on sale of fixed asset	750
		By Depreciation of fixed asset	1,000
		By Balance c/d	9,000
	12,500		12,500

(ii) Bank Account

Dr Cr.

Particulars	₹	Particulars	₹
To Balance b/d (balance figure)	62,500	By Creditors	2,80,000
To Debtors	3,40,000	By Expenses	49,250
To Capital	5,000	By Drawings	25,000
To sale of fixed assets	1,750	By Fixed Assets	5,000
		By Balance c/d	50,000
	4,09,250		4,09,250

(iii) Debtors Account

Dr Cr.

Particulars	₹	Particulars	₹
To Balance b/d	1,02,500	By Bank	3,40,000
To Sales	3,25,000	By Balance c/d (b.f)	87,500
[₹ 2,60,000 x 125/100			
	4,27,500		4,27,500

(iv) Creditors Account

Dr Cr.

P Particulars	₹	Particulars	₹
To Bank	2,80,000	By Particular b/d (balancing figure	53,500
To Balance c/d	46,000	By purchases (trading account)	2,72,500
	3,26,000		3,26,000

(v) Balance sheet as on 1st April ,2022

Dr Cr.

Liabilities	₹	Assets	₹
Creditors	53,500	Fixed assets	7,500
Capital (balance figure)	1,69,000	Debtors	1,02,500
		Stock	50,000
		Bank balance	62,500
	2,22,500		2,22,500

Illustration-31

From the following particulars furnished by Shri Ramji, prepare Trading and profit and loss account for the year ended 31.3.2023 . also draft his balance sheet as at 31.03.2023.

	Opening	Closing
	₹	₹
Creditors	3,15,400	2,48,000
Expenses outstanding	12,000	6,600
Fixed Assets (includes machinery)	2,32,200	2,40,800
Stock in hand	1,60,800	2,22,400
Cash in hand	59,200,	24,000
Cash in Bank	80,000	1,37,600
Sunday Debtors	3,30,600	?

Details of the year transections are as follows:

	₹		₹
Cash and discount credited to debtors	12,80,000	Returns from debtors	29,000
		Bad debts	8,400
Sales (Both cash and Credit)	14,36,200	Discount allow by creditors	14,000
Returns to creditors	8,000	Capital introduced by cheque	1,70,000
Cash purchases	20,600	Expenses paid by cheque	1,91,400
Deawing bt cheque	8,600	Machinery acquired by cheque	63,600
Cash deposited inti bank	1,00,000	Cash withdrawal from bank	1,84,800
Cash sales	92,000	Payment to creditors by cheque	12,05,400
Collection from debtors	12,50,000		

deposit into bank after receiving cash)

Note: Ramji has not sold any fixed asset during the year.

Solution

Trading and profit and loss account
For the year ended 31st March,2023

Dr Cr.

Particulars		₹	Particulars		₹
To Opening Stock		1,60,800	By sales		
To purchase:			Cash	92,000	
Cash	20,600		Credit	13,44,200	
Credit	11,60,000			14,36,200	
	11,80,600		Less: returns	29,000	14,07,200
Less Returns	8,000	11,72,600	By closing Stock		2,22,400
To gross profit c/d		2,96,200			16,29,600
		16,29,600	By Gross Profit b/d		2,96,200

Particulars		₹	Particulars		₹
To Discount Allowed		30,000	By Discount (received)		14,000
To Bad Debts		8,400			
To Expenses		1,86,000			
To Depreciation		55,000			
To Net Profit		30,800			
		3,10,200			3,10,200

Balance Sheet as At 31st March,2023

Liabilities		₹	Assets		₹
Capital			Sundry Assets	2,32,200	
Opening Balance	5,35,400		Add: New Machinery	63,600	
Add: Additional capital	1,70,000			2,95,800	
	30,800		Less : Depreciation	55,000	2,40,800
	7,36,200		Stock in Trade		2,22,400
Less: Drawings	8600	7,27,600	Sunday debtors		3,57,400,
Sundry Creditors		2,48,000	Cash in hand		24,000
Outstanding Expenses		6,600	Cash at Bank		1,37,600
		9,82,200			9,82,200

Working Notes:

(i) Statement of affairs as at 31st March, 2022

Liabilities	₹	Assets	₹
Sundry Creditors	3,15,400	Sundry Assets	2,32,200
Outstanding expenses	12,000	Stock	1,60,800
Ramji's Capital(b.f)	5,35,400	Debtors	3,30,600
		Cash in Hand	59,200
		Cash in Bank	80,000
	8,62,800		8,62,800

(ii) Sundry Debtors Account

Dr Cr.

Particulars	₹	Particulars	₹
To Balance b/d	3,30,600	By Cash	12,50,000
To Sales (14,36,200 - 92,000)	13,44,200	By Discount Allowed	30,000
		By Returns (Sales)	29,000
		By Bad debts	8,400
		By Balance (b.f)	3,57,400
	16,74,800		16,74,800

(iii) Sundry Creditors Account

Dr Cr.

Particulars	₹	Particulars	₹
To Bank Payments	12,05,400	By Balance b/d	3,15,400
To Discount	14,000	By Purchases (b.f)	11,60,000
To Return	8,000		
To Balance c/d	2,48,000		
	14.75.400		14,75,400

(iv) Fixed Assets Account

Dr Cr.

Particulars	₹	Particulars	₹
To Balance b/d	2,32,200	By Depreciation a/c (b.f)	55,000
To Bank A/c (Purchases)	63,600	By Balance c/d	2,40,800
	2,95,800		2,95,800

(v) Expenses Account

Dr Cr.

Particulars	₹	Particulars	₹
To Cash A/c	1,91,400	By Outstanding Exp. A/c	12,000
To Outstanding Exp. A/C		(o/s in the begening)	
(o/s at the end)	6,600	By Profit & Loss A/c (b.f)	1,86,000
	1 98,000		1,98,000

(vi) Cash and Bank Account

Particulars	₹	₹	Particulars	₹	₹
To Balance b/d	59,200	80,000	By Purchases	20,600,	-
To Capital	-	1,70,000	By Expenses	1,91,400	-
To Debtors	-	12,50,000	By Plant and Machinery	-	63,600
To Bank	1,84,800	-	By Drawings	-	8,600
To Cash	-	1,00,000	By Creditors	-	12,05,400
To Sales	92,000	-	By Cash	-	1,84,800
			By Bank	1,00,000	-
			By Balance c/d	24,000	1,37,600
	3,36,000	16,00,000		3,36,000	16,00,000

Exercise

A. Theoretical Questions:

Multiple Choice Questions

1. In case of a Club, the excess of expenditure over income is called as :
   (a) Surplus
   (b) Deficit
   (c) Capital Fund
   (d) Investment in Fixed Assets
2. Due to retrospective effect on revision of salary of employees, the arrears of salary relating to past years, payable in current year is
   (a) Prior - period item
   (b) Extra - ordinary item
   (c) Ordinary item requiring separate disclosure
   (d) Contingent item
3. Income statement of a Charitable Institution is known as
   (a) Statement of profit and loss
   (b) Receipts and Payments Account
   (c) Income and Expenditure Account
   (d) Profit and Loss Account
4. Which of the following will not appear in P&L A/c?
   (a) Capital
   (b) Bad Debts
   (c) Provision for Doubtful Debts
   (d) Rent paid
5. Outstanding salaries is shown as –
   (a) An Asset in the Balance Sheet
   (b) A Liability in the Balance sheet
   (c) By adjusting it in the P & L A/c
   (d) Both (b) and (c)

Answer:

1	b	2	c	3	c	4	a	5	d

State True or False

1. The preparation of Trading Account always starts with the Opening Stock of inventory.
2. Income & Expenditure Account is drafted by a trading concern.
3. Balance Sheet is prepared to show the operating results of an organisation on a specific date.
4. Final Accounts is prepared from the balances of ledger accounts
5. Receipts & Payments A/c begins with the cash & bank balance at the beginning of the accounting period.
6. Endowments received by a non-profit organisation are to be treated as revenue receipts.
7. Income & Expenditure A/c determines the 'Surplus' or 'Deficit' of the accounting period by matching expenses/ losses against incomes and gains.
8. Income & Expenditure A/c is a summarised form of the Cash Book.
9. Cash in hand represents cash actually held by the business on the balance sheet date.
10. Subscription received by an organisation is a Revenue Receipt.

Answers:

1	**False**	**2**	**False**	**3**	**False**	**4**	**True**	**5**	**True**
6	**False**	**7**	**True**	**8**	**False**	**9**	**True**	**10**	**True**

Fill in the Blanks

1. Outstanding subscription is shown in the___________ side of Balance Sheet.
2. The Sales ₹ 180 Lakh, Purchases ₹ 129 Lakh and Opening Stock ₹ 33 Lakh. If the rate of Gross Profit is 50% on cost, then the value of closing stock will be ________________ .
3. Profit & Loss Account is drafted to determine the _________ of a concern.
4. Distribution of profits is a/ an ________ item.
5. _________ is an account which is prepared by a merchandising concern which purchases goods and sells the same during a particular period.
6. Advance subscription is reflected in the ―――――― side of the Balance Sheet.
7. In Receipts & Payments Account, all receipts (whether, capital or revenue) are recorded on the _____-hand side of this account, while all payments (whether, capital or revenue) are recorded on the ______-hand side of this account.
8. Subscriptions received in advance by a Club are shown on _________ side of the Balance Sheet.

Answer:

1	**Asset**	2	**₹ 42 Lakh**
3	**Net Profit/ Loss**	4	**appropriation**
5	**Trading A/c**	6	**Liabilities**
7	**left, right;**	8	**Liabilities**

B. Numerical Questions

Multiple Choice Questions

1. Following information is given: (₹)

Opening Stock	2,13,000
Purchase	16,55,000
Sales	21,32,000
Carriage Inwards	32,500
Carriage Outwards	38,600
Return Inwards	38,000

The rate of gross profit is 25% on cost then value of closing stock will be ——————.

(a) ₹ 2,57,800

(b) ₹1,94,900

(c) ₹2,25,300

(d) ₹ 3,30,000

2. Subscription of ₹ 6,25,000 had been shown in the Income and Expenditure Account prepared for the year ending 31st March, 2023. Additional information is as below:

Particulars	On 31st March, 2022 (₹)	On 31st March, 2023 (₹)
Subscription Outstanding	55,000	72,000
Subscription Received in Advance	31,000	37,000

The amount of subscription received during the year 2022-23would be :

(a) ₹ 6,36,000

(b) ₹ 6,02,000

(c) ₹ 6,14,000

(d) ₹ 6,48,000

3. If opening capital is ₹70,000 and closing capital is ₹90,000, what is the amount of profit or loss?

(a) ₹ 20,000 Profit

(b) ₹ 20,000 Loss

(c) ₹ 70,000 Loss

(d) ₹ 90,000 Profit

4. A Charitable Institution has 250 members with a annual subscription of ₹ 5,000 each. The subscription received during 2021-22 were ₹ 11,25,000, which include ₹ 65,000 and 25,000 for the years of 2020-21 and 2022-23 respectively. Amount of outstanding subscription for the 2021-22 will be:

   (a) ₹ 90,000

   (b) ₹ 1,25,000

   (c) ₹ 2,15,000

   (d) ₹ 1,90,000

5. If average inventory is ₹ 1,25,000 and closing inventory is ₹ 10,000 less than opening inventory then the value of closing inventory will be:

   (a) ₹ 1,35,000

   (b) ₹ 1,15,000

   (c) ₹ 1,30,000

   (d) ₹ 1,20,000

Answers:

1	c	2	c	3	a	4	c	5	d

Comprehensive Numerical Problems

1. From the following Trial Balance of Shri Gurudas, prepare Trading and Profit & Loss Account for the year ended March 31, 2023 and the Balance Sheet as on that date, after taking into consideration the adjustments (All figures in ₹ '000):

   Trial Balance as on 31.3.2023

	Dr. (₹)	Cr. (₹)
Cash in hand	2,000	
Stock	7,000	
Creditors		7,800
Debtors	38,400	
Drawings	10,260	
Sales		185,600
Purchases	162,400	
Wages	14,400	
Expenses	10,340	

Furniture	8,000	
Goodwill	6,000	
Capital		65,400
Total	**258,800**	**258,800**

Adjustments:

(a) Stock on 31.12.2023 was valued at ₹ 9,000. In view of the constant fall in prices, it has been decided to value stock at 10% less.

(b) Furniture (book value on 1.4.2022 ₹ 800) was sold on 30.9.2022 for ₹ 900 and it was passed through Sales Day Book.

(c) Private purchases of the proprietor amounting to ₹ 200 had been booked through Purchases Book.

(d) Depreciate furniture at 10% p.a.

(e) Sales Book was overcast by ₹ 100.

(f) Wages outstanding ₹ 100, though included in Wages Account, was not included in the Trial Balance.

(g) Provide for bad debts @ 5% on debtors and 2.5% for discount on debtors.

[**Answer:** Net Loss ₹ 4,626, Balance Sheet Total ₹ 58,214]

2. From the following ledger balances and additional information obtained from Mrs. Kamala Shrivastav, prepare Trading and Profit & Loss Account for the year ended 31st March, 2023 and Balance Sheet as on that date:

Particulars	Dr. (₹)	Cr. (₹)
Stock-in-trade on 1.4.2022	3,00,000	
Purchases and Sales	20,50,000	35,40,000
Returns	40,000	50,000
Wages	2,00,000	
Carriage inwards	50,000	
Power & Light	20,000	
Discount	10,000	20,000
Miscellaneous Expenses	1,50,000	
Salaries	1,00,000	
Outstanding Salaries		30,000
Outstanding Rent		10,000
Depreciation	1,50,000	

Particulars	Dr. (₹)	Cr. (₹)
Rent & Rates	1,20,000	
Prepaid Insurance	10,000	
Life insurance premium	10,000	
Insurance	20,000	
Income Tax paid	30,000	
Freehold Premises	10,00,000	
Furniture	2,00,000	
Debtors & Creditors	4,50,000	5,00,000
Bills Receivable and Payable	1,00,000	90,000
Drawings and Capital	50,000	20,00,000
Cash and Bank	6,80,000	
Plant	5,00,000	
	62,40,000	62,40,000

Additional Information:

(a) Closing stock on 31.3.2023 ₹ 4,00,000.

(b) Stock destroyed by fire was ₹ 20,000 and the insurance company accepted the claim partly for ₹ 15,000.

(c) Goods purchased on credit worth ₹ 30,000 on March 30, 20223 was omitted to be recorded in the books.

(d) Purchases include goods valued ₹ 10,000 purchased for private purposes.

(e) Bills Receivable and cheques from customers dishonoured ₹ 20,000 and ₹ 10,000 respectively, but no entries were made in the books of accounts.

[**Answer:** Net Profit ₹ 7,95,000, Balance Sheet Total ₹ 33,45,000]

3. The following is the Receipts and Payments Account of Galaxy Women's Cricket Club for the year ended December 31, 2023:

Receipts	(₹)	Payments	(₹)
To Balance b/d:		By Ground Maintenance	5,250
Cash at bank	8,500	By Salaries	9,000
Cash in hand	3,000	By Gym Equipments	25,000
To Subscriptions	61,250	By Sports Expenses	11,750

To Life Membership Fees	7,500	By Coaches' Remuneration	10,000
		By General Expenses	2,750
		By Travelling expenses	2,000
		By Balance c/d:	
		Cash at bank	10,250
		Cash in hand	4,250
	80,250		**80,250**

Additional information:

(a) Interest on savings bank account for ₹ 880 has not been entered in the Cash Book.

(b) 80% of the Life Membership Fees is to be capitalized.

(c) An old gym equipment (WDV ₹ 20,000) was exchanged at an agreed price of ₹ 12,500 for a new gym equipment costing ₹ 37,500.

(d) The balances of some accounts are as under:

	31.12.2022	**31.12.2021**
Outstanding Salaries	750	1,500
Arrear Subscriptions	8,000	5,250
Advance Subscriptions	6,750	3,500
Prepaid Ground maintenance	2,250	3,000
Gym Equipments	57,500	45,000

You are required to prepare the Income and Expenditure Account of the club for the year ended on December 31, 2023.

[**Answer**: Surplus ₹ 9,880]

4. The following is the Receipts & Payments Account of Citizen Sports Club for the year ended December 31, 2022:

Receipts	**(₹)**	**Payments**	**(₹)**
To Balance (1.1.2022)	2,40,000	By Upkeep of ground	2,10,000
To Subscriptions	8,70,000	By Secretary's Salary	3,60,000
To Entrance Fees	50,000	By Wages of groundsmen	2,40,000
To Proceeds of Concerts	1,50,000	By Ground rent	15,000
To Interest on Investments	50,000	By Printing & Stationery	20,000
		By Sundry Expenses	17,500
		By Balance (31.12.2023)	4,97,500
	13,60,000		**13,60,000**

Additional Information:

(a) Subscriptions include arrear subscription brought over from previous year ₹ 50,000.

(b) Interest on Investments includes ₹ 10,000 in respect of interest accrued in the preceding period.

(c) Upkeep of ground and Wages of groundsmen include ₹ 30,000 and ₹ 15,000 respectively applicable to the preceding year.

(d) Other ledger balances at the commencement of the financial period were: Capital Fund ₹ 40,10,000; Surplus brought forward ₹ 8,90,000; Club Premises and Grounds (as per valuation) ₹ 30,00,000; Investments ₹ 10,00,000; Sports materials ₹ 2,45,000; Furniture ₹ 4,00,000.

(e) Entrance fees are to be capitalised.

(f) Outstanding liabilities on 31.12.2022: Wages of groundsmen ₹ 20,000; Printing ₹ 10,000.

(g) Interest accrued and outstanding on investments was ₹ 12,000.

(h) Depreciation to be provided on Club Premises by 2%, Furniture by 5% and Sports Equipment by 33.33%

Prepare the Income & Expenditure Account for the year ended December 31, 2023 and Balance Sheet as on that date.

[**Answer:** Surplus ₹ 12,833, Total of Balance Sheet ₹ 49,92,833]

5. The following is the Income and Expenditure Account of Moon Club for the year ending 31st March, 2023:

Dr. Cr.

Expenditure		(₹)	Income	(₹)
To Provisions used:			By Subscription	68,000
Opening Stock	20,000		By Sale of Provisions	3,26,000
Add : Purchases	2,80,000			
	3,00,000			
Less : Closing Stock	10,000	2,90,000		
To Salaries & Wages		36,000		
To General Expenses		10,000		
To Depreciation on Equipment		2,000		
To Surplus		56,000		
		3,94,000		3,94,000

The following Balance Shee ts are also provided:

Liabilities	31.3.23	31.3.22	Assets	31.3.23	31.3.22
Suppliers for provisions	16,000	20,000	Equipment		
Capital Fund	94,000	1,50,000	(Cost Less Depreciation)	20,000	50,000

			Stock of Provisions	20,000	10,000
			Arrear Subscription	10,000	20,000
			Cash at Bank & in hand	60,000	90,000
	1,10,000	1,70,000		1,10,000	1,70,000

From the above details prepare the Receipt and Payments Account for the year ended 31.3.2023 of the club.

[**Answer:** Closing Cash and Bank Balance of Receipts & Payments Account ₹ 90,000, Total of Balance Sheet ₹ 49,92,833]

6. Mr. Raja, a sole trader furnishes you with the following bank summary for the year ended December 31, 2023

Balance on December 31, 2022		11,000
Add: Deposits:		
Cash [out of cash sales]	1,25,000	
Collection from Credit Customers	3,50,000	
Income from Personal Investment	36,000	
	5,11,000	
		5,22,000
Deduct:		
Cash Withdrawn from:		
Personal Drawings	20,000	
Shop Expenses	40,000	
	60,000	
Cheques issued to Suppliers of:		

Goods	3,50,000		
Services	40,000	3,90,000	
Cheques issued for Personal Purposes		55,000	
Bank Charges		500	5,05,500
Balance on December 31, 2022			16,500

Raja informs you that he had the following Assets and Liabilities in addition to the Bank Balances described on December 31:

Asset & Liabilities	2023	2022
Assets:		
Cash Balance	7,000	4,000
Amounts due from Customers	37,000	27,500
Unsold Inventory at Cost	13,000	10,000
Prepaid Expenses	3,000	2,000
	60,000	43,500
Liabilities:		
Creditors for:		
Goods	23,000	28,000
Services	2,500	1,500
	25,500	29,500

He also informs you that:

(a) He uses 75% of cash sale proceeds for making cash purchases; the remaining balance being deposited in Bank.

(b) He had allowed cash discount of 5,000 to his credit customers for prompt payment; he was allowed cash discount 7,000 by his suppliers of goods for prompt payment.

(c) Collections from credit customers and payments to suppliers of goods are invariable by crossed cheques.

Raja ask you to show his capital account and prepare:

(i) Receipt and payment account for the year ended December 31, 2023

(ii) Trading and Profit & Loss account for the year ended December 31, 2023

(iii) Balance Sheet as on December 31, 2023

[**Answer:** Closing Cash Balance ₹ 7,000 and Closing Bank Balance ₹ 16,500 of Receipts & Payments Account ₹ 90,000, Net Profit ₹ 65,000, Total of Balance Sheet ₹ 76,500]

Unsolved Case

Citizen Sports Club is a prominent sports club of Nagpur, Maharashtra. During the immediately concluded financial year, the club organised a number of activities during a year involving its members. The following extracts of the various receipts and payments made by the club during the year ended December 31, 2023 has been made available to you from the club's office records:

Receipts	(₹)	Payments	(₹)
To, Balance (01.04.2021)	2,40,000	By, Upkeep of ground	2,10,000
To, Subscriptions	8,70,000	By, Secretary's salary	3,60,000
To, Entrance fees	50,000	By, Wages of groundsmen	2,40,000
To, Proceeds of concerts	1,50,000	By, Ground rent	15,000
To, Interest on investments	50,000	By, Printing & Stationery	20,000
		By, Sundry Expenses	17,500
		By, Balance (31.03.2022)	4,97,500
	13,60,000		**13,60,000**

Mr. Girish Agarkar, the secretary of the club has approached you to finalise the accounts of the club. As per his advice, the chief accountant of the club, Mr. Parash Ojha proived you the following additional information:

(a) Subscriptions include arrear subscription brought over from previous year ₹ 50,000.

(b) Interest on Investments includes ₹ 10,000 in respect of interest accrued in the preceding period.

(c) Upkeep of ground and Wages of groundsmen include ₹ 30,000 and ₹ 15,000 respectively applicable to the preceding year.

(d) Other ledger balances at the commencement of the financial period were:

Capital Fund ₹ 40,10,000; Surplus brought forward ₹8,90,000; Club Premises and Grounds (as per valuation) ₹ 30,00,000; Investments ₹ 10,00,000; Sports materials ₹ 2,45,000; Furniture ₹ 400,000.

(e) Entrance fees are to be capitalised.

(f) Outstanding liabilities on 31.03.2023: Wages of groundsmen ₹ 20,000; Printing ₹ 10,000.

(g) Interest accrued and outstanding on investments was ₹ 12,000.

(h) Depreciation to be provided on different assets at the following rates:

Club Premises by 2%, Furniture by 5% and Sports Equipments by 33.33%

1. Determine how much surplus, if any, has been earned by Citizen Sports Club during the financial year 2021-22.

2. Prepare the Balance Sheet of the Club as on March 31, 2023.

SECTION-D

Partnership Accounting

Partnership Accounting 4

This Module Includes

Partnership Accounting

SLOB Mapped against the Module

To develop detail understanding of accounting for changes in partnership structure and accounting in an LLP. (CMLO 4a, c)

Module Learning Objectives:

After studying this module, the students will be able to:

- Understand the accounting for admission of partner
- Know the process of accounting for retirement of partner
- Do the accounting in the event of death of a partner;
- Understand the treatment and accounting of joint life policy taken on partners;
- Learn the accounting in the event of dissolution of a partnership (including different methods of accounting for piecemeal distribution)
- Understanding the accounting of amalgamation of partnership firms;
- Do the accounting in the event of conversion of partnership firm to a company and sale of partnership firm to a company;
- Understand the concept of Limited Liability Partnership (LLP) and accounting thereof.

Admission of Partner

4.1

According to Section 4 of the Indian Partnership Act, 1932, the term 'partnership' refers to 'the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.' The persons who have entered into partnership agreement with each other are referred to as Partners, and they are collectively referred to as the Partnership Firm.

Sometimes for the requirement of additional capital, technical support or to improve managerial efficiency, a continuing partnership firm, in consensus with all the partners, decides to admit a new partner in their business.

Section 31(1) of the Indian Partnership Act, 1932 provides that a person can be admitted as a new partner only with the consent of all the existing partners, unless otherwise agreed upon.

This is a form of reconstruction of partnership, as because whenever a new partner is admitted to a firm, the partnership between/among the existing partners comes to an end which begins a new partnership.

Usually the following accounting adjustments are required at the time of such admission:

1. Computation of New Profit-Sharing Ratio
2. Revaluation of Assets and Liabilities
3. Memorandum Revaluation of Asset and liabilities (to bring the asset and liabilities to the book value)
4. Distribution of Reserves, Accumulated Profits and Losses
5. Adjustment for Goodwill
6. Adjustments regarding Capital Contribution of new partner and the Capitals of the existing partners
7. Adjustment for Life Policy.

Computation of New Profit-Sharing Ratio:

In the event of admission of a partner, the existing partners usually sacrifice a share of their future profit, which the new partner becomes entitled to.

The ratio in which each of the existing partners sacrifice their share of profit on the event of admission of a new partner is referred to as Sacrificing Ratio [which is basically, (Old Ratio – New Ratio)].

The new profit-sharing ratio may be agreed upon by the partners, or the mutual profit-sharing ratio among the existing partners may remain unchanged after giving away the share of the new partner.

Revaluation of Assets and Liabilities:

In order to unveil any 'secret profit' or 'secret loss' existing in the books of accounts, the revaluation of Assets and Liabilities are done at the time of Admission (or any other form of Reconstruction), so that they reflect their fair values. A firm earns profit as a result of increase in the value of assets and/or decrease in the value of liabilities.

Similarly loss suffered by an entity when there is decrease in assets and/or increase in liabilities. The effect of such revaluations are given by opening a Revaluation Account through the following journals:

Particulars		Journal Entry	
Assets	Upward revaluation:	Asset A/c To Revaluation A/c	Dr.
	Downward revaluation:	Revaluation A/c To Asset A/c	Dr.
	Recording of unrecorded asset	Asset A/c To Revaluation A/c	Dr.
Liabilities	Upward revaluation:	Revaluation A/c To Liability A/c	Dr.
	Downward revaluation:	Liability A/c To Revaluation A/c	Dr.
	Recording of unrecorded liability	Revaluation A/c To Liability A/c	Dr.
Revaluation Expenses	Paid by the firm	Revaluation A/c To Bank A/c	Dr.
	Paid by the partner	Revaluation A/c To Partner's Capital A/c	Dr.

A firm may decide to give the effect of such revaluations without incorporating the changes in the Balance Sheet values of those assets and liabilities. In that case, they have to open one Memorandum Revaluation Account. The preparation of Memorandum Revaluation Account involves the following:

(i) Record increase/decrease in the value of assets and liabilities as discussed.

(ii) Share the profit or loss on Revaluation amongst the old partners in their old profit sharing Ratio.

(iii) Reverse the increase/decrease in the value of assets and liabilities.

(iv) After reversal, calculate profit or loss.

(v) Share the profit/loss, after reversal amongst all the partners (including the new partner) in their new profit sharing ratio.

Memorandum Revaluation Account

Particulars	(₹)	Particulars	(₹)
To Assets (Decrease)	x x	By Assets (Increase)	x x
To Liabilities A/c (Increase)	x x	By Libilities A/c (Decrease)	x x

Particulars	(₹)	Particulars	(₹)
To Partners Capital A/c (Share of Revaluation Profit) [Old Partners in old Profit sharing Ratio]	x x x x	By Partners Capital A/c (Share of Revaluation loss) [Old Partners in their Old profit sharing ratio]	x x
	xxx		xxx
To Reversal of Items b/d	x x	By Revarsal of Items b/d	x x
To Partners' Capital A/c (Revaluation Profit amount all partners in new profit sharing Ratio)	x x	By Partners' Capital A/c (Revaluation loss amought all partners in their new Profit sharing (Ratio)	x x
	xxx		xxx

Distribution of Reserves, Accumulated Profits and Losses:

Reserves and accumulated profits or losses refer to the profits/losses that had been earned in preceding accounting periods but not yet distributed to the existing partners. For reserves and accumulated profits, partners' capital accounts are credited and for accumulated losses partners' capital accounts are debited in the old profit sharing ratio. The accounting entries are as follows:

In case of Reserves/ Accumulated Profits	
Under Fluctuating Capital Method	**Under Fixed Capital Method**
Reserves A/c Dr. Profit and Loss A/c Dr. To Partners' Capital A/c (Among old partners in old p.s.r.)	Reserves A/c Dr. Profit and Loss A/c Dr. To Partners' Current A/c (Among old partners in old p.s.r.)
In case of Accumulated Loss	
Under Fluctuating Capital Method	Under Fixed Capital Method
Partners' Capital A/c Dr. To Profit and Loss A/c (Among old partners in old p.s.r.)	Partners' Current A/c Dr. To Profit and Loss A/c (Among old partners in old p.s.r.)

Adjustment for Goodwill:

Due to the existence of goodwill (generated by the old partners), a firm may have the capacity to earn super-normal profit, the share of which will be enjoyed by the new partner from the moment of admission to the firm. For this reason, an incoming partner is supposed to bring in, some extra amount in addition to the capital contribution. This extra amount is called Premium for Goodwill.

While studying Partnership Account, students may face difficulty in treatment of Goodwill and different author have taken different views while recording goodwill. It may be mentioned here that AS-26 has given a clear understanding about the recognition and treatment of goodwill. AS 26 have given clear indication about the recognition, measurement and recording of intangible Asset i.e. Goodwill. Whether the asset is tangible or intangible, to record in the books of account, it must pass through the Asset recognition criteria i.e. (1) Future economic benefits flow to the organization (2) Reliably measured the cost of Goodwill. Usually, goodwill is an internally generated intangible assets and hence cannot fulfill the asset recognition criteria with reliability. Hence, goodwill is not shown in the books of Accounts.

Since goodwill cannot be shown in the books of Account, the treatment will be as below under different situations through new partner's capital/current Account.

In case of admission : A new partner, when admitted, pays premium for goodwill, may not pay or pays partly.

(i) When premium for goodwill is paid by the new partner
Bank/Cash/any other mode A/C Dr.
To Old partners capital/ Current Account (in sacrificing ratio)

(ii) When the new partner does not pay premium towards goodwill
New partner's capital/ Current A/C Dr.
To Old partners capital/ Current Account (in sacrificing ratio)

(iii) When new partner pays premium partly
New partner's capital/ Current A/C Dr (to the extent not paid)
Bank/Cash/any other mode A/C Dr
To Old partners capital/ Current Account (in sacrificing ratio)

There may be situation that Goodwill has already been shown in the Balance sheet before admission of the new partner. Under this situation the said goodwill would not be disturbed and will be maintained in the Balance sheetasx it is not known whether the said goodwill is self generated or purchased goodwill. It may also be noted that when goodwill is shown in the Balance sheet, the new partner will not pay premium for such goodwill as it has already been transferred to old partners capital account. If the question specifically says to write off the goodwill, students may do so with old partners in old profit sharing ratio.

Incase of retirement and Death of a partner the treatment of goodwill will be as under:

Remaining partners Capital/current A/C Dr.

To Retiring/Deceased partner Capital/Current Account

(in gaining ratio)

In case of dissolution/sale/conversion, no special treatment is required. The treatment will be same as other assets like tangible assets.

When the incoming partners brings in his share of Premium for goodwill then it is to be shared among the existing partners in the Sacrificing Ratio.

There are different methods of valuation of goodwill. They are discussed as under:

Valuation of Inherent or Non-Purchased Goodwill

Sl No.	Name of the Method	Description of the method	Other Consideration
1.	**Average Profits Methods**	Under this method - **Value of Goodwill = Agreed Number of Years (Purchase) × Average Maintainable Profits** Average Maintainable/Profit Average Annual Profits — 00 [Simple average or may be weighted average considering the trend of profits] Less: "Exceptional/Casual Income — 00 Add: Abnormal Loss — 00 00 Add: Capital Expenditure wrongly charged against profits — 00 00 Less: Provision for Taxation (As may be required) — 00 Adjusted Maintainable Profits — 000 ("Adjustments for undercharged or overcharged Depreciation or under or over valuation of stocks to be made, if required)	i. If profits are fluctuating, simple average is taken. If profits show an increasing trend, weights may be used. If profits constantly decrease, the lowest of the profits after adjustments may be considered. ii. Exceptional Income or Expense of any particular year, should better be adjusted against the profit of that year. iii. More weightage is usually given to later years.
2.	**Super Profits Method**	Super Profit = Future maintainable profits – Normal Return on Capital Employed Goodwill = Super Profit × No. of years Steps to be followed Steps (a) Calculation of Capital employed OR Average Capital Employed	i. Calculation of Average capital Employed cannot be made if current years' profits are not separately given. ii. Trading Profits exclude any non trading income like Interest on Non-trading investments. iii. Adjustments against profits including provision for managerial remuneration, should be made. iv. If there is any change in the value of any fixed asset on revaluation, that does not affect Annual Trading Profit.

Sl No.	Name of the Method	Description of the method	Other Consideration
			But adjustment for over charged or undercharged depreciation may be required to adjust the profits. v. If there is any decrease in the value of any Current Asset like bad debts or reduction of stock and that has not been adjusted, the adjustment should be made for finding out correct Trading Profit of the current year. vi. For calculating capital employed, proposed dividend need not be deducted. [Please see valuation of shares']
		Sundry Assets 00 **Excluding:** i. Goodwill But including Goodwill at Cost Paid for ii. Non-trading assets and iii. Fictitious Assets Less: (i) Current Liabilities & Provisions -00 (ii) Contingent & Probable Liabilities -00 (Trading) **Capital Employed** 00 Less: ½ of Current years trading profits after taxation (if the profits remain undistributed) -00 **Average Capital Employed** 000 **Step (b) Average Annual Adjusted Profits (Maintainable) 00** **Step (c) Calculate Normal Return on Capital Employed or Average Capital Employed** [Say at 10% or 12%, etc. — as may be given or assumed] **Step(d) Deduct Normal Return (c) from Average Maintainable Profits (b).**	

Sl No.	Name of the Method	Description of the method	Other Consideration
		The difference is called **Annual Super Profit** **Step (e) Goodwill = Annual Super Profit × No. of Years for which the Super Profit can be maintained.** [Usually expressed as...years purchase of super profit]	
3.	**Capitalization of Profits Methods** **(A) Profits**	Under the method follow these steps – a. Calculate Annual Maintainable Profit as shown above. b. Calculate normal Capital Employed capitalizing the above profit by applying the normal rate of return. $\text{Normal Capital Employed} = \frac{\text{Maintainable Profit}}{\text{Normal Rate of Return}} \times 100$ c. Calculate actual Capital Employed d. Goodwill = Normal Capital Employed – Actual capital Employed.	Here also the profits should be adjusted considering necessary adjustments for managerial remunerations, change of depreciation, etc.
	(B) Capitalization of Super Profits	a. Calculate Super profit as said under Method 2. b. $\text{Goodwill} = \frac{\text{Super Profit}}{\text{Normal Rate of Return}} \times 100$	
4.	**Annuity Method**	It is a derivative of super profit concept. If super profit is expected to be earned uniformly over a number of years, Goodwill is computed with the help of Annuity Table. Calculate Super Profit as discussed before **Goodwill = Annual Super ProfitxPresent Value of Annuity of ₹1.**	Here also similar principles as said before should be followed for calculating — Capital Employed or Average Capital Employed, Annual Average Profits and Annual Super Profits.

Adjustments regarding capital contribution of new partner and the capitals of the existing partners

At the time of admission the incoming partner is required to bring capital into the firm, the amount of which is mutually agreed upon by the partners. The capital introduced by the new partner may be either in cash or in the form of any other assets. Necessary adjustments regarding revaluation profit/loss, distribution of reserves, adjustment for goodwill etc. are effected in the books of the firm and thus, the adjusted capital account balances are found out which are shown in the Balance Sheet after admission of the new partner.

The partners may decide to maintain the closing balances of their capital accounts in a pre-determined ratio.

Adjustment for Life Policy:

Joint Life Insurance Policy is a common Life insurance policy which covers the lives of all the partners of the firm and the premium of which is borne by the firm. The Surrender Value of the Joint Life Policy as on the date of admission is to be considered for the accounting purpose. The Maturity Value is irrelevant in these cases.

Illustration 1

A and B are currently partners in a firm sharing Profit/Loss in the ratio of 4 : 3. A new partner C is admitted and after his admission new profit sharing ratio between A, B and C becomes 5: 3 : 2. What will be the sacrifice ratio of A and B after admission of C?

Solution:

Calculation of Sacrificing Ratio of A & B after C's admission

	A	:	B	:	C
Old Ratio	4	:	3		
New Ratio	5	:	3	:	2

$A = \frac{4}{7} - \frac{5}{10} = \frac{40 - 35}{70} = \frac{5}{70}$

$B = \frac{3}{7} - \frac{3}{10} = \frac{30 - 21}{70} = \frac{9}{70}$

Sacrificing Ratio is 5 : 9

Illustration 2

X, Y and Z are partners in the ratio of 3 : 2:1. W is admitted with $^1/_6$ th share in future profits. Z would retain his original shares. Find out the new profit sharing ratios of the partners.

Solution:

X's New share	= 3/6 - (1/6 × 3/5) = 12/30
Y's New share	= 2/6 - (1/6 × 2/5) 1=8/30
Z's share	= 1/6
W's share	= 1/6
Therefore, New Profit Sharing Ratio	= X:Y:Z:W = 12:8:5:5

Illustration 3

S and N are partners sharing Profit /(Loss) in the ratio of 5:3. They admit J into partnership for $\frac{3}{10}$th in the Profit /(Loss) in which J acquired $\frac{1}{5}$th share from S and $\frac{1}{10}$th share from N respectively.

Calculate the new profit and loss sharing ratios of the partners.

Solution:

S's new share $= \left[\frac{5}{8} - \frac{1}{5}\right] = \frac{25 - 8}{40} = \frac{17}{40}$

N's new share $= \left[\frac{3}{8} - \frac{1}{10}\right] = \frac{15 - 4}{40} = \frac{11}{40}$

J's share $= \frac{3}{10} = \frac{12}{40}$

Hence New profit/loss sharing ratios of the partners = 17:11:12

Illustration 4

X and Y are partners sharing profit/loss in the ratio of 5:4. They admit Z into partnership for $\frac{1}{5}$th the share in the profits which is given $\frac{2}{15}$th by X and $\frac{1}{15}$th by Y. Z brings ₹ 1,50,000 as his capital and ₹ 60,000 as premium. Goodwill account appears in the books at ₹ 1,65,000; Give necessary journal entries in the books of the firm at the time of Z's admission and find out the new profit sharing ratio.

Solution:

Journal

Particulars		Dr. (₹)	Cr. (₹)
i. Bank A/c	Dr.	2,10,000	
To, Z's Capital A/c			1,50,000
To, Premium for Goodwill A/c			60,000
(Being amount brought in as capital and premium for goodwill by Z)			
iii. Premium for goodwill A/c	Dr.	60,000	
To, X's Capital A/c			40,000
To, Y's Capital A/c			20,000
(Being transfer of premium brought by Z to X & Y's A/c)			
(Assuming that the goodwill shown in the books of account is purchased goodwill)			
(if it is a self generated Goodwill an extra entry as below will be passed to cancel the said goodwill between old partners in old profit sharing ratio then above tow entries I & ii will be passed))			
X's Captal Account	Dr	91667	
Y's Capital Account	Dr	73333	165000
To Goodwill Account			

New Profit sharing ratio will be:

X's new share = $\frac{5}{9} - \frac{2}{15} = \frac{25-6}{45} = \frac{19}{45}$

Y's new share = $\frac{4}{9} - \frac{1}{15} = \frac{20-3}{45} = \frac{17}{45}$

Y's new share = $\frac{1}{5}$ or $\frac{9}{45}$

Hence new ratio = 19 : 17 : 9

Note : From the above question , it is seen that goodwill is in the books at Rs.165000. Now the question is whether the said goodwill is self generated goodwill or purchased goodwill. If purchased goodwill, no need to writeoff from the books of account and whatever premium paid by the new partner will be shared by old partners in their sacrificing ratio. If self generated goodwill, first cancel that goodwill with old partners in old profit sharing ratio and distributed the premium paid by new partners as goodwill among the old partners in sacrificing ratio.

Illustration 5

X & Y share profit & loss in the ratio of 5:3. They admit Z with 1/5th share of profits. He pays ₹ 80,000 as capital but does not contribute anything towards goodwill which is valued at ₹ 60,000. The capitals of the Partners are fixed. All adjustments are to be made through partners' current accounts. Their Balance Sheet as on March 31, 2023 is as follows:

Balance Sheet as on 31.03.2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital:			Plant and Machinery		50,000
X—	80,000		Investments		31,000
Y—	60,000	1,40,000	Sundry Debtors		60,000
Current account:			Stock and Trade		90,000
X—	5,000		Bank		30,000
Y—	6,000	11,000			
General Reserve		60,000			
Sundry Creditors		50,000			
		2,61,000			**2,61,000**

Additional Information:

(i) Plant and Machinery is valued at ₹ 46,000 and stock at ₹ 96,000.

(ii) One Creditor for ₹ 6,000 is dead and nothing is likely to be paid on this account.

(iii) The Capital accounts are to be proportionately adjusted on the basis of Z's capital and his share of profit, through Current accounts

(iv) Partners decide to maintain the General Reserve in the books of the firm.

Prepare Revaluation Account, Capital and Current Accounts, Bank Account and Balance Sheet of the new firm.

Solution:

Dr. Revaluation Account Cr.

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
To Plant & Machinery A/c		4,000	By Stock A/c		6,000
To Partner's Current A/c			By Creditors A/c		6,000
X—	5,000				
Y—	3,000	8,000			
		12,000			**12,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Balance c/d	2,00,000	1,20,000	80,000	By Balance B/d By Bank A/c By Partners' Current A/c (b.f.)	80,000 — 1,20,000	60,000 — 60,000	— 80,000 ---
	2,00,000	**1,20,000**	**80,000**		**2,00,000**	**1,20,000**	**80,000**

Dr. **Partners' Current Account** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To General Reserve A/c	30,000	18,000	12,000	By Balance b/d	5,000	6,000	-
				By Revatuation A/c	5,000	3,000	-
To X's Current A/c	-	-	7,500	By Z's Current A/c	7,500	4,500	-
To Y's Current A/c	.	-	4,500	By General Reserve A/c	37,500	22,500	-
To Partners' Capital A/c	1,20,000	60,000	-	By Bank A/c (B/F)	95,000	42,000	24,000
	1,50,000	**78,000**	**24,000**		**1,50,000**	**78,000**	**24,000**

Note:

(1) General Reserve is to be maintained in the books of the firm hence is credited to old partners' capital A/c & debited to all partners' capital A/c.

(2) Sacrificing Ratio = X : Y

Old Ratio 5 : 3

Share of Z = 1/5 th

Share of X & Y in the firm = 1 – 1/5 = 4/5

X's share = 4/5 x 5/8 = 5/10

Y's share = 4/5 x 3/8 = 3/10

5/10: 3/10: 2/10 = New Ratio

Sacrificing Ratio = Old Ratio — New Ratio.

X = 5/8 – 5/10 = 10/80

Y = 3/8 – 3/10 = 6/80

Sacrificing Ratio = 10:6

(3) Adjustment for goodwill

Z's share of Goodwill = ₹ 60,000 × 1/5 = ₹ 12,000

X's share in Goodwill of Z = ₹ 12,000 × 10/16 = ₹ 7,500 in Sacrificing Ratio.

Y's share in Goodwill of Z = ₹ 12,000 × 6/16 = ₹ 4,500 in Sacrificing Ratio.

(4) Adjustment for capital

Total Capital of the firm according to capital contribution of Z = ₹ 80,000 × 5 = ₹ 4,00,000.

X's Capital balance = ₹ 4,00,000 × 5/10 = ₹ 2,00,000

Y's Capital balance = ₹ 4,00,000 × 3/10 = ₹ 1,20,000

Z's Capital balance = ₹ 4,00,000 × 2/10 = ₹ 80,000

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	30,000		
To Z's Capital A/c	80,000		
To X's Capital A/c	95,000		
To Y's Capital A/c	42,000	By Balance c/d	2,71,000
To Z's Capital A/c	24,000		
	2,71,000		**2,71,000**

Balance Sheet as on 31.03.23

Liabilities	(₹)	Assets	(₹)
Capital:		Bank	2,71,000
X	2,00,000	Debtors	60,000
Y	1,20,000	Stock	96,000
Z	80,000	Machine	46,000
Current A/c:		Investment	31,000
X	---		
Y	---		
General Reserve	60,000		
Sundry Creditors	44,000		
	5,04,000		**5,04,000**

Note: It is assumed that the partners will bring necessary fund in cash to adjust their capital through Current A/c.

Illustration 6

The Balance Sheet of a firm as on 31 .3.2023 was

Liabilities	(₹)	Assets	(₹)
Capital: Sun	50,000	Property	35,000
Moon	41,000	Motor car	7,500
Loan (Sun)	5,000	Furniture	1,000
General Reserve	5,000	Debtors	25,000
Sundry Creditors	15,000	Stock	45,000
Outstanding Expenses	1,500	Cash	4,000
	1,17,500		**1,17,500**

The profit sharing ratio between Sun & Moon was 3 : 2. They decided to admit Pluto as a new partner from 1st April, 2023 on the following terms & conditions:

(1) Property & Motor Car to be revalued at ₹45,000 & ₹6,500 respectively and 5% provision to be created on debtors.

(2) Pluto should pay premium for goodwill to be valued at 2 years' purchase of last three years average profits. Such amount of premium was to be credited to old partners loan accounts.

(3) Pluto should pay ₹37,500 as capital.

(4) The new profit sharing ratio should be 2: 1: 1.

(5) Last three years' profit were ₹5,000, ₹6,000 and ₹7,500.

The last three years' books of accounts, on verification, disclosed the following discrepancies:

2020-21 : Bad debts previously written of recovered ₹400, credited to Debtors Account, Closing Stock under valued by ₹1,250.

2021-22 : Furniture purchased ₹300 debited to Purchases Account,

Depreciation was provided @ 10% on reducing balance method but Closing Stock was overvalued by ₹2,000.

2022-23 : A purchase invoice of ₹1,000 was omitted from the books and Closing Stock was undervalued by ₹1,000.

Pass the journal entries at the time of admission of Pluto and prepare the Balance Sheet just after his admission.

Solution:

Dr. **Revaluation Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Motor Car A/c		1,000	By Property A/c	10,000
To Provision for Bad Debts A/c		1,250		
To Profit on Revaluation:				
Sun 3/5	4,650			
Moon 2/5	3,100	7,750		
		10,000		**10,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	Sun (₹)	Moon (₹)	Pluto (₹)	Particulars	Sun (₹)	Moon (₹)	Pluto (₹)
				By Balance b/d	50,000	41,000	—
				By Cash A/c	—	—	37,500
				By Profit on Revaluation	4,650	3,100	—
To Balance c/d	57,650	46,100	37,500	By General Reserve	3,000	2,000	
	57,650	**46,100**	**37,500**		**57,650**	**46,100**	**37,500**

Calculation of sacrificing / gaining ratio of sun & moon because of admission , Pluto.

	Sun: Moon : Pluto
Old Ratio	3:2
New Ratio	2:1:1
Sacrificing ratio (Sun's)	$\frac{3}{5} - \frac{2}{4} = \frac{12-10}{20} = \frac{2}{20}$
Moon's Sacrificing ratio =	$\frac{2}{5} - \frac{1}{4} = \frac{8-5}{20} = \frac{3}{20}$

Or, 2: 3

Dr. **Statement showing Adjusted Profit Account** **Cr.**

Particulars	2020-21 (₹)	2021-22 (₹)	2022-23 (₹)
Profits	5,000	6,000	7,500
Bad Debts Recovered	+ 400	—	—
Closing Stock Undervalued	+ 1,250	- 1,250	—
Furniture purchased debited to Purchases A/c		+ 300	—
Depreciation		-30	-27
Clossing stock overvalued		- 2,000	+ 2,000
Purchases not recorded			- 1,000
Closing stock undervalued			+ 1,000
	6,650	**3,020**	**9,473**

Calculation of premium to be paid by Pluto Average profit of 3 year's:

$$\frac{₹(6,650 + 3,020 + 9,473)}{3} = ₹6,381$$

Goodwill = ₹6,381 × 2 = ₹12,762

Pluto's share of goodwill = ₹12,762 × $\frac{1}{4}$ = ₹3,190.50

Adjustment Entries for rectification of past errors

Journal

Particulars		Dr. (₹)	Cr. (₹)
Furniture A/c	Dr.	243	
Debtors A/c	Dr.	400	
To Adjusted P/L A/c			643
Adjusted P/L A/c	Dr.	20	
To Provision for doubtful debts A/c			20
Closing Stock A/c	Dr.	1,000	
To Adjusted P/L A/c			1,000
Adjusted P/L A/c	Dr.	1,000	
To Creditors A/c			1,000
Adjusted P/L A/c	Dr.	623	
To Sun's Capital A/c			373.80
To Moon's Capital A/c			249.20

Journal

Particulars		Dr. (₹)	Cr. (₹)
Property A/c	Dr.	10,000	
To Revaluation A/c			10,000
(Being revaluation of property done at the time of admission of Pluto)			
Revaluation A/c	Dr.	2,250	
To Motor Car A/c			1,000
To Provision for bad debts A/c			1,250
(Being revaluation done of motor car & Provision calculated on debtors @ 5%)			
Revaluation A/c	Dr.	7,750	
To Sun's Capital A/c			4,650
To Moon's Capital A/c			3,100
(Being profit on revaluation distributed to Partner's Capital A/c)			
Cash A/c	Dr.	37,500	
To Pluto's Capital A/c			37,500
(Being cash brought in by Pluto as his share of capital)			
Cash A/c	Dr.	3,190.50	
To Pluto's Capital A/c			3,190.50
(Being cash .brought by Pluto for his share of goodwill)			
Pluto's Capital A/c	Dr.	3,190.50	
To Sun's Loan A/c			1,276.20
To Moon's Loan A/c			1,914.30
(Being Pluto's share of premium for goodwill credited to Old Partner's Capital A/c in their sacrificing ratio)			

Balance Sheet (Post-Admission)

Liabilities	(₹)	Assets	(₹)
Capital:		Property (35,000 + 10,000)	45,000.00
Sun	58,023.80	Motor Car (7,500 - 1,000)	6,500.00
Moon	46,349.20	Furniture (1,000 + 243)	1,243.00
Pluto	37,500.00	Debtors (25,000 + 400 - 1,270)	24,130.00
Loan (Sun)	6,276.20	Stock	46,000.00
Loan (Moon)	1,914.30	Cash (4,000 + 37,500 + 3,190.50)	44,690.50
Sundry creditors	16,000.00		
Outstanding Expenses	1 ,500.00		
	1,67,563.50		**1,67,563.50**

Illustration 7

P and Q are partners sharing profits and losses in the ratio of 5:4. On 1st April, 2022 they admitted their Manager R into partnership for $\frac{1}{5}$ th the share of the profits. As Manager, R was receiving a salary of ₹60,000 per year and a commission of 5 percent on the net profit after charging such salary and commission. It is, however, agreed that any excess over his former remuneration to which R becomes entitled as a partner is to be borne by Q.

The profits of the firm for the year ended 31st March, 2023 amounted to ₹4,27,500. You are required to show the division of profits among the partners.

Solution:

(i) R's remuneration as Manager

Salary ₹60,000 & Commission ₹4,27,500 - ₹60,000 = ₹3,67,500 × $\frac{5}{105}$ = ₹17,500

Or ₹60,000 + ₹17,500 = ₹77,500

(ii) R's share in profit = ₹4,27,500 × $\frac{1}{5}$ = ₹85,500; it excess over above (i)

= ₹85,500 - ₹77,500 = ₹8,000 which to be borne by Q

(iii) Share in profits of P & Q

P = ₹4,27,500 - ₹77,500 = ₹3,50,000 × $\frac{5}{9}$ = ₹1,94,444

Q = ₹3,50,000 × $\frac{4}{9}$ = ₹1,55,556 - ₹8,000 = ₹1,47,556

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

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To P's Capital A/c:		1,94,444	By Profit for the year		4,27,500
To Q's Capital A/c: Less: transferred to R: To R's Capital A/c As Manager: Add: Transferred from Q	1,55,556 8,000 77,500 8,000	 1,47,556 85,500			
		4,27,500			**4,27,500**

Illustration 8

A and B were partners of a firm sharing profits and losses in the ratio 2:1. The Balance Sheet of the firm as at 31st March, 2023 was as under:

Liabilities	(₹)	Assets	(₹)
Capital Accounts:		Plant and Machinery	5,00,000
A	8,00,000	Building	9,00,000
B	4,00,000	Sundry Debtors	2,50,000
Reserves	5,25,000	Stock	3,00,000
Sundry Creditors	2,75,000	Cash	1,50,000
Bills Payable	1,00,000		
	21,00,000		**21,00,000**

They agreed to admit P and Q into the partnership on the following terms:

(i) The firm's goodwill to be valued at 2 years' purchase of the weighted average of the profits' of the last 3 years. The relevant figures are:

Year ended 31.03.2020 - Profit ₹37,000

Year ended 31.03.2022 - Profit ₹40,000

Year ended 31.03.2023 - Profit ₹45,000

(ii) The value of the stock and Plant & Machinery were to be reduced by 10%.

(iii) Building was to be valued at ₹ 10,11,000.

(iv) There was an unrecorded liability of ₹ 10,000.

(v) A, B, P & Q agreed to share profits and losses in the ratio 3 : 2 :1:1.

(vi) The value of reserve, the values of liabilities and the values of assets other than cash were not to be altered.

(vii) P and Q were to bring capitals equal to their shares of Profit considering B's capital as base after all adjustments.

You are required to prepare:

(1) Memorandum Revaluation Account,

(2) Partner's Capital Accounts and

(3) The Balance Sheet of the newly constructed firm.

Solution:

Memorandum Revaluation Account

Particulars	(₹)	Particulars	(₹)
To Stock A/c To Plant & Machinery A/c To Unrecorded Liability A/c To Profit transferred to Partners' Capital A/c (in old ratio) A = ₹14,000 B = ₹7,000	30,000 50,000 10,000 21,000	By Building	1,11,000
	1,11,000		**1,11,000**
To Building	1,11,000	By Stock A/c By Plant & Machinery A/c By Unrecorded liability A/c By Loss transferred to Partners' Capital A/c s (in new ratio) A = ₹9,000 B = ₹6,000 P = ₹3,000 Q = ₹3,000	30,000 50,000 10,000 21,000
	1,11,000		**1,11,000**

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	A (₹)	B (₹)	P (₹)	Q (₹)	Particulars	A (₹)	B (₹)	P (₹)	Q (₹)
To Memorandum Revaluation A/c	9,000	6,000	3,000	3,000	By Balance b/d	8,00,000	4,00,000	—	—
To Reserves A/c	2,25,000	1,50,000	75,000	75,000	By Memorandum Revaluation A/c	14,000	7,000	—	—
To A & B A/c (W.N.2)	—	—	12,000	12,000	By Reserves A/c	3,50,000	1,75,000	—	—
To Balance c/d (Refer W.N.3)	9,50,000	4,30,000	2,15,000	2,15,000	By P & O A/c (W.N.2)	20,000	4,000	—	—
					By Cash A/c (Bal. fig.)	—	—	3,05,000	3,05,000
	11,84,000	**5,86,000**	**3,05,000**	**3,05,000**		**11,84,000**	**5,86,000**	**3,05,000**	**3,05,000**

Balance Sheet of newly reconstituted firm as on 31.03.2023

Liabilities	(₹)	Assets	(₹)
Capital Accounts:		Plant and Machinery	5,00,000
A — ₹9,50,000		Building	9,00,000
B — ₹4,30,000		Sundry Debtors	2,50,000
P — ₹2,15,000		Stock	3,00,000
Q — ₹2,15,000	18,10,000	Cash	7,60,000
Reserves	5,25,000	(₹1,50,000 + ₹3,05,000 + ₹3,05,000)	
Sundry Creditors	2,75,000		
Bills Payable	1,00,000		
	27,10,000		**27,10,000**

Working Notes:

1. **Calculation of Goodwill Weighted Average Profit:**

Year	Profit (₹)	Weight	Weighted Profit (₹)
2019	37,000	1	37,000
2020	40,000	2	80,000
2021	45,000	3	1,35,000
		6	2,52,000

Weighted Average Profit = ₹2,52,000/6 = ₹42,000

Goodwill is valued at 2 year's purchase

Value of Goodwill: ₹42,000 × 2 = ₹84,000

2. **(a) Profit Sacrificing Ratio**

Particulars	Old Shares	New Shares Share	Sacrificed Share	Gained
A	2/3	3/7	5/21	—
B	1/3	2/7	1/21	—
p	—	1/7	—	1/7
Q	—	1/7	—	1/7

(b) Adjustment for Goodwill

Partners	Goodwill as per old ratio (₹)	Goodwill as per new ratio (₹)	Effect (₹)	
A	56,000	36,000	+ 20,000	—

Partners	Goodwill as per old ratio (₹)	Goodwill as per new ratio (₹)	Effect (₹)	
B	28,000	24,000	+ 4,000	—
P	—	12,000	—	12,000
Q	—	12,000	—	12,000
	84,000	**84,000**	**24,000**	**24,000**

Journal

Particulars		Dr. (₹)	Cr. (₹)
P's Capital A/c	Dr.	12,000	
Q's Capital A/c	Dr.	12,000	
To A's Capital A/c			20,000
To B's Capital A/c			4,000

3. Calculation of closing capitals of P and Q

B's capital is taken as base. Closing capital of B after all adjustments is 4,30,000.

Total capital of firm will be = ₹4,30,000 × 7/2 = ₹15,05,000 Hence, P's and Q's closing capital should be ₹2,15,000 (₹15,05,000 × 1/7) each i.e. at par with B (as per new profit and loss sharing ratio).

Illustration-9

The balance sheet of Amit. Bhusan and Charan, who share profit and losses as 3:2:1 respectively, as on 01.04.2023 is as follows

Liabilities	Amount(₹)	Assets		Amount (₹)
Capital Accounts : Amit	1,80,000	Machinery		1,50,000
Bhusan	1,60,000	Furniture		1,50,000
Charan	1,40,000	Debtors	80,000	
Current Accounts: Bhusan	16,000	Less: Provision	4,000	76,000
Creditors	1,20,000	Stock		2,10,000
		Cash		20,000
		Current Account : charan		10,000
	6,16,000			6,16,000

Dev is admitted as a partner on the above data for 1/5th share in the profit and loss.
Following are agreed upon:

1) The profit and loss sharing ratio among the old partners will be equal
2) Dev brings in ₹ 1,50,000 as capital but is unable to bring the required amount of premium for goodwill
3) The goodwill of the firm is valued at ₹ 60,000

4) Assets and liabilities are to be valued as follows:
   Machinery ₹ 2,60,000 : Furniture ₹ 1,28,000 : Provision for doubtful debts @ 10% on debtors .
5) Necessary adjustment regarding goodwill and profit/loss on revolution are to made through the Partner's Current Accounts .
6) It is decided that the revalued figures of assets and liabilities will not appear in the Balance Sheet of the new firm.
7) Capital Accounts of the old partners in the new firm should be proportionate the new profit and loss sharing ratio, taking Dev's Capital as base. The existing partner's will not bring cash for future Capital. The necessary adjustment are to be made through the partner's current Account

Prepare Partner's Capital & Current Account, and the Balance Sheet of the new firm after admission

PARTNER'S CAPITAL ACCOUNTS

Dr. Cr.

Particular	Amit	Bhusan	Charan	Dev	Particulars	Amit	Bhusan	Charan	Dev
					By Balance b/d	1,80,000	1,60,000	1,40,000	
					By Bank A/c				1,50,000
To Balance c/d	2,00,000	2,00,000	2,00,000	1,50,000	By Partner's Current A/cs (bal. fig)	20,000	40,000	60,000	
	2,00,000	2,00,000	2,00,000	1,50,000		2,00,000	2,00,000	2,00,000	1,50,000

PARTNER'S CURRENT ACCOUNTS

Dr. Cr.

Particular	Amit	Bhusan	Charan	Dev	Particulars	Amit	Bhusan	Charan	Dev
To Balance b/d	-	-	10,000	-	By Balance b/d	-	16,000		-
To Amit & Bhusan (Profit)	-		3,000	6,000	By Dev & Charan Amit	7,000	2,000		
To Amit and Bhusan (Goodwill adjustment)			6,000	12,000	By Dev & Charan (Goodwill adjustment)	14,000	4,000		
To Partners Capital A/cs	20,000	40,000	60,000		By Balance c/d		18,000	79,000	18,000
To Balance c/d	1,000								
	21,000	40,000	79,000	18,000		21,000	40,000	79,000	18,000

Balance Sheet of New Firm after Dev's Admission

Liabilities	₹	Assets		₹
Amit	2,00,000	Machinery		1,50,000
Bhushan	2,00,000	Furniture		1,50,000
Charan	2,00,000	Stock		2,10,000
Dev	1,50,000	Debtors	80,000	
Current Account: Amit	1,000	Less: Provision	4,000	76,000
Creditors	1,20,000	Cash		1,70,000
		Current Account		
		Bhusan	18,000	
		Charan	79,000	
		Dev	18,000	1,15,000
	8,71,000			8,71,000

Working Notes:

1. Dev. Joins the business for 1/5th share and bring ₹ 1,50,000 ascapital. Thus total cap[ital of new firm will be ₹ 7,50,000 (1,50,000*5). Total capital of Amit, Bhushan 7 Charan will be ₹ 6,00,000 (7,50,000 – 1,50,000) which will be shared by them equally i.e. 2,00,000 each

2. **New Profit-Sharing Ration**

Amit	Bhushan	Charan	Dev
4/5×1/3 4/15	4/5×1/3 4/15	4/5× 1/3 4/15	1/5 3/15

NR= 4:4:4:3

3. **Adjustment of Goodwill**

Sacrifice/Gain of Partners

Amit	Bhushan	Charan	Dev
4/15-3/6 -21/90 (Sacrifice)	4/15×2/6 = 6/90 (Sacrifice)	4/15 × 1/6 = 9/90 (gain)	1/5 (Gain)

JOURNAL ENTRY TO ADJUST GODWILL

Charan [₹ 60,000 × 9/90]	Dr.	₹ 6,000	
Dev [₹ 60,000 × 1/5]	Dr.	₹ 12,000	
To Amit [₹ 60,000 × 21/90]			₹ 14,000
To Bhushan [₹ 60,000 × 6/90]			₹ 4,000

4. **Net Effect of Revolution of Assets and liabilities**

Increase in value of Machinery	₹ 56,000
Decrease in value of Furniture	(₹ 22,000)
Increase in Provision for Doubtful Debts	(₹ 4,000)
Net Effect of Revolution of Assets and liabilities	₹ 30,000

Journal Entry to Adjust on Revolution

Charan [₹ 30,000 × 9/90]	Dr. 3,000	
Dev [₹ 30,000 × 1/5]	Dr. 6,000	
To Amit [30,000 × 21/90]		7,000
To Bhusan [30,000 × 6/90]		2,000

Retirement of Partner

4.2

PARTNERSHIP ACCOUNTS: RETIREMENT

Partners form a partnership business. But sometimes a partner may decide to discontinue from the firm for different reasons. Normally the retirement takes place by consent of all the partners and/or by other mode of communication by the intended partner to all other partners.

As per Section 32 of the Indian Partnership Act, 1932 a partner may retire:

- With the consent of all the existing partners; or
- In accordance with an express agreement by the partners; or
- By giving a written notice to all other partners of his intention to retire in case of 'Partnership at Will'.

Like admission, retirement of a partner is another mode of reconstitution of partnership firm.

After retirement of a partner, the other partners may continue the business. For paying off the retiring partner(s), some specific adjustments are required to be done in the books of the firm. These are discussed as follows:

- Calculation of new profit sharing ratio and gaining ratio,
- Distribution of reserves and accumulated profits and losses,
- Revaluation of assets and liabilities,
- Adjustment for goodwill,
- Adjustment for Joint Life Policy (JLP),
- Settlement of final balance of the retiring partner,
- Adjustment of existing partners' capital accounts.

Calculation of New Profit Sharing Ratio and Gaining Ratio

As a consequence of retirement, the share of profit of the retiring partner gets distributed to the continuing partners which results in again in the share of the continuing partners. The ratio in which the continuing partners will share future profits and losses is known as the New Profit Sharing Ratio.

The ratio in which the continuing partners acquire the share of profit forgone by the retiring partner is referred to as Gaining Ratio. It is calculated by taking the difference between the old profit sharing ratio and the new profit sharing ratio.

Distribution of Reserves and Accumulated Profits and Losses

The balance of reserves or profit and loss account are distributed among all the partners (including the retiring partner), in their Old Profit Sharing Ratio in the event of Retirement.

Revaluation of Assets and liabilities

The logic for revaluation of Assets and liabilities at the time of retirement of a partner is same as that at the time of admission of a new partner. In case of retirement, the revaluation profit or loss is distributed among all the partners in the Old Profit Sharing Ratio.

Adjustment for Goodwill

The goodwill of the existing partnership firm had been created and developed by all the existing partners (including the retiring partner). That is why the continuing partners are required to compensate the retiring partner in their Gaining Ratio and the necessary adjustments for Goodwill is required to be made. Gaining ratio is the ratio of the gain or increase in the profit share that is made by the continuing partners on the retirement of an outgoing partner. It is calculated by taking the difference between the old profit sharing ratio and new profit sharing ratio. The accounting treatment of goodwill in the event of retirement of a partner is as under:

The Capital Accounts of the partners are required to be adjusted:

Gaining Partners' Capital A/c Dr. (in Gaining Ratio)
To Outgoing Partner's A/c (with his share of goodwill)

Adjustment for Joint Life Policy (JLP)

Joint Life Insurance Policy is a common Life insurance policy which covers the lives of all the partners of the firm and the premium of which is borne by the firm. The Surrender Value of the Joint Life Policy as on the date of reconstitution (i.e. Admission, Retirement, Change in Profit Sharing Ratio) is to be considered for the accounting purpose. Either this should be adjusted through the Capital Account of partners or raised in the books of Account to the extent of Surrender value. The Maturity Value is irrelevant in these cases.

Settlement of Final Balance of the Retiring Partner:

After considering all the points discussed above, the amount due to the retiring partner is ascertained and to be settled in a mode as decided by the firm according to the terms of the partnership deed; or in the absence of such deed it is to be mutually decided by the partners.

The amount due to the retiring partner can either be discharged immediately after his retirement by paying off the whole amount using the business funds (i.e. Cash or Bank), or, if the firm is having paucity of liquid funds, then the retiring partner is paid in a certain number of instalments. In such case, the firm opens a Loan Account in the name of the retiring partner. Right of retiring partner under Section 37 of the Indian Partnership Act,1932: The retiring partner has the option of claiming higher of the following amounts:

(a) Share in Profits: The retiring partner's profit share is determined since the date of retirement which is to be calculated in the ratio of the present adjusted capitals or

(b) Interest @ 6% per annum: Such interest is calculated on the amount due to the retiring partner from the firm for the period starting from the date of retirement up to the date of settlement.

Illustration 9

P, Q and R sharing profits and losses equally, had been trading for many years. R decided to retire on 31.3.2023 on which date Balance Sheet of the firm is as follows.

Liabilities	(₹)	Assets	(₹)
Capital accounts:		Cash	36,000
P	1,20,000	Debtors	74,000
Q	85,000	Stock	60,000
R	75,000	Plant and Machinery	1,20,000
Creditors	85,000	Land and Building	75,000
	3,65,000		**3,65,000**

Value of goodwill was agreed as ₹93,000. Land and building increased in value, it being agreed at ₹1,05,600, plant and machinery was revalued at ₹1,00,500 and it was agreed to provide 6% in respect of debtors. Prepare Revaluation Account, Capital Accounts and Balance Sheet.

Solution:

In the Books of the Firm

Dr. **Revaluation Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Plant & Machinery A/c		19,500	By Land & Building A/c	30,600
To Provision for Bad Debts A/c		4,440		
To Capital A/c (Profit)				
P	2,220			
Q	2,220			
R	2,220	6,660		
		30,600		**30,600**

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
To Balance	1,06,720	71,720	—	By Balance	1,20,000	85,000	75,000
To Loan A/c	—	—	1,08220	By Revaluation A/c	2,220	2,220	2,220
	15,500	15,500		By P & Q	—	—	31,000
	1,22,220	**87,720**	**1,08,220**		**1,22,220**	**87,720**	**1,08,220**

Balance Sheet as on 31.3.2023

Liabilities	(₹)	Assets		(₹)
Capital Accounts:		Cash		36,000
P	106720	Debtors	74,000	
Q	71720	Less: Provision	4,440	69,560
Loan Account: R	1,08,220	Stock		60,000
Creditors	85,000	Plant & Machinery		1,00,500
		Land & Building		1,05,600
	3,71,660			**3,71,660**

Illustration 10

A, B and C were in partnership sharing profits in the proportion of 5:4:3. The Balance Sheet of the firm as on 31st March, 2023 was as under :

Liabilities	(₹)	Assets	(₹)
Capital Accounts :		Goodwill	40,000
A	1,35,930	Fixtures	8,200
B	95,120	Stock	1,57,300
C	61,170	Sundry Debtors	93,500
Sundry Creditors	41,690	Cash	34,910
	3,33,910		**3,33,910**

A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore entered into as on 31st March, 2023, the terms of which were as follows:

(i) The Profit & Loss Account for the year ended 31st March, 2023, which showed a net profit of ₹48,000 was to be reopened. B was to be credited with ₹4,000 as bonus, in consideration of the extra work which had devolved upon him during the year. The profit sharing ratio was to be revised as from 1st April, 2021 to 3:4:4.

(ii) Goodwill was to be valued at two years' purchase of the average profits of the preceding five years. The Fixtures were to be revalued by an independent valuer. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.

(iii) The valuations arising out of the above agreement were Goodwill ₹56,800 and Fixture ₹10,980.

(iv) B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3:2 and decided to eliminate Goodwill from the Balance Sheet, to retain the Fixtures on the books at revised value, and to increase the provision for doubtful debts to 6%.

You are required to submit the Journal Entries necessary to give effect to the above arrangement and to draw up the Capital Accounts of the partners after carrying out all adjustment entries as stated above.

Solution:

In the books of the firm
Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
2023 March 31	A's Capital A/c [5/12 of ₹48,000]	Dr.	20,000	
	B's Capital A/c [4/12 of ₹48,000]	Dr.	16,000	
	C's Capital A/c [3/12 of ₹48,000]	Dr.	12,000	
	To Profit & Loss Adjustment A/c			48,000
	[Profits of ₹48,000 already shared by A, B & C as 5 : 4 : 3 written back]			
	Profit & Loss Adjustment A/c	Dr.	4,000	
	To B's Capital A/c			4,000
	[B Credited with bonus of ₹4,000 for his extra work]			
	Profit & Loss Adjustment A/c	Dr.	44,000	
	To A's Capital A/c [3/11 of ₹44,000]			12,000
	To B's Capital A/c [4/11 of ₹44,000]			16,000
	To C's Capital A/c [4/11 of ₹44,000]			16,000
	[The remaining profits re-distributed as 3 : 4 : 4]			
	Goodwill A/c	Dr.	16,800	
	Fixtures A/c	Dr.	2,780	
	To Profit & Loss Adjustment A/c			19,580
	[Values of assets increased on revaluation]			
	Profit & Loss Adjustment A/c	Dr.	1,870	
	To Provision for doubtful debts A/c			1,870
	[Provision created @ 2% on Debtors]			
	Profit & Loss Adjustment A/c	Dr.	17,710	
	To A's Capital A/c [3/11]			4,830
	To B's Capital A/c [4/11]			6,440
	To C's Capital A/c [4/11]			6,440
	[Profit on Revaluation shared among all partners as 3 : 4 : 4]			
	A's Capital A/c	Dr.	1,32,760	
	To A's Loan A/c			1,32,760
	[Transfer of A's dues to his Loan A/c]			
	B's Capital A/c [3/5]	Dr.	36,324	
	C's Capital A/c [2/5]	Dr.	24,216	
	To Goodwill A/c			56,800
	To Provision for doubtful debts A/c			3,740
	[Goodwill Account written off and provision on debtors increased by 4% further on ₹93,500]			

Partners' Capital Account

Dr.										Cr.
Date	**Particulars**	**A (₹)**	**B (₹)**	**C (₹)**	**Date**	**Particulars**	**A (₹)**	**B (₹)**	**C (₹)**	
31.3.22	To Profit & Loss Adjustment A/c	20,000	16,000	12,000	31.3.22	By Balance b/d Profit and Loss	1,35,930	95,120	61,170	
	To Loan A/c (Balance Transferred)	1,32,760	-	-		By Adjustment A/c (Bonus)	-	4,000	-	
	To Goodwill & Provision for Doubtful Debts	-	36,324	24,216		By Profit & Loss Adjustment A/c	12,000	16,000	16,000	
	To Balance c/d	-	69,236	47,394		By Profit & Loss Adjustment A/c	4,830	6,440	6,440	
		1,52,760	**1,21,560**	**83,610**			**1,52,760**	**1,21,560**	**83,610**	

Illustration 11

Compass, Cone and Circle are in partnership sharing profits and losses in the ratio of 3 : 2 : 1. The Balance Sheet of the firm as on 31st December, 2022 was as follows :

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital accounts :			Machinery (at Cost)	50,000	
Compass	40,000		Less : Provision for Dep.	8,000	42,000
Cone	60,000				
Circle	20,000	1,20,000	Furniture		1,000
Reserve		30,000	Sundry Debtors	80,000	
Sundry Creditors		60,000	Less : Prov. for Doubtful Debts	3,000	77,000
			Stocks		50,000
			Cash at Bank		40,000
		2,10,000			**2,10,000**

On 31st March, 2023 Cone retired and Compass and Circle continued in partnership, sharing profits and losses in the ratio of 3 : 2. It was agreed that adjustments were to be made in the Balance Sheet as on 31st March, 2022, in respect of the following :

(a) The Machinery was to be revalued at ₹45,000

(b) The Stock was to be reduced by 2%

(c) The Furniture was to be reduced to ₹600

(d) The Provision for Doubtful Debts would be ₹4,000

(e) A provision of ₹300 was to be made for Outstanding Expenses.

The Partnership agreement provided that on the retirement of a partner, goodwill was to be valued at ₹24,000 and Cone's share of the same was to be adjusted into the accounts of Compass and Circle. The profit up to the date of retirement was estimated at ₹18,000. Cone was to be paid off in full, Compass and Circle were to bring such an amount in cash so as to make their capital in proportion to the new profit sharing ratio. Subject to the condition that a cash balance of ₹20,000 was to be maintained as working capital.

Pass the necessary journal entries to give effect to the above arrangements and prepare the Partners' Capital Accounts on 31st March, 2023.

Solution:

In the books of the Firm
Journal

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
31.3.2023	Reserve A/c	Dr.		30,000	
	To Compass' Capital A/c				15,000
	To Cone's Capital A/c				10,000
	To Circle's Capital A/c				5,000
	(Reserve transferred to the capital accounts of the partners in 3 : 2 : 1)				
	Machinery A/c	Dr.		3,000	
	To Revaluation A/c				3,000
	(Value of the machinery increased on Cone's retirement)				
	Revaluation A/c	Dr.		2,700	
	To Stock A/c				1,000
	To Furniture A/c				400
	To Provision for Bad Debts A/c				1,000
	To Outstanding Expenses A/c				300
	(Value of the assets reduced on Cone's retirement)				
	Revaluation A/c	Dr.		300	
	To Compass' Capital A/c				150
	To Cone's Capital A/c				100
	To Circle's Capital A/c				50
	(Profit on revaluation transferred to the capital accounts of the partners)				
	Compass's Capital A/c	Dr.		2,400	
	Circle's Capital A/c	Dr.		5,600	
	To Cone's Capital A/c				8,000
	(Cone's share of goodwill to be adjusted against remaining partner's capital accounts in the gaining ratio of 3 : 7)				
	Profit and Loss Suspense A/c	Dr.		18,000	
	To Compass' Capital A/c				9,000
	To Cone's Capital A/c				6,000
	To Circle's Capital A/c				3,000
	(Estimated profit transferred to the capital accounts of the partners)				

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Bank Account Dr. To Profit and Loss Suspense Account (Assumed that cash has been generated due to profit accrued in this three months)		18,000	 18,000
	Cone's Capital A/c Dr. To Bank A/c (Payment is made to Cone on his retirement)		84,100	 84,100
	Bank A/c Dr. To Compass' Capital A/c To Circle's Capital A/c (Cash to be brought in by Compass and Circle as per agreement)		46,100	 16,430 29,670

Dr. **Partners' Capital Account** **Cr.**

Particulars	Compass (₹)	Cone (₹)	Circle (₹)	Particulars	Compass (₹)	Cone (₹)	Circle (₹)
To Cone's Capital A/c	2,400	—	5,600	By Balance b/d	40,000	60,000	20,000
" Bank A/c (Bal. fig.)	—	84,100	—	" Reserve A/c	15,000	10,000	5,000
" Balance c/d	78,180	—	52,120	" Revaluation A/c			
				— Profit	150	100	50
				" Share of Profit	9,000	6,000	3,000
				" Compass' Capital A/c	—	2,400	—
				" Circle's Capital A/c	—	5,600	—
				" Bank A/c (Bal. fig.)	16,430	—	29,670
	80,580	**84,100**	**57,720**		**80,580**	**84,100**	**57,720**
				By Balance b/d	78,180	—	52,120

Working Notes :

1. Total value of goodwill ₹24,000

∴ Cone's share of goodwill = ₹24,000 × 2/6 = ₹8,000 to be adjusted against Compass's and Circle capital in 3 : 7.

Computation of ratio : Compass = 3/5 - 3/6 = 3/30 (gain) Circle = 2/5 - 1/6 = 7/30 (gain)

2. Bank Related Transactions

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	40,000	By Cone's Capital	84,100
" Profit — increase in Cash	18,000	By Balance c/d (to be maintained)	20,000
" Compass and Circle's Capital (balance figure)	46,100		
	1,04,100		**1,04,100**

3. Total adjusted capitals of Compass and Circle :

Particulars	(₹)
Compass' Capital ₹(40,000 + 15,000 + 150 + 9,000 – 2,400)	61,750
Circle's Capital :	
₹(20,000 + 5,000 + 50 + 3,000 – 5,600)	22,450
Add : Total Cash to be brought in	46,100
Combined adjusted capitals	1,30,300

∴ Compass' Capital = ₹1,30,300 × 3/5 = ₹78,180 Circle's Cap. = ₹1,30,300 × 2/5 = ₹52,120

Notes: It is assumed that there is inflow of cash to the Business equivalent to estimated profit from 1.1.22 to 31.3.22

Illustration 12

The Balance Sheet of A, B and C who are sharing profits in proportion to their capital stood as follows on March 31st 2023:

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Accounts:			Land and Buildings		50,000
A	40,000		Plant and Machinery		17,000
B	30,000		Stock		16,000
C	20,000	90,000	Debtors	10,000	
Creditors		13,800	Less: Provision	200	9,800
			Cash at Bank		11,000
		1,03,800			**1,03,800**

B retired on the above date and the following was agreed upon:

(i) The stock be depreciated by 6%.

(ii) That the provision for doubtful debts be brought up to 5% on Debtors.

(iii) That the Land and Buildings be appreciated by 20%.

(iv) That a provision for ₹ 1,540 be made in respect of outstanding legal charges.

(v) That the Goodwill of the entire firm be fixed at ₹ 21,600 and B's share of it be adjusted into the accounts of A and C who are going to share future profits in the ratio of 5: 3.

(vi) That the assets and liabilities (except Cash at Bank) were to appear in the Balance Sheet at their old figures.

(vii) That the entire capital of the firm as newly constituted by fixed at ₹ 56,000 between A and C in the proportion of 5: 3 (actual cash to be brought in as paid off, as the case may be).

Show the Balance Sheet after B's retirement.

Solution:

Balance Sheet as on 31st March, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Account:			Land and Building		50,000
A	35,000		Plant and Machinery		17,000
C	21,000	56,000	Stock		16,000
B's Loan A/c		39,600	Debtors	10,000	
Creditors		13,800	Less: Provision for Bad Debt	200	9,800
			Cash at Bank (₹ 11,000 + ₹ 5,600)		16,600
		1,09,400			**1,09,400**

Note: Since assets and liabilities will appear in the Balance Sheet at their old figure Memorandum Revaluation Account should be opened.

Working Notes:

Gaining Ratio

$$A = \frac{5}{8} - \frac{4}{9} = \frac{45 - 32}{72} = \frac{13}{72}$$

$$C = \frac{3}{8} - \frac{2}{9} = \frac{27 - 16}{72} = \frac{11}{72}$$

Hence, gaining ratio = 13: 11

Memorandum Revaluation Account

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Under valuation of Stock		960	By Overvaluation of Land and Building		10,000
To Provision for Bad Debts ₹(500-200)		300			
To Provision for legal changes		1,540			

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Profit on Rev:					
A	3,200				
B	2,400				
C	1,600	7,200			
		10,000			**10,000**
To Reversal of items		10,000	By Reversal of items:		
To Over valuation of Land and Building			By Undervaluation of Stock		960
			By Provision for Bad Debts		300
			By Provision for legal changes		1,540
			By Capital A/c		
			Profit to be written-back		
			A-5/8 =	4,500	
			C-3/8 =	2,700	7,200
		10,000			**10,000**

B's share of goodwill = ₹ 21,600 × 3/9 = ₹ 7,200

The entry being:

Particulars		Debit (₹)	Credit (₹)
A's Capital A/c	Dr.	3,900	
C's Capital A/c		3,300	
To, B's Capital A/c			7,200
(Being gaining ratio)			

Dr. **Partners' Capital Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Memo. Reval. A/c	4,500	-----	2,700	By Balance b/d	40,000	30,000	20,000
To B's Capital A/c	3,900	-----	3,300	By Revaluation A/c –Profit	3,200	2,400	1,600
To B's Loan A/c	----	39,600	-----	By A's capital A/c	-----	3,900	-----
				By B's Capital A/c	-----	3,300	-----
To Balance c/d	35,000*	-----	21,000	By Bank A/c (Balance Fig.)	200	-----	5,400
	43,400	**39,600**	**27,000**		**43,400**	**39,600**	**27,000**

* Total Capital = ₹ 56,000 in 5 : 3, i.e., A ₹ 35,000; C ₹ 21,000.

RETIREMENT-CUM- ADMISSION

In many cases, whenever an existing partner retires, another partner joins the continuing partners in the firm. This situation is referred to as Retirement-cum-Admission. The principles of accounting in the event of admission of a partner and retirement of a partner have been separately discussed. In this section, the combined effect of simultaneous admission and retirement has been highlighted. It should be remembered that no separate treatment is practically needed i.e. same principles for admission and retirement are followed but only two sets of transactions are incorporated simultaneously.

Illustration 13

Gita and Mita are equal partners. Gita, by agreement, retires and Lata joins the firm on the basis of one third share of profits on 01.04.2023. The balances of the books as on 31st March 2023 were:

Particulars	Dr. (₹)	Cr. (₹)
Good will	10,000	
Fixed Assets at Cost	1,20,000	
Current Assets:		
Stock	60,000	
Debtors	40,000	
Bank	8,000	
Creditors		20,000
Provision for Depreciation		12,000
Capital Accounts:		
Gita		1,04,000
Mita		1,02,000
	2,38,000	**2,38,000**

Goodwill and Fixed Assets valued at ₹30,000 and ₹1,40,000 respectively and it was agreed to be written up accordingly before admission of Lata as partner. Sufficient money is to be introduced so as to enable Gita to be paid off and leave ₹5,000 cash at Bank; Mita and Lata are to provide such sum as to make their Capitals proportionate to their share of profit. Assuming the agreement was carried out, you are required to pass the journal entries and prepare the Balance Sheet after admission of Lata.

Solution:

In the books of the firm
Journal

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
2023	Goodwill A/c	Dr.		20,000	
April 1	Fixed Asset A/c	Dr.		20,000	
	Prov. for Depreciation A/c	Dr.		12,000	
	To Revaluation A/c				52,000
	(Increased value of assets transferred to Revaluation A/c)				

Date	Particulars		L.F.	Debit (₹)	Credit (₹)
2023 April 1	Revaluation A/c	Dr.		52,000	
	To Gita's Capital A/c				26,000
	,, Mita's Capital A/c				26,000
	(Profit on revaluation transferred)				
	Gita's Capital A/c	Dr.		1,30,000	
	To Bank A/c				1,30,000
	(Amount paid to Gita)				
	Bank A/c	Dr.		1,27,000	
	To Mita's Capital A/c				42,000
	,, Lata's Capital A/c				85,000
	(Additional cash to be brought in to make their capital in proportion).				

Balance Sheet as on April 1, 2023

Liabilities	(₹)	Assets	(₹)
Capital:		Goodwill	30,000
Mita	1,70,000	Fixed Assets	1,40,000
Lata [WN: 2]	85,000	Stock	60,000
Creditor	20,000	Debtors	40,000
		Cash at Bank [WN: 1]	5,000
	2,75,000		**2,75,000**

Working Notes:

1. Bank balance on 1.4.2023

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	8,000	By Gita's capital A/C	1,30,000
To Mita's capital 42,000 []WN 4 Lata's Capital 85,000	1,27,000	,, Balance c/d	5,000
	1,35,000		**1,35,000**

2 . Capital of the new firm

Particulars	(₹)
Goodwill	30,000
Fixed Asset	1,40,000
Stock	60,000
Debtors	40,000
Cash at Bank	5,000
	2,75,000
Less: Creditors	20,000
	2,55,000

Mita = ₹2,55,00 × 2/3 = ₹1,70,000

Lata = ₹2,55,000 × 1/3 = ₹85,000

3. Profit on Revaluation

Dr. Revaluation Account Cr.

Particulars	(₹)	Particulars	(₹)
To Capital A/c		By Goodwill A/c	20,000
Profit on Revaluation :		,, Fixed Assets A/c	20,000
Gita 26,000		,, Prov. For Depreciation A/c.	12,000
Mita 26,000	52,000		
	52,000		**52,000**

4. Amount to be brought in by Mita

Particulars	(₹)	(₹)
Capital to be maintained [WN: 2]		1,70,000
Less: Opening balance	1,02,000	
Profit on Revaluation [WN: 3]	26,000	1,28,000
To be brought in by Mita		42,000

Illustration 14

X, Y, & Z were equal partners. Their Balance Sheet as on 31.12.2022 was as follows :

Partners' Capital			Land & Freehold Property	1,00,000
X	1,00,000		Plant & Machinery	2,00,000
Y	1,00,000		Furniture & Equipment	50,000
Z	2,00,000	4,00,000	Stock in-trade	1,00,000

Partner's Current A/c :			Sundry Debtors	1,00,000
X	50,000		Balance with Bankers	1,50,000
Y	75,000			
Z	25,000	1,50,000		
Sundry Creditors		1,50,000		
		7,00,000		**7,00,000**

On 1.1.2023, X retired and it was agreed that he should be paid all his dues in full on that date. For this purpose, goodwill was to be calculated on the basis of 3 years purchase of past 3 years profits which amounted to ₹1,00,000, ₹1,40,000 and ₹1,20,000 respectively.

In order to meet his obligation, a bank loan was arranged on 1.1.2023 for ₹2,00,000 pledging the fixed assets as security.

Further, to compensate a loyal manager Q, it was agreed between Y and Z that Q should be admitted as a partner, who should bring in, over and above a capital of ₹1,00,000, his share of Goodwill in cash to serve as working capital. Y and Z agreed to forego 1/3rd of their individual share of profits to Q.

Prepare Partners Capital Accounts, Partners' Current Accounts and opening Balance Sheet of the firm as on 1.1.2023.

Solution:

Dr. **Partners' Capital Account** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Q (₹)	Particulars	X (₹)	Y (₹)	Z (₹)	Q (₹)
To Cash A/c (Final settlement)	2,70,000	-	-	-	By Balance b/d	1,00,000	1,00,000	2,00,000	-
					" X's Current A/c (Transfer)	1,70,000	-	-	-
To Balance c/d	-	1,00,000	2,00,000	1,00,000					
					" Cash A/c (Capital introduced)	-	-	-	1,00,000
	2,70,000	**1,00,000**	**2,00,000**	**1,00,000**		**2,70,000**	**1,00,000**	**2,00,000**	**1,00,000**

Dr. **Partners' Current Account** **Cr.**

Particulars	X	Y	Z	Particulars	X	Y	Z
To X's Capital A/c (Tran)	1,70,000	-	-	By Balance b/d	50,000	75,000	25,000
				" Y's Current A/c	60,000	-	-
To X's Current A/c	-	60,000	60,000	" Z's Current A/c	60,000	-	-
To Balance c/d	-	75,000	25,000	" Cash A/c	-	60,000	60,000
	1,70,000	**1,35,000**	**85,000**		**1,70,000**	**1,35,000**	**85,000**

Balance Sheet as on 1.1.2022

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Partners' Capital A/cs :			Land and Freehold Property		1,00,000
Y	1,00,000		Plant & Machinery		2,00,000
Z	2,00,000		Furniture & Equipment		50,000
Q	1,00,000	4,00,000	Stock		1,00,000
			Debtors		1,00,000
Partner's Current A/cs :			Cash at Bank (WN: 2)		3,00,000
Y	75,000				
Z	25,000	1,00,000			
Bank loan (Secured)		2,00,000			
Sundry Creditors		1,50,000			
		8,50,000			**8,50,000**

Working Notes :

(1) Valuation of Goodwill

$$\text{Average Annual Profits} = \frac{₹\ (1,00,000 + 1,40,000 + 1,20,000)}{3} = ₹\ 1,20,000$$

∴ Goodwill = 3 × ₹1,20,000 = ₹3,60,000

Premium to be paid by Q = 1/3 of ₹3,60,000 = ₹1,20,000 and to be shared by Y and Z equally. Similarly, X should be provided ₹1,20,000 by Y and Z equally.

2. Balance with Bank on 1.1.2023

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	1,50,000	By X's Capital A/c	2,70,000
To Bank Loan A/c	2,00,000		
To Cash A/c (Premium for goodwill)	1,20,000		
To Q's capital A/c	1,00,000	By Balance c/d	3,00,000
	5,70,000		**5,70,000**

Illustration 15

X,Y and Z are partners sharing profits and losses in the proportion to 3:2:2, respectively. The Balance Sheet of the firm as on 01.01.2023 was as follows:

Liabilities		(₹)	Assets	(₹)
Capital Accounts;	(₹)		Plant and Machinery	72,000
X	1,00,000		Furniture	28,000
Y	80,000		Stock	1,12,000
Z	70,000	2,50,000	Sundry Debtors	96,000
Bank overdraft		20,000	Cash at Bank	18,000
Sundry Creditors		56,000		
		3,26,000		**3,26,000**

X retired on 01.01.2023 on which date R is admitted as new partner. For the purpose of adjusting the rights as between on partners' goodwill to be valued at ₹84,000 and Sundry Debtors and Stock to be reduced by ₹16,000 and to ₹1,00,000 respectively. X is to receive ₹44,000 in cash on the date of retirement and the balance due to him is to remain as loan at 8% p.a. Repayment of loan to be made at the end of each year by annual installments representing 25% of the future profit before charging interest on loan.

R is to bring in ₹1,00,000 in cash as his capital on the date of admission. The new partners are to share profits and losses equally after paying the interest on X's Loan.

The net profit for the year ended 31st December 2023, is ₹64,000 before taking into account the installment payable to X.

You are required to show:

(a) Profit and Loss Appropriation Account for the year ended 31st December,2023.

(b) Capital Accounts of the new partners; and

(c) X's Loan Account as on 31st Dec, 2023.

Solution:

In the books of firm

Revaluation Account

Dr. Cr.

Particulars		(₹)	Particulars	(₹)
To Provision for Bad Debts		16,000	By Goodwill	84,000
To Stock		12,000		
To Share of Profit:				
- X 3/7	24,000			
- Y 2/7	16,000			
- Z 2/7	16,000	56,000		
		84,000		**84,000**

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

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Bank – Repayment	44,000	-	-	By Balance c/d	1,00,000	80,000	70,000
„ X's Loan A/c	80,000	-	-	„ Revaluation A/c			
„ Balance c/d	-	96,000	86,000	- Profit	24,000	16,000	16,000
	1,24,000	**96,000**	**86,000**		**1,24,000**	**96,000**	**86,000**

Profit and Loss Appropriation Account
for the year ended 31.12.2023

Dr. Cr.

Particulars		(₹)	Particulars	(₹)
To Loan Redemption Fund A/c		16,000	By Profit and Loss A/c	
(25% of ₹64,000)			- Net Profit	64,000
„ Share of Profit:				
- Y (1/3)	16,000			
- Z (1/3)	16,000			
- R (1/3)	16,000	48,000		
		64,000		**64,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	Y (₹)	Z (₹)	R (₹)	Particulars	Y (₹)	Z (₹)	R (₹)
To Balance c/d	1,12,000	1,02,000	1,16,000	By Balance c/d	96,000	86,000	-
				„ Bank A/c	-	-	1,00,000
				„ Share of profit	16,000	16,000	16,000
				By Balance b/d	1,12,000	1,02,000	1,16,000
	1,12,000	**1,02,000**	**1,16,000**		**1,12,000**	**1,02,000**	**1,16,000**

Dr. **X's 8% Loan Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank A/c	16,000	By X's Capital A/c	80,000
To Balance c/d	70,400	" Interest [80,000 × 8%]	6,400
	86,400		**86,400**
		By Balance c/d	70,400

Illustration 16

P, Q and R were partners sharing Profits & Losses as 2 : 3 : 5. P retired on 31.03.2022 and X joined as a new partner on the same date, the new profit sharing ratio between Q, R and X being 2 : 3 : 1. The Balance Sheet of P, Q & R on 31.03.2023 was as follows :

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	50,000	Cash in hand	2,000
Loan from X	50,000	Cash at Bank	93,000
General Reserve	40,000	Sundry Debtors	30,000
Capitals :		Stock	20,000
P 10,000		Machinery	30,000
Q 15,000		Buildings	10,000
R 20,000	45,000		
	1,85,000		**1,85,000**

X was admitted on the following terms :

(i) Machinery was to be depreciated by ₹3,000

(ii) Buildings were revalued at ₹30,000

(iii) Stock was to be written off by ₹5,000

(iv) Provision of 5% was made against doubtful debts

(v) General Reserve would be apportioned among the partners

(vi) The firm's Goodwill was to be valued at two years purchase of the average profits of the last three years

(vii) The amount due to P was retained in the business as a loan but X's Capital contribution should be 1/5th of the combined adjusted capitals of Q and R. His capital would be transferred from his Loan Account,

(viii) the Goodwill would be wiped off from the books after X's admission.

(ix) Partners decided not to alter the book values of assets & liabilities after admission.

The profits/losses during the last 3 years had been 31.03.2021 ₹20,000 (Profit) 31.03.20212 ₹15,000 (loss) and 31.03.2023 ₹40,000 (Profit).

Show the Memorandum Revaluation Account, Partners' Capital Accounts and Balance Sheet of the firm.

Solution:

Memorandum Revaluation Account

Particulars	(₹)	Particulars	(₹)
To Machinery A/c	3,000	By Building A/c	20,000
" Stock	5,000		
" Prov. for doubtful Debts	1,500		
" P/Capital A/c			
(Share of Rev. Profit)			
P – ₹2,100			
Q – ₹3,150			
R – ₹5,250	10,500		

	20,000		**20,000**
To Reversal of Items b/d	20,000	By Reversal of Items b/d	
Building		Machinery	3,000
		Stock	5,000
		Provision for D/Debts	1,500
		By P/Capital A/c	
		(Share of Rev. Profit)	
		Q – 3,500	
		R – 5,250	
		X – 1,750	10,500
	20,000		**20,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	P (₹)	Q (₹)	R (₹)	X (₹)	Particulars	P (₹)	Q (₹)	R (₹)	X (₹)
To Memorandum Rev A/c					By Balance b/d	10,000	15,000	20,000	-
- Share of loss	-	3,500	5,250	1,750	By General Reserve	8,000	12,000	20,000	-
To Goodwill writtenoff	-	10,000	15,000	5,000	By Memorandum Rev A/c				
					- Share of profit	2,100	3,150	5,250	-
To P's loan A/c	26,100				By Goodwill raised	6,000	9,000	15,000	-
(transfer)					By Loan from X A/c	-	-	-	19,880
					(Transfer)				
To Balance c/d	-	25,650	40,000	13,130					
	26,100	**39,150**	**60,250**	**19,880**		**26,100**	**39,150**	**60,250**	**19,880**

Capital Balance of X = 1/5 of (₹25,650 + ₹40,000) = 1/5 × ₹65,650 = ₹13,130

Therefore from X's loan A/c :

Loan from X A/c	Dr.	₹19,880
To, X's Capital A/c		₹19,880

Balance Sheet of Q, R & X
as at 31.3.2023

Liabilities		(₹)	Assets	(₹)
S/Creditors		50,000	Building	10,000
Loan for X		30,120	Machinery	30,000
Loan from P		26,100	Stock	20,000
Capitals :			Debtors	30,000
Q :	25,650		Cash in hand	2,000
R :	40,000		Cash at Bank	93,000
X :	13,130	78,780		
		1,85,000		**1,85,000**

Working Notes :

1. **Valuation of Goodwill**

   Average Annual Profits = [₹20,000 + (₹15,000) + ₹40,000]/3 = ₹45,000/3 = ₹15,000.

   Goodwill = 2 × ₹15,000 = ₹30,000

Illustration 17

A, B and C are in partnership sharing Profits and Losses in the ratio 3:2:1 respectively. The Balance Sheet of the partnership firm as on 31st March, 2023 is as under:

Capital & Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Accounts			Premises		1 80,000
A	1,70,000		Plant		74,000
B	1,30,000		Vehicles		30,000
C	70,000	3,70,000	Fixtures		4,000
Current Accounts			Current Account		
A	7,428		B		5,018
C	9,356	16,784	Stock		1,24,758
Loan-C		56,000	Debtors		69,960
Creditors		38,072	Cash in hand		1,520
Bank Overdraft		8,400			
		4,89,256			**4,89,256**

C decides to retire from the business as on the above date and D is admitted as a partner on that date. The following matters agreed:

(i) Assets revalued as : Premises - ₹2,40,000, Plant- ₹70,000 Stock - ₹1,08,358.

(ii) A provision of ₹6,000 is created against debtors.

(iii) Goodwill is to be recorded in the books on the day C retires at ₹ 84,000. The partners in the new firm do not wish to maintain a Goodwill Account so that amount is to be written-off against the New Partners' Capital Accounts.

(iv) A and B are to share profit in the same ratio as before, and D is to have the same share of profits as C.

(v) C is to take a car at its book value of ₹ 7,800 in part payment, and the balance of all he is owed by the firm in cash except ₹ 40,000 which he is willing to leave as a Loan Account.

(vi) The partners in the new firm are to start on an equal footing so far as Capital and Current Account are concerned. D is to contribute cash to bring his Capital and Current Account to the same amount as the original partner from the old firm who has the lower investment in the business. The original partner in the old firm who has the higher investment will draw out cash so that his capital and current account balances equal those of his new partners. -

(vii) Revaluation profit or loss is to be adjusted in the Partners' Current Account.

You are required to prepare Revaluation Account, Partners' Capital Accounts, Partners' Current Accounts, C's Loan Account, Bank Account and Balance Sheet of the newly constituted firm as at April 1, 2023.

Solution:

(a) **In the books of the firm**

Dr. **Revaluation Account** **Cr.**

Particulars		(₹)	Particulars	(₹)
To Plant A/c		4,000	By Premises A/c	60,000
To Stock A/c		16,400		
To Provision for doubtful debts A/c		6,000		
To Partner's Current A/c s		33,600		
A	16,800			
B	11,200			
C	5,600			
		60,000		**60,000**

(b)

Dr. **Partners' Capital Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	D (₹)	Particulars	A (₹)	B (₹)	C (₹)	D(₹)
To Goodwill A/c	36,000	24,000	—	24,000	By Balance b/d	1,70,000	1,30,000	70,000	—
(3:2:2)					By Goodwill				—
To Loan A/c	42,000	—	84,000*	—	A/c (3:2:1)	42,000	28,000	14,000	1,58,000
To Bank A/c	—	—	—	—	By Bank A/c	—	—	—	
To Balance c/d	1,34,000	1,34,000	—	1,34,000					
	2,12,000	**1,58,000**	**84,000**	**1,58,000**		**2,12,000**	**1,58,000**	**84,000**	**1,58,000**

* As mentioned in the illustration that goodwill is to be recoreded in the books on the day C retires at ₹84,000.

(c) Dr. **Partners' Current Account** Cr.

Particulars	A (₹)	B (₹)	C (₹)	D (₹)	Particulars	A (₹)	B (₹)	C (₹)	D(₹)
To Balance b/d	—	5,018	—	—	By Balance b/d	7,428	—	9,356	—
To C's Loan A/c	—	—	14,956	—	By Revaluation A/c	16,800	11,200	5,600	—
To Bank A/c	18,046	—	—	—	By Bank A/c	—	—	—	6,182
To Balance c/d	6,182	6,182	—	6,182					
	24,228	**11,200**	**14,956**	**6,182**		**24,228**	**11,200**	**14,956**	**6,182**

(d) Dr. **C's Loan Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To Vehicles A/c	7,800	31.03.23	By Balance b/d	56,000
	To Bank A/c (Bal. fig.)	1,07,156		By C's Capital A/c	84,000
	To Balance c/d	40,000		By C's Current A/c	14,956
		1,54,956			**1,54,956**

(e) Dr. **Bank Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To D Capital A/c	1,58,000	31.03.23	By Balance b/d	8,400
	To D Current A/c	6,182		By C's Loan A/c	1,07,156
	To Balance c/d	11,420		By A's Capital A/c	42,000
				By A's Current A/c	18,046
		1,75,602			**1,75,602**

(f) **Balance Sheet of as on 01 .04.2023**

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Accounts:			Premises		2,40,000
A	1,34,000		Plant		70,000
B	1,34,000		Vehicles		22,200
D	1,34,000	4,02,000	Fixtures		4,000
Current Accounts:			Stock		1,08,358
A	6,182		Debtors	69,960	
B	6,182		Less: Provision for bad debts	6.000	63,960
D	6,182	18,546	Cash		1,520
C's Loan Account:		40,000			
Creditors		38,072			
Bank Overdraft		11,420			
		5,10,038			**5,10,038**

Working Notes:

Calculation of New P.S.R.

D's share = B's share = $\frac{2}{6}$

A's share = $\frac{3}{6}$;

B's share = $\frac{2}{6}$

$\therefore$ A:B:D = $\frac{3}{6} : \frac{2}{6} : \frac{2}{6}$ = 3:2:2

Death of Partner

4.3

If a continuing partner dies, then it leads to reconstitution of partnership firm.

In the event of death of a partner, the other partners may decide to continue the business which requires certain adjustments to be made in the books of accounts of the existing partnership firm which are as follows:

- Calculation of new profit sharing ratio and gaining ratio,
- Distribution of reserves and accumulated profits and losses,
- Revaluation of assets and liabilities,
- Adjustment for goodwill,
- Adjustment for Joint Life Policy (JLP),
- Adjustment for interim period's profit/loss,
- Settlement of final balance of the deceased partner to his Executor.

Calculation of new profit sharing ratio and Gaining Ratio:

As a consequence of death, the share of profit of the deceased partner gets distributed to the continuing partners which results in again in the share of the continuing partners. The ratio in which the continuing partners will share future profits and losses is known as the New Profit Sharing Ratio. The ratio in which the continuing partners acquire the share of profit forgone by the deceased partner is referred to as Gaining Ratio. It is calculated by taking the difference between the old profit sharing ratio and the new profit sharing ratio.

Distribution of Reserves and Accumulated Profits and Losses:

The balance of reserves or undistributed profit (as represented by balance of Profit & Loss Account) are distributed among all the partners (including the Executor of deceased partner) in their old profit sharing ratio in the event of death of a partner.

Revaluation of assets and liabilities:

The logic for revaluation of Assets and liabilities at the time of death of a partner is same as that at the time of admission of a new partner. In case of death, the revaluation profit or loss is distributed among all the partners (including the Executor of the deceased partner) in the Old Profit Sharing Ratio.

Adjustment for Goodwill:

The goodwill of the existing partnership firm had been created and developed by all the existing partners (including the deceased partner). So, the continuing partners are required to compensate the deceased partner in their Gaining Ratio and the necessary adjustment for Goodwill is required to be made...

Adjustment for Joint Life Policy (JLP):

The mode of accounting for Joint life policy depends upon the accounting policy of the firm. Either JLP is treated as an asset or as an expense in the books of the firm. Unlike Admission and Retirement, the Surrender Value has no role to play, only the maturity value of the Joint Life Policy is to be taken into consideration in the case of death of a partner.

Adjustment for interim period's profit/loss:

Unlike Admission and Retirement, the date of which are generally pre-planned, the death of a partner can take place anytime during the Accounting Period. In such case, the amount of profit or loss, starting from the opening date of the accounting period ending up to the date of death, is to be determined (which is called as the interim period's profit or loss) and the share of the deceased partner in such Profit/Loss is to be duly accounted for. For this purpose, generally a temporary account is opened in the books of the firm called P/L Suspense A/c.

Normally two approaches are there to estimate the profit or loss for the interim period:

(i) **On Time Basis:** Here the average profit of last periods is considered, which is apportioned between the pre-death period and the post-death period.

(ii) **On Sales Basis:** Under this approach, the rate of profit on sales earned in the last year is computed and is applied to the interim period's sales.

Settlement of final balance of the deceased partner to his Executor:

The amount payable to the representative of the deceased partner (commonly known as Executor) can be made either immediately or as deferred settlement. The accounting procedure involved is similar to that followed in case of retirement of a partner. The mode of payment depends on the agreement between the partners. It may be:

(i) **Lump Sum Payment:** If the firm has sufficient funds, the total amount payable on account of the deceased partner is transferred to his Representative's Account (or Executor). Such Representative's Account is debited and Bank Account is credited on payment of the dues.

(ii) **Instalment Payment/Loan Payment:** The firm may not have enough funds to make prompt payment. In such a case, the total amount payable is transferred to a loan account in the name of the legal representative or executor. The loan is paid off gradually by installments after considering interest on unpaid balance. The word "Loan" may or may not be appended with the Account. But its gradual payment will definitely resemble the payment of loan.

Illustration 18

A, B and C have been in business partnership for some years, Sharing Profit in the proportions of 4:3:3. The balances in the books of the firm as on 31st March, 2023 subject to final Adjustment, were as under:

	Dr. (₹)	Cr. (₹)
Capital Account - A		3,00000
Capital Account - B		1,50,000
Capital Account - C		1,80,000
Profit for the year before charging interest		3,12,000
Land and Buildings	2,40,000	
Furniture and Fixtures	45,000	
Stock	3,75,000	

	Dr. (₹)	Cr. (₹)
Debtors	60,000	
Bank	1,20,000	
Creditors		90,000
Partner's Drawings - A	48,000	
Partner's Drawings - B	72,000	
Partner's Drawings - C	72,000	
Total	**10,32,000**	**10,32,000**

C died on 30.09.2022. The Partnership deed provided that:

(1) Interest was to be credited on Capital accounts of partners at 10% P.A. on the balance at the beginning of the year.

(2) On the death of a Partner:

(i) Goodwill was to be valued at three years' purchase of average Annual Profits of three years up to the date of death, after deducting interest on Capital Employed at 8% P;A. and a fair remuneration for each of the partners;

(ii) Fixed Assets were to be valued by an independent valuer and all other assets and liabilities to be taken at Book Value.

(3) Wherever necessary, profit or loss should be apportioned on a time basis.

(4) The amount due to the deceased partner's Sole Heir was to receive interest @ 12% P.A. from the date of death until paid.

It was ascertained that:

(a) Profits for three years, before charging partners' interest were: 2019-20; ₹3,36,000, 2020-21 : ₹3,78,000 and 2021-22: ₹3,60,000 respectively.

(b) The independent valuation at the date of death revealed: Land and Buildings ₹3,00,000 and Furniture and Fixtures ₹30,000.

(c) A fair remuneration for each of the Partners would be ₹75,000 P.A. and that the Capital employed in business to be taken as ₹7,80,000 throughout.

It was agreed among the Partners that:

(i) Goodwill was not to be shown as an asset of the firm as on 31.03.2023. Therefore, adjustment for goodwill was to be made in Capital Accounts.

(ii) A and B would share equally from the date of death of C.

(iii) Depreciation on revised value of assets would be ignored.

You are required to prepare:

(i) Revaluation Account

(ii) Partners' Capital Accounts

(iii) Partners' Current Accounts

(iv) C's Heir Account

(v) Balance Sheet as on 31.03.2022

Solution:

(i) In the Books of firm

Dr. **Revaluation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Furniture and Fixture A/c To Partners' Capital A/c s (A- ₹18,000, B - ₹13,500, C - ₹13,500)	15,000 45,000	By Land and Building A/c	60,000
	60,000		**60,000**

Dr. **(ii) Partners' Capital Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To C's Capital A/c - Goodwill	19,980	39,960	------	By Balance b/d	3,00,000	1,50,000	1,80,000
To C's Current A/c. - Transfer	-----	-----	25,650	By Revaluation A/c	18,000	13,500	13,500
To C's Heir A/c	-----	-----	2,27,790	By A's Capital A/c Goodwill	-------	-------	19,980
To Balance c/d	2,98,020	1,23,540	------	By A's Capital A/c Goodwill	-------	-------	39,960
	3,18,000	**1,63,500**	**2,53,440**		**3,18,000**	**1,63,500**	**2,53,440**

Dr. **(iii) Partners' Current Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Balance b/d	48,000	72,000	72,000	By P/L Appropriation A/c (Interest on Capital A/c)	30,000	15,000	9,000
To Balance c/d	91,716	40,266		By P/L Appropriation A/c	1,09,716	97,266	37,350
				By Capital A/c (Transfer)	-------	-------	25,650
	1,39,716	**1,12,266**	**72,000**		**1,39,716**	**1,12,266**	**72,000**

Dr. **(iv) C's Heir Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance c/d	2,41,458	By C's Capital A/c By Profit & Loss Appropriation	2,27,790 13,668
	2,41,458		**2,41,458**

(v) Balance Sheet as on 31st March, 2023

Liabilities	(₹)	Assets	(₹)
Capital Account - A	2,98,020	Land and Buildings	3,00,000
Capital Account - B	1,23,540	Furniture and Fixtures	30,000
Current Account - A	91,716	Stock	3,75,000
Current Account - B	40,266	Debtors	60,000
C's Heir Account	2,41,458	Bank	1,20,000
Creditors	90,000		
	8,85,000		**8,85,000**

Working Note:

(1) Adjustment in Regard to Goodwill

Particulars		(₹)
Aggregate profits for three years upto date of death (30.09.2021) are as follows:		
Profit for the year ended 30.9.20: (½ of ₹ 3,36,000 + ½ of ₹ 3,78,000)		3,57,000
Profit for the year ended 30.9.21: (½ of ₹ 3,78,000 + ½ of ₹ 3,60,000)		3,69,000
Profit for the year ended 30.9.22: (½ of ₹ 3,60,000 + ½ of ₹ 3,12,000)		3,36,000
Total profits for three years		10,62,000
Average profits (₹ 10,62,000 ÷ 3)		3,54,000
Less: interest on capital employed (8% on ₹7,80,000)	₹62,400	
Fair remuneration to partners	₹2,25,000	2,87,400
Adjusted average profit for goodwill		66,600
Goodwill is the purchase of 3 year's profit = 3 × ₹66,600		1,99,800

Partners	A (₹)	B (₹)	C (₹)
Right of goodwill before death (4:3:3)	79,920	59,940	59,940
Right of goodwill after death (1:1)	99,900	99,900	—
Gain (+) / Sacrifice(-)	**(+) 19,980**	**(+) 39,960**	**(-) 59,940**

Profit & Loss Appropriation Account

Dr. Cr.

Particulars	01.04.21 to 30.09.22	01.10.21 to 31.03.23	Particulars	01.04.21 to 30.09.22	01.10.21 to 31.03.23

To Partners' Current A/c			By Profit & Loss A/c	1,56,000	1,56,000
Interest on Capital A/c - A	15,000	15,000	(Apportioned on Time Basis)		
Interest on Capital A/c - B	7,500	7,500			
Interest on Capital A/c- C	9,000				
To Interest on hire C's A/c (-12%)	—	—			
Partners' Current A/cs - A	49,800	13,668			
Partners' Current A/cs - B	37,350	59,916			
Partners' Current A/cs - C	37,350	59,916			
	1,56,000	**1,56,000**		**1,56,000**	**1,56,000**

Illustration 19

A, B and C are partners in a firm sharing profits and losses as 3:2:1. Their Balance Sheet as on 31st March, 2023 was as follows:

(₹ in Lakh)

Liabilities	(₹)	Assets	(₹)
Partners' Capital A/c		Land and Building	210
A	145	Plant and Machinery	255
B	110	Stock	125
C	75	Debtors	95
General Reserve	165	Bills Receivable	25
Partners' Loan:		Cash in Hand	3
A	30	Cash at Bank	37
B	20		
Sundry Creditors	205		
	750		**750**

B died on 1 August, 2023. His account is to be-settled under the following terms:

(i) Goodwill will be valued at 3 years purchase of last four accounting years average profit. Profits were :2019-2020 ₹135 Lakh, 2020-2021 ₹145 Lakh, 2021-2022 ₹131 Lakh and 2022-2023 ₹165 Lakh.

(ii) Land and Building will be valued at ₹ 250 Lakh and Plant and Machinery will be valued at ₹ 240 Lakh.

(iii) For the purpose of calculating B's share in the profits of 01.04.2023 to 31.07.2023, the profits for the year 2022-2023 will be taken as base.

(iv) Interest on Partners' Loan will be calculated @ 6% per annum.

(v) A sum of ₹50 Lakh to be paid immediately to B's Executor and the balance to be paid on 1 December, 2023 together with interest @ 10% per annum.

You are required to pass necessary journal entries to record the above transactions and amount payable to B's Executor's Account.

Solution:

Books of the firm

Journal

(₹ in Lakh)

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
01.08.23	Land & Building A/c	Dr.		40	
	To Revaluation A/c				40
	(For increase in the value of land and building)				
‘’	Revaluation A/c	Dr.		15	
	To Plant & Machinery A/c				15
	(For degrease in the value of Plant & Machinery)				
‘’	Revaluation A/c	Dr.		25	
	To A's Capital A/c				12.5
	To B's Capital A/c				8.333
	To C's Capital Ac				4.167
	(For profit on revaluation)				
‘’	General Reserve A/c	Dr.		165	
	To A's Capital A/c				82.5
	To B's Capital A/c				55
	To C's Capital A/c				27.5
	(For transfer of general reserve)				
‘’	A's Capital A/c	Dr.		108	
	C's Capital A/c	Dr.		36	
	To B's Capital A/c				144
	(For the adjustment of goodwill)				
‘’	Profit & Loss Suspense A/c	Dr.		18.333	
	To B's Capital A/c				18.333
	(For the adjustment of profit from 1.4.23 to 1.8.23)				
‘’	B's Loan A/c	Dr.		20	
	To B's Capital A/c				20
	(Balance transferred)				

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
‘’	Interest on B’s Loan A/c	Dr.		0.40	
	To B’s Capital A/c				0.40
	(Interest on B’s Loan from 1.04.18 to 1.08.18 credited to B’s Capital A/c)				
‘’	B’s Capital A/c	Dr.		356.066	
	To B’s Executor’s A/c				356.066
	(Being balance of B’s Capital A/c transferred to his Executor’s A/c = 110 + 8.333 + 55 + 144 + 18.333 + 20 + 0.40)				
‘’	B’s Executor’s A/c	Dr.		50	
	To Bank A/c				50
	(Amount paid)				
‘’	Interest A/c	Dr.		10.202	
	To B’s Executor’s A/c				10.202
	(For interest due)				
01.12.23	Bs Executor’s A/c	Dr.		316.268	
	To Bank A/c				316.268
	(Amount due to Bs Executor including interest, paid)				

(₹ in lakh)

Dr. **B’s Executor’s Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
1.08.23	To Bank A/c	50	1.08.23	By Capital A/c	356.066
1.12.23	To Bank A/c	316.268	1.12.23	By Interest A/c	10.202
		366.268			**366.268**

Working Notes:

(1) Calculation of Share of B in Goodwill:

Average of past four years profits = ₹ (135 Lakh + 145 Lakh + 131 Lakh + 165 Lakh)/4 = ₹ 144 Lakh

Value of Firm’s Goodwill = ₹ 144 Lakh × 3 = ₹ 432 Lakh

B’s Share in Goodwill = ₹ 432 Lakh × 2/6 = ₹ 144 Lakh, which will be credited to B’s Capital A/c and debited to A’s Capital A/c & C’s Capital A/c in the ratio of 3:1

(2) B’s Share in profit from 01 .04.2023 to 1.8.2023 = (₹ 165 × 4/12) × 2/6 = ₹ 18.333 Lakh

(3) Interest on B’s Loan from 01.04.2023 to 1.8.2023 = ₹ 20 Lakh × 6% × 4/12 = ₹ 40,000

(4) Interest to B’s Executor’s from 01.08.2023 - 01.12.2023 = ₹ 356.066 Lakh – ₹ 50 Lakh

= ₹ 306.066 × 10% × 4/12 = ₹ 10.2022 Lakh

Illustration 20

The following was the Balance Sheet of A, B and C who shared profits in the ratio of 1:2: 2 as on 31st December, 2022:

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	10,000	Goodwill	15,000
Capital A/c :		Debtors	10,000
A 10,000		Machinery	20,000
B 20,000		Buildings	30,000
C 20,000	50,000	Stock	10,000
General Reserve	5,000	Cash at Bank	5,000
Investment Fluctuation Fund	3,000	Investments	10,000
Bad Debts Reserve	2,000		
Bank Loan	30,000		
	1,00,000		**1,00,000**

C died on 31st March, 2023. His account is to be settled under the following terms :

Goodwill is to be calculated at the rate of 2 years purchase on the basis of the average of 5 years profit or loss. Profit for January to March 2022 is to be calculated proportionately on the average profit of 3 years. The profits were: 2018: ₹ 3,000, 2019: ₹ 7,000, 2020: ₹ 10,000, 2021 ₹ 14,000, 2022: Loss ₹ 12,000. During 2022 a Moped costing ₹ 4,000 was purchased and debited to Travelling Expenses Account on which depreciation is to be calculated @ 25%. Other values agreed on assets are : Stock ₹ 12,000, Building ₹ 35,000, Machinery ₹ 25,000 and Investments ₹ 8,000. Debtors are considered good.

Prepare new Balance Sheet of the firm, necessary Journal entries and Ledger Accounts of the Partners.

Solution:

Books of firm

Journal

Date	Particulars		L. F.	Dr. (₹)	Cr. (₹)
2022	Stock A/c	Dr.		2,000	
	Buildings A/c	Dr.		5,000	
	Machinery A/c	Dr.		5,000	
	Moped A/c [₹4,000 – Depr. ₹1,000]	Dr.		3,000	
	To Revaluation A/c				15,000
	[Values of assets increased on revaluation]				

Date	Particulars		L. F.	Dr. (₹)	Cr. (₹)
	General Reserve A/c	Dr.		5,000	
	Investment Fluctuation Fund A/c	Dr.		3,000	
	Bad Debts Reserve A/c	Dr.		2,000	
	To A's Capital A/c				2,000
	To B's Capital A/c				4,000
	To C's Capital A/c				4,000
	[Transfer of Reserves etc. to Partners Capitals in 1 : 2 : 2]				
	Revaluation A/c	Dr.		2,000	
	To Investment A/c				2,000
	[Value of investments reduced]				
	Revaluation A/c	Dr.		13,000	
	To A's Capital A/c				2,600
	To B's Capital A/c				5,200
	To C's Capital A/c				5,200
	(Being profit on revaluation shared in 1 : 2 : 2)				
	A's Capital A/c	Dr.		1,000	
	B's Capital A/c	Dr.		2,000	
	C's Capital A/c	Dr.		2,000	
	To Goodwill A/c				5,000
	[Value of Goodwill reduced]				
	A's Capital A/c	Dr.		3,333	
	B's Capital A/c	Dr.		6,667	
	To Goodwill A/c				10,000
	[Value of Goodwill shared between A & B in the ratio of 1 : 2]				
	Profit & Loss Suspense A/c	Dr.		500	
	To C's Capital A/c				500
	[Estimated share of Profit till his date of death transferred to the decreased partner's Capital]				
	C's Capital A/c	Dr.		27,700	
	To C's Executors A/c				27,700
	[Total dues to the deceased partner transferred to his Executor's A/c]				

Dr. **Partners' Capital Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Goodwill A/c (1:2:2)	1,000	2,000	2,000	By Balance b/d	10,000	20,000	20,000
To Goodwill A/c (1:2)	3,333	6,667	-	" Revaluation A/c	2,600	5,200	5,200
To C's Executors A/c (Balance transferred)			27,700	"Sundry Reserves A/c	2,000	4,000	4,000
To Balance c/d	10,267	20,533	-	" P & L Suspense A/c	-	-	500
	14,600	**29,200**	**29,700**		**14,600**	**29,200**	**29,700**

Balance Sheet as at 31.3.2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital A/cs :			Buildings		35,000
A	10,267		Machinery		25,000
B	20,533	30,800	Moped		3,000
C's Executor's A/c		27,700	(cost less depreciation)		
Bank Loan		30,000	Investments		8,000
Sundry Creditors		10,000	Stock		12,000
			Debtors		10,000
			Bank		5,000
			Profit & Loss Suspense A/c (Dr.)		500
		98,500			**98,500**

Working Notes :

1. Adjusted profit for 2022

	(₹)
Loss	(12,000)
Add : Cost of MopedWrongly treated as Travelling Expense	4,000
Less : Depreciation not charged on Moped @ 25% on ₹ 4,000	(1,000)
Adjusted Loss	(9,000)

2. Valuation of Goodwill

Total Profit/Loss for the last 5 years = ₹(3,000 + 7,000 + 10,000 + 14,000– 9,000) = ₹ 25,000

Average Profit = ₹ 25,000/5 = ₹ 5,000; Goodwill = 2 × ₹ 5,000 = ₹ 10,000

But Goodwill is appearing at Balance Sheet at ₹ 15,000.

Over valuation of Goodwill ₹ 5,000 should be written off among A, B & C as 1:2:2.

The balance of Goodwill between A & B in the ratio 1:2

3. Share of Profit of Deceased Partner till his date of death

Average Profit of the last 3 years = ₹(10,000 + 14,000 – 9,000)/3 = ₹ 5,000

Estimated Profit for 3 months [Jan - March, 2022] = ₹ 5,000 × 3/12 = ₹ 1,250

C's share of profit = ₹ 1,250 × 2/5 = ₹ 500

Treatment of Joint Life Policy 4.4

In case of death of a partner of an existing partnership business, any amount due towards the deceased partner is required to be paid by the firm to his/ her legal representatives. This payment happens to be a burden for a firm because it has to be paid all of a sudden, and thus it may adversely affect the financial position of the firm. In order to overcome such a situation, a firm usually takes an insurance policy to cover the lives of the partners.

Such insurance policy can be taken either on the name of the partners - individually or jointly. The premium on such insurance is paid by the firm. This policy happens to be an asset of the firm on which all the partners have their proportionate stake. So, it should be adequately accounted for in case of change in constitution of a firm (i.e. Admission, Retirement, Change in profit sharing ratio etc.) and also in the event of death of a partner. The insurance policy matures on the death/ expiry of a partner, or on the expiry of the policy period, whichever occurs earlier. On the basis of the number of persons that have been covered under an insurance policy agreement, the life insurance policy taken by a firm may be classified into two types – Individual Life Insurance Policy and Joint Life Insurance Policy.

The life insurance policy that is taken by a partnership firm covering the lives of all its partners is referred to as Joint Life Policy. It is a single policy that covers the lives of all the partners of the firm. Such a policy matures in the event of the death of any one of the partners of the firm or on the date of maturity, whichever is earlier.

The accounting of joint life policy involves accounting on payment of the premium of such policy, accounting in the event of reconstitution of the firm (using the surrender value), and accounting in the event of death of a partner (using the maturity value). The maturity value and surrender value of joint life policy have a significant role in partnership accounting.

Maturity value (also known as Sum Assured) refers to the amount receivable by the firm from the insurance company in the event of the death of a partner or on the expiry of the policy period.

A firm may decide to terminate i.e. surrender an insurance policy before its date of maturity. In that case, the insurance company pays an amount to the insured and this amount is referred to as 'Surrender Value'. This surrender value does not remain constant over the years. It gradually increases with time. It is considered to be its 'fair value' for the purpose of accounting.

There are two broad methods of JLP accounting:

Method A: JLP is not treated as an asset in the books of the firm

Method B: JLP is treated as an asset in the books of the firm

Method A: JLP is not treated as an asset in the books of the firm

Under this method, the insurance premium paid on the joint life policy is treated as an 'expense' of the firm and not as an asset. The insurance premium is debited to the Profit & Loss A/c and JLP A/c does not appear in the Balance Sheet. The surrender value of the JLP does not get reflected in the books.

On payment of insurance premium on joint life policy the following entries are passed as under:

Joint Life Policy Premium A/c	Dr.
To Bank A/c	
P/L A/c	Dr.
To Joint Life Policy Premium A/c	

On change in constitution of firm (i.e. Admission, Retirement, Change in profit sharing ratio etc.)

The surrender value of the JLP is accounted for in any one of the following two ways:

- By raising and writing-off JLP Account; or
- By adjusting the capital accounts of the partners

Raising and writing-off JLP Account	**Raising of JLP A/c**	
	JLP A/c	Dr.
	To Existing Partners' Capital A/c (in old p.s.r.)	
	Writing-off JLP A/c	
	Continuing Partners' Capital A/c	Dr.
	To JLP A/c (in new p.s.r.)	
Adjusting the capital accounts of the partners	Gaining Partners' Capital A/c	Dr.
	To Sacrificing Partners' Capital A/c	

On the event of death of a partner

The JLP taken by the firm matures, and the policy value is received by the firm and it gets distributed among all the existing partners in their old profit sharing ratio. It is accounted for as under:

On maturity of the JLP	JLP Receivable A/c	Dr.
	To Existing Partners' Capital A/c (in old p.s.r.)	
On receipt of maturity value	Bank A/c	Dr.
	To JLP Receivable A/c	

Method B: JLP is treated as an asset in the books of the firm

Under this method, the insurance premium paid on the joint life policy is treated as 'investment in an asset' of the firm. It is reflected in the Balance Sheet at its surrender value.

The surrender value of the JLP on any date happens to be lower than the amount of the total amount of insurance premium paid on the JLP over the years. So, to maintain the JLP A/c at its surrender value, the difference between the amount of premium paid and the surrender value as on the date of preparation of the Balance Sheet is written-off. For the purpose of ensuring that the JLP A/c is reflected at its surrender value, there are two recognised methods of accounting. They are discussed as under:

Approach 1: Surrender Value Method

In this case one ledger account – Joint Life Policy Account (JLP A/c) is maintained. The insurance premium paid on the joint life policy is recorded in the JLP A/c as under:

JLP A/c Dr.

To Bank A/c

Thereafter for ensuring that this JLP A/c is maintained at its 'surrender value', the excess of premium paid over the increase in surrend-er value is debited to the Profit & Loss A/c by passing the following entry:

P/L A/c Dr.

To JLP A/c

This ensures that JLP A/c appears in the Balance Sheet of the firm at its 'Surrender value'.

Approach 2: Joint Life Policy Reserve Method

Under this method, two ledger accounts are maintained – Joint Life Policy Account (JLP A/c) and Joint Life Policy Reserve Account (JLP Reserve A/c).

In this case, the insurance premium paid on the joint life policy is treated as an investment in joint life policy. It is debited to the JLP A/c as under:

JLP A/c Dr.

To Bank A/c

Moreover, the insurance premium paid on the joint life policy is considered as an 'appropriation of profit' and so it is provided through JLP Reserve A/c. In this case, an amount equal to the insurance premium is debited to the Profit & Loss Appropriation A/c, as follows:

P/L Appropriation A/c Dr.

To JLP Reserve A/c

Both the JLP A/c and JLP Reserve A/c appear in the Balance Sheet of the firm in the Asset-side and Liabilities-side respectively.

Further, for ensuring that JLP A/c and JLP Reserve A/c are maintained at its 'surrender value', the excess of premium paid over the increase in surrender value is adjusted between JLP A/c and JLP Reserve A/c by passing the following entry:

JLP Reserve A/c Dr.

To JLP A/c

The above entry ensures that both JLP A/c and JLP Reserve A/c appear in the Balance Sheet of the firm at the 'Surrender value'.

On change in constitution of firm (i.e. Admission, Retirement, Change in profit sharing ratio)

Under the 'Surrender Value Method': JLP is considered as an asset and it already appears in the books of the firm at the surrender value. As such no further accounting treatment is required.

Under the 'JLP Reserve Method': both the JLP A/c and JLP Reserve A/c appear in the books of the firm at surrender value.

Cases	Treatment
If the partners decide not to maintain the JLP Reserve A/c	JLP Reserve A/c is written-back and distributed among the existing partners' in old P.S.R.: JLP Reserve A/c Dr. To Existing Partners' Capital A/c (in old P.S.R.)
If the partners decide to keep on maintaining the JLP Reserve A/c	Adjustment is required to be made through Partners' Capital A/c: Gaining Partners' Capital A/c Dr. To Sacrificing Partners' Capital A/c

On the event of death of a partner

The JLP matures, and the maturity value of the policy is received by the firm. Thereafter it gets distributed among all the existing partners in their old p.s.r.

Transactions	Surrender Value Method	JLP Reserve Method
On death of partner i.e. maturity of the JLP	JLP Receivable A/c Dr. To JLP A/c (with Maturity Value)	JLP Receivable A/c Dr. To JLP A/c (with Maturity Value)
On receipt of maturity value	Bank A/c Dr. To JLP Receivable A/c	Bank A/c Dr. To JLP Receivable A/c
Closing of JLP Reserve A/c by transfer to JLP A/c	N.A.	JLP Reserve A/c Dr. To JLP A/c (with 'last recorded Surrender Value')
Closing of JLP A/c	JLP A/c Dr. To All Partners' Capital A/c (with the difference between 'last recorded surrender value' and 'maturity value' in old P.S.R.)	JLP A/c Dr. To All Partners' Capital A/c (with the difference between 'current year premium paid, if any' and 'maturity value' in old P.S.R.)

Illustration 21

Naresh, Rohit and Krishna are partners sharing profits and losses in the ratio of 2:2:1. On 1st January, 2019, they took out a joint life policy of ₹ 2,00,000. Annual premium of ₹ 10,000 was payable on 1st January each year. Last premium was paid on 15th January, 2023. Rohit died on 1st March, 2023, and policy money was received on 31st March, 2023. The surrender value of policy as on 31st March each year were as follows:

2020	:	Nil
2021	:	₹ 2,000
2022	:	₹ 5,000

Show Joint Life Policy accounts as on 31st March each year assuming that:

(i) The premium is charged to profit and loss account every year.

(ii) The premium is debited to joint life policy account and the balance of the joint life policy account is adjusted every year to its surrender value.

Solution:

(i)

Dr. **Joint Life Policy Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
31.03.23	To Partner's Capital A/c Naresh ₹80,000 Rohit ₹80,000 Krishna ₹40,000	2,00,000	31.03.22	By Bank (Policy Money Received)	2,00,000
		2,00,000			**2,00,000**

(ii)

Dr. **Joint Life Policy Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.20	To Bank A/c (Premium)	10,000	31.03.20	By P & L A/c	10,000
		10,000			10,000
01.11. 21	To Bank A/c (Premium)	10,000	31.03. 21	By P & L A/c	8,000
			31.03. 21	By Balance c/d	2,000
		10,000			10,000
01.04.21	To Balance b/d	2,000	31.03.21	By P & L A/c	7,000
01.01.22	To Bank A/c (Premium)	10,000	31.03.22	By Balance c/d	5,000
		12,000			12,000
01.04.22	To Balance b/d	5,000			
01.01.23	To Bank A/c (Premium)	10,000	31.03.23	By Bank A/c (Police Money Received)	2,00,000
31.03.23	To Partner's Capital A/c Naresh ₹74,000 Rohit ₹74,000 Krishna ₹37,000	1,85,000			
		2,00,000			**2,00,000**

Dissolution of Partnership Firms including Piecemeal Distribution

4.5

Whenever a reconstitution takes place within a Partnership in the form of admission, retirement or death of a Partner, the existing partnership is dissolved. The Partnership firm, may however, continue, if the remaining partners desire so.

But if the partnership firm is discontinued for any reason, that is called Dissolution of the firm. Dissolution of Firm – when does it take place [in accordance with the Indian Partnership Act of 1932]

1. By Mutual consent of all the partners or in accordance with a contract made by them [Section 40]
2. By Notice – given in writing, by any partner to all other partners if the Partnership is at will [Section 43].
3. On the happening of any one of the following events : [Section 42] :
   (i) expiry of the term, where the Partnership was constituted for a fixed term;
   (ii) completion of the adventure for which the firm was constituted;
   (iii) Death of a partner,
   (iv) Adjudication of a Partner as insolvent.
4. Compulsory Dissolution [Section 41]
   (i) Where all the partners or all but one are adjudged insolvent.
   (ii) If any event occurs making it unlawful for the business of the firm to be carried on.
5. Dissolution by Court: According to Section 44 of the Indian Partnership Act the court, at the suit of a partner, may dissolve a firm on any one of the grounds namely –
   (i) insanity of a partner;
   (ii) permanent incapability of a partner to do his duties;
   (iii) if a partner is guilty of misconduct that might affect prejudicially the carrying on of the business;
   (iv) If a partner willfully or persistently commits breach of agreement;
   (v) If a partner transfers all his shares to a third party or has allowed his share to be charged under the Provisions of Rule 49 of order XXI of the First Schedule to the Code of Civil Procedure, 1908;
   (vi) If the court considers that the business cannot be carried on except at loss;
   (vii) On any other ground on which the court considers the dissolution as just and equitable.

Settlement of Accounts on Dissolution

According to Section 48 of the Indian Partnership Act the following rules should be observed for settlement of Accounts after dissolution, subject to agreement by partners :

(a) Regarding Losses : "Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly if necessary, by the partners individually in the proportions in which they are entitled to share profits”. [Section 48(1)]

(b) Regarding Assets : “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 ratably what is due to him from the firm for advances as distinguished from capital;

(iii) In paying to each partner ratably what is due to him as capital; and

(iv) The residue, if any, shall be divided among the partners in the proportions in which they are entitled to share profits.” [Section 48(2)]

Accounting Entries Regarding Dissolution

The two separate aspects of Dissolution for which accounting entries have to be made are:

[A] Realization of Assets and Payment of liabilities and [B] Settlement of the dues of the Partners,

[A] Realization of Assets and Payment of liabilities

(i) Prepare Realisation Account

(ii) Trausfer all assets (except cash, bank & fictitious assets) and liabilities at book values to Realisation Account.

Journal Entries

Item/Purpose	Entry	Special Points to be noted
1. Transfer of book values of assets as recorded in the Balance Sheet	Realization A/c Dr. To Sundry Assets [Book value] (including goodwill if any, shown in the Balance Sheet) Realization A/c Dr. To Debtors A/c Provision for Bad Debts A/c Dr. To Realization A/c.	(a) Cash or Bank A/c are not to be credited unless the firm, as a whole, is sold out as a going concern. (b) Debit balance of any Cap. A/c etc. or Debit balance of P/L A/c not to be transferred to Realization A/c. (c) If there is any Provision for bad Debts, debit Realization A/c and credit Debtors A/c with gross figure. Then debit Provision A/c and credit Realization A/c. Same treatment for Provision for Depreciation.
2. Realization/Sale of above assets	Cash/Bank A/c (amt. realized) Dr. Or Partners Cap. A/c Dr. (agreed value at which a partner takes over an asset/assets) To Realization A/c.	

Item/Purpose	Entry	Special Points to be noted
3. Shares etc. received as purchase consideration	In exchange of the firm's assets. Shares A/c Dr. To Realization A/c. (agreed value)	
4. Closing the External liabilities	External Liabilities A/c Dr. (such as creditors, outstanding expenses, Bank Loan etc.) To Realization A/c. (book value)	(a) Alternatively – this entry may be passed (combining 4,5 & 6) Liability A/c .... Dr. To Bank A/c (actual amt. paid) OR, To Partners Cap. A/c (agreed value) To Realization A/c (Discount, if any received on payment/discharge) (b) Where assets and liabilities are taken over by another business on making some lump sum payment, separate entries for realization of assets / payment of liabilities need not be made.
5. External liabilities paid off	Realization A/c. Dr. To Cash/Bank A/c (actual amt. paid)	
6. External liabilities taken over by any partner	Realization A/c. Dr. To Particular Partner's Cap. A/c (agreed value)	
7. Unrecorded asset sold or taken over by any partner	Cash / Bank A/c Dr. Partners Capital A/c Dr. To Realisation A/c	
8. If any unrecorded liability is paid.	Realization A/c Dr. To Cash/Bank A/c (actual amt.)	
9. If shares etc. received and shown in (3) above are sold out or transferred to partners.	Cash/Bank A/c Dr. Or, Partners Cap. A/c Dr. [excluding insolvent partner] To shares A/c	For sale, there may be profit or loss on sale which is transferred to Realization A/c.
10. Payment of Expenses of Realization.	Realization A/c Dr. To Cash/Bank A/c (if paid by the firm) Or, To Partners Cap. A/c (if paid by any partner)	If a partner bears such expenses personally in pursuance of a separate agreement – NO ENTRY is required.

Item/Purpose	Entry	Special Points to be noted
11. Balance of Realization Account representing Profit or Loss on Realization.	Realization A/c. Dr. To Partners Cap. A/c (Profit shared in Profit Sharing Ratio) Or, Partner's Cap. A/c Dr. To Realization A/c. (Loss shared in Profit Sharing Ratio)	

[B] Settlement of Partners Dues – through Capital Accounts

Item/Purpose	Entry	Special Points to be noted
1. Prepare Capital Accounts with balance as per Balance Sheet before the dissolution.	By Balance b/d (Cr. balance) To Balance b/d (Dr. balance)	
2. Transfer of Current A/c, if any.	Partner's Current A/c … Dr. To Partner's Cap. A/c. (Credit Balance) Or Partner's Capital A/c … Dr. To Partner's Current A/c (Debit balance)	
3. Undistributed Profit, Reserve, Joint Life Policy Reserve, Investment Fluctuation Fund, Contingency Reserve etc. transfer.	Profit & Loss (Cr.) A/c… Dr. Or, Any Reserve A/c …….. Dr. To Partner's Capital A/cs [Profit sharing ratio]	
4. Undistributed Loss, Fictitious/ Unrealizable Assets etc. transfer.	Partners Capital A/c… Dr. To Profit & Loss (Dr.) A/c Or, To Fictitious Assets A/c (Profit Sharing Ratio)	Example of unrealizable Asset- Advertisement Suspense A/c
5. Any loan taken from any partner	Partner's Loan A/c …. Dr. To Cash/Bank A/c	u/s 48 Repayment of loan should enjoy priority over repayment of capital.

Item/Purpose	Entry	Special Points to be noted
6. Any loan given to any partner	Cash/Bank A/c….. Dr. To Partner's Loan A/c Or Partner's Capital A/c ..... Dr. To Partner's Loan A/c	If such amount is realized. Adjustment of loan against Capital
7. If any Partner's Capital A/c shows a debit balance (after balancing)	Cash/Bank A/c….. Dr. To Particulars Partner's Capital A/c [Cash brought in to make up the shortfall]	If the deficient partner is insolvent, treatment will be different- Vide – Insolvency of Partner.
8. Payment of credit balance (after final balancing)	Particulars Partner's Cap. A/c Dr. To Cash/Bank A/c	Same as above

Illustration 22

A, B and C sharing profits in 3 : 1 : 1 agree upon dissolution. They each decide to take over certain assets and liabilities and continue business separately.

Balance Sheet
as on date of dissolution

Liabilities		(₹)	Assets		(₹)
Creditors		6,000	Cash at Bank		3,200
Loan		1,500	Sundry Assets		17,000
Capitals:	(₹)		Debtors	24,200	
A	27,500		Less: Bad Debts Provision	1,200	23,000
B	10,000		Stock		7800
C	7,000	44,500	Furnitures		1,000
		52,000			**52,000**

It is agreed as follows:

(i) Goodwill is to be ignored.

(ii) A is to take over all the Fixtures at ₹ 800; Debtors amounting to ₹ 20,000 at ₹ 17,200. The creditors of ₹ 6,000 to be assumed by A at the figure.

(iii) B is to take over all the stocks at ₹ 7,000 and certain of the sundry assets at ₹ 7,200 (being book value less 10%)

(iv) C is take over the remaining sundry assets at 90% of book values less ₹ 100 allowances and assume responsibility for the discharge of the loan, together with accruing interest of ₹ 30 which has not been recorded in the books of the firm.

(v) The expenses of dissolution were ₹ 270. The remaining debtors were sold to a debt collecting agency for 50% of book values.

Prepare Realisation Account, partners' Capital Accounts and Bank Account.

Solution:

In the books of A, B and C

Dr. Realisation Account Cr.

Particulars		(₹)	Particulars		(₹)
To Sundry Assets:			By Provision for bad debts		1,200
			Capital Account A :		
Sundry Assets	₹17,000		Fixtures	₹800	
Debtors	₹24,200		Debtors	₹17,200	
Stock	₹7,800				18,000
Fixtures	₹1,000		B: Stock	₹7,000	
		50,000	Sundry Assets	₹7,200	
					14,200
,, Bank – Expenses		270	C: Sundry Assets		8,000
,, Capital Account			By Bank: Collection from Debtors		2,100
C- Interest on loan		30	By Loss on realization:		
			A (3/5)	₹4,080	
			B (1/5)	₹1,360	
			C (1/5)	₹1,360	6,800
		50,300			**50,300**

Dr. Capital Account Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Dissolution Assets taken	18,000	14,200	8,000	By Balance b/d	27,500	10,000	7,000
				,, Creditors	6,000	-	-
,, Dissolution A/c Loss	4,080	1,360	1,360	,, Loan(with interest)	-	-	1,530
,, Bank — Final payment	11,420	-	-	,, Bank Final receipts	-	5,560	830
	33,500	**15,560**	**9,360**		**33,500**	**15,560**	**9,360**

Bank Account

Dr. Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	3,200	By Dissolution Account	
,, Dissolution A/c		Expenses	270
Collection from Debtors	2,100	,, Capital Account:	
,, Capital Accounts:		A	11,420
B 5,560			
C 830	6,390		
	11,690		**11,690**

Working Notes: (₹)

1. Realization of Sundry Assets:

Sundry Assets (Book Value)	17,000
Less: Taken by B [7,200 × (100/90)]	8,000
Remaining at book value	9,000

Taken by C: 90% of Book value

i.e. (₹9,000 × (90/100) = ₹8,100 – ₹100 for allowance = ₹8,000

2. Collection from Debtors: (₹)

Debtors (Book Value)	24,200
Less: Taken by (Book value)	20,000
	4,200

Remaining at 50% i.e., ₹ 2,100

Illustration 23

X, Y and Z sharing profits & Losses in the ratio of 2 : 2: 1 agreed upon dissolution of their partnership on 31st December, 2023 on which date their Balance Sheet was as under :

Liabilities	(₹)	Assets	(₹)
Capital :		Fixed Assets	50,000
X	40,000	Joint Life Policy (at surrender Value)	10,000
Y	30,000		
Reserve Fund	10,000	Debtors ₹10,000	
Joint Life Policy Fund	10,000	Less : Provision for	
Creditors ₹19,000			
Less: Prov ₹500	18,500	Bad Debts ₹500	9,500

Liabilities	(₹)	Assets		(₹)
Salary Outstanding	2,000	Stock at Invoice Price	₹10,000	
		Less: Price loading	₹2,000	8,000
		Investments	₹8,000	
		Less: Fluctuation Fund	₹500	7,500
		Capital Account –Z		2,000
		Bank		23,500
	1,10,500			**1,10,500**

Investments were taken over by X at ₹ 6,000, creditors of ₹ 10,000 were taken over by Y who has agreed to settle account with them at ₹ 9,900. Remaining creditors were paid ₹ 7,500. Joint Life Policy was surrendered and Fixed Assets realized ₹ 70,000, Stock and Debtors realized ₹ 7,000 and ₹ 9,000 respectively. One customer, whose account was written off as bad, now paid ₹ 800 which is not included in ₹ 9,000 mentioned above. There was an unrecorded asset estimated at ₹ 3,000, half of which as handed over to an unrecorded liability of ₹ 5,000 in settlement of claim of ₹ 2,500 and the remaining half was sold in the market which realized ₹ 1,300.

Y took over the responsibility of completing the dissolution and he is granted a salary of ₹ 400 per month. Actual expenses amounted to ₹ 1,100. Dissolution was completed and final payments were made on 30th April, 2024.

You are required to prepare the Realization Account, Capital Account and Bank Account.

Solution:

Books of the firm

Dr. **Realization Account** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Fixed Assets A/c		50,000	By Provision on Debtors A/c		500
To Joint Life Policy A/c		10,000	By Provision on Stock A/c		2,000
To Debtors A/c		10,000	By Investment Fluctuation		
To Stock (at I. P.)		10,000	Fund A/c		500
To Investments A/c		8,000	By Joint Life Policy Fund A/c		10,000
To Pro. for Disc. on		500	By Creditors A/c		19,000
Creditors A/c			By Outstanding Salary A/c		2,000
To Y's Capital A/c		10,000	By X' Capital A/c		6,000
[Creditors taken			(Investments taken over)		
over- see Note]			By Bank A/c :		
To Bank A/c :			Joint Life Policy	10,000	
Creditors paid off	7,500		Fixed Assets	70,000	
Unrecorded liability	2,500		Stock	7,000	
paid [1/2 × 5,000]			Debtors	9,800	
Outstanding Salary	2,000		Unrecorded Assets (Sold)	1,300	

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
Outstanding Expense	1,100	13,100	Bad Debt Recovered	800	98,100
To Y's Cap. A/c		1,600			
[Salary 400 × 4]					
To Partner's Capital A/c					
(Profit on Realization)					
X [2/5]	9,960				
Y [2/5]	9,960				
Z [1/5]	4,980	24,900			
		1,38,100			**1,38,100**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f	23,500	By Realization A/c	
To Realization A/c		Creditors	7,500
Joint Life Policy	10,000	Unrecorded Liability	2,500
Fixed Assets	70,000	Outstanding Salary	2,000
Stock	7,000	Expenses	1,100
Debtors	9,800	By X's Capital A/c	47,960
Unrecorded Assets	1,300	By Y's Capital A/c	55,560
		By Z's Capital A/c	4,980
	1,21,600		**1,21,600**

Dr. **Partners' Capital Account** **Cr.**

Date 2023	Particulars	X (₹)	Y (₹)	Z (₹)	Date 2023	Particulars	X (₹)	Y (₹)	Z (₹)
	To Balance b/d	-	-	2,000		By Balance b/d	40,000	30,000	-
	To Realization A/c	6,000	-	-		By Reserve Fund [2:2:1]	4,000	4,000	2,000
	To Bank A/c (Balance withdrawn)	47,960	55,560	4,980		By Realization A/c (Profit)	9,960	9,960	4,980
						By Realization A/c (Creditors)	-	10,000	-
						By Realization A/c (4 months Salary)	-	1,600	-
		53,960	**55,560**	**6,980**			**53,960**	**55,560**	**6,980**

Note :

1. Unrecorded Asset and unrecorded liability were not recorded. Any part of such asset utilized to discharge any part of such liability and discount received there on have been ignored.

   But unrecorded asset realized (debts previously written off now recovered) has been recorded. Similarly unrecorded asset sold has been recorded.

2. Y took over creditors of ₹ 10,000. This has been recorded. How he settles such liability is his personal matter. The discount on payment does not benefit the firm.

Special considerations for a retiring partner and the estate of a deceased partner in relation to debts contracted by the partnership firm:

(a) debts due on the date of retirement/death: the retiring partner and the estate of the deceased partner is liable for the whole of the debts due by the firm at the date of retirement or death, to the extent of their share.

(b) debts incurred after retirement: where the notice of retirement is not published in accordance with law, the retiring partner is liable for debts contracted after retirement.

(c) deceased/ insolvent partner: the estate of a deceased or bankrupt partner will not be liable for debts contracted by the firm after the death or bankruptcy.

Applicability of Section 37 of the Partnership Act:

In case of retirement, the retiring partner or in case of death, the executor of the deceased partner, if the dues are not settled, then such retired partner or the executor is entitled to the following :

Maximum of :

Interest @ 6% p.a. on the amount due to them(i.e. if the amount is unsettled, like, rate of interest on loan to be allowed to the retired partner or the executor is not mentioned)

Or

The share of profit earned for the amount due to the partner

Conditions :

(a) The surviving partners/continuing partners continue to carry on the business of the firm.

(b) The business is carried on without any final settlement of accounts between the continuing partners and the outgoing partners or his estate.

(c) There is no contract to the contrary of the options contained in Section 37 i.e. share in the profits or interest @ 6% p.a. on the unsettled capital.

Example : Unsettled capital of C ₹ 52,000 (Date of retirement : 30.09.22, financial year 2022-2023). Net Profit earned by the firm after C's retirement ₹ 25,000. Capitals of A: ₹ 57,000 and B: ₹ 76,000)

C is entitled to the maximum of the following :

(i) Interest on unsettled capital = ₹ 52,000 × 6% × 6 months = ₹ 1,560

(ii) Profit earned out of unsettled capital = Profit × Retired or Deceased Partner's unsettled

Dues/ Total Capital of the firm (including the amount due to the retired or deceased partner)

= ₹ (25,000 × 52,000)/(₹ 52,000 + 57,000 + 76,000) = ₹ 7,027.

Insolvency of a partner

If a partner becomes insolvent and fails to pay his debit balance of Capital A/c either wholly or in part, the unrecoverable portion is a loss to be borne by the solvent partners. The question now arises is that, in what ratio they will share this loss. Prior to the decision in the leading case of Garner vs. Murray this loss was borne by the solvent partners in the profit sharing ratio just like ordinary losses.

Decision in Garner vs. Murray Case

Justice Joyee held in the case of Garner vs. Murray that the loss arising due to the insolvency of a partner must be distinguished from an ordinary loss (including realization loss). Unless otherwise agreed, the decision in Garner vs. Murray requires –

(i) That the solvent partners should bring in cash equal to their respective shares of the loss on realization;

(ii) That the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.

In case of fixed capital system, capitals as per last Balance Sheet represent last agreed capitals. In case of fluctuating capital system, however, all necessary adjustments in respect of reserved, unappropriated profits or losses (but not realization profit or loss), Drawings A/c., undisclosed liabilities and assets etc. must be made to get last agreed capitals. A partner who has nil or negative balance in his capital account before dissolution does not contribute anything to the loss arising as a result of insolvency of a partner.

Criticism of the decision of Garner vs. Murray

The following criticism may be advocated against the decisions laid down in Garner vs. Murray principle:

(i) If any solvent partner has a debit balance in capital account, he must not bear the deficiency of the insolvent partner;

(ii) This principle does not apply if there are only two partners;

(iii) In spite of having a credit balance in capital account the solvent partner must bring cash equal to the amount of loss on reasilation which is immaterial and useless; and

(iv) If any solvent partner who possess more private asset but contributes less capital, he will naturally, as per Garner vs. Murray decision, bear less amount of deficiency of the insolvent partner than the other solvent partner who possess less private assets but contributes more capital to the firm. This is not justified.

Applicability in India

According to sub section (ii) of Sec 48(b) of the Indian Partnership Act, if a partner becomes insolvent or otherwise incapable of paying his share of the contribution, the solvent partners must share ratably the available assets (including their own contribution to the capital deficiency). That is to say, the available assets will be distributed in proportion to their capitals.

Thus, under the Indian Partnership Act also the solvent partners are required to make good their share of the realization loss (i.e., capital deficiency). The total cash available after making good the solvent partners' share of capital deficiency shall be shared by the solvent partners in proportion to their capitals. As a result of this the ultimate debit balance of the insolvent partner's Capital A/c. is borne by the solvent partners in capital ratio.

The provision of the Indian Partnership Act in this respect are, thus, similar to the rules laid down by the decision in Garner vs. Murray.

When there is a specific provision in the Partnership Deed as to how the deficiency of an insolvent partner is to be borne by the solvent partners, such provision must be followed, because the provision of the Act will apply only when there is no specific agreement.

Illustration 24

A, B and C are in partnership sharing profit and losses equally and agreed to dissolve the firm on 30.06.2023. On that date their Balance Sheet stood as follows:

Balance Sheet
as at 30th June, 2023

Liabilities	(₹)	Asset	(₹)
Capital A/c (₹)		Sundry Asset	50,000
A 34,000		Profit & Loss A/c	12,000
B 24,000	58,000	Capital A/c	
Creditors	12,000	C	8,000
	70,000		**70,000**

The assets are realised at 50% of the book value. Realization expenses amounted to ₹5,000. C became insolvent and received ₹2,000 from his estates.

Close the book of the firm under

(i) Fixed Capital Method and

(ii) Fluctuating Capital Method applying Garner Vs. Murray principle.

Solution:

In the books of A, B & C

Dr. **Realization Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Sundry Asset A/c	50,000	By Bank A/c	
" Bank A/c		Amount Realised	25,000
" Expense	5,000	" Capital A/c	
		By Loss on Realization	
		A ₹10,000	
		B ₹10,000	
		C ₹10,000	30,000
	55,000		**55,000**

Working Notes:

(a) Under Fixed Capital Method

Deficiency of the insolvent partner Mr. C must be borne by the solvent partner A and B as per their last agreed capital given in the Balance Sheet i.e., 17:12.

(b) Under Fluctuating Capital Method

Deficiency of the insolvent partner Mr. C must be borne by the solvent partners A & B as the following adjusted capital which will be considered as the last agreed capital i.e., after adjusting the debit balance of Profit and Loss Account.

Particulars	A (₹)	B (₹)
Capital as per Balance Sheet	34,000	24,000
Less: Debit balance of P&L A/c (equally)	(-) 4,000	(-) 4,000
	30,000	**20,000**

∴ Ratio = 3:2

(a) Capital Account under Fixed Capital Method

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Balance b/d	---	---	8,000	By Balance b/d	34,000	24,000	---
" Realisation A/c Loss	10,000	10,000	10,000	" Bank A/c	---	---	2,000
" Profit & Loss A/c Loss	4,000	4,000	4,000	" Bank A/c	10,000	10,000	---
" C's Capital A/c	11,724	8,276	---	" A's Capital	---	---	11,724
" Bank A/c (bal. fig.)	18,276	11,724	---	" B's Capital	---	---	8,276
	44,000	**34,000**	**22,000**		**44,000**	**34,000**	**22,000**

Dr. Bank Account Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	25,000	By Realisation A/c	
" Capital A/c		Expenses	5,000
A 10,000		" Creditors	12,000
B 10,000		" Capital A/c	
C 2,000	22,000	A	18,276
		B	11,724
	47,000		**47,000**

(b) Under Fluctuating Capital Method

Dr. Partners' Capital Accounts Cr.

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Balance b/d	---	---	8,000	By Balance b/d	34,000	24,000	---
" Realisation A/c Loss	10,000	10,000	10,000	" Bank A/c	10,000	10,000	---

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
" Profit & Loss A/c Loss	4,000	4,000	4,000	" Bank A/c	---	---	2,000
" C's Capital A/c	12,000	8,000	---	" A's Capital	---	---	12,000
" Bank A/c (bal. fig.)	18,000	12,000	---	" B's Capital	---	---	8,000
	44,000	**34,000**	**22,000**		**44,000**	**34,000**	**22,000**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Realisation A/c	25,000	By Realisation A/c	
Assets realized		Expenses	5,000
" Capital A/c		" Creditors	12,000
A	10,000	" Capital A/c	
B	10,000	A	18,000
C	2,000	B	12,000
	47,000		**47,000**

Illustration 25

Ram, Rahim and Robert are partners of the firm ABC sharing profits and losses in the ratio of 5: 3: 2. The Balance Sheet of the firm as on 01.4.2023 is given below:

Liabilities	(₹)	Assets	(₹)
Partners Capital:		Goodwill	50,000
Ram	3,00,000	Machinery	4,55,000
Rahim	2,50,000	Furniture	10,000
Robert	2,00,000	Stock	2,00,000
General Reserve	1,05,000	Debtors	3,00,000
Loan	95.000	Cash & Bank	35,000
Sundry Creditors	1,00,000		
	10,50,000		**10,50,000**

Partners of firm decided to dissolve the firm. The firm decided to settle the loan creditors directly. Ram took over goodwill for 75,000. Rahim took over machinery and furniture at 90% of book value and sundry creditors at book value.

Robert took over stock at 95% of book value and debtors at 90% of the book value. Partners have to pay cash if the assets taken over had exceeded the amounts due to them.

Prepare:

(i) Realisation Account;

(ii) Partners Capital Account; and

(iii) Cash Account of the firm to show the dissolution proceedings.

Solution:

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Goodwill	50,000	By Loan.	95,000
To Machinery	4,55,000	By Sundry creditors	1,00,000
To Furniture	10,000	By Ram's Capital A/c	75,000
To Stock	2,00,000	By Rahim's Capital A/c	4,18,500
To Debtors	3,00,000	By Robert's Capital A/c	
To Cash (Loan)	95,000	95% of 2,00,000	
To Rahim's Capital A/c	1,00,000	90% of 3,00,000	4,60,000
		By Ram's Capital	30,750
		By Rahim's Capital	18,450
		By Robert's Capital	12,300
	12,10,000		**12,10,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	Ram	Rahim	Robert	Particulars	Ram	Rahim	Robert
To Realisation A/c	75,000	4,18,500	4,60,000	By Balance b/d	3,00,000	2,50,000	2,00,000
To Realisation A/c	30,750	18,450	12,300	By General Reserve	52,500	31,500	21,000
To Cash (b/f)	2,46,750			By Realisation A/c		1,00,000	2,51,300
				By Cash A/c (b/f)		55,450	
	3,52,500	**4,36.950**	**4,72,300**		**3,52,500**	**4,36,950**	**4,72,300**

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

Particulars	(₹)	Particulars	(₹)
To Balance bid	35,000	By Loans A/c	95,000
To Rahim Capital A/c	55,450	By Ram Capital A/c	2,46,750
To Robert Capital A/c	2,51,300		
	3,41,750		**3,41,750**

Illustration 26

Ram, Rahim and Robert are partners in a firm sharing profits and losses in the proportion of 3:3:2. Their Balance Sheet as on 31.03.2023 was as follows:

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Partners Capital Account:			Bank		55,000
Ram	75,000		Stock		69,000
			Investments		6,000

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Rahim	75,000		Debtors		70,000
Robert	1,00,000	2,50,000	Laud and Building		1,25,000
Partners Current Accounts:			Goodwill		25,000
Ram	15,000				
Rahim	25,000				
Robert	12,500	52,500			
Sundry creditors		47,500			
		3,50,000			**3,50,000**

They decided to dissolve the firm on 01.04.2023. They report the result realization as follows:

	(₹)	
Land and Buildings	90,000	— realized in cash
Debtors	60,000	— realized in cash
Investments	5,500	— taken over by Ram
Stock	75,500	— taken over by Rahim
Goodwill	18,000	— taken over by Robert

The realization expenses amounted to ₹ 2,000. You are required to close the books of accounts of the firm.

Solution:

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Stock	69,000	By Sundry Creditors	47,500
To Investments	6,000	By Bank (assets realized)	1,50,000
To Debtors	70,000	By Ram's Capital A/c (investments)	5,500
To Land & Buildings	1,25,000	By Rahim's Capital A/c (Stock)	75,500
To Goodwill	25,000	By Robert's Capital A/c (Goodwill)	18,000
To Bank (Expenses)	2,000	By Loss transferred to Current A/c: (₹)	
To Bank (Creditors)	47,500	Ram 18,000	
		Rahim 18,000	
		Robert 12,000	48,000
	3,44,500		**3,44,500**

Dr. **Partners' Current Account** Cr.

Particulars	Ram (₹)	Rahim (₹)	Robert (₹)	Particulars	Ram (₹)	Rahim (₹)	Robert (₹)
To Realisation A/c	5,500	75,500	18,000	By Balance b/d	15,000	25,000	12,500
To Realisation A/c	18,000	18,000	12,000	By Capital A/c	8,500	68,500	17,500
	23,500	**93,500**	**30,000**		**23,500**	**93,500**	**30,000**

Dr. **Partners' Capital Account** Cr.

Particulars	Ram (₹)	Rahim (₹)	Robert (₹)	Particulars	Ram (₹)	Rahim (₹)	Robert (₹)
To Current A/c	8,500	68,500	17,500	By Balance C/d	75,000	75,000	1,00,000
To Bank A/c (Bal. Fig)	66,500	6,500	82,500				
	75,000	**75,000**	**1,00,000**		**75,000**	**75,000**	**1,00,000**

Dr. **Bank Account** Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/d	55,000	By Realisation A/c (expenses)	2,000
To Realisation (Assets realized)	1,50,000	By Realisation A/c (Creditors)	47,500
		By Ram's Capital A/c	66,500
		By Rahim's Capital A/c	6,500
		By Robert's Capital A/c	82,500
	2,05,000		**2,05,000**

If all the partners are insolvent

Since all partners are insolvent, creditors cannot expect to be paid in full. In such a case Sundry Creditors should not be transferred to Realization Account. Cash in hand together with the amount realized on sale of assets and surplus from private estate of partners, if any, less expenses will be applied in making payment to the creditors. The balance of Creditors Account represents the deficiency to be borne by them which to be transferred to a Deficiency Account. The balance of Capital Accounts should also to be transferred to the Deficiency Account to close the books. Alternatively, the deficiency to be borne by the Creditors may be directly adjusted in between Creditors Account and Capital Accounts.

The following entries required to be passed :

(i) To, pay-off the creditors

Creditors A/c	Dr.	(Total Creditors)
To Bank A/c		(Amount paid)
To Deficiency A/c		(Amount unpaid)

(ii) When deficiency is transferred

Deficiency A/c Dr.

To Partners' Capital A/c

Illustration 27

A, B and C were equal partners in a firm. Their Balance Sheet as on 31st March, 2023 was as follows:

Liabilities	(₹)	Assets	(₹)
A's Capital	1,60,000	Building	4,00,000
C's Capital	1,00,000	Machinery	4,00,000
A's Loan	2,00,000	Furniture and Fixtures	1,60,000
Creditors	10,00,000	Stock	1,60,000
		Book Debts	2,00,000
		Cash at Bank	10,000
		B's Capital (Overdrawn)	1,30,000
	14,60,000		**14,60,000**

The firm was dissolved as all the partners were declared insolvent. The assets were realized as under:

Book debts: 45% less; Building: ₹1,60,000; Stock: ₹1,00,000; Machinery: ₹2,00,000; and Furnitures and fixtures; ₹40,000. Realization expenses were ₹10,000.

Partner	Private Assets (₹)	Private Liabilities (₹)
A	2,50,000	2,50,000
B	2,00,000	1,80,000
C	2,30,000	2,50,000

You are required to prepare:

(i) Realisation Account,

(ii) Bank Account,

(iii) Creditors Account,

(iv) Partners' Capital Account, and

(v) Deficiency Account.

Solution:

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars		(₹)
To Building	4,00,000	By Bank		
To Machinery	4,00,000	Book debts	1,10,000	
To Furniture	1,60,000	Building	1,60,000	
To Stock	1,60,000	Stock	1,00,000	
To Book debts	2,00,000	Machinery	2,00,000	
To Bank - Realisation exp.	10,000	Furniture	40,000	6,10,000
		By Partners' Capital A/c: (Realisation loss)		7,20,000
	13,30,000			**13,30,000**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	10,000	By Realisation	10,000
To Realisation A/c	6,10,000	By Creditors A/c (Bal. Fig.)	6,30,000
To B's Capital A/c (Excess of B's estate)	20,000		
	6,40,000		**6,40,000**

Dr. **Creditors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank	6,30,000	By Bal b/d	10,00,000
To Deficiency A/c (Bal. Fig.)	3,70,000		
	10,00,000		**10,00,000**

Dr. **Partners' Capital Account** **Cr.**

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Bal. b/d		1,30,000		By Bal. b/d	1,60,000		1,00,000
To Realisahon loss	2,40,000	2,40,000	2,40,000	By A's Loan A/c	2,00,000		
(7.20,000 in 1:1:1)				By Bank A/c.		20,000	
To Deficiency	1,20,000			By Deficiency A/c		3,50,000	1,40,000
	3,60,000	**3,70,000**	**2,40,000**		**3,60,000**	**3,70,000**	**2,40,000**

Dr. **Deficiency Account** Cr.

Particulars	(₹)	Particulars	(₹)
To B's Capital A/c	3,50,000	By Creditors A/c	3,70,000
To C's Capital A/c	1,40,000	By A's Capital A/c	1,20,000
	4,90,000		**4,90,000**

Illustration 28

P, Q, R and T have been carrying on business in partnership sharing profits and losses in the ratio of 4:1:2:3. The following is their Balance Sheet as on 31st March, 2023:

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Accounts:			Premises		2,80,000
P	7,00,000		Furnitures		30,000
T	3,00,000	10,00,000	Stock-in-Trade		2,00,000
Trade Creditors		3,00,000	Trade Debtors	3,50,000	
			Less: Provision for Bad Debts	50,000	3,00,000
			Cash at Bank		1,40,000
			Capital Accounts:		
			Q	2,00,000	
			R	1,50,000	3,50,000
		13,00,000			**13,00,000**

It has been agreed to dissolve the partnership on 1st April, 2023, on basis of the following points agreed upon between the partners:

(i) P is to take over Trade Debtors at 80% of Book Value (₹3,50,000);

(ii) T is to take over the stock in Trade at 95% of the value; and

(iii) R is to discharge Trade Creditors.

(iv) The realisation is: Premises ₹2,75,000 and Furnitures ₹25,000.

(v) The expenses of realisation come to ₹30,000.

(vi) Q is found insolvent and ₹21,900 is realised from his estate.

Note: The loss arising out of capital deficiency may be distributed following decision in Garner vs. Murray.

You are required to prepare:

(a) Realisation Account

(b) Bank/Cash Account

(c) Capital Accounts of the Partners.

Solution:

In the books of Firm

Dr. **Realisation Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
2023	To Trade debtors A/c	3,50,000	2023	By Provision for Bad Debts A/c	50,000
April 1	To Stock in Trade A/c	2,00,000	April 1	By Trade Creditor A/c	3,00,000
	To Premises A/c	2,80,000		By P's Capital A/c	2,80,000
	To Furniture A/c	30,000		(Trade Debtors taken over)	
	To R's Capital A/c	3,00,000		By T's Capital A/c	1 ,90,000
	Trade credit discharged)	30,000		(Stock-in-trade taken over)	
	Co Bank/Cash (Expenses)			By Bank A/c	3,00,000
				(Assets realised)	
				By Partners' Capital A/c	70,000
				(P: 28,000: Q: 7,000;	
				R: 14,000: T: 21,000)	
		11,90,000			**11,90,000**

Dr. **Bank Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2023	To Balance b/d	1,40,000	2023	By Realisation A/c (expenses)	30,000
April 1	To Realization A/c	3,00,000	April 1	By Partners' Capital A/c	
	To Partner's Capital A/c:			P:	2,90,430
	P:	28,000		R:	1,50,000
	Q:	21,900		T:	54,470
	R:	14,000			
	T:	21,000			
		5,24,900			**5,24,900**

Dr. **Partners' Capital Account** Cr.

Particulars	P (₹)	Q (₹)	R (₹)	T (₹)	Particulars	P (₹)	Q (₹)	R (₹)	T (₹)
To Balance b/d	—	2,00,000	1,50,000	—	By Balance b/d	7,00,000	—	—	3,00,00
To Realisation A/c	2,80,000	—	—	1,90,000	By Realisation A/c (Trade Credit discharged)	—	—	3,00,000	—
To Realisation A/c (Loss)	28,000	7,000	14,000	21,000					
To Capital A/c (WN-2)	129,570	—	—	55,530	By Bank/Cash A/c (W.N. 1)	28.000	—	14,000	21,000
To Bank/Cash A/c	2,90,430	—	1,50,000	54,470	By Bank/Cash (W.I)	—	21,900	—	—
					By P's Capital A/c	—	1,29,570	—	—
					By T's Capital A/c	—	55,530	—	—
	7,28,000	**2,07,000**	**3,14,000**	**3.21,000**		**7,28,000**	**2,07,000**	**3,14,000**	**3.21,000**

Working Notes :

(1) Q's deficiency of ₹ 1,85,100 (₹ 2,07,000 - ₹ 21,900) should be shared by P and Tin the ratio of their capital i.e. 7:3. R will not bear any loss on deficiency, because at the time of dissolution he had a debit balance in his Capital Account.

(2) The amount realised from the estate of Q is ₹ 21,900.

Illustration 29

Balance Sheet as at 30.10.2023

Liabilities	(₹)	Asset	(₹)
Capitals		Fixed Assets	1,00,000
P	5,000		
Q	3,000		
R	2,000	Cash	10,000
Bank Loan	60,000		
Sundry Creditors	40,000		
	1,10,000		**1,10,000**

All the partners were declared insolvent. Profit sharing ratio : 5 : 3 : 2. Assets realized ₹ 60,000. Prepare necessary ledger accounts to close the books of the firm.

Solution :

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Fixed Assets	1,00,000	By Cash A/c (realisation)	60,000
		By Partners Capital A/cs	
		(loss on realisation)	
		P: 20,000	
		Q: 12,000	
		R: 8,000	40,000
	1,00,000		**1,00,000**

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
				By Balance b/d	5,000	3,000	2,000
To Realization A/c	20,000	12,000	8,000	By Deficiency A/c	15,000	9,000	6,000
	20,000	**12,000**	**8,000**		**20,000**	**12,000**	**8,000**

Dr. **Deficiency Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Partners Capital A/cs :			
P	15,000	By Bank Loan A/c	18,000
Q	9,000	By Creditors	12,000
R	6,000		
	30,000		**30,000**

Dr. **Bank Loan Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Deficiency A/c	18,000	By Balance b/d	60,000
To Cash A/c	42,000		
	60,000		**60,000**

Dr. **Creditors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Deficiency A/c	12,000	By Balance b/d	40,000
To Cash A/c	28,000		
	40,000		**40,000**

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

Particulars	(₹)	Particulars	(₹)
To Balance b/d	10,000	By Bank Loan A/c	42,000
To Realisation A/c	60,000	By Creditors A/c	28,000
	70,000		**70,000**

Note :

The total deficiency of the partners i.e. the firm is ₹30,000. This is shared between the external liabilities in the ratio of their amount outstanding ₹60,000 : ₹40,000 = 3 : 2

Bank Loan A/c	Dr.	₹18,000	
Creditors A/c	Dr.	₹12,000	
To Deficiency A/c			₹30,000

Return of Premium to a partner on dissolution before expiry of term :

Conditions :

(i) A partner was admitted in the partnership firm for a fixed term period,

(ii) Such partner had paid a premium for goodwill at the time of admission.

(iii) The partnership firm has dissolved.

Exceptions : The partner will not be entitled to any claim under any of the following conditions :

(i) the firm is dissolved due to death of a partner

(ii) the dissolution is due to the misconduct of the partner claiming refund

(iii) dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

Amount of Refund: the amount to be repaid will be determined having regard to the terms upon which the admission was made and to the length of the period agreed upon and the period that has expired.

Liability of other partners: the amount of refund payable shall be borne by the other partners in their profit sharing ratio.

Ilustration 30

X was admitted into partnership for 5 years, for which he paid a premium of ₹ 1,20,000. After 39 months, the partnership firm was dissolved due to misconduct of Mr. Z , another partner of the firm. Y, being the third partner. Profit Sharing Ratio : Y : Z : X = 5 : 3 : 2.

Solution:

X is entitled to claim the refund of premium paid at the time of admission, since the admission was for a fixed term period and the firm is getting dissolved due to a misconduct of Mr.Z, another partner of the firm.

The amount of refund is

= (Total Premium Paid × Unexpired term of the partnership) / Total term of the partnership

= 1,20,000 × 21/60 = ₹ 42,000

This shall be shared by the other partners Y and Z in their profit sharing ratio 3 : 2.

Y's Capital A/c	Dr.	₹25,200	
Z's Capital A/c	Dr.	₹16,800	
To X's Capital A/c			₹42,000
(Being premium paid during admission now refunded to X after adjusting capitals of other partners)			

Piecemeal Distribution

Till now the discussion was based on the implicit assumption that all assets were realized and settlement was done on the same date. In fact, on the dissolution of a partnership, assets are sometimes realized gradually over a period of time. In such a case it may be agreed that different parties are to be paid in order of preference as and when assets are realized without unnecessarily waiting for the final realization of all the assets.

The order of the payment will be as follows :

(i) Realisation expenses

(ii) For provision for expenses that are to be made

(iii) Preferential creditors (say, Income Tax or any payment made to the Government)

(iv) Secured creditors – upto the amount realized from the disposal of assets by which they are secured and for the balance, if any, to be paid to unsecured creditors

(v) Unsecured creditors – in proportion to the amount of debts, if more than one creditor

(vi) Partners' loan – if there is more than one partner – in that case, in proportion to the amount of loan

(vii) Partners' capital – the order of payment may be made by any one of the following two methods:

(a) Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method

(b) Maximum Possible Loss Method

Surplus Capital Method

This method is applicable when all the partners are solvent. The following steps are to be followed to calculate the surplus capital:

1. Adjusted capital: the balance lying in the capital accounts of the partners are adjusted with the undistributed profit or loss, drawings and reserves.
2. Base capital: the adjusted capital is divided by the unit of profit share and the minimum amount is called the base capital. For example if profit sharing ratio is 5:3:2 the respective capitals will be divided by 5, 3 and 2 respectively.
3. Proportionate capital: the amount is ascertained by multiplying the base capital with unit of profit share. For example if base capital is ₹20,000 it is multiplied by 5,3 and 2 respectively.
4. Surplus capital: it is ascertained by the difference of adjusted capital and the proportionate capital.

The process continues until we get an absolute surplus.

Example: (Computation of Surplus Capital)

Balance of Capital Accounts

X : ₹ 35,000, Y: ₹ 33,000, AND Z : ₹ 18,000. Reserves ₹ 10,000. Profit sharing ratio 5:3:2.

Statement Showing Surplus Capital

Particulars		(₹)	X (₹)	Y (₹)	Z (₹)
Capital Balance	A		35,000	33,000	18,000
Add Reserves (5:3:2)	B		5,000	3,000	2,000
Adjusted Capital	C		40,000	36,000	20,000
Unit Share of Profit	D		5	3	2
Capital per Unit of Profit Share	E		8,000	12,000	10,000
Base Capital (being minimum)	F	8,000			
Unit Share of Profit	G		5	3	2

Particulars		(₹)	X (₹)	Y (₹)	Z (₹)
Proportionate Capital (F × G)	H		40,000	24,000	16,000
Surplus Capital (C – H)	I		0	12,000	4,000
Unit Share of Profit	J			3	2
Capital per Unit of Profit Share	K			4,000	2,000
Base Capital (being minimum)	L	2,000			
Unit Share of Profit	M			3	2
Proportionate Capital (L × M)	N			6,000	4,000
Absolute Surplus Capital (I – N)	O			6,000	0

Implication:

The above table indicates that Y will get the first preference of settlement by ₹6,000. Thereafter, Y and Z will be settled in the ratio of 3:2. Any balance left will then be open to X Y and Z in the ratio of 5:3:2.

Example: (Distribution of Cash)

A, B and C were partners sharing profits and losses as 2:1:1. The balance sheet as on 31.03.2023 when they dissolved their partnership was as under:

Liabilities	(₹)	Assets	(₹)
Capital :			
A	60,000	Sundry assets	1,85,000
B	50,000	Cash	15,000
C	30,000		
Reserves	10,000		
B's Loan	20,000		
Creditors	20,000		
Government Due	10,000		
	2,00,000		**2,00,000**

₹ 2,000 was spent for packaging of materials before sale. The realization were made on different dates as under:

April ₹15,000; May ₹ 20,000; June ₹ 30,000; July ₹ 60,000; August ₹40,000.

The collections were distributed as and when realized. Prepare a statement showing the distribution of cash collected.

Solution:

Computation of Surplus Capital

Particulars		(₹)	X (₹)	Y (₹)	Z (₹)
Capital Balance	A		60,000	50,000	30,000
Add: Reserves (2:1:1)	B		5,000	2,500	2,500
Adjusted Capital	C		65,000	52,500	32,500
Unit Share of Profit	D		2	1	1
Capital Per Unit of Profit Share	E		32,500	52,500	32,500
Base Capital (Being Minimum)	F	32,500			
Unit Share of Profit	G		2	1	1
Proportionate Capital (F × G)	H		65,000	32,500	32,500
Surplus Capital (C – H)	I		0	20,000	0
Unit Share of Profit	J		-	-	-
Capital Per Unit of Profit Share	K		-	-	-
Base Capital (Being Minimum)	L		-	-	-
Unit Share of Profit	M		-	-	-
Proportionate Capital (L × M)	N		-	-	-
Absolute Surplus Capital (I – N)	O		-	-	-

Statement Showing Distribution of Cash

Particulars	(₹)	External Debt		B's Loan (₹)	Partners Capital		
		Govt. Due (₹)	Creditors (₹)		A (₹)	B (₹)	C (₹)
Balance as on 31.03.2023	15,000	10,000	20,000	20,000	65,000	52,500	32,500
Less: expense for packaging	2,000						
	13,000						
Payment of govt. dues	10,000	10,000					
	3,000	NIL					
Payment to creditors	3,000		3,000				
	NIL		17,000	20,000	65,000	52,500	32,500
1ST Realisation	15,000						

Particulars	(₹)	External Debt		B's Loan (₹)	Partners Capital		
		Govt. Due (₹)	Creditors (₹)		A (₹)	B (₹)	C (₹)
Payment to creditors	15,000		15,000				
			2,000	20,000	65,000	52,500	32,500
2nd Realisation	20,000						
Payment to creditors	2,000		2,000				
Paid to B	18,000			18,000			
				2,000	65,000	52,500	32,500
3rd Realisation	30,000						
Paid to B	2,000			2,000			
Payment of surplus capital to B	20,000					20,000	
Payment to partners (2:1:1)	8,000				4,000	2,000	2,000
					61,000	30,500	30,500
4th Rrealisation	60,000						
Paid to partners (2:1:1)	60,000				3,0000	15,000	15,000
					31,000	15,500	15,500
5th Realisation	40,000						
Paid to partners (2:1:1)	40,000				20,000	10,000	10,000
Loss on Realisation					11,000	5,500	5,000

Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method

Under this method, actual capital of the partners on the date of dissolution is compared with their proportionate capital (determined on the basis of minimum capital per unit of profit) to determine surplus capital of the partners. Surplus capital is paid first and any balance left thereafter is distributed in the profit sharing ratio. This ensures that final balances of partners show their share of realisation profit/loss and thus, no settlement need to be dome at that point of time.

Illustration 31

Partners M, N and P have called upon you to assist them in winding up the affairs of their partnership on 30th June, 2023. Their Balance Sheet as on that date is given below :

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	17,000	Cash at Bank	6,500
Capital		Sundry Debtors	22,000
Accounts : M	67,000	Stock in trade	13,500
N	45,000	Plant and Equipment	99,000
P	31,500	Loan : M	12,000
		Loan : N	7,500
	1,60,500		**1,60,500**

(a) The partners share profits and losses in the ratio of 5 : 3 : 2.

(b) Cash is distributed to the partners at the end of each month.

(c) A summary of liquidation transaction are as follows :

July :

₹ 16,000 — collected from Debtors; balance is irrecoverable.

₹ 10,000 — received from sale of entire stock.

₹ 1,000 — liquidation expenses paid.

₹ 8,000 — cash retained in the business at the end of the month.

August :

₹ 1,500 — liquidation expenses paid; as part of the payment of his capital, P accepted an equipment for ₹ 10,000 (book value ₹ 4,000).

₹ 2,500 — cash retained in the business at the end of the month.

September :

₹ 75,000 — received on sale of remaining plant and equipment.

₹ 1,000 — liquidation expenses paid. No cash is retained in the business.

Required : Prepare a Schedule of cash payments as on 30th September, showing how the cash was distributed.

Solution :

Statement showing the Distribution of Cash (According to Proportionate Capital Method)

Particulars	Creditors (₹)	Capital		
		M (₹)	N (₹)	P (₹)
A. Balance Due	17,000	55,000	37,500	31,500
B. Amount Distributed as on 31st July	17,000	—	—	6,500
C. Balance Due (A – B)	—	55,000	37,500	25,000
D. Cash paid to 'N' and Equipment Given to P on 31st August.			4,000	10,000

Particulars	Creditors (₹)	Capital		
		M (₹)	N (₹)	P (₹)
E. Balance Due (C – D)		55,000	33,500	15,000
F. Amount Paid to Partners on 30th September		41,500	25,400	9,600
G. Loss on Realisation (Unpaid Balance) [E – F]		13,500	8,100	5,400

Working Notes :

(i) Statement showing the Calculation of Highest Relative Capital (₹)

Particulars	M	N	P
A Balance of Capital Accounts	67,000	45,000	31,500
B Less : Loan	12,000	7,500	—
C Actual Capital (A – B)	55,000	37,500	31,500
D Profit Sharing Ratio	5	3	2
E Actual Capital ÷ Profit Sharing Ratio	11,000	12,500	15,750
F Proportionate Capitals Taking M's Capital as Base Capital	55,000	33,000	22,000
G Excess of Actual Capitals Over Proportionate Capitals (C – F)		4,500	9,500
H Profit Sharing Ratio	—	3	2
I Surplus Capital ÷ Profit Sharing Ratio	—	1,500	4,750
J Revised Proportionate Capital taking N's Capital as Base Capital	—	4,500	3,000
K Excess of Surplus Capital over Revised Proportionate Capitals (G – J)	—	—	6,500

Scheme of distribution of available cash : First instalment up to ₹ 6,500 will be paid to P. Next instalment up to ₹ 7,500 will be distribution between N and P in the ratio of 3 : 2. Balance realisation will be distributed among M, N and P in the ratio of 5 : 3 : 2.

(ii) Statement showing the Calculation of Cash Available for Distribution

Particulars	July (₹)	August (₹)	September (₹)
A Opening Balance	6,500	8,000	2,500
B Add : Net amount realised (Gross amount — Expenses)	25,000	(1,500)	74,000
C Less : Closing Balance	8,000	2,500	—
D Amount available for distribution (A + B – C)	23,500	4,000	76,500

(iii) Statement showing the Manner of Distribution of amount available in August and September

Particulars	July (₹)	August (₹)	September (₹)
First ₹ 7,500	—	4,500	3,000
Balance ₹ 83,000	41,500	24,900	16,600
(Cash and Equipment)	41,500	29,400	19,600
Less : Actual Distribution in August	—	4,000	10,000
Manner of Distribution in September	41,500	25,400	9,600

Illustration 32.

The firm of Blue Collars presented you with the following Balance Sheet drawn as on 31st March 2023 :

Liabilities	(₹)	Assets	(₹)
Sundry Creditors	37,000	Cash in hand	3,000
Capital Accounts :		Sundry Debtors	34,000
L 40,000		Stock in trade	39,000
K 30,000		Plant and Machinery	51,000
J 27,000	97,000	Current Accounts :	
		K 4,000	
		J 3,000	7,000
	1,34,000		**1,34,000**

Partners shared profits and losses in the ratio of 4 : 3 : 3. Due to difference among the partners, it was decided to wind up the firm, realise the assets and distribute cash among the partners at the end of each month.

The following realisations were made :

(i) May — ₹ 15,000 from debtors and ₹ 20,000 by sale of stock. Expenses on realisation were ₹ 500.

(ii) June — Balance of debtors realised ₹ 10,000. Balance of stock fetched ₹ 24,000.

(iii) August — Part of machinery was sold for ₹ 18,000. Expenses incidental to sale were ₹ 600.

(iv) September — Part of machinery valued in the books at ₹ 5,000 was taken by K, in part discharge at an agreed value of ₹ 10,000. Balance of machinery was sold for ₹ 30,000 (net).

Partners decided to keep a minimum cash balance of ₹ 2,000 in the first 3 months and ₹ 1,000 thereafter.

Required : Show how the amounts due to partners will be settled.

Solution :

(i) Statement showing the Distribution of Cash (According to Proportionate Capital Method)

Particulars	Creditors (₹)	Capital		
		L (₹)	K (₹)	J (₹)
A Amount Due	37,000	40,000	26,000	24,000

Particulars	Creditors (₹)	Capital L (₹)	Capital K (₹)	Capital J (₹)
B Amount Distribution as on 31st May	35,500	—	—	—
C Balance Due (A – B)	1,500	40,000	26,000	24,000
D Amount Distributed as on 30th June				
First ₹ 1,500	1,500			
Next ₹ 5,333	—	5,333	—	—
Next ₹ 4,667	—	2,667	2,000	—
Balance ₹ 22,500	—	9,000	6,750	6,750
E Balance Due (C – D)		23,000	17,250	17,250
F Amount Distributed as on 31st August		7,360	5,520	5,520
G Balance Due (E – F)		15,640	11,730	11,730
H Add : Profit on Realisation (₹ 41,000 – ₹ 39,100)		760	570	570
I Amount Distributed (Including Machinery Taken by K) as on 30th September. * Includes Value of Machinery ₹ 10,000 and Cash ₹ 2,300		16,400	12,300*	12,300

Working Notes :

(i) Assumption : As the firm is dissolved due to difference among the partners, all partners are presumed to be solvent and the problem has been worked out on the basis of the highest relative capital.

(ii) Statement showing the Calculation of Highest Relative Capitals

Particulars	L (₹)	K (₹)	J (₹)
A Actual Capitals	40,000	26,000	24,000
B Profit Sharing Ratio	4	3	3
C Actual Capitals ÷ Profit Ratio	10,000	8,667	8,000
D Proportionate Capitals Taking J's Capital as Base Capital	32,000	24,000	24,000
E Surplus Capital of L and K (A – D)	8,000	2,000	—
F Profit Sharing Ratio	4	3	_
G Surplus Capital ÷ Profit Sharing Ratio	2,000	667	_
H Revised Proportionate Capital of L and J	2,667	2,000	—
I Revised Surplus Capital of L (E – H)	5,333	—	—

While distributing surplus among partners, 1st instalment up to ₹ 5,333 will be paid to L, next instalment up to ₹ 4,667 will be distributed between L and K in the ratio of 4 : 3 and the Balance among L, K and J in the ratio of 4 : 3 : 3.

(iii) Statement showing the Calculation of Cash available each month

Particulars	May (₹)	June (₹)	August (₹)	September (₹)
A Opening Balance	3,000	2,000	2,000	1,000
B Add : Amount realised Less Expenses	34,500	34,000	17,400	30,000
C Less : Closing blance	2,000	2,000	1,000	—
D Total Cash available for Distribution (A+B–C)	35,500	34,000	18,400	31,000

(iv)

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Sundry Debtors	34,000	By Sundry Creditors	37,000
To Stock in trade	39,000	By Cash/Bank	1,17,000
To Plant and Machinery	51,000	By L (Assets taken over)	10,000
To Cash/Bank :			
Creditors	37,000		
Expenses	1,100		
To Profit transferred to Capital A/c	1,900		
	1,64,000		**1,64,000**

Illustration 33.

A partnership firm was dissolved on 30th June, 2023. Its Balance Sheet on the date of dissolution was as follows :

Liabilities	(₹)	Assets	(₹)
Capitals :		Cash	5,400
Atrik	38,000	Sundry Assets	94,600
Mohit	24,000		
Rupa	18,000		
Loan A/c — Mohit	5,000		
Sundry Creditors	15,000		
	1,00,000		**1,00,000**

The assets were realised in instalments and the payments were made on the proportionate capital basis. Creditors were paid ₹ 14,500 in full settlement of their account. Expenses of realisation were estimated to be ₹ 2,700 but actual amount spent on this account was ₹ 2,000. This amount was paid on 15th September. Draw up a Memorandum of distribution of Cash, which was realised as follows :

On 5th July	₹	12,600
On 30th August	₹	30,000
On 15th September	₹	40,000

The partners shared profits and losses in the ratio of 2 : 2 : 1. Give working notes.

Solution :

Statement Showing the Distribution of Cash
(According to Proportionate Capital Method)

	Particulars	Creditors (₹)	Mohit's Loan (₹)	Atrik (₹)	Mohit (₹)	Rupa (₹)
A	Balance Due	15,000	5,000	38,000	24,000	18,000
B	Cash Paid (₹ 5,400 – ₹ 2,700)	2,700	—	—	—	—
C	Balance Unpaid (A – B)	12,300	5,000	38,000	24,000	18,000
D	1st Installment of ₹ 12,600	11,800	800	—	—	—
E	Balance Unpaid (C – D)	500	4,200	38,000	24,000	18,000
F	Less : Written-off	500				
G	2nd Installment of ₹ 30,000		4,200	16,320	2,320	7,160
H	Balance Unpaid (E – F – G)			21,680	21,680	10,840
I	3rd Installment (₹ 40,000 + ₹ 700)			16,280	16,280	8,140
J	Unpaid Balance (H – I) = Loss on Realisation			5,400	5,400	2,700

Working Notes :

(i) Statement showing the Calculation of Highest Relative Capitals

	Particulars	Atrik (₹)	Mohit (₹)	Rupa (₹)
A	Actual Capitals	38,000	24,000	18,000
B	Profit-Sharing Ratio	2	2	1
C	Actual Capitals ÷ Profit Sharing Ratio	19,000	12,000	18,000
D	Proportionate Capitals Taking Mohit's Capital as Base Capital	24,000	24,000	12,000
E	Surplus Capital [A–D]	14,000	Nil	6,000
F	Surplus Capital ÷ Profit Sharing Ratio	7,000	—	6,000
G	Revised Proportionate Capitals Taking Rupa's Capital as the Basis	12,000	—	6,000
H	Revised Surplus Capital (E – G)	2,000	—	—

(ii) Distribution of Second Instalment of ₹ 30,000

Particulars	Mohit's Loan (₹)	Atrik (₹)	Mohit (₹)	Rupa (₹)
First ₹ 4,200	4,200	—	—	—
Next ₹ 2,000 (Absolute Surplus)		2,000	—	—
Next ₹ 18,000 (Balance of Surplus)		12,000	—	6,000
Balance ₹ 5,800 (2 : 2 : 1)	4,200	2,320	2,320	1,160
Total ₹ 30,000		16,320	2,320	7,160

Illustration 34

East, South and North are in partnership sharing profits and losses in the ratio 3 : 2 : 1 respectively. They decide to dissolve the business on 31st July, 2023 on which date their Balance Sheet was as follows :

Liabilities	(₹)	Assets	(₹)
Capital Accounts :		Land and Buildings	30,810
East	38,700	Motor car	5,160
South	10,680	Investment	1,080
North	11,100	Stock	19,530
Loan account : North	3,000	Debtors	11,280
Creditors	10,320	Cash	5,940
	73,800		**73,800**

The assets were realised piecemeal as follows and it was agreed that cash should be distributed as and when realised :

			(₹)
14th	August		10,380
20th	September		27,900
16th	October		3,600
		North took over investment as follows at a value of:-	
15th	November		1,260
18th	November		19,200

Dissolution expenses were originally provided for an estimated amount of ₹ 2,700, but actual amount spent on 25th October was ₹ 1,920. The creditors were settled for ₹ 10,080.

Required : Prepare a statement showing distribution of cash amongst the partners, according to Proportionate Capital Method.

Solution :

Statement Showing the Distribution of Cash
(According to Proportionate Capital Method)

	Particualr	Creditors (₹)	Loan (₹)	East (₹)	South (₹)	North (₹)
A	Balance Due	10,320	3,000	38,700	10,680	11,100
B	Paid to Creditors [₹ 5,940 – ₹ 2,700]	3,240	—	—	—	—
C	Balance Due (A - B)	7,080	3,000	38,700	10,680	11,100
D	Amount paid on 14th August	6,840	3,000	540		
E	Less : Written off	240	—	38,160	10,680	11,100
F	Balances Due (D - E)	(240)	—	—	—	—
G	Amount paid on 20th September			38,160	10,680	11,100
	(i) First 4,860 (i.e. ₹ 5,400 – ₹ 540)			4,860	—	—
	(ii) Balance ₹ 23,040			33,300	10,680	11,100
H	Balance Due (F - G)			17,280	—	5,760
I	Amount paid on 16th October			16,020	10,680	5,340
J	Balance Due (H-I)			1,800	1,200	600
K	Amount paid on 25th October (being excess over estimated expenses ₹ 780)			14,220 390	9,480 260	4,740 130
L	Balance due (J - K)			13,830	9,220	4,610
M	Cash brought in by North			630	420	210
N	Balance Due (L-M)			13,200	8,800	4,400
O	Amount paid on 18th November			9,600	6,400	3,200
P	Balance unpaid (N-O)			3,600	2,400	1,200

Working Note :

Statement Showing the Calculation of Highest Relative Capitals

	Particulars	East (₹)	South (₹)	North (₹)
A	Actual Capitals	38,700	10,680	11,100
B	Profit Sharing Ratio	3	2	1
C	Actual Capital ÷ Profit Sharing Ratio	12,900	5,340	11,100
D	Proportionate capitals taking South's Capital as Base Capital (being the smallest) × PSR	16,020	10,680	5,340
E	Surplus capital (i.e. Excess of Actual Capitals over proportionate capital) [A-D]	22,680	—	5,760

	Particulars	East (₹)	South (₹)	North (₹)
F	Profit Sharing Ratio	3	—	1
G	Surplus Capital ÷ Profit Sharing Ratio	7,560	—	5,760
H	Revised Proportionate Capitals taking North's Capital as Base Capital	17,280	—	5,760
	Revised Surplus Capital [E-H]			
I	Distribution Sequence	5,400	—	—
J	First ₹ 5,400 [To East]	5,400	—	—
	Next ₹23,040 [To East & North in the ratio of 3:1]	17,280	—	5,760
	Balance ₹19,200 [To East, South & North in the ratio of 3:2:1]	9,600	6,400	3,200

Maximum Loss Method :

Steps

(1) Prepare a statement showing distribution of cash

(2) Pay off the external Liabilities

(3) After all the payment is made for the external liabilities, the partners will be paid off.

Total Due of Partners	xxx
Less : Net/Balance of Realisation	(x)
Maximum Loss	xxx

(4) The maximum loss shall be shared amongst the partners in their profit sharing ratio, as if, there will be no further realisation.

(5) If any of the partner capitals, after step (4) is negative, that partner shall be treated like an insolvent partner.

(6) The deficiency of the insolvent partner as per step (5) shall be shared by the other solvent partners (i.e. those partners who has positive capital balances) in their capital contribution ratio as per Garner vs. Murray Rule.

(7) Repeat the steps (3) to (6) till final realisation.

PROBLEMS ON MAXIMUM LOSS METHOD

Illustration 35

The following is the Balance Sheet of X, Y and Z, who were sharing in the ratio 5 : 3 : 2, on 31st December, 2023 when they decided to dissolve the partnership.

Liabilities	(₹)	Assets	(₹)
Capital Account		Cash	20,000
- X	55,000	Other assets	13,04,000
- Y	37,500		
- Z	31,500		
Loan Account - Y	2,00,000		
Crditors	10,00,000		
	13,24,000		**13,24,000**

Note : There was a bill for ₹ 4,000 due on 01.04.2024 under discount.

Other assets realised as under :

1st January : ₹ 8,85,000, 1st February : ₹ 3,00,000 ; 1st March : ₹ 8,000; 1st April : ₹ 5,000; 1st May : ₹ 10,000. The expenses of realisation were expected to be ₹ 5,000, but ultimately amounted to ₹ 4,000 only and were paid on 1st May. The acceptor of the bill under discount met the bill on the due date.

Required : Prepare a statement showing the monthly distribution of cash according to Maximum Loss Method.

Solution:

Statement showing the Distribution towards Firm's Outside debts' & Partners' Loan

	Particulars	Creditors (₹)	Y's Loan (₹)
A	Amount Due	10,00,000	2,00,000
B	Amount paid on 1st Jan. (₹ 20,000 + ₹ 8,85,000 – ₹ 5,000)	9,00,000	—
C	Balance Due (A - B)	1,00,000	2,00,000
D	Amount paid on 1st February	1,00,000	2,00,000
E	Balance Due (C - D)	Nil	Nil

Statement showing the Distribution of Cash
(According to Maximum Loss Method)

	Particulars	Total (₹)	X (₹)	Y (₹)	Z (₹)
(i)	Distribution of ₹ 4,000				
A.	Amount due as on 1st March	1,24,000	55,000	37,500	31,500
	Less : Max. Possible Loss if the remaining nothing (₹ 1,24,000 – ₹ 4,000) in the ratio of 5 : 3 : 2	1,20,000	60,000	36,000	24,000
	Note : Cash available = ₹ 8,000 – ₹ 4,000 (Reserved for discounted B/R) = ₹ 4,000				
	Adjustment of X's Deficiency between Y and Z in their Capital ratio i.e. 375 : 315	—	5,000	(2,717)	(2,283)
		—	—	(1,217)	5,217
	Adjustment of Y's Deficiency (charged to Z)	—	—	1,217	(1,217)
B.	Cash paid as on 1st March	4,000	—	—	4,000
(ii)	Distribution of ₹ 9,000 (including amount kept reserved for B/R no longer required)		—		
C.	Balance due (A-B)	1,20,000	55,000	37,500	27,500
	Less : Max. Possible Loss (₹ 1,20,000 – ₹ 9,000)	1,11,000	55,500	33,300	22,200
	Note : Cash available = ₹ 5,000 + ₹ 4,000 = ₹ 9,000		(500)	4,200	5,300

	Particulars	Total (₹)	X (₹)	Y (₹)	Z (₹)
	Adjustment of X's Deficiency between Y and Z in their Capital ratio i.e. 375 : 315	—	500	(272)	(228)
D.	Cash paid as on 1st April	9,000	—	3,928	5,072
(iii)	Distribution of ₹ 11,000				
E.	Balance due (C-D)	1,11,000	55,000	33,572	22,428
	Less : Max. Possible Loss (₹ 1,11,000 – ₹ 11,000)	1,00,000	50,000	30,000	20,000
F.	Cash paid as on 1st May	11,000	5,000	3,572	2,428
G.	Unpaid Balance (E - F)	1,00,000	50,000	30,000	20,000

Illustration 36

The following is the Balance Sheet of P, Q and R on 31st August, 2023 when they decided to dissolve the partnership. They share profits in the ratio of 2 : 2 : 1.

Liabilities	(₹)	Assets	(₹)
Creditors	2,000	Sundry Assets	48,500
P's Loan	5,000	Cash	500
P's Capital	15,000		
Q's Capital	18,000		
R's Capial	9,000		
	49,000		**49,000**

The assets realised the following sums in instalments.

I— ₹ 1,000, II— ₹ 3,000, III— ₹ 3,900, IV— ₹ 6,000, V— ₹ 20,000.

The expenses of realisation were expected to be ₹ 500 but ultimately amounted to ₹ 400 only.

Required : Show, how at each stage, the cash received should be distributed among partners according to Maximum Loss Method.

Solution :

Statement showing the Realisation and Distribution of Cash

Installments		Realisation (₹)	Creditors (₹)	Partners' Loans (₹)	Partners' Capital (₹)
(I)	(After taking into account cash and amount set aside for expenses)	1,000	1,000		
(II)		3,000	1,000	2,000	
(III)		3,900		3,000	900

Installments	Realisation (₹)	Creditors (₹)	Partners' Loans (₹)	Partners' Capital (₹)
(IV)	6,000	—	—	6,000
(V) (including saving in expenses)	20,100	—	—	20,100
	34,000	**2,000**	**5,000**	**27,000**

Statement showing the Distribution of Cash among partners
(According to Maximum Loss Method)

Particulars	Total (₹)	P (₹)	Q (₹)	R (₹)
(i) Distribution of ₹ 900				
A. Balance Due	42,000	15,000	18,000	9,000
B. Less : Max. Possible loss, if the remaining assets prove to be worthless (₹ 42,000 – ₹ 900) in the ratio (2 : 2 : 1)	41,100	16,440	16,440	8,220
C. Deficiency of P's Capital charged to Q and R in the ratio of their Capitals i.e., 18,000 : 9,000 (Garner vs. Murray)	—	1,440	(960)	(480)
D. Amount paid	900	—	600	300
(ii) Distribution of ₹ 6,000				
E. Balance after payment (A -D)	41,100	15,000	17,400	8,700
F. Less : Max. Possible loss (₹ 41,100 – ₹ 6,000)	35,100	14,040	14,040	7,020
G. Amount paid	6,000	960	3,360	1,680
(iii) Distribution of ₹ 20,100				
H. Balance after payment (E - G)	35,100	14,040	14,040	7,020
I. Less : Max. Possible loss (₹ 35,100 – ₹ 20,100)	15,000	6,000	6,000	3,000
J. Amount paid	20,100	8,040	8,040	4,020
K. Unpaid balance (H - J)	15,000	6,000	6,000	3,000

Illustration 37

Rahul, Roshan and Rohan were in partnership sharing profits and losses in the ratio of 3 : 2 : 1 respectively. The partnership was dissolved on 30th June, 2023 when the position was as follows :

Liabilities	(₹)	Assets	(₹)
Capitals :		Cash in hand	28,000
Rahul	1,40,000	Sundry Debtors	2,94,000

Liabilities	(₹)	Assets	(₹)
Roshan	70,000	Stock in trade	1,12,000
Rohan	14,000		
Creditors	2,10,000		
	4,34,000		**4,34,000**

There was bill for ₹ 10,000, due on 30th November, 2023, under discount. It was agreed that the net realisations should be distributed in their due order (at end of each month) but as safely as possible. The realisations and expenses were as under :

Date	Stock and Debtors (₹)	Expenses (₹)
31st July	84,000	7,000
31st August	1,26,000	5,400
30th September	70,000	4,900
31st October	77,000	3,500
30th November	35,500	3,500

The Stock was completely disposed off and amounts due from debtors were realised, the balance being irrecoverable. The acceptor of the bill under discount met the billl on the due date. Prepare a Statement showing the piecemeal distribution of cash according to Maximum Loss Method.

Solution :

Statement showing the Distribution of Cash
(According to Maximum Loss Method)

	Particulars	Creditors (₹)	Rahul (₹)	Roshan (₹)	Rohan (₹)
A.	Balance Due	2,10,000	1,40,000	70,000	14,000
B.	Cash on hand on 30th June paid to creditors	28,000	—	—	—
C.	Balance outstanding (A – B)	1,82,000	1,40,000	70,000	14,000
D.	Cash paid on 31st July	77,000	—	—	—
E.	Balance outstanding (C – D)	1,05,000	1,40,000	70,000	14,000
F.	₹ 1,05,000 paid to creditors on 31st August	1,05,000	—	—	—
G.	Balance outstanding (E – F)	—	1,40,000	70,000	14,000
	Balance available for distribution (₹1,20,600 – ₹ 1,05,000 – ₹ 10,000) = ₹ 5,600				
	Less : Maximum loss (₹ 2,24,000 – ₹ 5,600) in ratio of 3 : 2 : 1		(1,09,200)	(72,800)	(36,400)

	Particulars	Creditors (₹)	Rahul (₹)	Roshan (₹)	Rohan (₹)
	Balance		30,800	(2,800)	(22,400)
	Deficiency of Roshan and Rohan's capital charged to Rahul		(25,200)	2,800	22,400
H.	Cash paid on 31st August		5,600	—	—
I.	Balance outstanding (G – H)		1,34,400	70,000	14,000
	Less : Maximum Loss (₹ 2,18,400 – ₹ 65,100)		(76,650)	(51,100)	(25,550)
	Balance		57,750	18,900	(11,550)
	Deficiency of Rohan's capital charged to Rahul and Roshan (2 : 1)		(7,700)	(3,850)	11,550
J.	Cash paid on 30th September		50,050	15,050	—
K.	Balance outstanding (I – J)		84,350	54,950	14,000
	Less : Maximum loss (₹ 1,53,300 – ₹ 73,500)		(39,900)	(26,600)	(13,300)
L.	Cash paid on 31st October		44,450	28,350	700
M.	Balance outstanding (K – L)		39,900	26,600	13,300
	Less : Maximum loss (₹ 79,800 – ₹42,000*)		(18,900)	(12,600)	(6,300)
N.	Cash paid on 30th November		21,000	14,000	7,000
O.	Unpaid Balance (M – N)		18,900	12,600	6,300

***Note :** Cash available on 30th November = (₹ 35,500 – ₹3,500) + ₹10,000 (Reserved for Discounted B/R, now no longer required) = ₹42,000.

Illustration 38

E, F and G were partners in a firm, sharing profits and losses in the ratio of 3 : 2 : 1, respectively. Due to extreme competition, it was decided to dissolve the partnership on 31st December, 2023. The Balance Sheet on that date was as follows :

Liabilities		(₹)	Assets	(₹)
Capitals Accounts :			Machinery	1,54,000
E	1,13,100		Furniture and Fittings	25,800
F	35,400		Investments	5,400
G	31,500	1,80,000	Stock	97,700
Current Accounts :			Debtors	56,400
E	26,400		Bank	29,700
G	6,000	32,400	Current Account : F	18,000
Reserves		1,08,000		
Loan Account : G		15,000		
Creditors		51,600		
		3,87,000		**3,87,000**

The realisation of assets is spread over the next few months as follows :

February, Debtors, ₹ 51,900; March : Machinery, ₹ 1,39,500; April, Furniture, etc. ₹ 18,000; May : G agreed to take over Investments at ₹ 6,300; June, Stock, ₹ 96,000.

Dissolution expenses, originally provided, were ₹ 13,500, but actually amounted to ₹ 9,600 and were paid on 30th April. The partners decided that after creditors were settled for ₹ 50,400, all cash received should be distributed at the end of each month in the most equitable manner.

Required : Prepare a statement of actual cash distribution as is received following "Maximum Loss basis".

Solution :

Statement showing the Distribution of Cash
(According to Maximum Loss Method)

	Particular	Creditors	G's Loan (₹)	Capital Accounts E (₹)	F (₹)	G (₹)	Total (₹)
A	Balance due [Creditors net of discount]	51,600	15,000	1,93,500	53,400	55,500	3,02,400
	Paid to Creditors and G	50,400	15,000	—	—	—	—
B	Balance due (A - B) Max. Possible	—	—	1,93,500	53,400	55,500	3,02,400
C	Loss if remaining assets fetch nothing (₹ 3,02,400 – ₹ 2,700) in the ratio of 3 : 2 : 1			1,49,850	99,900	49,950	2,99,700
	Adjustment of F's Deficiency between E and G in the ratio of their fixed capitals i.e. ₹1,13,100 : ₹31,500			43,650	(46,500)	5,550	
				(36,370)	46,500	(10,130)	
	Balance Adjustment of G's Deficiency			7,280	—	(4,580)	
	(charged to E)			(4,580)		4,580	2,700
D	Cash paid to E on 28th Feb.			2,700	—	—	2,99,700
E	Balance due (C - D)			1,90,800	53,400	55,500	
	Possible Max. Loss (₹ 2,99,700 – ₹ 1,39,500)						1,60,200
F	Cash paid on 31st Mar.			80,100	53,400	26,700	1,39,500
G	Balance Due (E - F)			1,10,700	—	28,800	1,60,200
	Possible Max. Loss			80,100	53,400	26,700	
	(₹1,60,200 – ₹ 21,900)						1,38,300
H	Cash paid on 30th April			69,150	46,100	23,050	21,900
I	Balance Due (G - H)			10,950	7,300	3,650	1,38,300
J	Maximum Loss (₹1,38,300 – ₹ 6,300)			69,150	46,100	23,050	1,32,000
K	Cash brought in by G			66,000	44,000	22,000	

	Particular	Creditors G's Loan (₹)		Capital Accounts			
				E (₹)	F (₹)	G (₹)	Total (₹)
L	Balance Due (I + K)			3,150	2,100	1,050	(6,300)
	Possible Max. Loss			66,000	44,000	22,000	1,32,000
	(₹ 1,32,000 – ₹96,000)			18,000	12,000	6,000	36,000
M	Cash paid on 30th June			48,000	32,000	16,000	96,000
N	Unpaid Balance (L – N)			18,000	12,000	6,000	36,000

Working Note :

Statement showing the Calculation of Cash Available for Distribution

	Particular	February (₹)	March (₹)	April (₹)	May (₹)	June (₹)
A	Opening Balance	29,700	—	—	—	—
B	Add : Net Amount realised	51,900	1,39,500	18,000	—	96,000
C	Less : Provision for Expenses	13,500	—	—	—	—
D	Add : Provision no longer required	—	—	3,900	—	—
E	Cash available for distribution (A + B – C + D)	68,100	1,39,500	21,900	—	96,000

Amalgamation of Partnership Firms

4.6

As defined earlier, a Partnership firm is formed with two or more persons. But it can also be formed in any of the following ways.

(A) When two or more sole proprietors forms new partnership firm;

(B) When one existing partnership firm absorbs a sole proprietorship;

(C) When one existing partnership firm absorbs another partnership firm;

(D) When two or more partnership firms form new partnership firm.

The amalgamation is used to be done to avoid competition amongst them and to maximize the profit of the firm/firms.

Accounting entries under different situation are in below:

(A) When two or more sole proprietors form a new partnership firm

When two or more sole proprietorship businesses amalgamate to form a new partnership firm, the existing sets of books will be closed and a new set of books of accounts to be opened, recording all assets, liabilities and transactions of the partnership.

Steps to be taken for the existing books.

Step 1 : Prepare the Balance Sheet of the business on the date of dissolution.

Step 2 : Open a Realisation Account and transfer all assets and liabilities, except cash in hand and cash at bank, at their book values.

However, cash in hand and cash at bank are transferred to Realisation Account only when they are taken over by the new firm.

Step 3 : All undistributed reserves or profits or losses (appearing in the balance sheet) are to be transferred to Partners' Capital Accounts.

Step 4 : Calculate Purchase Consideration on the basis of terms and conditions agreed upon by the parties. Generally, purchase consideration is calculated on the basis of agreed value of assets and liabilities taken over by the new firm. The purchase consideration is calculated as under:

	(₹)
Agreed values of assets taken over	xxxx
Less: Agreed values of liabilities assumed	(xxx)
Purchase consideration	xxxx

Step 5 : Credit Realisation Account by the amount of Purchase Consideration.

Step 6 : If there are any unrecorded assets or liabilities, they are to be recorded.

Step 7 : The Profit or loss on relisation (balancing figure of Realisation Account) to be transferred to the Capital Account of the proprietor.

Step 8 : To ensure that all the accounts of the Sole Proprietor's business are closed.

Accounting Entries in the Books of Amalgamating Sole Proprietors :

1. For transferring sundry assets to Realisation Account

   Realisation A/c Dr.

   To Sundry Assets A/c [Individually]

   (Assets transferred to Realisation Account at their book values except Cash and Bank i.e. if not taken over by the new firm)

2. For transferring sundry liabilities to Realisation Account

   Liabilities A/c Dr.

   To Realisation A/c [Individually]

   (Liabilities transferred to Realisation Account at their book values)

3. For the amount of purchase consideration

   New Firm A/c Dr.

   To Realisation A/c

   (Purchase consideration due from the new firm)

4. For assets taken over by the proprietor

   Capital A/c Dr.

   To Realisation A/c

   (Assets taken over by the proprietor)

5. For realisation of assets not taken over by the new firm

   Bank A/c Dr.

   To Realisation A/c

   (Realisation of assets not taken over by the new firm)

6. For recording of unrecorded assets

   Assets A/c Dr.

   To Capital A/c

   (Unrecorded assets are recorded)

7. For realisation of unrecorded assets

   Bank A/c Dr.

   To Assets A/c

   (Realisation of unrecorded assets)

   (**Note:** If unrecorded assets are taken over by the new firm, it is also transferred to Realisation Account along with other assets.)

8. For payment of liabilities not taken over

    Realisation A/c Dr.

    To Bank A/c

    (Payment of liabilities not taken overby the new firm)

9. For recording of unrecorded liabilities

    Capital A/c Dr.

    To Liabilities A/c

    (Being the unrecorded liabilities are recorded)

10. For payment of unrecorded liabilities

    Liabilities A/c Dr.

    To Bank A/c

    (Payment of unrecorded liabilities)

    (**Note :** If unrecorded liabilities are taken over by the new firm, it is also transferred to Realisation Account along with other liabilities.)

11. For liabilities taken over by the proprietor

    Realisation A/c Dr.

    To Capital A/c

    (Being liabilities assumed by the proprietor)

12. For realisation expenses

    Realisation A/c Dr.

    To Bank A/c

    (Realisation expenses paid)

13. For profit on realisation

    Realisation A/c Dr.

    To Capital A/c

    (Profit on realisation transferred to Capital Account)

14. For loss on realisation

    Capital A/c Dr.

    To Realisation A/c

    (Loss on realisation transferred to Capital Account)

15. For accumulated profits / reserves

    Reserves A/c Dr.

    Profit and Loss A/c Dr.

    To Capital A/c

    (Undrawn profits transferred to Capital Account)

16. For accumulated losses

Capital A/c	Dr.	
To Profit and Loss A/c (if any)		
(Accumulated losses transferred to Capital A/c))		

17. For settlement of purchase consideration by the New firm

Capital in New Firm A/c	Dr.	
To New Firm A/c		
(Settlement of purchase consideration)		

18. For final adjustment

Capital A/c	Dr.	
To Capital in New Firm A/c		
To Bank A/c (if any)		
(Final adjustment to close the books of account)		

Accounting Entries in the Books of the New Firm

The new firm records all the assets and liabilities at the values it has decided to take over. If the purchase consideration payable is, more than the net assets (assets minus liabilities) acquired, it represents goodwill. Conversely, if the purchase consideration payable is less than the net assets acquired, it represents capital reserve.

1. If the net acquired assets is equal to purchase consideration.

Assets A/c	Dr.	[Acquired value]
To Liabilities A/c		[Assumed value]
To Partners' Capital A/c		[Purchase consideration]

2. If the net acquired asset is more than the purchase consideration:

Assets A/c	Dr.	[Acquired value]
To Liabilities A/c		[Assumed value]
To Partners' Capital A/c		[Purchase consideration]
To Capital Reserve A/c		[Purchase consideration - net assets]

3. If the net acquired asset is less than the amount of purchase consideration, it represents goodwill.

Assets A/c	Dr.	[Acquired value]
Goodwill A/c	Dr.	[Purchase consideration - net assets]
To Liabilities A/c		[Assumed value]
To Partners' Capital A/c		[Purchase consideration]

Illustration 39

A and B carry on independent business and their position on 31.03.2023 are reflected in the Balance Sheet given below :

Liabilities	A (₹)	B (₹)	Assets	A (₹)	B (₹)
Sundry creditors for purchases	1,10,000	47,000	Stock-in-trade	1,70,000	98,000
			Sundry Debtors	89,000	37,000
Sundry creditors for expenses	750	2,000	Cash at bank	13,000	7,500
			Cash in hand	987	234
Bills payable	12,500	-	Furniture and Fixtures	2,750	1,766
Capital A/c	1,53,000	95,500	Investments	513	—
	2,76,250	**1,44,500**		**2,76,250**	**1,44,500**

Both of them want to form a partnership firm from 1.4.2023 in the style of AB & Co. on the following terms:

(a) The capital of the partnership firm would be ₹ 3,00,000 and to be contributed by them in the ratio of 2:1.

(b) The assets of the individual businesses would be evaluated by C at which values, the firm will take them over and the value would be adjusted against the contribution due by A and B.

(c) C gave his valuation report as follows :

Assets of A : Stock-in trade to be written-down by 15% and a portion of the sundry debtors amounting to ₹9,000 estimated unrealisable; furniture and fixtures to be valued at ₹ 2,000 and investments to be taken at market value of ₹ 1,000.

Assets of B : Stocks to be written-up by 10% and sundry debtors to be admitted at 85% of their value; rest of the assets to be assumed at their book values.

(d) The firm is not to consider any creditors other than the dues on account of purchases made.

(e) Creditors for expenses waived their claims.

You are required to pass necessary Journal entries in the books of A and B. Also prepare the opening Balance Sheet of the firm as on 01.04.2023.

Solution :

In the books of A

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
2023	Realisation A/c	Dr.	2,76,250	
Apr.1	To Stock-in-trade A/c			1,70,000
	To Sundry Debtors A/c			89,000
	To Cash at bank A/c			13,000
	To Cash in hand A/c			987
	To Furniture & Fixture A/c			2,750
	To Investments A/c			513
	(Transfer of different Assets to Realisation A/c)			

Date	Particulars		Dr. (₹)	Cr. (₹)
	Creditors for Goods A/c	Dr.	1,10,000	
	Creditors for Expenses A/c	Dr.	750	
	Bills Payable A/c	Dr.	12,500	
	To Realisation A/c			1,23,250
	(Transfer of different liabilities to Realisation A/c)			
	AB & Co. A/c (Note 1)	Dr.	1,18,987	
	To Realisation A/c			1,18,987
	(Purchase consideration due)			
	Capital A/c	Dr.	34,013	
	To Realisation A/c			34,013
	(Realisation loss transferred to Capital A/c)			
	Capital in AB & Co. A/c	Dr.	1,18,987	
	To AB & Co. A/c			1,18,987
	(Settlement of purchase consideration)			
	Capital A/c	Dr.	1,18,987	
	To Capital in AB & Co. A/c			1,18,987
	(Final adjustment to close the books of account)			

In the books of B

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
2023	Realisation A/c	Dr.	1,44,500	
Apr.1	To Stock-in-trade A/c			98,000
	To Sundry Debtors A/c			37,000
	To Cash at bank A/c			7,500
	To Cash in hand A/c			234
	To Furniture & Fixture A/c			1,766
	(Transfer of different Assets to Realisation A/c)			
	Creditors for Goods A/c	Dr.	47,000	
	Creditors for Expenses A/c	Dr.	2,000	
	To Realisation A/c			49,000
	(Transfer of different liabilities to Realisation A/c)			
	AB & Co. A/c	Dr.	1,01,750	
	To Realisation A/c			1,01,750
	(Purchase consideration due)			

Date	Particulars		Dr. (₹)	Cr. (₹)
	Realisation A/c To Capital A/c (Realisation Profit transferred to Capital A/c)	Dr.	6,250	 6,250
	Capital in AB & Co. A/c To AB & Co. A/c (Settlement of purchase consideration)	Dr.	1,01,750	 1,01,750
	Capital A/c To Capital in AB & Co. A/c (Final adjustment to close the books of account)	Dr.	1,01,750	 1,01,750

Balance Sheet of AB & Co. as on 01.04.2023

Liabilities	(₹)	Assets	(₹)
Capital Accounts :		Furniture & Fittings	3,766
A	2,00,000	Investments	1,000
B	1,00,000	Stock-in-trade	2,52,300
Sundry creditors for purchases	1,57,000	Sundry Debtors	1,11,450
Bills payable	12,500	Cash at bank	99,763
		(13,000 + 7,500 + 81,013 - 1,750)	
		Cash in hand (987 + 234)	1,221
	4,69,500		**4,69,500**

Working Notes :

(1) Calculation of purchase consideration :

Particulars	A (₹)	B (₹)
Furniture	2,000	1,776
Investments	1,000	-
Stock-in-trade	1,44,500	1,07,800
Sundry Debtors	80,000	31,450
Cash at bank	13,000	7,500
Cash in hand	987	234
	2,41,487	1,48,750
Less : Sundry creditors for purchases	1,10,000	47,000
Bills payable (Assumed arising out of credit purchases)	12,500	-
Net assets taken over by the AB & Co.	1,18,987	1,01,750
Capital as per agreement	2,00,000	1,00,000
Less: Net assets taken over	1,18,987 (+)	1,01,750 (-)
Cash to be introduced (+) / withdrawn (-)	81,013	1,750

(B) When an existing partnership firm absorbs a sole proprietorship

When a sole proprietorship is taken over by an existing firm, the original business of the sole proprietor is dissolved and compensated by a share of the partnership firm which is acquiring it. In this case, assets and liabilities of the sole proprietorship business are taken over by the partnership firm at agreed values. **The procedures for closing the books of account of the sole proprietorship are same as explained earlier**.

However, the following points are to be noted:

(i) The assets and liabilities of the sole proprietorship taken over by the existing firm, are added with the existing assets and liabilities of the firm.

(ii) The capital of the new partner (the sole proprietorship) is equal to the purchase consideration agreed upon.

(iii) Calculation and treatment for goodwill and Capital reserve are same as explained in situation (A).

(iv) Before amalgamation, all the assets and liabilities of the firm may be revalued. Any profit or loss on revaluation is transferred to the Partners' Capital Accounts in the old profit-sharing ratio.

(v) Goodwill of the firm is to be adjusted by crediting the Partners' Capital Accounts in their old profit-sharing ratio.

(vi) Balance of reserve and surplus of the firm is also to be credited to partners' Capital Accounts in the old profit-sharing ratio.

Illustration 40

Following are the Balance Sheets of partners X and Y (sharing profits and losses in the ratio of their capital) and the sole proprietor Z as on 31.03.2023 :

Liabilities	Partners X & Y	Sole Proprietor Z	Assets	Partners X & Y	Sole Proprietor Z
Capital			Goodwill	-	2,000
X	15,000	-	Building	25,000	-
Y	5,000	-	Stock	10,000	15,000
Z	-	10,000	Bills receivable	5,000	5,000
Creditors	26,000	13,000	Debtors	4,000	6,000
Loan	-	5,000	Cash in Hand	2,000	-
	46,000	**28,000**		**46,000**	**28,000**

The partners decided to admit Z as a partner and Z agreed to amalgamate his business with that of the partnership on the following terms :

1. The new profit-sharing ratio among X, Y, and Z will be in the ratio of their capitals.
2. The building is to be appreciated by ₹ 15,000 and provision @ 5 % is to be created on debtors.
3. The goodwill of the partnership is valued at ₹ 10,000 and of the sole proprietor at ₹ 1,500; both are to be recorded in the books.
4. Stock is to be taken at ₹ 9,200 and ₹ 16,800, respectively of the firm and the sole proprietor.

Prepare ledger accounts to close the books of Z, to make necessary Journal entries in the books of the firm and prepare the Balance Sheet of the re-constituted partnership.

Solution :

Working Note : Calculation of purchase consideration

Assets taken over :	(₹)	(₹)
Goodwill	1,500	
Stock	16,800	
Bills receivable	5,000	
Debtors	6,000	29,300
Less: Liabillties taken over:		
Creditors	13,000	
Loan	5,000	
Provision for bad debts	300	18,300
Purchase consideration		11,000

In the books of Z

Dr. **Realisation Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Goodwill A/c	2,000		By Creditors A/c	13,000
	To Stock A/c	15,000		By Loan A/c	5,000
	To Bills receivable A/c	5,000		By Partners X & Y A/c	11,000
	To Debtors A/c	6,000			
	To Capital A/c - Profit	1,000			
		29,000			**29,000**

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

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Partners X & Y A/c	11,000		By Balance b/d	10,000
				By Realisation A/c	1,000
		11,000			**11,000**

Dr. **Partners X & Y Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Realisation A/c	11,000		By Capital A/c	11,000
		11,000			**11,000**

In the Books of X & Y

Journals

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
	Building A/c	Dr.		15,000	
	To Revaluation A/c				
	(Increase in the Value of Building)				15,000
	Revaluation A/c	Dr.		1,000	
	To Stock A/c				
	To Provision for Bad Debt A/c				800
	(Decrease in the value of assets)				200
	Revaluation A/c	Dr.		14,000	
	To X Capital A/c				
	To Y Capital A/c				10,500
	(Profit on revaluation transferred)				3,500
	Goodwill A/c	Dr.		10,000	
	To X Capital A/c				
	To Y Capital A/c				7,500
	(Goodwill raised in the books)				2,500
	Goodwill A/c	Dr.		1,500	
	Stock A/c	Dr.		16,800	
	Bills Receivable A/c	Dr.		5,000	
	Debtors A/c	Dr.		6,000	
	To Loan A/c				5,000
	To Creditors A/c				13,000
	To Provision for Bad Debt A/c				300
	To Z Capital A/c				11,000
	(Assets and liabilities taken over)				

Balance Sheet of X, Y & Z (after absorption) as at 01.04.2023

Liabilities	(₹)	Assets	(₹)	(₹)
Capital Account		Goodwill		11,500
- X	33,000	Building		40,000
- Y	11,000	Stock		26,000
- Z	11,000	Bills Receivable		10,000
Loan	5,000	Debtors	10,000	
Crditors	39,000	Less: Provision	500	9,500
		Cash in hand		2,000
	99,000			**99,000**

(C) When one firm takes over another firm

In this case, the procedures for closing of books are same as earlier. The assets of the absorbed firm added with the firm who absorbed the firm.

The treatment for capital reserve and goodwill are same as before.

Illustration 41

Following is the Balance sheet of AB & Co. and CD & Co. as on 31.03.2023.

Liabilities	AB & Co. (₹)	CD & Co. (₹)	Assets	AB & Co. (₹)	CD & Co. (₹)
Bank Loan	10,000	-	Stock-in-trade	32,000	24,000
Bills Payable	30,000	40,000	Sundry Debtors	18,000	30,000
Capital A	60,000	-	Machinery	60,000	20,000
Capital B	30,000	-	Cash in hand	12,000	2,000
Capital C		36,000	Furniture	8,000	6,000
Capital D		24,000	Investments	-	18,000
	130,000	**100,000**		**130,000**	**100,000**

AB & Co. absorbed CD & Co. on 01.04.2023 on the following terms:

(a) The value of the goodwill of CD & Co. would be ₹ 12,000;

(b) The investments of CD & Co. to be sold out for ₹ 24,000 and the realised cash will be introduced in the acquiring business;

(c) The stock of CD & Co. to be reduced to ₹ 22,000;

(d) The machinery of CD & Co. will be increased by 40%;

(e) The Furniture of CD & Co. will be reduced by 10%.

It was further agreed that for AB & Co., following are the adjustments to be made :

(i) Assets are to be revalued as follows :

Goodwill- ₹ 16,000; Stock - ₹ 40,000; Machinery - ₹ 84,000; Furniture - ₹ 7,200;

(ii) Bank loan to be repaid

Show necessary Ledger Accounts to close the books of CD & Co. and to prepare necessary Journal entry and Balance Sheet of AB & Co. after absorption.

Solution :

Working Notes:

Calculation of Purchase Consideration

Assets taken over :	(₹)
Machinery	28,000
Furniture	5,400
Stock	22,000

Assets taken over :	(₹)
Debtors	30,000
Cash (₹ 24,000 + ₹ 2,000)	26,000
Goodwill	12,000
	1,23,400
Less : **Liability taken over**	
– Bills payable	40,000
Purchase consideration	83,400

In the books of CD & Co.

Realisation Account

Dr. Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Stock-in-trade	24,000		By Bills Payable A/c	40,000
	" Sundry Debtors	30,000		By AB & Co A/c	83,400
	" Machinery	20,000			
	" Cash in hand	26,000			
	" Furniture	6,000			
	To Partners' Capital A/cs:				
	C - 8,700				
	D - 8,700	17,400			
		123,400			**123,400**

Cash Account

Dr. Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
	To Balance b/d	2,000		By Realisation A/c	26,000
	To Investments A/c	24,000			
		26,000			**26,000**

Partners' Capital Account

Dr. Cr.

Date	Particulars	C (₹)	D (₹)	Date	Particulars	C (₹)	D (₹)
	To Capital in				By Balance b/d	36,000	24,000
	AB & Co. A/c	47,700	35,700		By Profit on Sale of	3,000	3,000
					Investment A/c		
					By Realisation A/c	8,700	8,700
		47,700	**35,700**			**47,700**	**35,700**

In the books of AB & Co.

Dr. Partners' Capital Account Cr.

Date	Particulars	A (₹)	B (₹)	Date	Particulars	A (₹)	B (₹)
	To Balance c/d	83,600	53,600		By Balance b/d	60,000	30,000
					By Goodwill A/c	8,000	8,000
					By Revaluation A/c	15,600	15,600
		83,600	**53,600**			**83,600**	**53,600**

Balance Sheet as on 01.04.2023

Liabilities	(₹)	Assets	(₹)
Capital Accounts		Goodwill	28,000
A	83,600	Machinery	1,12,000
B	53,600	Furniture	12,600
C	47,700	Stock	62,000
D	35,700	Debtors	48,000
Bills payable	70,000	Cash ₹(26,000 + 12,000 – 10,000)	28,000
	2,90,600		**2,90,600**

Journal

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
2023	Bank Loan A/c	Dr.		10,000	
	To Cash A/c				10,000
	(Being the bank loan repaid)				
	Goodwill A/c	Dr.		16,000	
	To A's Capital A/c				8,000
	To B's Capital A/c				8,000
	(Being the goodwill raised)				
	Stock A/c	Dr.		8,000	
	Machinery A/c	Dr.		24,000	
	To Revaluation A/c				32,000
	(Being increase in the value of assets)				
	Revaluation A/c	Dr.		800	
	To Furniture A/c				800
	(Being the decrease in the value of furniture)				

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
	Revaluation A/c	Dr.		31,200	
	To A's Capital A/c				15,600
	To B's Capital A/c				15,600
	(Being the profit on revaluation transferred to Partners' Capital A/cs in the profit-sharing ratio)				
	Goodwill A/c	Dr.		12,000	
	Machinery A/c	Dr.		28,000	
	Furniture A/c	Dr.		5,400	
	Stock A/c	Dr.		22,000	
	Debtors A/c	Dr.		30,000	
	Cash A/c	Dr.		26,000	
	To Bills Payable A/c				40,000
	To C 's Capital A/c				47,700
	To D's Capital A/c				35,700
	(Being the introduction of capital by C & D)				

(D) When two or more partnership firms form a new partnership firm

When two or more partnership firms amalgamate to form a new partnership firm, the books of account of the old firm is to be closed. In the books of each old firm, a Realisation Account to be opened. The accounting entries of the amalgamating firm is same as before as they were absorbed.

Illustration 42

Two partnership firms, carrying on business under the style of R & Co. (Partners A & B) and W & Co. (Partners C & D) respectively, decided to amalgamate into RW & Co. with effect from 1st April 2023. The respective Balance Sheets of both the firms as on 31st March, 2023 are in below :

Liabilities	R (₹)	W (₹)	Assets	R (₹)	W (₹)
Capital B	19,000	-	Goodwill	-	5,000
Capital C	-	10,000	Machinery	10,000	-
Capital D	-	2,000	Stock-in-trade	20,000	5,000
Bank Loan	15,000	-	Sundry Debtors	10,000	10,000
Creditors	10,000	9,500	Cash in hand	-	1,500
			Capital - A	4,000	-
	44,000	**21,500**		**44,000**	**21,500**

Profit sharing ratios are : A & B = 1:2; C & D = 1:1. Agreed terms are :

(i) All fixed assets are to be devalued by 20%.

(ii) All stock in trade is to be appreciated by 50%.

(iii) R & Co. owes ₹ 5,000 to W & Co. as on 31st March 2013. This is settled at ₹ 2,000. Goodwill is to be ignored for the purpose of amalgamation.

(iv) The fixed capital accounts in the new firm (RW & Co.) are to be : Mr A ₹ 2,000; Mr. B ₹ 3,000; Mr C ₹ 1,000 and D ₹ 4,000.

(v) Mr. B takes over bank overdraft of R & Co. and contributed to Mr. A the amount of money to be brought in by Mr. A to make up his capital contribution.

(vi) Mr C is paid off in cash from W & Co. and Mr. D brings in sufficient cash to make up his required capital contribution.

Pass necessary Journal entries to close the books of both the firms as on 31st March 2023.

Solution :

Calculation of Purchase Consideration

Assets taken over :		**R & Co. (₹)**	**W & Co. (₹)**
Plant & Machinery		8,000	-
Stock-in-trade		30,000	7,500
Sundry Debtors [(* After adjustment of ₹ 3,000 (₹ 5,000 – 2,000)]		10,000	*7,000
	(A)	48,000	14,500
Liability taken over:			
Sundry Creditors [(* ₹ (10,000 – 3000)]	(B)	*7,000	9,500
Purchase consideration	(A-B)	41,000	5,000

In the books of R & Co.

Journals

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
31.3.23	Realisation A/c	Dr.		40,000	
	To Machinery A/c				10,000
	To Stock-in-trade A/c				20,000
	To Sundry Debtors A/c				10,000
	(Different assets transferred)				
	Sundry Creditors A/c	Dr.		10,000	
	To Realisation A/c				10,000
	(Sundry creditors transferred to Realisation Account)				
	Bank Loan A/c	Dr.		15,000	
	To B Capital A/c				15,000
	(Bank overdraft taken over by B)				

Date	Particulars	L.F	Dr. (₹)	Cr. (₹)
	RW & Co. A/c Dr.		41,000	
	To Realisation A/c			41,000
	(Purchase consideration due)			
	Realisation A/c Dr.		11,000	
	To A Capital A/c			3,667
	To B Capital A/c			7,333
	(Profit on realisation transferred to partners capital in the ratio of 1:2)			
	B Capital A/c Dr.		2,333	
	To A Capital A/c			2,333
	(Deficit in A's capital made good by B)			
	A Capital A/c Dr.		2,000	
	B Capital A/c (3,000 + 36,000) Dr.		39,000	
	To RW & Co. A/c			41,000
	(Capital accounts of the partners closed by transfer to RW & Co.)			
	Alternatively Shows:			
	A Capital A/c Dr.		2,000	
	B Capital A/c Dr.		3,000	
	Loan from B A/c Dr.		36,000	
	To RW & Co. A/c			41,000

Note : It should be noted that the credit balance in B's capital account is ₹ 39,000. His agreed capital in RW & Co is ₹ 3,000 only. Since there is no liquid assets in R & Co. from which B can be repaid, the excess amount of ₹ 36,000 should be taken over by RW & Co. as loan from B.

In the books of W & Co.

Journals

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
31.3.23	Realisalion A/c Dr.		20,000	
	To Goodwill A/c			5,000
	To Stock-in-trade A/c			5,000
	To Sundry Debtors A/c			10,000
	(Different Assets transferred)			

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
	Sundry Creditors A/c	Dr.		9,500	
	To Realisation A/c				9,500
	(Sundry creditors transferred)				
	RW & Co. A/c	Dr.		5,000	
	To Realisation A/c				5,000
	(Purchase consideration due)				
	C's Capital A/c	Dr.		2,750	
	D's Capital A/c	Dr.		2,750	
	To Realisation A/c				5,500
	(Loss on realisation transferred to Capital Account equally)				
	Cash A/c	Dr.		4,750	
	To D's Capital A/c				4,750
	(Being the necessary amount brought in by D to make up his required capital contribution)				
	C's Capital A/c	Dr.		7,250	
	D's Capital A/c	Dr.		4,000	
	To RW & Co. A/c				5,000
	To Cash A/c				6,250
	(Capital accounts of the partners closed by transfer to RW & Co. and balance paid by cash)				
	Alternatively Shows:				
	C's Capital A/c	Dr.		6,250	
	To Cash A/c				6,250
	(Being the C's Capital is paid off)				
	C's Capital A/c	Dr.		1,000	
	D's Capital A/c	Dr.		4,000	
	To RW & Co. A/c				5,000
	(Being the Partner's Capital transferred to RW & Co.)				

Dr. **Realization Account** **Cr.**

Particulars	R & Co. (₹)	W & Co. (₹)	Particulars	R & Co. (₹)	W & Co. (₹)
To Goodwill	-	5,000	By Creditors	10,000	9,500
" Machinery	10,000	-	By RW & Co.	41,000	5,000
" Stock-in-trade	20,000	5,000	By C's Capital		2,750

Particulars	R & Co. (₹)	W & Co. (₹)	Particulars	R & Co. (₹)	W & Co. (₹)
" Sundry Debtors	10,000	10,000	By D's Capital		2,750
" Cash in hand	-				
" A's Capital	3,667				
" B's Capital	7,333				
	51,000	**20,000**		**51,000**	**20,000**

Dr. **Partners' Capital Accounts of R & Co.** **Cr.**

Date	Particulars	A (₹)	B (₹)	Date	Particulars	A (₹)	B (₹)
2022	To Balance b/d	4,000	—	2022	By Balance b/d	—	19,000
Mar	" A Capital A/c	—	2,333	Mar	" Realisation A/c (Profit)	3,667	7,333
	" Loan A/c	—	36,000		" Bank overdraft A/c	—	15,000
	" R W & Co. A/c	2,000	3,000		" B's Capital A/c	2,333	—
		6,000	**41,333**			**6,000**	**41,333**

Dr. **Partners' Capital Accounts of W & Co.** **Cr.**

Date	Particulars	C (₹)	D (₹)	Date	Particulars	C (₹)	D (₹)
2022	To Realisation A/c (Loss)	2,750	2,750	2022	By Balance b/d	10,000	2,000
Mar	" Cash A/c	6,250	—	Mar	" Cash A/c	—	4,750
	" R W & Co. A/c	1,000	4,000				
		10,000	**6,750**			**10,000**	**6,750**

Illustration 43

A and B carry on independent business in provisions and their position as at 31.3.2023 are reflected in the Balance Sheets given below:

	A (₹)	B (₹)
Stock in Trade	1,70,000	98,000
Sundry Debtors	89,000	37,000
Cash at Bank	13,000	7,500
Cash in hand	987	234
Furniture and Fixtures	2,750	1,766
Investments	513	-----
	2,76,250	**1,44,500**

	A (₹)	B (₹)
Represented by Sundry Creditors for		
Purchases	1,10,000	47,000
Expenses	13,250	2,000
Capital Account	1,53,000	95.500
	2,76,250	**1,44.500**

Both of them want to. form a partnership firm from 1st April, 2023 on the following understanding:

(a) The capital of the partnership would,be ₹3 lakhs which would be contributed by them in the ratio of 2 :1.

(b) The assets of the individual business would be evaluated by C at which values, the firm will take them over and the value would be adjusted against the contribution due by A and B.

(c) C gave his valuation report as follows:

Business of A: Stock in Trade to be written down by 15% and a portion of Sundry Debtors amounting to ₹9,000 estimated unrealisable not to be assumed by the firm; furniture and fixtures to be valued at ₹2,000 and investments to be taken of market value of 1,000. Assets of B: Stocks to be increased by 10%, and Sundry Debtors to be admitted at 85% of their value; rest of the assets to be assumed at their book value.

(d) The firm is not to assume any Creditors other than the dues on account of purchases made.

Prepare the opening Balance Sheet of the firm.

Solution:

Calculation Net Assets taken over

	A (₹)	B (₹)
Investments	1,000	—
Sundry debtors	80,000	31,450
Furniture & fixtures	2,000	1,766
Stock in trade	1,44,500	1,07,800
Cash in hand	987	234
Cash at bank	13,000	7,500
	2,41,487	1,48,750
Less: Sundry Trade Creditors	1,10,000	47,000
	1,31,487	1,01,750
Add: Additional Cash bought is by A	68,513	—
Less: Excess Amount transferred to Current A/c.	—	1,750
	2,00,000	**1,00,000**

M/s A & B

Balance Sheet as at 01.04.2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital			Furniture and Fixtures		3,766
A	2,00,000		Investments		1,000
B	1,00,000	3,00,000	Sundry Debtors		1,11,450
Sundry Creditors		1,57,000	Stock in Trade		2,52,300
B's Current A/c		1,750	Cash in hand		1 ,221
			Cash at Bank		89,013
		4,58,750			**4,58,750**

Conversion of Partnership Firm into a Company and Sale of Partnership Firm to a Company

4.7

For various reasons, an existing partnership may sell its entire business to an existing Joint Stock Company. It can also convert itself into a Joint Stock Company. The former case is the absorption of a partnership firm by a Joint Stock Company but the latter case is the flotation of a new company to take over the business of the partnership.

In either of the above cases, the existing partnership firm is dissolved and all the books of account are closed. Broadly, the procedure of liquidation of the partnership business is same as what has already been explained in "Amalgamation of Partnership"

Some important points :

(1) The Purchase Consideration is satisfied by the Company either in the form of cash or shares or debentures or a combination of two or more of these. The shares may be equity or preference shares. The shares may be issued at par or at a premium. For the partnership, the issue price is relevant which may form a part of the purchase consideration.

(2) In the absence of any agreement, share received from purchasing company should be distributed among the partners in the same ratio as profits and losses are shared.

Accounting Entries in the books of selling firms.

1. For transferring different assets to Realisation Account

Realisation A/c	Dr.	[Individually]
To Sundry Assets A/c		
(Assets transferred to Realisation Account at their book values)		

2. For transferring different liabilities to Realisation Account

Liabilities A/c	Dr.	[Individually]
To Realisation A/c		
(Liabilities transferred to Realisation Account at their book values)		

3. For purchase consideration due

Purchasing Co. A/c	Dr
To Realisation A/c	
(Purchase consideration due from the new firm)	

4. For assets taken over by the proprietor

Capital A/c	Dr
To Realisation A/c	
(Assets taken over by the proprietor)	

5. For realisation of assets not taken over by the Company

   Bank A/c Dr.

   To Realisation A/c

   (Realisation of assets not taken over by the new firm)

6. For recording unrecorded assets

   Assets A/c Dr

   To Capital A/c

   (Unrecorded assets recorded)

7. For realisation of unrecorded assets

   Bank A/c Dr

   To Assets A/c

8. For payment of liabilities not taken over

   Realisation A/c Dr

   To Bank A/c

   (Payment of liabilities not taken over by the new firm)

9. For recording unrecorded liabilities

   Capital A/c Dr

   To Liabilities A/c

   (Being the unrecorded liabilities recorded)

10. For payment of unrecorded liabilities

    Liabilities A/c Dr

    To Bank A/c

    (Payment of unrecorded liabilities)

    (**Note:** If unrecorded liabilities are taken over by the Company, it is also transferred to Realisation Account along with other liabilities.)

11. For liabilities taken over by the proprietor

    Realisation A/c Dr

    To Capital A/c

    (Being liabilities assumed by the proprietor)

12. For realisation expenses

    Realisation A/c Dr.

    To Bank A/c

    (Realisation expenses paid)

13. For profit on realisation

    Realisation A/c Dr

    To Capital A/c

    (Profit on realisation transferred to Capital Account)

14. For loss on realisation

    Capital A/c Dr

    To Realisation A/c

    (Loss on realisation transferred to Capital Account)

15. For accumulated profits / reserves

    Reserves A/c Dr

    Profit and Loss A/c Dr

    To Capital A/c

    (Undrawn profits transferred to Capital Account)

16. For Loss : Reverse entry of 15.

17. For transferring partners' current accounts (Credit balances) to capital accounts

    Partners' Current A/cs Dr.

    To Partners' Capital A/cs

    If there is a debit balance in current account, the reverse entry shall be recorded.

18. For Settlement of purchase consideration by the company

    Shares in Purchasing Co. Dr.

    Debentures in Purchasing Co. Dr.

    Cash A/c Dr.

    To Purchasing Co. A/c

19. For final adjustment

    Partners' Capital A/cs Dr.

    To Shares in Purchasing Co. A/c

    To Debenture in Purchasing Co. A/c

    To Cash A/c

Accounting Entries in the books of the Purchasing Company

The purchasing company will record all the assets and liabilities at agreed values. Calculation of Goodwill and Capital Reserve same as explained earlier.

1. For assets and liabilities taken over:

(When net assets taken over is less than the Purchase consideration)

Assets A/c	Dr.	(Agreed Value)
Goodwill A/c	Dr.	(Balancing figure)
To Liabilities A/c		(Agreed Value)
To Firm A/c		(Purchase Consideration)

(Being different assets and liabilities taken over)

(When net assets taken over is more than the Purchase consideration)

Assets A/c	Dr.	(Agreed Value)
To Liabilities A/c		(Agreed Value)
To Firm A/c		(Purchase Consideration)
To Capital Reserve A/c		(Balancing Figure)

(Being different assets and liabilities taken over)

2. For discharge of Purchase Consideration:

Firm A/c	Dr	(Purchase Consideration)
To Share Capital A/c		(Face value of shares issued)
To Securities Premium A/c		(if any)
To Debentures A/c		
To Bank A/c		

Illustration 44

X and Y were in partnership in XY & Co. sharing profits in the proportions 3:2. On 31st March 2023, they accepted an offer from P Ltd. to acquire at that date their fixed assets and stock at an agreed price of ₹ 7,20,000. Debtors, creditors and bank overdraft would be collected and discharged by the partnership firm.

The purchase consideration of ₹ 7,20,000 consisted of cash ₹ 3,60,000, debentures in P Ltd. (at par) ₹ 1,80,000 and 12,000 Equity Shares of ₹ 10 each in P Ltd. X will be employed in P Ltd. but, since Y was retiring X agreed to allow him ₹ 30,000 in compensation, to be adjusted through their Capital Accounts. Y was to receive 1,800 shares in P Ltd. and the balance due to him in cash. The Balance Sheet of the firm as on 31.03.2023 is in below :

Liabilities	(₹)	Assets	(₹)
X's Capital Account	1,20,000	Fixed Assets	4,80,000
Loan from X	2,10,000	Stock	45,000
Bank overdraft	1,50,000	Debtors	75,000
Creditors	1,80,000	Y's Capital Account	60,000
	6,60,000		**6,60,000**

The sale of the assets to P. Ltd. took place as agreed; the debtors realised ₹ 60,000 and creditors were settled for ₹ 1,71,000. The firm then ceased business. You are required to pass necessary Journal entries and show: (a) Realisation Account (b) Bank Account (c) Partners' Capital Accounts.

Solution:

In the books of XY & Co.

Journals

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
31.3.23	Realisalion A/c	Dr.		6,00,000	
	To Fixed Assets A/c				4,80,000
	To Stock-in-trade A/c				45,000
	To Sundry Debtors A/c				75,000
	(Different Assets transferred)				
	Creditors A/c	Dr.		1,80,000	
	To Realisation A/c				1,80,000
	(Sundry creditors transferred)				
	P Ltd A/c	Dr.		7,20,000	
	To Realisation A/c				7,20,000
	(Purchase consideration due)				
	Bank A/c	Dr.		3,60,000	
	Debentures in P Ltd.	Dr.		1,80,000	
	Shares in P Ltd.	Dr.		1,80,000	
	To P. Ltd A/c				
	(Purchase consideration Received)				7,20,000
	Bank A/c	Dr.		60,000	
	To Realisation A/c				60,000
	(Debtors realized)				
	Realisation A/c	Dr.		1,71,000	
	To Bank A/c				1,71,000
	(Payment to Creditors)				
	Realisation A/c	Dr.		1,89,000	
	To X Capital A/c				1,13,400
	To Y Capital A/c				75,600
	(Profit on realisation transferred to Capital Account)				
	Loan from X	Dr.		2,10,000	
	To X Capital				2,10,000
	(Loan Balance transferred)				

Date	Particulars		L.F	Dr. (₹)	Cr. (₹)
	X Capital A/c	Dr.		30,000	
	To Y Capital A/c				30,000
	(Adjustment for compensation)				
	X Capital A/c	Dr.		4,13,400	
	To Share in P Ltd				1,53,000
	To Debenture in P Ltd.				1,80,000
	To Bank A/c				80,400
	(Final settlement of accounts of X)				
	Y Capital A/c	Dr.		45,600	
	To Shares in P Ltd.				27,000
	To Bank				18,600
	(Final settlement of accounts of Y)				

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Fixed Assets A/c	4,80,000	By Creditors A/c	1,80,000
To Stock A/c	45,000	By Bank A/c (Debtors realised)	60,000
To Debtors A/c	75,000	By P Ltd A/c (Purch. Consid.)	
To Bank A/c (creditors payment)	1,71,000	Bank	3,60,000
To X's Capital A/c (profit)	1,13,400	Debentures in P Ltd	1,80,000
To Y's Capital A/c (profit)	75,600	Shares in P Ltd.	1,80,000
	9,60,000		**9,60,000**

Dr. **Bank Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Realisation A/c	60,000	By Balance b/d	1,50,000
(Debtors realised)		By Realisation A/c	1,71,000
To S Ltd. A/c	3,60,000	(Crs payment)	
(Purchase Consideration)		By Capital A/c - X	80,400
		By Capital A/c - Y	18,600
	4,20,000		**4,20,000**

Dr.		Partners' Capital Accounts					Cr.
Dt.	**Particulars**	**X (₹)**	**Y (₹)**	**Dt.**	**Particulars**	**X (₹)**	**Y (₹)**
	To Balance b/d	-	60,000		By Balance b/d	1,20,000	-
	To Y Capital A/c	30,000			By Loan from X	2,10,000	-
	To Shares in P Ltd	1,53,000			By Realisation A/c	1,13,400	75,600
	To Debentures in		27,000		(profit)		
	P Ltd A/c				By X 's Capital A/c		
	To Bank A/c (final	1,80,000				-	30,000
	payment)	80,400	-				
			18,600				
		4,43,400	**1,05,600**			**4,43,400**	**1,05,600**

Note :

Value of equity shares	**(₹)**	**(₹)**
Total Purchase consideration		7,20,000
Discharged:		
In Cash	3,60,000	
By Debentures	1,80,000	5,40,000
Balance by 12,000 Equity shares of ₹ 10 per each		1,80,000

So the cost of each equity share be ₹ 1,80,000/12,000 = ₹ 15 per share.

Thus in the books of P Ltd. Security premium will be ₹ 12,000 × 5 = ₹ 60,000

Illustration 45

Suchandra, Ashmita and Kasturi were running partnership business sharing Profit and Losses in 2:2:1 ratio. Their Balance Sheet as on 31.03.2023 stood as following: (₹ in 000's)

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Fixed Capital			Fixed Assets		920.00
Suchandra	690.00		Investment		115.00
Ashmita	460.00		Current Assets:		
Kasturi	230.00	1,380.00	Stock	230.00	
Current Account:			Debtors	632.50	
Suchandra	138.00		Cash in Bank	287.50	1,150.00
Kasturi	92.00	230.00			
Unsecured Loan		230.00			
Current Liabilities		345.00			
		2,185.00			**2,185.00**

On 1.4.2023, they agreed to form new company TT (P). Ltd. with Ashmita and Kasturi each taking up 460 eq. share of ₹10 each, which shall take over the firm as going concern including Goodwill, but excluding cash and bank balance.

The following are also agreed upon:

(a) Goodwill will be valued at 3 years purchase of super profit.

(b) The actual profit for the purpose of Goodwill valuation will be ₹ 4,60,000.

(c) The normal rate of return will be 18% p.a. on Fixed Capital.

(d) All other assets and liabilities will be taken at Book value.

(e) Ashmita and Kasturi are to acquire interest in the new company at the ratio 3:2.

(f) The purchase consideration will be payable partly in shares of ₹10 each and partly in cash. Payment in cash being to meet the requirement to discharge Suchandra, who has agreed to retire.

(g) Realisation expenses amounted to ₹ 1,17,300.

You are required to close the books of the firm by passing necessary journal entries.

Solution:

	Particulars		Dr. (₹)	Cr. (₹)
(a)	Realization A/c	Dr.	26,49,600	
	To Fixed Assets A/c			9,20,000
	To Investment A/c			1,15,000
	To Stock A/c			2,30,000
	To Sundry Debtors A/c			6,32,500
	To Goodwill N			6,34,800
	To Bank A/c (Realization Expenses)			1,17,300
	(Being transfer of Assets To, Realization A/c)			
(b)	Unsecured loan A/c	Dr.	2,30,000	
	Current liabilities A/c	Dr.	3,45,000	
	To Realisation A/c			5,75,000
	(Being transfer of liabilities To, Realization A/c)			
(c)	Suchandra's Capital A/c	Dr.	46,920	
	Ashmita's Capital A/c	Dr.	46,920	
	Kasturi's Capital A/c	Dr.	23,460	
	To Realisation A/c			1,17,300
	(Being transfer of realization losses To, partner's Capital A/c)			
(d)	TT (P) Ltd. A/c	Dr. W.N.(3)	19,57,300	
	To Realisation A/c			19,57,300
	(Being purchase consideration due)			
(e)	Goodwill A/c	Dr.W.N. (2)	6,34,800	
	To Suchandra's Capital A/c			2,53,920
	To Ashmita's Capital A/c			2,53,920
	To Kasturi's Capital No			1 ,26,960
	(Being transfer of goodwill To, parties Capital A/c)			

	Particulars		Dr. (₹)	Cr. (₹)
(f)	Suchandra's Current A/c	Dr.	1,38,000	
	Kasturi's Current A/c	Dr.	92,000	
	To Suchandra's Capital A/c			
	To Kasturi's Capital A/c			
	(Being transfer of Current A/c balances To, Capital A/c)			
(g)	Suchandra's Capital A/c	Dr.	10,35,000	
	To Bank A/c			10,35,000
	(Being amount of Capital paid To, Suchandra)			
(h)	Ashmita's Capital A/c	Dr.	11,500	
	To Kasturi's Capital A/c			11,500
	(Being amount payable by Kasturi To, Ashmita in order To, make their claim in new company as 3:2)			
(i)	Bank A/c	Dr.	8,64,800	
	Shares in TT (P) Ltd. A/c	Dr.	10,92,500	
	To TT (P). Ltd. A/c			19,57,300
	(Being amount received, amount shares in Tata (P) Ltd. distributed for Purchase consideration)			

Working Notes:

1. **Dr.** **Ashmita's Capital A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Realiztion A/c	46,920	By Balance c/d	4,60,000
To Kasturi's Capital	11,500	By Goodwill A/c	2,53,920
To Shares in TT (P) Ltd.	6,55,500		
	7,13,920		**7,13,920**

Dr. **Kasturi's Capital A/c** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Realization A/c	23,460	By Balance c/d	2,30,000
To Shares in TT (P) Ltd.	4,37,000	By Goodwill A/c	1,26,960
		By Current A/c	92,000
		By Ashmita's Capital A/c	11,500
	4,60,460		**4,60,460**

2. **Calculation of goodwill.**

Normal Ratio of return = 1 8% p.a. or fixed capital

= ₹ 13,80,000 × 18%

= ₹ 2,48,400

Actual Profit	=	₹ 4,60,000
(-) Normal Profit	=	₹ 2,48,400
Super Profit	=	₹ 2,11,600
Goodwill	= ₹ 2,11,600 × 3 years of purchase of S.P.	
	= ₹ 6,34,800	
Suchandra's Share	= ₹ 6,34,800 × 2/5	
	= ₹ 2,53,920	
Ashmita's Share	= ₹ 6,34,800 × 2/5	
	= ₹ 2,53,920	
Kasturi's Share	= ₹ 6,34,800 × 1/5	
	= ₹ 1,26,960	

3. Computation of Purchases Consideration

Investments	₹ 1,15,000
Fixed Assets	₹ 9,20,000
Stock	₹ 2,30,000
Debtors	₹ 6,32,500
Goodwill	₹ 6,34,800
	₹ 25,32,300
Less: Unsecured loan	₹ 2,30,000
Current liabilities	₹ 3,45,000
	₹ 19,57,300

4. Calculation of cash required from TT (P) Ltd.

Cash required to pay to Suchandra	₹ 10,35,000
Less: Cash available after expenses (₹ 2,87,500 - ₹ 1,17,300)	₹ 1,70,200
Cash received for purchase Consideration	₹ 8,64,800

5. Shares of ₹ 10,92,500 are to be issued to Ashmita and Kasturi in the ratio of 3:2

Ashmita ₹10,92,500 × $\frac{3}{5}$ = ₹6,55,500

Kasluri ₹10,92,500 × $\frac{2}{5}$ = ₹4,37,000

Accounting of Limited Liability Partnership

4.8

In the recent times, a new form of business organisation, namely the Limited Liability Partnership has been formed which combines the features of two common forms of business – the partnership and the company.

Meaning of Limited Liability Partnership (LLP)

Limited Liability Partnership is a specific form of business organisation consisting of partners whose liability is limited to the capital contribution made by them. It is a combination of both partnership and company and has the characteristics of both these forms of organisations. Unlike a partnership, the partners of a limited liability partnership have limited liability (similar to that in the company) which implies that personal assets of the partners will not be not used for paying off the debts of the organisation.

In India, all limited liability partnerships are governed by the Limited Liability Partnership Act, 2008 which came into effect from April 1, 2009.

NB: the provisions of Indian Partnership Act, 1932 shall not apply to a limited liability partnership.

Nature of Limited Liability Partnership

The nature of a limited liability partnership can be understood from the following:

- A limited liability partnership is a body corporate formed and incorporated under a statute.
- It has a legal entity separate from that of its partners.
- Any change in the partners of a limited liability partnership would not affect the existence, rights or liabilities of the limited liability partnership.

Features of Limited Liability Partnership

Some of the important features of a limited liability partnership registered in India are:

- A limited liability partnership is a body corporate.
- It is formed and incorporated under the Limited Liability Partnership Act, 2008.
- Any individual or body corporate may be a partner in a limited liability partnership.
- Every limited liability partnership shall have at least two partners.
- Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.
- Every limited liability partnership shall have either the words “limited liability partnership” or the acronym “LLP” as the last words of its name.

Books of Accounts of Limited Liability Partnership

As per Sec. 34 of Limited Liability Partnership Act, 2008, a limited liability partnership shall maintain such proper books of accounts as may be prescribed relating to its affairs for each year of its existence on cash or accrual basis and according to double entry system of accounting and shall maintain the same at its registered office for such period as may be prescribed.

As per Rule 24(1) of the Limited Liability Partnership Rules, 2009 every limited liability partnership shall keep books of accounts which are sufficient to show and explain the limited liability partnership's transactions, and are such as to:

(a) Disclose with reasonable accuracy, at any time, the financial position of the limited liability partnership at that time; and

(b) Enable the designated partners to ensure that any Statement of Account and Solvency prepared under this rule complies with the requirements of the Act.

The books of account shall contain:

(a) particulars of all sums of money received and expended by the limited liability partnership and the matters in respect of which the receipt and expenditure takes place;

(b) a record of the assets and liabilities of the limited liability partnership;

(c) statements of goods purchased, inventories, work-in-progress, finished goods and cost of goods sold; and

(d) any other particulars which the partners may decide.

Rule 24(3) of the Limited Liability Partnership Rules, 2009 specifies that the books of accounts which a limited liability partnership is required to keep shall be preserved for eight years from the date on which they are made.

Statement of Account and Insolvency

Every limited liability partnership shall, within a period of six months from the end of each financial year, prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year in such form as may be prescribed, and such statement shall be signed by the designated partners of the limited liability partnership. As per Sec. 36 of the said Act, such Statement of Account and Insolvency filed by a limited liability partnership with the Registrar shall be available for inspection by any person in such manner and on payment of such fees as may be prescribed. Every limited liability partnership shall file within the prescribed time, the Statement of Account and Solvency with the Registrar every year in such form and manner, and accompanied by such fees as may be prescribed.

Rule 24(3) of the Limited Liability Partnership Rules, 2009 specifies that every limited liability partnership shall file the Statement of Account and Solvency in Form 8 with the Registrar, within a period of thirty days from the end of the six months of the financial year to which the Statement of Account and Solvency relates. Such Statement of Account and Solvency has to be signed on behalf of the limited liability partnership by its designated partners.

Every limited liability partnership has to prepare the following statement of account as prescribed in Part B of LLP Form 8 pursuant to Rule 24 of Limited Liability Partnership Rules, 2009:

1. Statement of Assets and Liabilities; and
2. Statement of Income and Expenditure.

The format of the Statement of Assets and Liabilities is as follows:

Particulars	Figures as at the end of the current reporting period (in ₹)	Figures as at the end of the previous reporting period (in ₹)
(I) CONTRIBUTION AND LIABILITIES		
(1) Partner's funds		
Contribution received		
Reserves and surplus (including surplus being the profit/loss made during year)		
(2) Liabilities		
Secured loans		
Unsecured loans		
Short term borrowings		
Creditors/Trade payables - Advance from customers		
Amount of other liabilities		
Other liabilities (to specify)		
Provisions		
For taxation		
For contingencies		
For insurance		
Other provisions (if any)		
Total		
(II) ASSETS		
Gross Fixed assets (including intangible assets)		
Less: depreciation and amortization		
Net fixed assets		
Investments		
Loans and advances		
Inventories		
Debtors/trade receivables		
Cash and cash equivalents		
Amount of other assets		
Other assets (to specify)		
Total		

The details of contingent liabilities are required to disclosed separately as under:

(a) Whether there are any contingent liabilities to report? Yes/ No

(b)	(c)	(d)
S. No.	**Description of contingent liability**	**Amount**

The format of the Statement of Income and Expenditure is as follows:

Particulars	**Figures for the period (Current reporting period)** **From (DD/MM/YYYY)** **To (DD/MM/YYYY** **(in ₹)**	**Figures for the period (Previous reporting period)** **From (DD/MM/YYYY)** **To (DD/MM/YYYY** **(in ₹)**
Income		
Gross turnover		
Less: Excise duty or service tax		
Net Turnover Details		
(I) Domestic turnover		
(a) Sale of goods manufactured		
(b) Sale of goods traded		
(c) Sale or supply of services		
(II) Export turnover		
(a) Sale of goods manufactured		
(b) Sale of goods traded		
(c) Sale or supply of services		
Other income		
Increase/ (decrease) in stocks including for raw materials, work in progress and finished goods		
Total Income		
Expenses		
Raw material consumed		
Purchases made for re-sale		
Consumption of stores and spare parts		

Power and fuel		
Personnel Expenses		
Administrative expenses		
Payment to auditors		
Selling expenses		
Insurance expenses		
Depreciation and amortization		
Interest		
Other expenses		
Total expenditure		
Net Profit or Net Loss (before taxes)		
Provision for Tax		
Profit after Tax		
Profit transferred to Partners' account		
Profit transferred to Reserves and Surplus		

Failure to maintain books of accounts, prepare Statement of Account and Solvency etc.

Any limited liability partnership which fails to comply with the provisions as set out u/s 34 shall be punishable with fine which shall not be less than ₹25,000 but which may extend to ₹5,00,000, and every designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ₹10,000 but which may extend to ₹1,00,000.

Annual Return

As per Sec. 35 of Limited Liability Act, 2008, every limited liability partnership shall file an Annual Return duly authenticated with the Registrar within sixty days of closure of its financial year in such form and manner, and accompanied by such fees as may be prescribed. Any limited liability partnership which fails to comply with the provision as set out u/s 35 shall be punishable with fine which shall not be less than ₹25,000 but which may extend to ₹5,00,000. If a limited liability partnership contravenes the provisions of this section, the designated partner of such limited liability partnership shall be punishable with fine which shall not be less than ₹10,000 but which may extend to ₹1,00,000. As per Sec. 36 of the said Act, the Annual return filed by a limited liability partnership with the Registrar shall be available for inspection by any person in such manner and on payment of such fees as may be prescribed. If in any return, any person makes any statement which is false in any material particular knowing it to be false or, which omits any material fact knowing it to be material, he shall be punishable with imprisonment which may extend to two years, and also be liable to fine which may extend to ₹5,00,000 but which shall not be less than ₹1,00,000.

Audit of books of accounts

The accounts of the limited liability partnership shall be audited in accordance with the prescribed rules. An auditor or auditors of a limited liability partnership shall be appointed for each financial year of the LLP for auditing its accounts. A person shall be qualified for appointment as an auditor of a limited liability partnership unless he is a Chartered Accountant in practice.

Illustration 46

P and Q are the partners of a limited liability partnership - M/s P&Q LLP dealing in electrical goods. The following is their trial balance as on March 31, 2023:

Name of Accounts	Dr. (₹)	Cr. (₹)
Inventories on April 1, 2022	4,50,000	
Equipment	5,50,000	
Premises	8,00,000	
Bank	9,46,500	
Sundry Debtors	3,60,000	
Sundry creditors		1,65,000
Secured loan		1,80,000
Unsecured loan		1,35,000
Returns outward		67,500
Outstanding expenses		24,000
Sales revenue from goods traded		53,00,000
Revenue from services rendered		2,35,000
Indirect Tax on turnover	1,35,000	
Interest received on investment		67,500
Purchases	29,47,500	
Salaries	8,45,000	
Rent & Rates	3,12,000	
Stationery charges	13,200	
Communication charges	27,300	
Insurance	54,800	
Advertisement	44,200	
Delivery charges	48,000	
Interest on debt	95,500	
Furniture & Fixture	5,40,000	
Long-term investments	3,15,000	
Cash	2,10,000	

General Reserve		270,000
P's contribution		1,300,000
Q's contribution		950,000
	8,694,000	**8,694,000**

Additional information:

(a) Unsold inventories on 31.03.2023 worth ₹5,62,500.

(b) Outstanding rent amounts to ₹36,000.

(c) Rate of depreciation on Furniture & Fixture @ 10%.

(d) Depreciate equipment by ₹67,500

(e) Provisions to be created: ₹22,500 for possible bad debts and ₹180,000 for taxation.

Considering the additional information provided above, you are required to prepare:

(i) Statement of Income and Expenditure for the year ended March 31, 2023; and

(ii) Statement of Assets and Liabilities as on that date.

Solution:

M/s P&Q LLP

Statement of Income and Expenditure for the year ended March 31, 2023

Particulars	(₹)	(₹)
Income		
Gross Turnover [53,00,000+235,000]	55,35,000	
Less: Excise duty	(1,35,000)	
Net Turnover Details		54,00,000
Other income: Interest on investments		67,500
Increase in inventories [Closing 562,500 – Opening 450,000]		1,12,500
Total Income		55,80,000
Expenses		
Purchases	29,47,500	
Less: Returns outward	(67,500)	28,80,000
Salaries		8,45,000
Rent & Rates	3,12,000	
Add: Outstanding	36,000	3,48,000
Stationery charges		13,200

Particulars	(₹)	(₹)
Communication charges		27,300
Insurance		54,800
Advertisement		44,200
Delivery charges		48,000
Interest on debt		95,500
Depreciation: on Furniture & Fixture	54,000	
on Equipment	67,500	1,21,500
Provision for bad debts		22,500
Total expenditure		45,00,000
Net Profit or Net Loss (before taxes) (Total Income – Total Expenditure)		10,80,000
Less: Provision for Tax		1,80,000
Profit after Tax		9,00,000
Profit transferred to Reserves and Surplus		9,00,000

Statement of Assets and Liabilities as on March 31, 2023

Particulars	(₹)	(₹)
(I) CONTRIBUTION AND LIABILITIES		
(1) Partner's funds		
P's Contribution	13,00,000	
Q's Contribution	9,50,000	22,50,000
General Reserves		2,70,000
Profit earned in 2022-23		9,00,000
(2) Liabilities		
Secured loans		1,80,000
Unsecured loans		1,35,000
Sundry creditors		1,65,000
Outstanding expenses [24,000 + 36,000]		60,000
Provision for taxation		1,80,000
Total		**41,40,000**
(II) ASSETS		
Premises		8,00,000

Particulars	(₹)	(₹)
Equipment	5,50,000	
Less: Depreciation	67,500	4,82,500
Furniture & Fixture	5,40,000	
Less: Depreciation	54,000,	4,86,000
Net fixed assets		17,68,500
Investments: Long-term		3,15,000
Inventories		5,62,500
Sundry Debtors	3,60,000	
Less: Provision for bad debts	22,500	3,37,500
Cash and cash equivalents		
Bank	9,46,500	
Cash	2,10,000	11,56,500
Total		41,40,000

Solved Case(s)

Amal, Bimal and Kamal were the partners in a firm which is engaged in the manufacturing of leather shoes. Their business is located in the outskirts of the city of Kanpur in Uttar Pradesh. The partners are in this business since 1997, and they share profits and losses in the ratio of 3:2:1.

On November 5, 2022, Kamal met with a serious road accident while travelling from Lucknow to Kanpur after attending a meeting with one of their customers. After being hospitalized for three long months, he was released in the first week of February 2023. During this time, he realised that it would not be possible for him to continue as a partner in this business and so he decided to retire from the firm. He communicated his decision to the other partners and it was mutually agreed upon that Kamal will continue till the end of this financial year and thereafter retire from the business, while the other partners will continue. The Balance Sheet of the firm as on 31.03.2022 was as follows:

Liabilities		(₹)	Assets	(₹)
Capital Accounts:			Plant	40,000
Amal	45,000		Building	50,000
Bimal	35,000		Furniture	4,000
Kamal	25,000	1,05,000	Debtors	30,000
Profit & Loss A/c		12,000	Stock	25,000
Reserve fund		15,000	Bank	3,500
Creditors		20,500		

Liabilities	(₹)	Assets	(₹)
	1,52,500		1,52,500

Kamal retired on that date subject to the following conditions:

(i) Goodwill of the firm to be valued at Rs. 36,000;

(ii) Building is to be appreciated by 20%;

(iii) Plant and Furniture are to be depreciated by 10% and 15% respectively;

(iv) Provision to be made for doubtful debts @ 5%.

Amal and Bimal are to bring in cash, if necessary, in their profit sharing ratio to pay off Kamal's dues on retirement and leave a sum of Rs. 10,000 as working capital.

1. Ascertain the amount of profit or loss arising to the firm out of revaluation. Also state the share of individual partner therein.
2. Determine the amount of cash to be brought in by Amal and Bimal to pay off Kamal's dues.
3. Draft the post-retirement Balance Sheet of the partnership firm.

Answer:

1. The amount of profit or loss arising to the firm out of revaluation is - ₹39,900 share of individual partner therein are ₹19,950, ₹13,300 and ₹6,650 respectively.

Dr. Revaluation Account Cr.

Particulars		(₹)	Particulars	(₹)
To Provision for Doubtful Debts A/c		1,500	By Goodwill A/c	36,000
To Depreciation on Plant A/c		4,000	By Building A/c	10,000
To Depreciation on Furniture A/c		600		
To Partner's Capital A/c				
- Amal's Capital (3/6)	19,950			
- Bimal's Capital (2/6)	13,300			
- Kamal's Capital (1/6)	6,650	39,900		
		46,000		**46,000**

2. Additional amount to be brought in by Amal and Bimal:

	(₹)
Amount paid to Kamal	36,150
Add: required working capital to be maintained	10,000
	46,150
Less: Cash at Bank as per existing balance Sheet	3,500
Amount to be brought in	42,650

So, Amount to be brought in by Amal = 42,650 × 3/5 = 25,590

Amount to be brought in by Bimal = 42,650 × 2/5 = 17,060

3. **Balance Sheet as at 31.03.2023**

Liabilities			(₹)	Assets		(₹)
Capital A/C				Goodwill		36,000
	Amal	1,04,040		Buildings		60,000
	Bimal	74,360	1,78,400	Plant		36,000
				Furniture		3,400
Creditors			20,500	Debtors	30,000	
				Less: Provision	1,500	28,500
				Stock		25,000
				Bank [Note 1]		10,000
			1,98,900			**1,98,900**

Working Notes:

Dr. **Partners' Capital Account** **Cr.**

Particulars	Amal (₹)	Bimal (₹)	Kamal (₹)	Particulars	Amal (₹)	Bimal (₹)	Kamal (₹)
To Bank A/c	-	-	36,150	By Balance b/d	45,000	35,000	25,000
- Dues paid off (Bal. fig.)				By Reserve Fund A/c	7,500	5,000	2,500
				By Revaluation A/c	19,950	13,300	6,650
				- Profit			
				By Profit & Loss A/c	6,000	4,000	2,000
To Balance c/d (Bal. fig.)	1,04,040	74,360	-	By Bank A/c (Def.)	25,590	17,060	-
	1,04,040	**74,360**	**36,150**		**1,04,040**	**74,360**	**36,150**
				By Balance b/d	1,04,040	74,360	-

Exercise

A. Theoretical Questions:

Multiple Choice Questions

1. Sacrificing ratio is:
   a. New Profit sharing ratio - old profit sharing ratio.
   b. Equal to old profit sharing ratio
   c. Equal
   d. Old profit sharing ratio - new profit sharing ratio.
2. Which of the following is not an essential feature of a partnership firm?
   a. Mutual agency.
   b. Existence of business.
   c. Association of two or more people.
   d. Compulsory registration
3. Generally sacrifice ratio is concerned with the situation of:
   a. Admission of a new partner
   b. Retirement of a partner
   c. Dissolution of firm
   d. Conversion of firm into company
4. Which of the following account is mainly prepared at the time of dissolution of the firm?
   a. Revaluation A/c
   b. Goodwill A/c
   c. Realization A/c
   d. Memorandum Revaluation A/c

Answers:

1	d	2	d	3	a	4	d

State True or False

1. In absence of partnership deed the profit or loss should be distributed among partners in their capital ratio.
2. In absence of partnership deed, partners are entitled to interest on capital @ 6% p.a.
3. New-partner pays premium for goodwill, which will be shared by old partners in their new profit sharing ratio.
4. When the capitalization of profits method is used then the value of goodwill on the basis of future maintainable profits is more than that of on the basis of super profits.
5. It is necessary to revalue of assets and liabilities at the time of admission of a new partner.
6. After the death of a partner, the combined shares of continuing partners decrease.
7. Changes in profit sharing ratio among the existing partners may occur at any time during the financial year.
8. Loss on Realisation should be distributed according to capital ratio.
9. The surrender value of Joint Life Policy is distributed among all partners in their old ratio upon retirement.
10. Adjustments are recorded in Partner's Current Account in Fixed Capital Method.

Answers:

1	**False**	**2**	**False**	**3**	**False**	**4**	**False**	**5**	**True**
6	**False**	**7**	**True**	**8**	**False**	**9**	**True**	**10**	**True**

Fill in the Blanks

1. Profit or Loss on revaluation is shared among the partners in _________ Ratio.
2. Realisation account is opened at the time of __________ of firm.
3. Memorandum revaluation account is prepared when the _________ of assets and liabilities are not altered.
4. Interest to be allowed @ 0.75 per cent per month on Partners Capital of ₹ 60 Lakh; Manager's Commission @ 5 per cent of Net Profit before charging such commission. If the Net Profit before charging interest on capital and manager's commission amounted to ₹ 14.85 Lakh, then manager's commission will be _____________.
5. The amount due to deceased partner is paid to his/ her _____________.

6. Surplus capital method is suitable when all partners are _____________.

7. Profit or loss on revaluation of assets and liabilities is shared by the _____________.

8. At the time of admission of a partner, General Reserve is distributed among the partners in _____________ sharing ratio.

9. If there is any change in profit sharing ratio of the partners, the old partnership will be _____________

10. An incoming partner contributes _____________ to share in the total assets and _____________ for future profits.

Answer:

1	**Old profit sharing**	2	**Dissolution of the firm**
3	**Book value**	4	**₹ 47,250**
5	**Executors**	6	**Solvent**
7	**Old Partners**	8	**Old Profit.**
9	**Terminated**	10	**Capital, goodwill**

B. Numerical Questions

⊙ Multple Choice Questions

1. X and Y are partners with the capital of ₹ 50,000 and ₹ 30,000 respectively. Interest Payable on Capital is 10% p.a. If the profits earned by the firm is ₹ 4,800, what will be the Interest on Capital for X and Y?

   a. ₹ 5,000 and ₹ 3,000

   b. ₹ 3,000 and ₹ 1,800

   c. No interest will be paid to the partners

   d. None of the above

2. X and Y were partners sharing profit/losses as 3:2. They admit Z as a new partner, giving him 1/5th share of future profits. What should be the new profit sharing ratio?

   a. 12:8:5

   b. 3:2:1

   c. 8:12:5

   d. 5:8:12

3. B and D are partners, sharing profit or loss in the ratio 3 : 2. They admit K for 1/6th share of profits in the firms of which she takes 2/3rd from B and 1/3rd from D. What will be the new profit sharing ratio?

    a. 44: 31: 15

    b. 31: 44: 15

    c. 32: 41: 14

    d. 15: 31: 44

4. G and C are partners. They are entitled for 9% interest on their capital contributions. The firm allowed ₹ 54,000 towards interest on capital to partners. What will be the capital contribution of each partner if interest on Gunnu's capital is ₹13,500 more than the interest on Chinu's capital?

    a. ₹ 2,25,000

    b. ₹2,55,000

    c. ₹2,50,000

    d. ₹2,15,000

Answers:

1	**b**	**2**	**a**	**3**	**a**	**4**	**a**

Comprehensive Numerical Problems

1. A, B and C are the partners in Cosco Engineering Works sharing profits and losses at 6: 3: 5. The Balance Sheet as on 31.12.2023 is given below:

    Balance Sheet as on 31st December 2023

Liabilities		Amount (₹)	Assets	Amount (₹)
Capital Accounts:			Land and Building	10,000
A	25,000		Furniture & Fixture	5,000
B	15,000	40,000	Debtors	30,000
Current Accounts:			Stock	23,100
A	1,000		Bank	2,500
B	500	1,500	C's Current Accounts	4,900
Reserve		1,400		
Creditors		28,600		
Mortgage Loan		4,000		
		75,500		75,500

It was decided by the partners to dissolve the partnership on 31.12.2023. The following amount has been realized:

Furniture & Fixture ₹ 2,000; Land and Building ₹ 6,000; Debtors ₹ 20,000 and Stock ₹ 15,000. Creditors are agreed to forgo 25% in full settlement of their total dues. The full amount of Mortgage Loan has been paid. Realisation expenses paid for ₹ 1,650. It was ascertained that B had become insolvent, and B's estate had contributed only 50 paise in a rupee.

You are required to prepare Realisation Account, Bank Account and Partners Capital Account following the rule given in Garner Vs. Murray.

[**Answer:** Loss on realisation ₹19,600; Final dividend from B ₹ 4,400; Bln paid off to A ₹ 23,850 and C ₹ 14,350]

2. M/s P and Co., having P and Q as equal partners, decided to amalgamate with R and Co., having R and S as equal partners on the following terms and condition:

   (i) The new firm PR and Co. to pay ₹ 12,000 to each firm for Goodwill.

   (ii) The new firm to take over investments at 10% depreciation, land at ₹ 66,800, premises at ₹ 53,000, machinery at ₹ 9,000 and only the trade liabilities of both the firms. The Debtors being taken over at given value.

   (ii) Type writers (written off) worth ₹ 800, belonging to R & Co., and not appearing in the balance sheet was also not taken over by the new firm.

   (iv) Bills Payable pertains to trade transaction only.

   (v) All the four partners in the new firm to bring in ₹ 1, 60,000 as capital in equal shares.

The following were the Balance Sheets of both firms on the date of amalgamation: (₹)

Liabilities	P & Co.	R & Co.	Assets	P & Co.	R & Co.
Trade Creditors	20,000	10,000	Cash	15,000	12,000
Bills Payable	5,000	-	Investments	10,000	8,000
Bank Overdraft	2,000	10,000	Debtors ₹ 10,000		
P's Loan	6,000	-	Less: ₹ 1,000	9,000	4,000
Capital :			Furniture	12,000	6,000
P	35,000	-	Premises	30,000	-
Q	22,000	-	Land	-	50,000
R	-	36,000	Machinery	15,000	-
S	-	20,000	Goodwill (Purchased)	9,000	-
General Reserve Investment	8,000	3,000			
FluctuationFund	2,000	1,000			
	1,00,000	80,000		1,00,000	80,000

Assuming immediate discharge of bank overdraft, pass necessary Journal Entries to close the books of P & Co. and R & Co. Also pass Journal entries in the books and prepare the Balance Sheet of the New Firm.

[**Answer:** Purchase Consideration of A & Co. ₹ 80,000 and B & Co. ₹ 80,000, Total of Balance Sheet ₹ 1,95,000]

3. Amar, Akbar and Anthony are equal partners of M/S. Andal & Co. The Balance Sheet of the firm as on 31.12.2023 was as follows:

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital Account:			Fixed Assets:		
Ram	50,000		Land	50,000	
Manas	1,00,000		Building	70,000	
Param	(30,000)	1,20,000	Plant & Machinery	2,00,000	3,20,000
			Current Assets:		
Loan from bank		5,00,000	Stock	3,00,000	
Creditors		1,00,000	Debtors	1,00,000	4,00,000
		7,20,000			7,20,000

On the date, it is decided to convert the partnership into limited company called Pandal limited on the following items:

a. Land to be revalued at ₹ 1,50,000

b. Plant and machinery is to be revalued at ₹ 2,50,000.

c. Depreciation amounting ₹ 20000 is to be written off on building.

d. A provision of 10% books valued to be mate of obsolete stock.

e. Provision of doubtful debts made at 10% of debtors.

f. A discount of 6% would be earned on creditors when paid out.

g. The new company issue ₹ 12,000 equity shares 10 each credited as full paid up, such share capital being valued at ₹ 1,50,000 and the balance payable is to be discharge by issue of 10% debentures of ₹ 100 each.

Show the necessary ledger accounts to close the books of Andal & Co. and show the opening balance sheet of the new company. All partners are solvent and have sufficient cash resource as may be necessary to settle the respective accounts, Shares and debentures are divided equal among the partner.

[**Answer:** Profit on Realisation of Amar ₹ 32,000, Akbar ₹ 32,000, Anthony ₹ 32,000; Purchase Consideration ₹ 2,16,000; Cash Brought in by Anthony ₹ 70,000; Total of Balance Sheet ₹ 8,10,000]

4. Abhi, Sara and Parth carry on business in partnership under the style of M/s A & Co sharing profits and losses in the ratio of 5:3:2. They have floated A Pvt. Ltd for the purpose of takeover of their business. The following is the Balance Sheet of the firm as on 31st December, 2023:

Liabilities	(₹)	Assets		(₹)
Capital Account:		Cash		6,000
Abhi	1,01,000	Bank		14,000
Sara	1,51,000	Debtors	60,000	
Parth	1,33,000	(-) Provision	2,000	58,000
		Stock		42,000
Creditors	50,000	Fixed Assets at WDV		3,00,000
		Expenditure related to A. Pvt. Ltd:		
		Formation Expenses	12,000	
		Bank Account (note-1)	3,000	
				15,000
	4,35,000			4,35,000

Note-1: (In the name of A Pvt. Ltd.) Deposit of par value of 300 equity shares of ₹ 10 each, subscribed equally by the partners as subscribers to the memorandum and article of association. On that day A Pvt. Ltd took over the business for a total consideration of ₹5,00,000 (excluding 300 shares allotted as subscribers of memorandum). The purchase consideration was to be discharge by the allotment of equity shares of ₹10 each at par in the profit- sharing ratio and 15% debenture of ₹100 each at par for surplus capital. The directors of A. Pvt Ltd revalued fixed assets of A & Co. as ₹ 4,00,000.

You are asked to:

(a) State the number of equity shares and debenture allotted by A Pvt Ltd to Abhi, Sara & Parth.

(b) Show the journal entries in connection with the above transaction in the books of A Pvt Ltd. Show your workings.

[**Answer:** Profit on Realisation of Abhi ₹59,000, Sara ₹35,400, Parth ₹23,600; No. of equity shares issued: Abhi 16,000, Sara 9,600, Parth 6,400; No. of debentures issued: Sara 904, Parth 926]

Unsolved Case

M/s PQR is a partnership business in Guwahati, Assam engaged in the wholesale of edible oil. The business has three partners, P, Q and R who started the business way back in October 1987. As per their partnership deed, the partners share profits and losses in the ratio of 5: 3: 2.

Even though their business was going on pretty well, none of their daughters and sons agreed to carry on the business started by their fathers. So, during the year 2022-23, the partners mutually decided to dissolve their business after the close of the accounts for that financial year. The Balance Sheet of the firm as on 31.03.2023 is given below:

Liabilities		(₹)	Assets	(₹)
Capital Accounts:			Machinery	5,00,000
P	1,00,000		Car	1,00,000
Q	4,00,000		Debtors	4,50,000
R	2,00,000	7,00,000	Stock	6,00,000
Creditors		10,00,000	Bank	50,000
		17,00,000		**17,00,000**

Machinery and stock are sold for ₹ 2,50,000 and ₹ 1,80,000 respectively. Car is taken over by Q for ₹ 1,20,000. An amount of ₹ 2,00,000 could be realized from the Debtors. It was agrred between P, Q and R that any deficiency of any partner in Capital account is to be met by other partners in their profit sharing ratio. During the dissolution process, P was declared insolvent, the third partner, R could bring in ₹ 50,000 only.

1. Ascertain the amount of profit or loss arising in the event of dissolution of the firm.
2. Determine the amount of deficiency of P and how such deficiency has been borne by the other partners.
3. Show the settlement of the Bank Account of the firm as at the end of the dissolution process.

SECTION - E

Lease, Branch and Departmental Accounts etc.

Lease Accounting 5

SLOB Mapped against the Module

To equip oneself with the detail understanding of accounting of certain special transactions to determine surplus, ensure control on resources, for divisional performance evaluation or acquisition of assets through deferred payments. (CMLO 2a, 4c)

Module Learning Objectives:

After Studying this module, the students will be able to:

- Identify the types of lease;
- Get detail knowledge of accounting and reporting of lease transactions as per AS 19;
- Earn the knowledge of comparative provisions under Ind AS.

Lease Accounting

5

Lease is an arrangement by which the lessor gives the right to use an asset for a certain period of time to the lessee on rent. It involves two parties, a lessor and a lessee and an asset which is to be leased. The lessor who owns the asset, agrees to allow to the lessee to use it for a specified period of time in return for periodic rent payments.

The lease transactions derive its accounting complexity from number of alternatives available to the parties involved. Lease can be structured to take tax benefit. It can be used to transfer ownership of the leased asset, and it can also be used to transfer the risk of ownership.

In India, accounting for leases is covered under Accounting Standard (AS) 19 Leases.

Objective

The objective of AS 19 is to prescribe the appropriate accounting policies and disclosures in relation to finance leases and operating leases for both lessees and lessors.

Applicability

AS 19 should be applied in accounting for all leases other than:

(a) lease agreements to explore for or use natural resources, such as oil, gas, timber, metals and other mineral rights;

(b) licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and

(c) lease agreements to use lands.

Important Definitions

The following terms are used in this Standard with the meanings specified:

A **lease** is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

The **lease term** is the non-cancellable period for which the lessee has agreed to take on lease the asset together with any further periods for which the lessee has the option to continue the lease of the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.

Residual value of a leased asset is the estimated fair value of the asset at the end of the lease term.

Guaranteed residual value is:

(a) in the case of the lessee, that part of the residual value which is guaranteed by the lessee or by a party on behalf of the lessee.

(b) in the case of the lessor, that part of the residual value which is guaranteed by or on behalf of the lessee, or by an independent third party.

Unguaranteed Residual value – It is the difference between residual value of asset and its guaranteed residual value is unguaranteed residual value.

Gross Investment is the sum of the following:

(a) Minimum lease payment (from the standpoint of lessor) and

(b) Any unguaranteed residual value accruring to the lessor.

Interest rate implicit in the lease – When the lessor gives an asset on lease (particularly on finance lease), the total amount, which he receives over lease period by giving the asset on lease, includes the element of interest plus payment of principal amount of asset. The rate at which the interest amount is calculated can be simply called implicit rate of interest. More accurately it can be expressed as under

It is the discount rate at which Fair Value of leased Asset (At the inception of lease) is calculated = Present value of [Minimum lease payment (In respect of lessor) + any unguaranteed residual value accruing to the lessor]

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

Economic life is either: (a) the period over which an asset is expected to be economically usable by one or more users; or (b) the number of production or similar units expected to be obtained from the asset by one or more users.

Useful life of a leased asset is either: (a) the period over which the leased asset is expected to be used by the lessee; or (b) the number of production or similar units expected to be obtained from the use of the asset by the lessee.

Contingent rent is that portion of the lease payments that is not fixed in amount but is based on a factor other than just the passage of time (e.g., percentage of sales, amount of usage, price indices etc.

Minimum lease payments:

For lessor = Total lease rent to be paid by lessee over the lease terms + any guaranteed residual value (by or on behalf of lessee) - contingent rent - cost for service and tax to be paid by and reimbursed to lessor + residual value guaranteed by third party.

For lessee = Total lease rent to be paid by lessee over the lease terms any guaranteed residual value (for lessee) - contingent rent - cost for service and tax to be paid by and reimbursed to lessor.

Unearned finance income is the difference between:

(a) the gross investment in the lease; and

(b) the present value of (i) the minimum lease payments under a finance lease from the standpoint of the lessor; and (ii) any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Net investment in the lease is the gross investment in the lease less unearned finance income.

The **lessee's incremental borrowing rate of interest** is the rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

Classification of Leases

The classification of leases is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee.

Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions. Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

Leases are classified into two types:

1. **Finance lease:** A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. Title may or may not eventually be transferred.
2. **Operating lease:** A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership.

It is important to note that lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease the revised agreement is considered as a new agreement over its revised term. However, Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased asset) or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

1. Finance Lease

Finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than its form.

Situations which lead to a lease being classified as a finance lease

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the inception of the lease, it is reasonably certain that the option will be exercised;

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred;

(d) at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and

(e) the leased asset is of a specialised nature such that only the lessee can use it without major modifications being made.

Indicators of situations leading to finance lease

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

(b) gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

(c) the lessee can continue the lease for a secondary period at a rent which is substantially lower than market rent.

Treatment of finance lease in financial statement of lessee

As it is already mentioned that legally the ownership of leased asset remains with lessor but risk and reward of leased asset is transferred to lessee therefore the substance of transactions is lessee becomes the owner, hence the transactions are recorded by substance not by their legal form.

Leased asset as well as liability for lease should be recognised at the lower of-

- Fair value of the leased asset at the inception of lease or

- Present value of minimum lease payment from the lessee point of view, whichever is lower.
- Apportionment of lease payment

Each lease payment is apportioned between finance charge and principal amount. Principal amount is reduced from the outstanding liability. Finance charge is allocated over the lease term in such a manner that it would produce a constant rate of return on the remaining principal balance.

- The lessee in its books should charge depreciation on finance lease asset as per AS-10.
- Initial direct cost for financial lease is included in asset under lease.

Accounting for finance lease - In the books of lessor

The substance of finance lease is that the lessor sells leased assets to lessee

Therefore, the lessor should recognize asset given under finance lease as receivable at an amount equal to net investment in the lease and corresponding credit to sale of asset.

Net Investment = Gross Investment - Unearned Finance Income

Gross Investment = (Minimum lease payment from lessor point of view + Unguaranteed residual value).

Unearned Finance Income = Gross Investment - present value of Gross Investment

Recognition of Finance Income

The lessor should recognize the finance income based on a pattern reflecting, constant periodic return on the net investment outstanding in respect of the finance lease. In simple words interest/finance income will be recognized in proportion to outstanding balance receivable from lease over lease period.

Disclosure of financial lease by lessee:

The lessee should, in addition to the requirements of AS 10, Property, Plant & Equipment, make the following disclosures for finance leases:

(a) assets acquired under finance lease as segregated from the assets owned;

(b) for each class of assets, the net carrying amount at the balance sheet date;

(c) a reconciliation between the total of minimum lease payments at the balance sheet date and their present value. In addition, an enterprise should disclose the total of minimum lease payments at the balance sheet date, and their present value, for each of the following periods: (i) not later than one year; (ii) later than one year and not later than five years; (iii) later than five years;

(d) contingent rents recognised as expense in the statement of profit and loss for the period;

(e) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date; and

(f) a general description of the lessee's significant leasing arrangements including, but not limited to, the following: (i) the basis on which contingent rent payments are determined; (ii) the existence and terms of renewal or purchase options and escalation clauses; and (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Provided that a Small and Medium Sized Company, as defined in the Notification, may not comply with sub-paragraphs (c), (e) and (f).

Disclosure of financial lease by lessor:

The lessor should make the following disclosures for finance leases:

(a) a reconciliation between the total gross investment in the lease at the balance sheet date, and the present value of minimum lease payments receivable at the balance sheet date. In addition, an enterprise should disclose the total gross investment in the lease and the present value of minimum lease payments receivable at the balance sheet date, for each of the following periods: (i) not later than one year; (ii) later than one year and not later than five years; (iii) later than five years;

(b) unearned finance income;

(c) the unguaranteed residual values accruing to the benefit of the lessor;

(d) the accumulated provision for uncollectible minimum lease payments receivable;

(e) contingent rents recognised in the statement of profit and loss for the period;

(f) a general description of the significant leasing arrangements of the lessor; and

(g) accounting policy adopted in respect of initial direct costs.

Provided that a Small and Medium Sized Company, as defined in the Notification, may not comply with sub-paragraphs (a) and (f).

2. Operating Lease

Operating lease is a lease other than a finance lease.

Accounting for operating lease

In the books of lessor:

- Record leased out asset as the fixed asset in the balance sheet.
- Charge depreciation as per AS-10.
- Recognize lease income in profit & loss account using straight-line method. If any other method reflects more systematic allocation of earning derived from the diminishing value of leased out asset, that approach can be adopted.
- Other costs of operating lease should be recognized the year in which they are incurred.
- Initial direct cost of the lease may be expensed immediately or deferred.

Accounting for operating lease - In the Books of lessee

Lease payments should be recognized as an expense in the profit and loss account on a straight-line basis over the lease term. If any other method is more representative of the time pattern of the user's benefit, such method can be used.

Disclosure of operating lease:

The lessee should make the following disclosures for operating leases:

(a) the total of future minimum lease payments under noncancellable operating leases for each of the following periods: (i) not later than one year; (ii) later than one year and not later than five years; (iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date;

(c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following: (i) the basis on which contingent rent payments are determined; (ii) the existence and terms of renewal or purchase options and escalation clauses; and (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing.

Provided that a Small and Medium Sized Company, as defined in the Notification, may not comply with sub-paragraphs (a), (b) and (e).

Sale and Leaseback Transactions

A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payments and the sale price are usually interdependent as they are negotiated as a package.

Accounting of sale and leaseback transaction

The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.

When a sale and leaseback transaction results in a finance lease: Any excess or deficiency of sales proceeds over the carrying amount should not be immediately recognised as income or loss in the financial statements of a seller-lessee. Instead, it should be deferred and amortised over the lease term in proportion to the depreciation of the leased asset.

When a sale and leaseback transaction results in an operating lease: In such a case, if it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately. For finance leases, no such adjustment is necessary unless there has been an impairment in value, in which case the carrying amount is reduced to recoverable amount in accordance with the Accounting Standard dealing with impairment of assets.

Illustration 1

Arun Ltd. has taken an equipment on operating lease for the coming 5 years. As per the agreement with the lessor, it will not make any payment for lease rentals for the first 2 years, and will have to pay ₹ 21,00,000 in each of the following 3 years. Advise Arun Ltd. on accounting for the lease rentals in this case.

Solution:

As per AS-19, lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

The pattern of payment, in this case, does not follow straight line basis, rather it is arising towards the end of the lease period. For accounting purpose, such effect should be neutralized i.e. the total payment of ₹ 63,00,000 in the last 3 years should be spread over the entire lease period of 5 years i.e. ₹ 12,60,000 should be charged to the statement of profit and loss for each year.

Illustration 2

Vishnu Ltd. leased a printing machine from Garur Ltd. for a period of 3 years. The useful life of the printing machine is known to be of 5 years. It was agreed between the lessor and lessee that the amount will be paid in 3 instalments and at the termination of the lessee, Garur Ltd. will take back the said machine. The following details are available in respect of the machine lessee:

- Cost of the printing machine is ₹ 15,00,000;
- Unguaranteed residual value at the end of the lease period is ₹ 2,00,000;
- Fair value of the machine is ₹ 15,00,000;
- The internal rate of return of the investment is 10%.

You are required to:

(a) State whether the lease is a finance lease or an operating lease?

(b) Ascertain the amount of unearned finance income.

Given: PVF10%, 3 = 0.7513; PVAF10%, 3 = 2.4868.

Solution:

(a) Present value of unguaranteed residual value = ₹ 2,00,000 × 0.7513 = ₹ 1,50,260

∴ Present value of lease payments = ₹ (15,00,000 – 1,50,260) = ₹ 13,49,740

Present value of lease payments as percentage of Fair value = $\frac{13,49,740}{15,00,000}$ = 90% (approx.)

As the 'Present value of lease payments' makes a substantial portion of the 'Fair value', the machine lease by Vishnu Ltd. from Garur Ltd. is a finance lease by nature.

(b) Annual lease payments = $\frac{\text{Present value of lease payments}}{\text{PVAF10\%, 3}} = \frac{13,49,740}{2.4868}$ = ₹ 5,42,762 (approx.)

Gross investment in lease = ₹ [(₹ 5,42,762 × 3) + 2,00,000] = ₹ 18,28,286

∴ Unearned finance income = Excess of 'Gross investment in lease' over 'Cost of the printing machine'

= ₹ (18,28,286 – 15,00,000)

= ₹ 3,28,286

Illustration 3

PQ Ltd. sold machinery having WDV of ₹80 lakhs to BR Ltd. for ₹ 100 lakhs and the same machinery was leased back by BR Ltd. to PQ Ltd. The lease back is operating lease. Comment if –

(a) Sale price of ₹100 lakhs is equal to fair value.

(b) Fair value is ₹ 120 lakhs.

(c) Fair value is ₹ 90 lakhs and sale price is ₹ 76 lakhs.

(d) Fair value is ₹ 80 lakhs and sale price is ₹ 100 lakhs.

(e) Fair value is ₹ 92 lakhs and sale price is ₹ 100 lakhs

(f) Fair value is ₹ 70 lakhs and sale price is ₹ 78 lakhs.

Solution:

Following will be the treatment in the given cases:

(a) When sales price of ₹ 100 lakhs is equal to fair value, PQ Ltd. should immediately recognise the profit of ₹ 20 lakhs (i.e. 100 – 80) in its books.

(b) When fair value is ₹ 120 lakhs then also profit of ₹ 20 lakhs should be immediately recognised by PQ Ltd.

(c) When fair value of leased machinery is ₹ 90 lakhs & sales price is ₹ 76 lakhs, then loss of ₹4 lakhs (80 – 76) to be immediately recognised by PQ Ltd. in its books provided loss is not compensated by future lease payment, otherwise it can defer and amortise the loss.

(d) When fair value is ₹80 lakhs & sales price is ₹100 lakhs then, profit of ₹20 lakhs is to be deferred and amortised over the lease period.

(e) When fair value is ₹92 lakhs & sales price is ₹100 lakhs, profit of ₹12 lakhs (92 - 80) to be immediately recognised in its books and balance profit of ₹8 lakhs (100-92) is to be amortised/deferred over lease period.

When fair value is ₹70 lakhs & sales price is ₹78 lakhs, then the loss of ₹10 lakhs (80-70) to be immediately recognised by PQ Ltd. in its books and profit of ₹ 8 lakhs (78-70) should be amortised/deferred over lease period.

Illustration 4

SKS Ltd. has taken the assets on lease from PC Soft Ltd. The following information is given below:

Lease term	=	4 years
Fair value at inception of the lease term	=	₹ 16,00,000
Lease Rent	=	₹ 5,00,000 p.a. at the end of the year
Guaranteed Residual Value	=	₹ 1,00,000
Expected Residual value	=	₹ 3,00,000
Implicit Interest Rate	=	14.97%

Show the accounting in the book of lessee.

Solution:

Present value of minimum lease payment

Year	MLP	Discount rate at 14.97%	PV
1	5,00,000	0.8698	4,34,900
2	5,00,000	0.7565	3,78,250
3	5,00,000	0.6580	3,29,000
4	6,00,000	0.5724	3,43,000
	(Including ₹ 1,00,000)		14,85,590

Present value of minimum lease payment (₹ 14,85,590) which is less than Fair value at the inception of lease (₹ 16,00,000) hende the leased asset and liability will be recognized at ₹ 14,85,590.

Apportionment of Finance Lease: **Rate of Interest 14.97%**

Year	Liability	MLP	Finance Charge	Principal Amt. of reduction
0	14,85,590	-	-	-
1	12,07,983	5,00,000	2,22,393	2,77,607
2	8,88,818	5,00,000	1,80,835	3,19,165
3	5,21,874	5,00,000	1,33,056	3,66,944
4	-	6,00,000	78,125	5,21,875

Books of SKS Ltd.

Lease Rent Account

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
1st year To Bank	5,00,000	By Finance Charge	2,22,393
		By Lease liability A/c	2,77,607
	5,00,000		5,00,000
2nd year To Bank	5,00,000	By Finance Charge	1,80,835
		By Lease liability A/c	3,19,165
	5,00,000		5,00,000
3rd year To Bank	5,00,000	By Finance Charge	1,33,056
		By Lease liability A/c	3,66,944
	5,00,000		5,00,000
4th year To Bank	6,00,000	By Finance Charge	78,126
		By Lease liability A/c	5,21,874
	6,00,000		6,00,000

Lease Liability Account (Lessor)

Dr. **Cr.**

Particulars	Amount (₹)	Particulars	Amount (₹)
1st year			
To Lease Rental	2,77,607	By Fixed Asset under	14,85,590
To Balance c/d	12,07,983	Finance lease	
	14,85,590		14,85,590
2nd year			
To Lease Rental	3,19,165	By Balance b/d	12,07,903
To Balance C/d	8,88,818		
	12,07,903		12,07,903
3rd year			
To Lease Rent	3,66,944	By Balance b/d	8,88,818
To Balance c/d	5,21,874		
	8,88,818		8,88,818
4th year			
To Lease Rent	5,21,874	By Balance b/d	5,21,874
	5,21,874		5,21,874

Extract of Profit and Loss Account

Year	Particulars	Amount (₹)
1st Year	To Finance Charge	2,22,393
	To Depreciation on leased asset under SLM	3,71,397
2nd Year	To Finance Charge	1,80,835
	To Depreciation	3,71,397
3rd Year	To Finance Charge	1,33,056
	To Depreciation on leased Asset under SLM	3,71,397
4th Year	To Finance Charge	78,125
	To Depreciation on leased Asset under SLM	3,71,397

Extract of Balance Sheet

Liability	Amount (₹)	Asset	Amount (₹)
Lease liability A/c	12,07,983	Fixed Asset under Finance Lease	14,85,590
		Less: Depreciation	3,71,397
			11,14,193
2nd year			
Lease liability A/c	8,88,818	Fixed Asset under Finance Lease	14,85,590
		Less: Depreciation	7,42,794
			7,42,796
3rd year			
Lease liability A/c	5,21,874	Fixed Asset under Finance Lease	14,85,590
		Less: Depreciation	11,14,191
			3,71,399
4th year			
Lease liability A/c	Nil	Fixed Asset under Finance Lease	14,85,590
		Less: Depreciation	14,85,590
			NIL

Illustration 5

RK Soft Ltd. has taken the assets on lease from BD Tech Ltd. The following information is given below:

Lease term	=	4 years
Fair value at inception of lease	=	₹16,00,000
Lease Rent	=	₹5,00,000 p.a. at the end of the year
Guaranteed Residual Value	=	₹1,20,000
Expected Residual value	=	₹3,00,000
Implicit Interest Rate	=	14.97%

Show the accounting in the book of lessor.

Solution:

Lessor should recognize asset given under lease at net investment in lease.

Net investment in lease = Gross investment - unearned finance income

Gross Investment = MLP + Guaranteed residual value + Unguaranteed residual value

= 20,00,000 + 1,20,000 + 1,80,000

= 23,00,000

Unearned finance Income = Gross investment – Present value of gross investment

Present Year	Value of MLP (₹)	Gross investment discount factor	Present Value (₹)
1	5,00,000	0.8698	4,34,900
2	5,00,000	0.7565	3,78,250
3	5,00,000	0.6580	3,29,000
4	8,00,000	0.5724	4,57,920
	23,00,000		16,00,070 say 16,00,000

Unearned finance income = ₹23,00,000 – ₹16,00,000 = ₹7,00,000

Appointment of MLP into Capital recovery & finance income

Year	Balance of lease receivable (₹)	Cash receipts (₹)	Finance (₹)	Capital recovery reduced from receivable (₹)
0	16,00,000	-	-	-
1	13,39,520	5,00,000	2,39,520	2,60,480
2	10,40,045	5,00,000	2,00,525	2,99,475
3	6,95,740	5,00,000	1,55,695	3,44,305
4	-	8,00,000	1,04,260	6,95,747
			7,00,000	16,00,000

The lease receivable account, as shown in the books of lessor will not tally with the lease liability account as shown by the lessee in his book. Difference will remain due to the guaranteed residual value from the third party or /and unguaranteed residual value from the lessee point of view.

Illustration 6

VHR Ltd. availed a lease from Alpha Ltd. on following terms:

- A lease for a tenor of 3 years, in the beginning of year 2021 for equipment costing ₹6,00,000 and which has an expected useful life of 5 years. The fair market value is also ₹6,00,000.
- 3 equal annual payments are made at end of each year.
- The property reverts back to the lessor on termination of the lease.
- The unguaranteed residual value is estimated at ₹75,000 at the end of year 2023.
- IRR = 10%
- The present value of ₹1 due at the end of 3rd year at 10% rate of interest is 0.7513.
- The present value of annuity of ₹1 due at the end of 3rd year at 10% IRR is ₹2.4868

(i) State with reason whether the lease constitute finance lease.

(ii) Calculate unearned finance income.

Solution:

(i) Computation of Annual payment to the lessor

PV of residual value (₹)	= 75,000 x 0.7513	=	56,348
PV of lease payments (₹)	= 6,00,000 – 56,348	=	5,43,652
Annual payments (₹)	= 5,43,652 / 2.4868	=	2,18,615

The present value of lease payments i.e. ₹5,43,652 equals 90.60% of the fair market value i.e., ₹6,00,000. As the present value of minimum lease payment substantially covers the initial fair value of the leased assets and leased term (3 years) covers the major part of the life of asset (5 years). Therefore, it constitutes a finance lease.

(ii) Computation of unearned finance income

		Amt. (₹)
Gross investment in the lease	(3 x 2,18,615) + 75,000	7,30,845
Cost of leased property		6,00,000
Unearned finance income		1,30,845

Illustration 7

Beta Ltd. leased a machinery to Gama Ltd. on the following terms:

	(₹ In Lakhs)
Fair value of the machinery	20.00
Lease term	5 years
Lease rental per annuam	5.00
Guaranteed Residual value	1.00
Expected residual value	2.00
Internal Rate of Return	15%

Depreciation is provided on Straight line method @10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the First year.

Solution:

Present value of MLP (for lessee)

Year	MLP (₹)	Discount Rate	PV (₹)
1	5,00,000	0.8696	4,34,800
2	5,00,000	0.7561	3,78,050
3	5,00,000	0.6575	3,28,750
4	5,00,000	0.5718	2,85,900
5	6,00,000	0.4972	2,98,320
			17,25,820

Note:

It has been assumed that the lease rent is paid at the end of the year

Present value of MLP is less than fair value of ₹20,00,000, so the leased asset and liability should be recognized at ₹17,25,820 in the books of lessee (Beta Ltd.)

Calculation of unearned finance income

Unearned finance income = Gross investment – PV of Gross Investment.

For the Lesser.

Year	MLP (₹)	Discount Rate	P.V. (₹)
1	5,00,000	0.8696	4,34,800
2	5,00,000	0.7561	3,78,050
3	5,00,000	0.6575	3,28,750
4	5,00,000	0.5718	2,85,900
5	7,00,000	0.4972	3,48,040
	27,00,000		17,75,540

Unearned Finance Income –

₹27,00,000 - ₹17,75,540 = ₹9,24,460

Apportionment of MLP into finance charge and principal amount at the end of the year.

Year	Liability (₹)	MLP (₹)	Finance Charge (₹)	Principal (₹)
0	17,25,820	-	-	-
1	14,84,693	5,00,000	2,58,873	2,41,127
2	12,07,397	5,00,000	2,22,704	2,77,296
3	12,07,397	5,00,000	1,81,110	3,18,890
4	8,88,507	5,00,000	1,33,276	3,66,724
5	-	6,00,000	78,267	5,21,733

Entries in the books of Beta Ltd. (lessee) in first year

Particulars		Dr. (₹)	Cr. (₹)
Machinery (leased) A/c	Dr.	17,25,820	
To lease liability			17,25,820
Depreciation A/c	Dr.	1,72,582	
To Machinery A/c			1,72,582
Lease Liability A/c (Beta Ltd.)	Dr.	2,41,127	
Finance Charge	Dr.	2,58,873	
To Bank			5,00,000
Profit & Loss A/c	Dr.	4,31,455	
To Depreciation A/c			1,72,582
To Finance Charges			2,58,873

Exercise

A. Theoretical Questions:

Multiple Choice Questions

1. The person who undertake an agreement, conveys to another person the right to use in return for rent, an assest for an agreed period of time.
   a. Lessor
   b. Lessee
   c. Both
   d. None of the above

2. Operating lease is a _________ .
   a. Revocable contract
   b. Non revocable contract
   c. Operating contract
   d. None of the above

3. Which lease transfer substantially all the risk and rewards incident to ownership of an asset?
   a. Operating lease
   b. Finance lease
   c. Both
   d. None of the above

4. In which types of lease expenses like maintenance, repair, and taxes are born by the lessor?
   a. Operating lease
   b. Financial lease
   c. Both
   d. None of the above

5. Short-term lease which is often cancellable is known as
   a. Finance Lease
   b. Net Lease
   c. Operating Lease
   d. Leverage Lease

6. A lease which is generally not cancellable and covers full economic life of the asset is known as:
   a. Sale and leaseback
   b. Operating Lease
   c. Finance Lease
   d. Economic Lease

7. One difference between Operating and Financial lease is:
   a. There is often an option to buy in operating lease

b. There is often a call option in financial lease.
c. An operating lease is generally cancelable by lease
d. A financial lease in generally cancelable by lease.

Answer:

1	a	2	a	3	b	4	a	5	c	6	c	7	c

- **Fill in the Blanks**

1. As per AS-19 in__________ lease risk and reward is not transferred to the lessee.
2. In financial lease as per As-19 leased assets is shown in the Balanced sheet of _________.
3. __________ account is credited when lessor receive an amount.

Answer:

1	**Operating**	2	**Lessee**
3	**Lessee Account**		

B. Numerical Questions:

- **Comprehensive Numerical Problems**

1. Unique Ltd. availed a lease from Papan Ltd. on following terms:
   - A lease for a tenor of 3 years, in the beginning of year 2020 for equipment costing ₹ 7,00,000 and which has an expected useful life of 5 years. The fair market value is also ₹ 7,00,000.
   - 3 equal annual payments are made at end of each year.
   - The property reverts back to the lessor on termination of the lease.
   - The unguaranteed residual value is estimated at ₹ 75,000 at the end of year 2022.
   - IRR=10%
   - The present value of ₹ 1 due at the end of 3rd year at 10% rate of interest is 0.7513.
   - The present value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868

   (i) State with reason whether the lease constitute finance lease.
   (ii) Calculate unearned finance income.

[**Answer:** Unearned finance income ₹1,51,451]

Branch (including Foreign Branch) and Departmental Accounts

6

Branch (including Foreign Branch) and Departmental Accounts

SLOB Mapped against the Module

To equip oneself with the detail understanding of accounting of certain special transactions to determine surplus, ensure control on resources, for divisional performance evaluation or acquisition of assets through deferred payments. (CMLO 2a, 4c)

Module Learning Objectives:

After studying this module, the students will be able to:

- Do the accounting of domestic branches.
- Understand the accounting of foreign branches.
- Get the knowledge for preparation of Departmental Income Statement.

Branch Accounting

6.1

Branch is an extended location of an organisation, other than its head office, where businesses of similar or related to the organisation are conducted. Usually a organisation opens branches for the following purposes:

- **For profit making organisations:** Through opening a branch organisation can offer visibility and brand exposure which can positively influence its profits.
- **For non-profit making organisations:** To satisfy a large number of stakeholders needs by increasing its outreach.

The typical characteristics of a branch are:

- A branch is not a separate legal entity, but rather an extended unit of an organisation.
- All branches are controlled by their head office; hence a branch is completely dependent on its head office for its operation and decision making.
- An organisation can open a branch in the same country where it is registered or in any other country.
- Branches are opened by both profit making organisations (viz. departmental stores, hotels etc.) and non-profit making organisations (viz. charitable institutions) as well.

Classification of Branches

On the basis of geographical area of operation branches are of two types

- **Domestic Branch:** Domestic branch is mainly opened and operated in the same country where the organisation is registered and has its head office.

  Example: State bank of India and its different branches all over the India
- **Foreign Branch:** Foreign branch is opened and operated in a country other than the country where the organisation is registered and has its head office.

  Example: Dubai branch of State bank of India.

Moreover, depending on the level of control between the branch and head office, a domestic branch can be further classified into the following two types:

- **Dependent Branch:** This type of branch is completely dependent on its head office in respect of its operation, administration and further maintenance of its accounts.
- **Independent Branch:** It maintains its own books of accounts and records its transactions independently.

Branch Accounting

- Branch accounting refers to the recording and maintenance of each transaction taken place by a branch to determine the financial results and also get to know the financial position of a branch.

- For the dependent branch, accounting is done by the H.O and while for an independent branch the accounting is done at the branch itself.
- Branch accounting is based on 'Responsibility Accounting' system, where the branches act as a 'Revenue Centre' in addition to being 'Cost Centre'.
- The transactions between branch and head office are recorded; and branch and other parties. At the end of each financial period it ascertains the financial result of each branch viz. profit and loss.

Some of the common transactions that are usually involved in branch accounting include goods sent by the H.O and return of the goods, if any, assets sent by H.O, cash remitted by H.O for meeting the branch expenses, sales effected by branch, branch proceeds sent to H.O at time intervals, Goods sent by the H.O for sale; such goods may be sent either at cost price or invoice price:

Methods of Branch Accounting

Accounting for Dependent Branches: The recording of transactions take place at branch and maintenance of accounts of each branch is done by the H.O. Any dependent branch follows any of the following four methods of accounting:

1. Debtors Method or Synthetic Method.
2. Stock Debtors method or Analytical Method.
3. Final Accounts Method (Cost Basis)
4. Final Accounts Method (on Whole Sale Price Basis).

Debtor Method or Synthetic Method

Under this method of accounting, head office maintains separate branch account for each branch which appears as 'Debtor' in the books of the H.O; hence the H.O has the right to claim the money arising out of the operations carried out by the branch after meeting the necessary expenses of branch. Primarily H.O adopts Debtor Method or Synthetic Method for its dependent branch accounting which generally small scale and size. This method is also called the '**Synthetic Method**'

The typical characteristics of this method of accounting for dependent branches are:

- Two ledger accounts are maintained for recording the transactions, namely Branch Account and Goods Sent to Branch Account.
- In the Branch Account only the transactions between the H.O and branch are to be recorded.
- Under this method, all transactions relating to a branch are recorded and maintained in the Branch Account.

The Branch Account is by nature a nominal account which ascertains the net profit or loss of the branch.

When goods are sent by H.O to branch at 'Cost' that are to be accounted at cost price whereas, when goods sent by H.O at 'Invoice Price' that are to be accounted at Invoice Price and load thereof has to be cancelled to ensure the proper result. The journal entries of the various transactions under this method are:

- Common for Cost or Invoice Price

1. Goods sent to branch by the head office	Branch A/c To Goods sent to branch A/c	Dr.

2. Cash sent to branch by head office for meeting different expenses.	Branch A/c Dr. To Bank/Cash A/c
3. Cash remitted by branch to head office on account of sale.	Bank/Cash A/c Dr. To Branch A/c
4. Goods returned by branch to the head office.	Goods sent to branch A/c Dr. To Branch A/c
5. Abnormal loss in the branch.	Abnormal Loss A/c Dr. To Branch A/c
6. Claim received from insurance company on account of abnormal loss.	Bank/Cash A/c Dr. To Abnormal Loss A/c
7. Actual loss due to abnormal loss.	General P&L A/c Dr. To Abnormal Loss A/c

- Additional entries (Only if goods sent at invoice price)

1. To reduce load on opening stock.	Stock Reserve A/c Dr. To Branch A/c
2. To reduce load on goods sent to branch by the head office.	Goods sent to branch A/c Dr. To Branch A/c
3. To reduce load on goods returned by branch to the head office.	Branch A/c Dr. To Goods sent to branch A/c
4. To reduce load on abnormal loss in the branch	Branch A/c Dr. To Abnormal Loss A/c
5. To reduce load on closing stock.	Branch A/c Dr. To Stock Reserve A/c

Transactions which do not appear in Branch Account

The following transactions do not appear in the Branch Account:

(a) Expenses incurred by Branch out of cash, since either reduced cash balance at the end is decreased or the liability at the end is increased.

(b) Purchase of Goods/Fixed Assets by Branch, since book value of Goods/Fixed assets at the end is increased and either the amount of remittances is reduced or the Creditors at the end are increased.

(c) Sale of Goods/Fixed Assets by Branch since book value of Goods/Fixed assets at the end is decreased and either the amount of remittances is increased or the Debtors at the end are increased.

(d) Bad debts, discount allowed, sales returns by customers to branch, cash received by Branch from Branch Debtors, etc., since the debtors at the end appear at the adjusted figure.

(e) Depreciation and Profit/Loss on sale of fixed assets since fixed assets at the end appear at the adjusted figure.

(f) Abnormal Losses since stock at the end appears at the adjusted figure.

Illustration 1

DK Traders of Assam has a branch at Mumbai. The branch receives all supply of goods from the head office (Assam). From the following particulars relating to Mumbai Branch for the year ending Mar.31, 2023. Prepare a Branch Accounts and a Goods Sent to Branch Account in the books of the Head office.

Particulars	(₹)	Particulars	(₹)
Stock at Branch on 1.04.2022 (at cost):	8400	Bills Receivable received from Debtor	20,000
Branch Debtor on 1.04.2022	6200	Cash sent to branch for exp.	
Petty Cash at Branch on 1.04.2022:	200	- Salaries	3,800
Goods Sent to Branch		- Petty exp.	400
during the year (at cost):	80,000	Stock at Branch on 31.3.2023 (at cost)	6,400
Goods returned by the branch	800	Petty Cash at Branch on 31.3.2023	300
Cash Sales during the year	72,000	Branch Debtor on 31.3.2023	?
Credit Sales during the year	46,000		
Cash received from Debtor	18,800		

Solution: **Books of DK Traders (Assam H.O.)**

Dr. **Mumbai Branch Account** **Cr.**

Particulars		(₹)	Particulars		(₹)
To Balance b/f:			By Bank A/c [Remittance by branch]		
Stock (at cost)		8,400	Cash Sales	₹ 72,000	
Debtors		6,200	Collection from Debtors	₹ 18,800	90,800
Petty Cash		200	By Goods Sent to Branch A/c		800
To Goods Sent to Branch A/c [at cost]		80,000	[Returned by branch]		
To Bank A/c [Cash sent]			By Balance c/f		
Salaries	₹ 3,800		Stock (at cost)		6,400
Petty Expenses	₹ 400		Debtors [WN:1]		13,400
		4,200	Petty Cash		300
To General P/L A/C [Branch Transfer]		32,700	Bills Receivable		20,000
		1,31,700			**1,31,700**

Dr. **Goods Sent to Branch Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Mumbai Branch A/c	800	By Mumbai Branch A/c	80,000
[Returned by branch]		[Cost of goods sent]	
To Trading/ Purchases A/c [Transfer]	79,200		
	80,000		**80,000**

Working Notes:

1. Closing Balance of Branch Debtors:

Memorandum Branch Debtors Account

Particulars	(₹)	Particulars	(₹)
To Opening Balance	6,200	By Cash collected	18,800
To Credit Sales	46,000	By Bills Receivable Received	20,000
		By Closing Balance [B/fig]	13,400
	52,200		52,200

Illustration 2

S Ltd. Sends goods to Siliguri Branch Account at an invoice price (IP) so as to show 20% profit on such IP. Branch sale are partly on cash and partly on credit. From the following details prepare Branch Account in the books of the Head Office [Fig. in ₹]:

Opening stock at Branch at invoice price	8,000	Cash received from customers	6,50,000
Closing stock at Branch at invoice price	8,500	Discount allowed to customers	20,000
Goods sent to Branch at cost price	4,80,000	Closing balance of Debtor	92,000
Goods returned to H.O at invoice price	40,000	Opening balance of Debtor	1,00,000
Sales:			
Credit – ₹6,80,000			
Cash – ₹1,10,000			
Bad debts	4,000		
Returns from Customers	14,000		
Sundry Branch Exp.	1,50,000		

Solution: **Books of S Ltd. (……H.O.)**

Dr. **Siliguri Branch Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f		By Stock Reserve A/c	1,600
Stock [at IP]	8,000	[Load on opening Stock Reserve: ₹8,000×20%]	
Debtors	1,00,000		
To Goods sent to branch A/c	6,00,000	By Goods sent to branch A/c	1,20,000
[goods sent at IP: ₹4,80,000 × 100/80]		[Load on goods sent: 6,00,000×20%]	
		By Goods sent to branch A/c	
To Goods sent to branch A/c	8,000	[Returns by Branch to H.O: at IP]	40,000
[Load on goods returned : ₹40,000 × 20%]		By Bank A/c [Remittance from branch]	
		Cash sales ₹ 1,10,000	
To Bank A/c	1,50,000	Receipt from customers ₹ 6,50,000	
[Remittance for branch expenses]			7,60,000

Particulars	(₹)	Particulars	(₹)
To Stock Reserve A/c	1,700	By Balance c/f	
[Load on closing Stock Reserve: 8500×20%]		Stock [at IP]	8,500
		Debtors	92,000
To General P/L A/c [Branch NP transferred]	1,54,400		
	10,22,100		**10,22,100**

Illustration 3

Prepare a Branch account in the books of Head Office from the following particulars for the year ended 31st March, 2023 assuming that H.O. sold goods at cost price 25%.

Particulars	(₹)	Particulars	(₹)
Stock on 1.4.2022 (I.P.)	12,500	Bad Debts	2,000
Debtors (”)	5,000	Allowances to customers	1,000
Petty Cash (”)	1,000	Returns Inwards	1,000
Goods sent to branch (I.P.)	40,000	Charges sent to Bank:	
Goods return to H.O. (I.P.)	5,000	Rates & Taxes	3,000
Cash Sales	12,000	Salaries	8,000
Cash received from Debtors	30,000	Misc. Exps.	1,000
		Stock on 31.03.2023 (I.P.)	15,000
		Debtors (”)	4,000
		Petty Cash (”)	1,000

Solution:

In the books of H.O.

Dr. **Branch Account** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Balance b/d			By Stock Reserve (Loading)		2,500
Stock	12,500		,, Bank A/c:		
Debtors	5,000		Cash Sales	12,000	
Petty Cash	1,000	18,500	,, Cash Received from Debtors	30,000	42,000
,, Goods sent to branch		40,000	,, Goods sent to branch (Return to H.O.)		5,000
,, Bank A/c:			,, Goods sent to branch		
Rates & Taxes	3,000		(Loading)		8,000

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
Salaries	8,000		By Balance c/d		
Misc. Expenses	1,000	12,000	Stock	15,000	
,, Goods sent to Branch (Loading on returns)		1,000	Debtors	4,000	
			Petty Cash	1,000	20,000
,, Closing Stock Reserve (₹ 15,000 × 1/5)		3,000			
,, General Profit & Loss A/c		3,000			
		77,500			**77,500**

Note: Here, loading is $\frac{25}{125} = \frac{1}{5}$ of invoice price. Hence, loading on opening stock will be ₹12,500 × $\frac{1}{5}$ = ₹2,500 and so on.

Stock-Debtors Method or Analytical Method

Under this method, the two primary assets of a branch namely Stock and Debtors are accounted for in full details. All transactions relating to a branch are recorded and maintained in details through separate accounts; hence it is also called 'Analytical Method'. Under this method, specific sets of following ledger accounts namely are maintained: Branch Stock Account, Branch Debtors Account, Goods Sent to Branch Account, Branch Adjustment Account, Branch Cash Account, Branch Expenses Account, Branch Profit and Loss Account; and Branch Fixed Assets Account. In addition to the above ledger account the Branch Stock Adjustment Account is required to be maintained in case when goods are sent at Invoice Price (IP) to eliminate the 'load factor' arising from IP. Branch Stock Adjustment Account records the transactions relating to stock/goods involving IP, (viz. Opening & Closing Branch Stock, Goods sent to Branch, Goods Returned to Branch Abnormal loss). Branch Stock Adjustment Account reflects the gross Profit/loss of the branch. Thus, this method determines both the gross profit/loss and net profit/loss of a branch.

Branches having large scale of operations and required detailed recording of transactions adopt Stock-Debtors Method or Analytical Method of Branch Accounting.

Journal Entries

1. For goods sent to branch

   Branch Stock A/c Dr.

   To Goods Sent to Branch A/c

2. For goods returned by branch to head office

   Goods Sent to Branch A/c Dr.

   To Branch Stock A/c

3. For goods received from other branches

   Branch Stock A/c Dr.

   To Goods Sent to Branch A/c.

4. For goods transferred to other branches on advice of head office

Goods Sent to Branch A/c	Dr.
To Branch Stock A/c	

5. For Cash Sales

Bank A/c	Dr.
To Branch Stock A/c	

6. For Credit Sales

Branch Debtors A/c	Dr.
To Branch Stock A/c	

7. For bills accepted by Branch Debtors

Bills Receivable A/c	Dr.
To Branch Debtors A/c	

8. For cash collected from debtors

Bank A/c	Dr.
To Branch Debtors A/c	

9. For bad debts, discount allowed, etc.

Branch Expenses A/c	Dr.
To Branch Debtors A/c	

10. For depreciation on branch fixed assets

Branch Expenses A/c	Dr.
To Branch Fixed Assets A/c	

11. For branch expenses incurred in cash

Branch Expenses A/c	Dr.
To Cash/Bank A/c	

12. For transferring branch expenses to Branch Profit and Loss Account/Branch Adjustment Account

Branch Profit and Loss A/c	Dr.
Or, Branch Adjustment A/c	Dr.
To Branch Expenses A/c	

13. For shortage in stock/pilferage/theft

(i) Shortage in Stock/Pilferage/Theft A/c	Dr.
To Branch Stock A/c	
(ii) Branch Adjustment A/c	Dr.
Branch Profit and Loss A/c	Dr.
To Shortage in Stock/Pilferage/Theft A/c	

14. For loss by fire/loss in transit

(i) Accidental Loss A/c	Dr.	
To Branch Stock A/c		
(ii) Branch Adjustment A/c (Loading)	Dr.	
Bank A/c (insurance claim received)	Dr.	
Insurance Company (claim yet to receive)	Dr.	
General Profit and Loss A/c	Dr.	
To Accidental Loss A/c		

15. For loading on opening stock including stock in transit at the beginning

Stock Reserve A/c	Dr.
To Branch Adjustment A/c	

16. For loading on net goods sent

Goods Sent to Branch A/c	Dr.
To Branch Adjustment A/c	

17. For loading on closing stock including stock-in-transit at the end

Branch Adjustment A/c	Dr.
To Stock Reserve A/c	

[In the Balance Sheet of head office, the Stock Reserve is shown as a deduction from branch stock at the end]

18. For transferring gross profit

(i) Branch Adjustment A/c	Dr.
To Gross Profit A/c	
(ii) Gross Profit A/c	Dr.
To Branch Profit and Loss A/c	

19. For transferring net profit of the branch

Branch Profit and Loss A/c	Dr.
To General Profit and Loss A/c	
(For net loss, reverse entry)	

20. For closing Goods Sent to Branch A/c

Goods Sent to Branch A/c	Dr.
To Purchases A/c [Trader]	
To Trading A/c [Manufacturer]	

Illustration 4

M/S C and Sons has a branch at Kolkata where it sends goods at cost plus 50%. From the following particulars regarding the branch, prepare Branch Stock Accounts, Branch Adjustment Account, Branch Debtor Account and Branch Profit & loss Account as would appear in the books of C Ltd.'s head office. [Fig. in ₹]

	(₹)		(₹)
Stock at cost (1.04.2022)	40,000	Sales returned to Branch	6,000
Debtors (1.04.2022)	36,000	Bad Debts	400
Cash (1.04.2022)	10,000	Cash remitted to H.O	1,60,000
Goods sent to Branch (at IP)	1,98,000	Expenses paid by H.O	10,000
Sales: Cash: ₹54,0000 credit:	1,58000	Cash (31.3.2023)	12,000
Normal loss at cost	4,000	Stock at IP (31.03.2023)	54,000
		Debtor (31.03.2023)	60,000

Solution:

Books of M/S C and Sons. (H.O.)

Dr. **Kolkata Branch Stock Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f [at IP ₹ 40,000 × 150/100]	60,000	By Branch Cash A/c [Cash sales]	54,000
To Goods Sent to Branch A/c [at IP]	1,98,000	By Branch Debtors A/c [Credit sales]	1,58,000
To Branch Debtors A/c [Sales return]	6,000	By Branch Adjustment A/c	6,000
To Branch Adjustment A/c	8,000	[Normal loss – at IP (₹4000 × 150/100)	
[Apparent Gross Profit B/fig]		By Balance c/f [at IP] [B/fig]	54,000
	2,72,000		**2,72,000**

NB: The missing figure appearing in the debit-side of Branch Stock A/c has been considered as Apparent Gross Profit and NOT Stock Surplus as the branch has suffered normal loss of stock.

Kolkata Branch Adjustment Account

Dr. **Cr.**

Particulars	(₹)	Particulars	(₹)
To Branch Stock A/c [Normal loss]	6,000	By Balance b/f [Load on opening stock: ₹ 60,000×50/150]	20,000
To Branch P/L A/c [Gross profit transferred - B/fig]	70,000	By Goods Sent to Branch A/c [Load on goods sent: ₹ 1,98,000 × 50/100]	66,000
To Balance c/f [Load on closing stock: ₹ 54,000 × 50/150]	18,000	By Branch Stock A/c [Apparent Gross Profit]	8,000
	94,000		**94,000**

Kolkata Branch Debtors Account

Dr. **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f	36,000	By Branch Stock A/c [Sales return]	6,000
To Branch Stock A/c [Credit sales]	1,58,000	By Bad Debts A/c	400
		By Branch Cash A/c	1,27,600
		[Collection from Debtors B/fig]	60,000
		By Balance c/f	
	1,94,000		**1,94,000**

Kolkata Branch Profit & Loss Account

Dr. **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bad Debts A/c	400	By Branch Stock Adjustment A/c	70,000
To Branch Expenses A/c [WN:1]	39,600	[Gross Profit Transferred]	
To General P/L A/c [Branch Net Profit]	30,000		
	70,000		**70,000**

Working Notes:

1. **Branch expenses paid by branch**

Dr. **Kolkata Branch Cash Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f	10,000	By Bank A/c[Cash remitted to Branch]	1,60,000
To Branch Stock A/c [Cash sales]	54,000	By Branch Expenses A/c [b/fig]	19,600
To Branch Debtors A/c [Collection from debtors]	1,27,600	By Balance figure c/f	12,000
	1,91,600		**1,91,600**

Kolkata Branch expenses for the year

Dr. **Kolkata Branch Expense Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank A/c [Paid by H.O]	20,000	By Branch Profit & Loss A/c – B/fig	39,600
To Branch Cash A/c [Paid by Branch-WN1]	19,600	39,600	
	39,600		**39,600**

NB: The drafting of Branch Expenses A/c is not mandatory and the total branch expenses could be ascertained by simple aggregation.

Illustration 5

Green Ltd. with their H.O. at Kolkata, invoiced goods to their Patna Branch at 20% less than the list price, which is Cost plus 100% with instruction that cash sales are made at invoice price and credit price at list price. From following particulars, prepare Branch Stock account and Branch Stock Adjustment Account for the year ended on 31.3.2023

Particulars	(₹)	Particulars	(₹)
Stock at cost (1.4.2022)	4,800	Cash received from Debtors	34,254
Debtors (1.4.2022)	4,000	Expenses at Branch	6,946
Goods received from H.O. (at IP)	52,800	Remitted to H.O	48,000
Goods returned to H.O.	400	Debtor (31.3.2023)	9,746
		Stock at IP (31.3.2023)	7,040
Sales: Credit	40,000		
Cash	18,400		

Solution:

Books of Green Ltd. (Kolkata H.O.)

Dr **Patna Branch Stock Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f [at IP]	4,800	By Goods Sent to Branch A/c	400
To Goods Sent to Branch A/c [at IP]	52,800	[Goods returned (at IP) – assumed]	
To Branch Adjustment A/c	8,000	By Branch Cash A/c	18,400
[Excess Contribution to Gross Profit - WN:3]		By Branch Debtors A/c	40,000
		By Balance c/f [at IP]	7,040
To Stock Surplus A/c [B/fig]	240		
	65,840		**65,840**

NB: Balancing figure appearing in the debit-side of Branch stock A/c has been considered as 'Stock Surplus' as the problem involves 'Excess Contribution to Gross Profit'.

Dr. **Patna Branch Adjustment Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Goods Sent to Branch A/c	150	By Balance b/f [Load on opening stock: ₹4800 × 60/160]	1,800
[Load: 400 × 60/160]		By Goods Sent to Branch A/c	19,800
To Branch P/L A/c	26,900	[Load on goods sent: ₹52,800 × 60/160]	
[Gross Profit transferred – B/fig]		By Branch Stock A/c	8,000
To Balance c/f [Load on closing stock: ₹7,040 × 60/160]	2,640	[Excess Contribution to Gross Profit]	
		By Stock Surplus A/c	90
		[Load: ₹240 × 60/160]	
	29,690		**29,690**

Working Notes:

1. **Relation between Cost Price(CP), Invoice Price(IP) and List Price(LP):**

   Considering CP=100, LP=100+100% thereof=200. Hence IP= LP Less 20% thereof = 200 – 20% =160.

2. **Transactions relating to Branch Debtors:**

Dr. Patna Branch Debtors Account Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/f	4,000	By Bank A/c [Cash received from Debtors]	34,254
To Branch Stock A/c [Credit sales]	40,000	By Balance c/f	9,746
	44,000		**44,000**

3. **Excess Contribution to Gross Profit:**

   Here, the difference between the LP and IP results 'Excess Contribution to Gross Profit'. It arises only out of the credit sales which have been made at list price.

   ∴ Excess Contribution to Gross Profit = ₹ 40,000 × 40/200 = ₹ 8,000

Final Accounts Method

- This method of Branch accounting is applicable for every branch whether dealing with goods or services.
- Features:
  - Under this method, a Branch Trading and Profit & Loss Account and a separate Branch Account for recording branch related transactions are prepared and maintained.
  - Branch Trading and Profit & Loss Account determines both Gross Profit/Loss and Net Profit/Loss
  - This Branch Account follows double entry system which is by nature a personal account.Performa of Branch Trading and Profit & Loss Account

Branch Trading and Profit & Loss Account

Dr. for the year ended…. Cr.

Particulars		(₹)	Particulars		(₹)
To Opening Stock		***	By Sales: Cash	***	
To Goods Sent to Branch	***		Credit	***	
Less: Returns by Branch	**		Less: Returns	**	***
To Gross Profit c/d		***	By Goods-in-Transit		***
			By Abnormal Loss		***
			By Closing stock		***
			By Gross Loss c/d (if any)		***
		***			***

Particulars	(₹)	Particulars	(₹)
To Gross Loss b/d	***	By Gross Profit b/d	***
To Salaries	***	By Net Loss (if any)	***
To Rent & Salaries	***		
To Petty Cash Exp.	***		
To Abnormal loss	***		
Less, Insurance claim	***		
To Net Profit	***		
	****		****

Dr. **Branch Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance B/f		By Bank A/c (remittance to H.O.)	***
Stock	***	By Goods Sent to Branch A/c	***
Debtor	***	(Returns by Branch)	***
Petty Cash	***	By General Profit & Loss A/c	***
To Goods Sent to Branch A/c	***		
To Bank A/c (remittance)	***	By Balance c/f	***
To General Profit & Loss A/c	***		
	***		***

Final Accounts Method (on Wholesale Price basis)

- This method of accounting is adopted by those mercantile organisations where both the H.O and Branch sell goods to the customers hence both contributes to the organisation's total profit.
- Here H.O gets the due credit for profit arising out of the 'Goods sent to Branch' and 'Goods sold to Customers'; whereas Branch gets credit for 'Goods sold to Customers' only.
- Under this method, the transactions involving goods movement are valued at different ways in the books of H.O and branch; According to the values different profits take place
  - **At Cost:** Price at which H.O has purchased the goods.
  - **At Retail Price:** It also referred as **List Price** or **Catalogue Price**; the value at which goods are sold by the H.O and Branch to the customers.
    - Profit made by H.O from sale of goods to customers at Retail Price **Retail Profit** = Retail Price (–)Less Cost.
    - Profit made by branch from sale of goods to customers Retail Price, **Retail Profit** = Retail Price (–) Less Wholesale Price.
  - **At Wholesale Price:** It is same as Invoice Price at which Goods are sent by the H.O to its Branch. Profit made by the H.O is, Wholesale Profit = Wholesale Price (–)Less cost.
- **Features:**
  - Under this method, a Branch Trading and Profit & Loss Account and a separate Branch Account for recording branch related transactions are prepared and maintained.

- Branch Trading and Profit & Loss Account determines both Gross Profit/Loss and Net Profit/Loss.
- This Branch Account follows double entry system which is by nature a personal account.

- Values at which the transactions relation to movement of goods are recorded in the books of accounts of the H.O are hereunder:

Transactions	Value
Opening stock of goods	At Cost
Purchase (less Purchase returns)	At Cost
Goods Sent to Branch	At Wholesale Price
Sales by H.O to customers	At Retail Price
Goods lost abnormally	At Cost
Closing stock of goods	At Cost

- Values at which the transactions relation to movement of goods are recorded in the books of accounts of the H.O are hereunder:

Transactions	Value
Opening stock of goods	At Wholesale Price
Goods Sent by H.O to Branch Less Returns	At Wholesale Price
Goods-in-transit	At Wholesale Price
Sales by H.O to customers	At Wholesale Price
Goods lost abnormally	At Wholesale Price
Closing stock of goods	At Wholesale Price

Illustration 6

Blue Ltd has a retail branch at Mumbai. Goods are sold at 60% profit on cost. The wholesale price is cost plus 40%. Goods are invoiced from Pune H.O. to Mumbai Branch at wholesale price. From the following particulars ascertain the profit made at H.O. and Branch for the year ended on 31.3.2023. [Fig. in ₹]:

Particulars	H.O	Branch	Particulars	H.O	Branch
Stock on 1.4.2022	7,00,000	-	Sales	42,84,000	14,40,000
Purchases Goods sent to Branch (at IP)	42,00,000 15,12,000	- -	Stock on 31.3.2023	16,80,000	2,52,000

Sales at H.O are made only on wholesale basis and that at Branch only to consumers.

Solution:

Problem Note:

Blue Ltd. (H.O.)

Trading and Profit & Loss account for the year ended 31.3.2023

Dr. **Cr.**

Particulars	H.O (₹)	Branch (₹)	Particulars	H.O (₹)	Branch (₹)
To Opening Stock	7,00,000	-	By Sales	42,84,000	14,40,000
To Purchase	42,00,000	-	By Goods Sent to Branch	15,12,000	-
To Goods Received from H.O	-	15,12,000	By Closing Stock	16,80,000	2,52,000
To Gross Profit c/d	25,76,000	1,80,000			
	74,76,000	**16,92,000**		**74,76,000**	**16,92,000**
To Stock Reserve [WN:2]	72,000	-	By Gross Profit b/d	25,76,000	1,80,000
To Net Profit	25,04,000	1,80,000			
	25,76,000	**1,80,000**		**25,76,000**	**1,80,000**

Working Notes:

1. **Relationship Between Cost Price (CP), Selling Price (SP) and Wholesale Price (WP)**

   Let CP be ₹100. Thereof SP =₹ (100+60) = ₹160; and WP = (100+40) = 140

2. **Unrealised profit in Unsold stock**

   Unrealised profit on closing stock of branch = ₹ (2,52,000×40/140) = ₹ 72,000

Branch Petty Cash under Imprest System

- H.O allowed its branches to maintain petty cash in respect of small amount of expenses incurred by the concerned branch; such petty cash is reimbursed by the H.O to branch to meet the expenses from time to time. Under 'Imprest System' such petty cash balance has been maintained by the branch-
  - The Imprest balance of petty cash is determined by the H.O and sent to the branch at the beginning of the period.
  - Branch petty expenses are incurred out of the Imprest balance.
  - This method ensures the maintenance of original balance of Branch Petty Cash.

Accounting for Independent Branch

When there are voluminous transactions in a Branch, they prepare the accounts independently. They purchase and sell goods independently and also sell the goods which are sent by H.O.. As the branches are owned by H.O., the profit or loss so made by the branch is enjoyed by H.O.

These independent branches maintain a complete set of books of account for recording its transactions. They prepare a Trial Balance, Trading and Profit and Loss Account and a Balance Sheet at the end of the year. As such, they maintain a Head Office Account and on contrary H.O. maintains a Branch Account. All sorts of transactions, e.g., remittance of cash, transfer of goods etc. are to be passed through these accounts.

Needless to say that where H.O. receives the accounts from the branches, it incorporates profit of the branches as –

Branch A/c Dr.

To Profit & Loss A/c

Sometimes, the balance of branch account in H.O. books and H.O. accounts in branch books do not agree. If that be so, the same must be adjusted accordingly i.e., Goods-in-Transit or Cash-in-Transit etc. At last the Branch Balance Sheet is amalgamated with H.O. Balance Sheet by eliminating inter-branch/H.O. transaction as per the respective heads of assets and liabilities.

At the Branch Level all transactions that take place in the branch are recorded in the books of Branch like Cash Book, Subsidiary Books etc.). All necessary ledger accounts and after that the trial balance are prepared and maintained by the Branch itself. The independent branch may at times draft its final accounts and send it to the H.O At the H.O transaction between branch and H.O are also recorded in the books of the H.O. Moreover, the H.O also maintains 'Goods Sent to Branch Account' and 'Branch Account' separately for each independent branch.

The relevant journal entries are:

Sl. No.	Transaction	HO Books	Branch Books
1.	Goods sent by H.O. to Branch	Branch A/c Dr. To Goods Sent to Branch A/c	Goods Recd. from H.O. A/c. Dr. To H.O. A/c
2.	Goods returned by Branch to H.O.	Goods Sent to Branch A/c Dr. To Branch A/c	HO A/c. Dr. To Goods Recd. From H. O. A/c
3.	Branch Expenses incurred at Branch Office	—	Expenses A/c Dr. To Cash / Bank A/c
4.	Branch expenses paid for by the Head Office	Branch A/c Dr. To Cash/Bank A/c	Expenses A/c. Dr. To H.O. A/c
5.	Purchases made from parties other than H.O. by Branch	—	Purchases A/c Dr. To Bank/ Creditors A/c
6.	Sales effected by the Branch		Cash/Debtors A/c Dr. To Sales A/c
7.	Collection from Debtors received directly by the H.O.	Cash/Bank A/c Dr. To Branch A/c	H.O. A/c Dr. To Sundry Debtors A/c
8.	Payment by H.O. for Purchase made by the Branch	Branch A/c Dr. To Bank A/c	Purchases/Creditors A/c Dr. To H.O. A/c
9.	Purchase of Asset by Branch	—	Sundry Assets A/c Dr. To Bank/Liability

Sl. No.	Transaction	HO Books	Branch Books
10.	Asset account maintained at H.O. and asset purchased by Branch	Branch Asset A/c Dr. To Branch A/c	H.O. A/c Dr. To Bank/Creditors A/c
11.	Depreciation when asset account is maintained by H.O.	Branch A/c Dr To Branch Asset A/c	Depreciation A/c Dr. To H.O. A/c
12.	Remittance of Funds by H.O. to Branch	Branch A/c Dr. To Bank A/c	Bank A/c Dr. To H.O. A/c
13.	Remittance of Funds to H.O. by Branch	Bank A/c Dr. To Branch A/c	H.O. A/c Dr. To Bank A/c
14.	Transfer of Goods between different branches	Recipient Branch A/c Dr. To Supplying Branch A/c	i. Supplying Branch A/c Dr. To Goods recd. from H.O. A/c ii. Goods recd. from H.O. A/c Dr. To H.O. A/c
15.	Charging the Branch service charges by H.O.	Branch (Expenses) A/c Dr. To Service Charges A/c	Expense A/c Dr. To H.O. A/c
16.	Cash-in-transit	Cash-in-transit A/c. Dr. To Branch A/c.	Cash-in-transit A/c. Dr. To H.O. A/c.
17.	Goods-in-transit	Goods-in-Transit A/c. Dr. To Branch A/c.	Goods-in-Transit A/c. Dr. To H.O. A/c.

Illustration 7

Journalise the following transactions in the books of Kolkata Head Office, Delhi Branch and Agra Branch :

(a) Goods worth ₹ 50,000 are supplied by Delhi Branch to Agra Branch under the instructions of Head Office.

(b) Delhi Branch draws a bill receivable for ₹ 40,000 on Agra Branch which sends its acceptance.

(c) Delhi Branch received ₹ 10,000 from Agra Branch.

(d) Goods worth ₹ 20,000 were returned by a customer of Agra Branch to Delhi Branch.

(e) Agra Branch collected ₹ 20,000 from a customer of Delhi Branch.

Solution :

Books of Kolkata Head Office

Dr. **Journal** **Cr.**

Particulars		L.F.	Dr. (₹)	Cr. (₹)
(a) Agra Branch A/c	Dr.		50,000	
To Delhi Branch A/c				50,000
(Being the goods supplied by Delhi Branch to Agra Branch)				
(b) Delhi Branch A/c	Dr.		40,000	
To Agra Branch A/c				40,000
(Being a B/R drawn by Delhi upon Agra Branch)				
(c) Delhi Branch A/c	Dr.		10,000	
To Agra Branch A/c				10,000
(Being Cash sent by Agra Branch to Delhi Branch)				
(d) Delhi Branch A/c	Dr.		20,000	
To Agra Branch A/c				20,000
(Being the goods returned by customer of Agra Branch to Delhi Branch)				
(e) Agra Branch A/c	Dr.		20,000	
To Delhi Branch A/c				20,000
(Being the Cash collected by Agra Branch from a customer of Delhi Branch				

Books of Delhi Branch

Dr. **Journal** **Cr.**

Particulars		L.F.	(₹)	(₹)
(a) Kolkata H.O. A/c	Dr.		50,000	
To Goods sent to Branch A/c				50,000
(Being the goods supplied to Agra Branch)				
(b) Bills Receivable A/c	Dr.		40,000	
To Kolkata H.O. A/c				40,000
(Being the acceptance of a B/R received from Agra Branch)				

Particulars		L.F.	(₹)	(₹)
(c) Cash A/c	Dr.		10,000	
To Kolkata H.O. A/c				10,000
(Being the cash received from Agra Branch)				
(d) Goods Sent to Branch A/c	Dr.		20,000	
To Kolkata H.O. A/c				20,000
(Being the goods received from a customer of Agra Branch)				
(e) Kolkata H.O. A/c	Dr.		20,000	
To Debtors A/c				20,000
(Being the cash collected by Agra Branch from our customer)				

Books of Agra Branch

Dr. **Journal** **Cr.**

Particulars		L.F.	(₹)	(₹)
(a) Goods sent to Branch A/c	Dr.		50,000	
To Kolkata H.O. A/c				50,000
(Being the goods received from Delhi Branch)				
(b) Kolkata H.O. A/c	Dr.		40,000	
To Bill Payable A/c				40,000
(Being a B/P accepted for Delhi Branch)				
(c) Kolkata H.O. A/c	Dr.		10,000	
To Cash A/c				10,000
(Being cash paid to Delhi Branch)				
(d) Kolkata H.O. A/c	Dr.		20,000	
To Debtors A/c				
(Being the goods returned by customer of Delhi Branch)				20,000
(e) Cash A/c	Dr.		20,000	
To Kolkata H.O. A/c				
(Being the Cash received from a customer of Delhi Branch)				20,000

Illustration 8

X Ltd. of Assam has a Branch at Darjeeling. From the given information, reconcile Darjeeling Branch Current A/c with Assam H.O. Current A/c by preparing Branch Current A/c in the books of H.O.

Particulars	Assam H.O.		Darjeeling Branch	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Goods sent to branch	-	13,02,400	-	-
Goods received by branch	-	-	12,80,400	-
Cash sent by branch	-	-	-	1,86,500
Cash received by H.O.	1,00,000	-	-	-
Darjeeling Branch Current A/c	4,11,100	-	-	-
Assam H.O. Current A/c	-	-	-	3,02,600

Solution:

Books of X Ltd. (Assam H.O.)

Dr. **Darjeeling Branch Current Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f	4,11,100	By Goods-in-Transit A/c [WN:1]	22,000
		By Cash-in-Transit A/c [WN:2]	86,500
		By Balance c/f [B/fig]	3,02,600
	4,11,100		**4,11,100**

NB: The Darjeeling Branch Current A/c (in the books of H.O.) Assam H.O. Current A/c (in the Branch books) reflects the same but opposite balance; hence H.O. can proceed with incorporation of the Branch accounts in its books.

Working Notes

Assam H.O. Current Account			
Goods sent to Branch	13,02,400	Journal Entry:	
Less: Goods received by Branch	12,80,400	Goods-in-Transit A/c Dr.	22,000
	22,000	To Darjeeling Branch A/c	22,000
Cash-in-Transit Account			
Cash sent to Branch	1,86,500	Journal	
Less: Cash received by H.O.	1,00,000	Cash-in-Transit A/c……. Dr.	86,500
	86,500	To Darjeeling Branch A/c	86,500

llustration 9

A Delhi head office passes one entry at the end of each month to adjust the position arising out of inter- branch transactions during the month. From the following inter-branch transactions in March 2023, make the entries in the books of Delhi Head office.

(a) Kolkata Branch :

(i) Received goods from Patna branch ₹ 9,000 and Ahmedabad branch ₹ 6,000.

(ii) Sent goods to Ahmedabad branch ₹ 15,000 and Patna branch ₹ 12,000.

(iii) Sent acceptances to Patna branch ₹ 6,000 and Ahmedabad branch ₹ 3,000.

(b) Kanpur branch [apart from (a) above] :

(i) Sent goods to Ahmedabad branch ₹ 9,000.

(ii) Recived B/R from Ahmedabad branch ₹ 9,000.

(iii) Recived cash from Ahmedabad branch ₹ 5,000.

Solution:

Books of H.O.

Journal

Particulars		L.F.	Dr. (₹)	Cr. (₹)
Kanpur Branch A/c	Dr.		5,000	
Patna Branch A/c	Dr.		9,000	
Ahmedabad Branch A/c	Dr.		7,000	
To Kolkata Branch A/c				21,000

Statement of Inter-branch Transactions

Particulars	Kolkata		Kanpur		Patna		Ahmedabad	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr (₹)
Goods Received	15,000	–	–	–	–	9,000	–	6,000
Goods Sent	–	27,000	–	–	12,000	–	15,000	–
Acceptance	–	9,000	–	–	6,000	–	3,000	–
Goods Sent	–	–	–	9,000	–	–	9,000	–
B/R Received	–	–	9,000	–	–	–	–	9,000
Cash	–	–	5,000	–	–	–	–	5,000
	15,000	36,000	14,000	9,000	18,000	9,000	27,000	20,000
Balance	21,000	–	–	5,000	–	9,000	–	7,000
	36,000	36,000	14,000	14,000	18,000	18,000	27,000	27,000

Incorporation of Branch Trial Balance in Head Office Books

An branch prepares its own trial balance and the same is sent to the H.O. for incorporation. As such, after receiving the same from the branch, the H.O. has to incorporate the branch's accounts with that of its own accounts to prepare and ascertain the net financial result of the concern. There are two methods for incorporating branch trial balance in H.O. Book:

(a) First Method

All revenue items are passed through Branch Trading and Profit & Loss Account and Profit or Loss so made (in the Profit and Loss Account) together with assets and liabilities are passed through Branch Account for the purpose of preparing consolidated Balance Sheet in the Books of H.O.

Incorporation Entries

(a) For all revenue expenses related to Trading A/c
Branch Trading A/c ... Dr.
To Branch A/c
i.e. Opening stock, Purchase, Return Inwards, Wages and other items appearing in the debit side.

(b) For all revenue incomes related to Trading A/c
Branch A/c ... Dr.
To Branch Trading A/c
i.e. Sales, Closing Stock and Return Outwards and other items that appear in the credit side.

(c) For gross profit of the Branch
Branch Trading A/c ... Dr.
To Branch P&L A/c

In case of gross loss, the entry will be reversed.

(d) For all revenue expenses related to P&L A/c
Branch P & L A/c ... Dr.
To Branch (All Revenue Expenses) A/c
i.e. items that appear in the debit side of the P & L Account.

(e) For all revenue incomes related to P & L A/c
Branch (All Revenue Incomes) A/c ... Dr.
To Branch P&L A/c
i.e. items that appear in the credit side of the P & L Account.

(f) For net profit of the Branch
Branch P&L A/c ... Dr.
To General P&L A/c

In case of net loss, the enry will be reversed.

(g) For branch assets.
Branch Assets A/c ....Dr.
To Branch A/c

(h) For branch liabilities.
Branch A/c ....Dr.
To Branch Liabilties A/c

(b) Second Method / Abridged Method

This method is applicable only when net profit or net loss is given instead of detailed information about all revenue expense and income. Under this method, only net profit/net loss will be transferred to Branch Account. Branch Assets and Branch Liabilities will not appear in branch account and this branch account will show a balance. The same must be equal to the difference between assets and liabilities, i.e., in other words, net worth of the business.

Illustration 10

SL Corporation presented the following trial balance on 31.03.2023 to the H.O. at New Delhi.

Particulars	Debit (₹)	Particulars	Credit (₹)
Delhi H.O.	6,480	Sales	76,000
Stock 1.4.2022	12,000	Goods supplied to H.O.	12,000
Purchase	35,600	Creditors	3,700
Goods Return From H.O.	18,000		
Salaries	3,000		
Debtors	7,400		
Rent	1,920		
Misc. Expense	940		
Furniture	2,800		
Cash and Bank	3,560		
	91,700		91,700

Additional Information:

The branch account on H.O. books on 31.03.2023 stood at ₹ 920 (Debit).

On 31.03.2023, the, H.O. forwarded goods to the value of ₹ 5,000 to the branch which are received on 3rd July.

A cash remittance of ₹ 2,400 by branch on 29th March 2023, was received by the H.O. on 2nd April 2023. Closing Stock was valued at ₹ 5,400

Show the incorporation entries in the books of H.O. showing separate Branch Trading and Branch Profit and Loss Account, and Prepare Branch Account and Branch Balance Sheet also in H.O. books.

Solution:

(a) First Method

In the Books of H.O.

Journal

Date	Particulars		L/F	Dr. (₹)	Cr. (₹)
31.03.23	Branch Trading A/c	Dr.		65,600	
	To Branch A/c				65,600
	(Items of Br. Trading incorporated) ₹ 12,000 + ₹ 35,600 + ₹ 18,000)				
	Branch A/c	Dr.		93,400	
	To Branch Trading A/c				93,400
	(Items of Br. Trading incorporated i.e., ₹ 76,000 + ₹ 12,000 + ₹ 5,400)				
	Branch Trading A/c	Dr.		27,800	
	To Branch Profit & Loss A/c				27,800
	(Gross Profit transferred) [₹ 93,400 – ₹ 65,600]				
	Branch Profit and Loss A/c	Dr.		5,860	
	To Branch A/c				5,860
	(Item of Branch Profit & Loss incorporated i.e., ₹ 3,000 + ₹ 1,920 + ₹ 940)				
	Branch Profit and Loss A/c	Dr.		21,940	
	To General Profit & Loss A/c				21,940
	(Net Profit Transferred) [₹ 27,800 – ₹ 5,860]				
	Goods-in-Transit A/c	Dr.		5,000	
	To Branch A/c				5,000
	(Goods-in-Transit adjusted)				
	Remittance (Cash)-in-Transit A/c	Dr.		2,400	
	To Branch A/c				2,400
	(Remittance-in-Transit adjusted)				
	Branch Asset A/c	Dr.		19,160	
	To Branch A/c				19,160
	(Branch Asset incorporated) [₹ 2,800 + ₹ 5,400 + ₹ 7,400 + ₹ 3,560]				
	Branch A/c	Dr.		3,700	
	To Branch Liabilities A/c				3,700
	(Branch liabilities incorporated)				

Dr. Branch Trading and Profit and Loss Account Cr.

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Branch A/c			By Branch A/c		
Stock	12,000		Sales	76,000	
Purchase	35,600		Goods supplied to H.O.	12,000	
Goods from H.O.	18,000	65,600	Closing Stock	5,400	93,400
To Branch Profit and Loss A/c (Gross Profit transferred)		27,800			
		93,400			**93,400**
To Branch A/c			By Branch Trading A/c - Gross Profit		27,800
Salaries	3,000				
Rent	1,920				
Office Expenses	940	5,860			
To General Profit and Loss A/c (Net Profit transferred)		21,940			
		27,800			**27,800**

Dr. Branch Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.04.22	To Balance b/d	920	31.03.23	By Branch Trading A/c	65,600
				,, Branch P&L A/c	5,860
				,, Goods-in-Transit A/c	5,000
31.03.23	,, Branch Trading A/c	93,400		,, Remittance-in-Transit A/c	2,400
				,, Branch Assets A/c	
	,, Branch Liabilities A/c Creditors	3,700		Furniture 2,800	
				Stock 5,400	
				Debtors 7,400	
				Cash 3,560	19,160
		98,020			98,020

Branch Balance Sheet as at 31st March, 2023

Liabilities	(₹)	Assets	(₹)
H.O. A/c		Furniture	2,800
Opening balance (Dr.) 6,480		Stock	5,400
Less: Net Profit 21,940	15,460	Debtors	7.400
Creditors	3,700	Cash at Bank	3,560
	19,160		**19,160**

(b) Second Method/Abridged Method

Dr. **Branch Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.04.22	To Balance b/d	920	31.03.23	By Goods-in-Transit A/c	5,000
				,, Remittance-in-Transit A/c	2,400
31.03.23	,, Branch P&L A/c Net Profit	21,940		,, Balance c/d	15,460*
		22,860			**22,860**

Note: This is the difference between Branch Assets and Branch Liabilities
(₹19,160 – ₹3,700) = ₹15,460.

Closing of Branch Books

Branch closes its accounts at the end of the financial year by passing the following entries: In this situation, accounts can be prepared by two methods.

Method – 1

All revenue items are passed through H.O. Account.

Journal entries

(a) For all revenue expenses that appear in the debit side of Branch Trading A/c		
H.O. A/c To Opening Stock A/c ,, Purchase A/c ,, Goods Received from H.O. A/c ,, All revenue expenses	Dr.	**Actual amount**
(b) For all revenue incomes that appear in the credit side of Branch Trading A/c		
Sales A/c Closing Stock A/c All revenue incomes A/c To H.O. A/c	Dr. Dr. Dr.	**Actual amount**
(c) For all Branch Assets:		
H.O. A/c To Branch Assets A/c	Dr.	**Actual amount**
(d) For all Branch Liabilities:		
Branch Liabilities A/c To H.O. A/c	Dr.	**Actual amount**

Method - 2

In this case, net profit or net loss is transferred to Head Office Account, but treatment of branch assets and branch liabilities will remain the same.

(a) For Net Profit:	
Profit & Loss A/c Dr. To H.O. A/c with the amount of net profit	with the amount of net loss
(b) For Net Loss:	
H.O. A/c Dr. To Profit & Loss A/c	with the amount of net loss

Illustration 11

A Chennai Head Office has an independent Branch at Ahmedabad. From the following particulars, give journal entries to close the books of the Ahmedabad Branch. Show also the Chennai Head Office account in the branch books.

Ahmedabad Branch

Dr. **Trial Balance as at 31st December, 2022** **Cr.**

Particulars	(₹)	Particulars	(₹)
Stock on 1st January	8,200	Creditors	2,700
Purchases	12,800	Sales	34,950
Wages	6,550	Head Office	14,000
Manufacturing Expenses	3,400	Discount	150
Rent	1,700	Purchase Returns	300
Salaries	5,500		
Debtors	4,000		
General Expenses	2,000		
Goods received from H.O.	7,200		
Cash at Bank	750		
	52,100		**52,100**

(a) Closing Stock at Branch ₹ 14,350.

(b) The branch fixed assets maintained at H.O. books were: Machinery ₹ 25,000, Furniture ₹ 1,000 Depreciations are to be allowed at 10% on Machinery and 15% on Furniture.

(c) Rent due ₹ 150.

(d) A remittance of ₹ 4,000 made by the Branch on 29th Dec. 2022 was received by Head Office on 4th January, 2023.

Solution:
Method 1:

In the books of Branch
Journal

Date	Particulars		L/F	Dr. (₹)	Cr. (₹)
31.12.22	Depreciation A/c	Dr.		2,650	
	To Head Office A/c				2,650
	(Depreciation on fixed assets maintained in head office books @ 10% on Machinery and 15% on Furniture)				
	Rent A/c	Dr.		150	
	To Outstanding Rent A/c				150
	(Rent Outstanding)				
	Cash-in-Transit A/c	Dr.		4,000	
	To Head Office A/c				4,000
	(Cash remitted to H.O. but not received within 31st December)				
	Head Office A/c	Dr.		50,150	
	To Opening Stock				8,200
	,, Purchases				12,800
	,, Wages				6,550
	,, Manufacturing Expenses				3,400
	,, Rent (₹ 1,700 + ₹ 150)				1,850
	,, Salaries				5,500
	,, General Expenses				2,000
	,, Goods received from H.O.				7,200
	,, Depreciation				2,650
	(Above items transferred to H.O. A/c)				
	Discount A/c	Dr.		150	
	Sales A/c	Dr.		34,950	
	Purchase Returns A/c	Dr.		300	
	Closing Stock A/c	Dr.		14,350	
	To Head Office A/c				49,750
	(Above items transferred to H.O. A/c)				
	Head Office A/c	Dr.		23,100	
	To Closing Stock A/c				14,350
	,, Debtors A/c				4,000
	,, Bank A/c				750
	,, Cash-in-Transit A/c (Assets transferred to H.O. A/c)				4,000
	Creditors A/c	Dr.		2,700	
	Outstanding Rent A/c	Dr.		150	
	To Head Office A/c				2,850
	(Liabilities transferred to H.O. A/c)				

Dr. **Head Office Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.22	To Sundries- (debit balance of Revenue items)	50,150	1.1.21	By Balance b/d	14,000
				,, Depreciation A/c	2,650
				,, Cash-in-Transit A/c	4,000
	,, Sundry Assets	23,100		,, Sundries –Credit Balance of Revenue items	49,750
				,, Sundry Liabilities	2,850
		73,250			**73,250**

Method 2:

Date	Particulars		L/F	(₹)	(₹)
2022	Depreciation A/c	Dr.		2,650	
Dec. 31	To Head Office A/c				2,650
	(Depreciation on fixed assets @ 10% Monthly and @ 15% or Furniture in H.O. Books.)				
	Rent A/c	Dr.		150	
	To Outstanding Rent A/c				150
	(Rent Outstanding)				
	Cash-in-Transit A/c	Dr.		4,000	
	To Head Office A/c				4,000
	(Cash remitted to H.O. but in transit)				
	Head Office A/c	Dr.		400	
	To Profit & Loss A/c				400
	(Net Loss Transferred.) [₹ 50,150 – ₹ 49,750]				
	Head Office A/c	Dr.		23,100	
	To Closing Stock				14,350
	,, Debtors				4,000
	,, Cash at Bank				750
	,, Cash-in-Transit				4,000
	(Asset transferred to H.O. A/c)				
	Creditors A/c	Dr.		2,700	
	Outstanding Rent A/c	Dr.		150	
	To Head Office A/c				2,850
	(Various Liabilities transferred to H.O. A/c)				

Dr. **Head Office Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.22	To Profit & Loss A/c	400	31.12.22	By Balance b/d	14,000
	Net Loss			,, Depreciation A/c	2,650
	,, Closing Stock A/c	14,350		,, Cash-in-Transit A/c	4,000
	,, Debtors A/c	4,000		,, Credit A/c	2,700
	,, Cash at Bank	750		,, Outstanding Rent	150
	,, Cash-in-Transit A/c	4,000			
		23,500			**23,500**

Illustration 12

Puskar Enterprise has its H.O. in Ranchi and a branch in Imphal. The following Trial Balance has been extracted from the books of accounts as at 31st March, 2023:

Particulars	Head Office		Branch Office	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Capital	---	16,50,000	---	---
Debtors	3,00,000	---	1,80,000	---
Creditors	---	1,50,000	---	---
Purchases	27,42,000	---	---	---
Sales	---	25,50,000	---	13,11,000
Goods sent to Branch at I.P.	---	11,40,000	11,25,000	---
Fixed Assets (Net)	10,50,000	---	2,00,000	---
Stock (1.4.2022)	24,000	---	60,000	---
Stock Adjustment (Unrealised Profit)	---	12,000	---	---
H.O./Branch Current A/c	5,25,000	---	---	3,60,000
Administrative & Selling Expenses	8,41,500	---	74,500	---
Cash and Bank	46,500	---	39,000	---
Provision for Bad Debts	---	27,000	---	7,500
	55,29,000	**55,29,000**	**16,78,500**	**16,78,500**

Other relevant information:

i. All goods are purchased by the H.O. Goods are sent to branch at cost plus 25%.

ii. Stock 31.3.2023 are valued at:

H.O. ₹ 36,000

Branch ₹ 45,000 (Invoice Price)

iii. Depreciation is to be provided on fixed assets at 10% on book value.

iv. Bad debts provision is to be maintained at 5% on debtors as at the end of the year.

v. Cash-in-transit from branch to H.O. at 31st March 2023 was ₹1,50,000.

vi. Goods-in-transit from H.O. to branch at 31st March, 2023 at invoice price was ₹15,000.

Prepare in Columnar from, the branch and H.O. Trading and Profit and Loss Accounts for the year ended 31st March, 2023 and a combined Balance Sheet of Puskar Enterprises as on that date.

Solution:

In the books of H.O.

Columnar Trading and Profit and Loss Account

Dr. for the year ended March 31, 2023 Cr.

Particulars	H.O. (₹)	Branch (₹)	Particulars	H.O. (₹)	Branch (₹)
To Opening Stock	24,000	60,000	By Sales	25,50,000	13,11,000
,, Purchases	27,42,000	---	,, Goods Sent to Branch	11,40,000	---
,, Goods from H.O.	---	11,25,000	,, Closing Stock	36,000	45,000
,, Gross Profit c/d	9,60,000	1,71,000			
	37,26,000	**13,56,000**		**37,26,000**	**13,56,000**
To Adm. & Selling Exp.	8,41,500	74,500			
,, Depreciation	1,05,000	20,000	By Gross Profit b/d	9,60,000	1,71,000
,, Stock Adjustment (for closing) 20% of (45,000 + 15,000)	12,000	---	,, Stock Adjustment (for opening)	12,000	---
,, Provision for Bad Debts (new)	15,000	9,000	,, Provision for Bad Debts (old)	27,000	7,500
Net Profit	25,500	75,000			
	9,99,000	**1,78,500**		**9,99,000**	**1,78,500**

Balance Sheet (Combined) as at March 31, 2023

Liabilities	(₹)	(₹)	Assets	(₹)	(₹)
Capital	16,50,000		Fixed Assets	12,50,000	
Add: Net Profit (25,500 + 75,000)	1,00,500	17,50,500	Less: Depreciation	1,25,000	11,25,000
	5,25,000		Current Assets		
Current A/c – H.O.			Stock		
Less: Branch (Cr.) 3,60,000			H.O.	36,000	

Liabilities		(₹)	(₹)	Assets	(₹)	(₹)
Cash-in-transit	1,50,000			Branch	45,000	
Goods-in-transit	15,000	5,25,000			81,000	
			Nil	Less: Stock Adj.	12,000	69,000
Creditors			1,50,000			
				Goods-in-Transit		15,000
				Debtors		
				H.O.	3,00,000	
				Branch	1,80,000	
					4,80,000	
				Less; Prov. for Bad Debts	24,000	4,56,000
				Cash at Bank		
				H.O.	46,500	
				Branch	39,000	
				Cash-in-transit	1,50,000	2,35,500
			19,00,500			**19,00,500**

Foreign Branch

Foreign branch is opened and operated in a country other than the country where the organisation is registered and has its head office. Example: Dubai branch of State bank of India.

A foreign branch maintains its own books of accounts. It drafts the trial balance (in foreign currency) and sends the same to the head office. The H.O. converts the items of the trial balance in the domestic currency of the H.O. and thereafter drafts the final accounts. The branch trial balance is converted into H.O. currency under the following methods:

1. **Net Investment Method:** As per this method, all items of the trial balance except H. O. Account are converted using closing rate. H.O. Account is represented at the figure at which Branch Account appears in H.O. books, subject to adjustment for goods and cash-in-transit.
2. **Current and Non-current Method:** In this case, different rates are applied for current assets and liabilities, and fixed assets and liabilities. For current assets and current liabilities closing rate is used, and historical rates are applied on fixed assets and long-term liabilities.
3. **Temporal Method:** This method is considered applicable when exchange rate is fluctuating.

Differences between foreign branch and domestic branch:

	Domestic Branch	Foreign Branch
Location	A domestic branch is established and carried out in the same country where its H.O is situated.	A foreign branch is always established and carried out its operations in a country other than the country of its H.O
Nature	It can be either dependent or independent.	It's always independent.
Currency	H.O and Branch both follow the same currency for recording the transactions and preparing accounts.	Whereas the transactions and accounting for foreign branches happen to be different than its H.O.

Illustration 13

SS Textiles Ltd. have a branch in Auckland, New Zealand. The trail balance of the branch as on 31.03.2023 was as given below:

	Dr. (NZ $)	Cr. (NZ $)
Head Office Account		18,000
Sales		1,20,000
Goods from the Head Office Account	90,000	
Opening Stock	15,000	
Office furniture	20,000	
Cash	100	
Bank	1,900	
Expenses outstanding		2,000
Salaries	6,000	
Taxes & Insurance	500	
Rent	2,000	
Debtors	4,500	
	1,40,000	**1,40,000**

The Branch Account in the head office showed a debit balance of ₹ 13,20,000 and 'Goods sent to Branch Accounts' a credit balance of ₹ 80,00,000.

Office furniture were acquired in 2005 when NZ $1 = ₹ 80.

The exchange rates were (NZ $1): 01-04-2022 - ₹ 88; 31-03-2023 - ₹ 92; Average – ₹ 90.

The stock at branch on 31-03-2023 was valued at NZ $9,000.

Convert the Branch Trial Balance into rupees and prepare the Branch Trading and Profit and Loss Account for 2023, and the Branch Account in Head Office books. Depreciation is to be written off the office furniture @ 10%.

Solution:

Auckland Branch Trial Balance as at 31st March, 2023

Item	Rate (₹)	Dr. (NZ $)	Cr. (NZ $)	Dr. (₹)	Cr. (₹)
H.O. Account	-		18,000		13,20,000
Sales	90		1,20,000		108,00,000
Goods from H.O. A/c	-	90,000		80,00,000	
Stock on 01-04-2022	88	15,000		13,20,000	
Office Furniture	80	20,000		16,00,000	
Cash	92	100		9,200	
Bank	92	1,900		1,74,800	
Expenses outstanding	92		2,000		1,84,000
Salaries	90	6,000		5,40,000	
Taxes & Insurance	90	500		45,000	
Rent	90	2,000		1,80,000	
Debtors	92	4,500		4,14,000	
		1,40,000	**1,40,000**	**1,22,83,000**	**1,23,04,000**
Difference in exchange				21,000	
				123,04,000	123,04,000
Closing stock	92	9,000		**8,28,000**	

Auckland Branch Trading and Profit & Loss Account

Dr. **for the year ended 31st March, 2023** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Opening Stock	13,20,000	By Sales	108,00,000
To Goods from H.O.	80,00,000	By Closing Stock	8,28,000
To Gross Profit c/d	23,08,000		
	116,28,000		**116,28,000**
To Salaries	5,40,000	By Gross Profit b/d	23,08,000
To Taxes & Insurance	45,000		
To Rent	1,80,000		
To Difference in exchange	21,000		
To Depreciation	1,60,000		

Particulars	(₹)	Particulars	(₹)
To Net Profit	13,62,000		
	23,08,000		**23,08,000**

Dr. **Auckland Branch Account** **Cr.**

Particulars		(₹)	Particulars		(₹)
To Balance b/d		13,20,000	By Branch Trading A/c	(₹)	
To Branch Trading A/c	(₹)		Opening stock	13,20,000	
Sales	108,00,000		Goods from H.O.	80,00,000	93,20,000
Stock	8,28,000	116,28,000			
			By Branch P & L A/c		9,46,000
			(Sundry expenses)		
			By Balance c/d		26,82,000
		1,29,48,000			**1,29,48,000**

Departmental Accounting 6.2

For effective operation, efficient management and adequate control, many big organisations that deal with various products or services or multiple types of specialized activities, consider each product, service or specialized activities as separate segments or units of the entities. The concerned entity in order to record the details of segments or units rationally split into a few segments or units which are technically referred to as Departments.

Industry	Illustrative Departments
Bank	Forex, Underwriting, credit card
Hospitals	Rooms, medical store, cafeteria
Hotels	Rooms, restaurants, confectionary, gym and spa
Departmental store	Stationery, electronics, grocery
Two-wheelers	Motorcycles, scooters
Automobile	Hatchback, Sedan, SUV, EVs

Management of the concerned entity wants to evaluate the operating results (profit/loss) for each department. Hence, on the basis of system of Responsibility Accounting, the idea of Departmental Accounting has emerged and has been widely implemented.

Responsibility Accounting: For better performance and control, responsibility and authority are decentralized to each department. A manager or supervisor is assigned to each department to whom the targets and budgets are provided for carrying out the operations. Although all departments are "Cost Centres", all may not be "Revenue Centres". At the end of certain period, the performance of the Department/Centre is assessed and suitable measures are taken for betterment.

Concept note: Branch vs Department		
Points of Difference	**Department**	**Branch**
Concept	A segment or unit into which an entity is rationally divided.	Establishment of a large organisation that is located at different places
Purpose	Enhancement of effective operations, efficient management and proper control.	Primary objective is to boost up the sales revenue of the entity.

Points of Difference	Department	Branch
Location	Generally, Departments are not separated geographically.	Each branch is set up at different geographical location.
Interrelation	A department can never have a branch on its own.	A branch may consists of numerous departments.

Departmental Accounting

Concept of Departmental Accounting

Although traditional accounting reflects the overall financial performance (profit/loss) of an entity, it fails to provide the operating performances of each department. To ensure adequate managerial control and proper decision-making, it is necessary to ascertain the operating results of each department. The branch of accounting that gives emphasis on the assessment of the financial performance of each department of a large organisation is referred to as **Departmental Accounting**.

Features of Departmental Accounting

- In the books of accounts, transactions are recorded department-wise. All expenses and incomes are recognized separately for each department.
- It is an application of Responsibility Accounting system.
- Each department is considered as Responsibility Centre.
- Both external as-well-as internal transactions are recorded.
- It provides information to internal stakeholders of the entity.
- It involves the drafting of Departmental Trading & Profit & Loss Account.

Objectives of Departmental Accounting

- To get an analytical idea about the affairs of each department.
- To ascertain the true operating result and efficiency of each department (department profit/loss).
- To compare the financial performance among different departments.
- To provide data and information to the management for decision-making and policy-formulation.

Methods of Maintaining Departmental Accounts

Two approaches are usually followed for obtaining the individual figures of the various items of expenses and incomes. An organisation can follow any one of them.

- Maintenance of same set of books; or
- Maintenance of separate set of books

Maintenance of same set of books	The amounts of various items of expenses and incomes, etc. are gathered by maintaining the books of accounts in the tabular or columnar format. Hence, this method is referred to as Columnar or Tabular Method. Accounting Department, centralized in nature, maintains the entire records. This method is widely accepted because of it is comparatively less expensive.

Maintenance of separate set of books	Individual figures of various items of expenses and incomes, etc. are obtained by keeping the books of each department separately. Hence, this method is referred to as Unitary Method. Each concerned department maintains their records independently. Although the method is very expensive, large-sized firms usually practice it.

Preparation of Departmental Final Accounts

Components of Departmental Final Accounts

Departmental Trading Account: This account is drafted in columnar format where each column represents each department. It is prepared for ascertaining Departmental Gross Profits/Gross Loss of individual departments. In this account, the direct expenses are debited and direct incomes are credited.

Departmental Profit & Loss Account: This account is also drafted in columnar format where each column represents each department. It is prepared for ascertaining Departmental Net Profits / Net Loss of individual departments. In this account the indirect expenses are debited and allocated indirect incomes are credited, after considering Gross Profit/Gross Loss of individual departments.

General Profit & Loss Account: This account is drafted for the determination of Overall Net Profit/ Net Loss of the entity. Indirect expenses and Indirect incomes that cannot be rationally apportioned between the departments are debited and credited respectively, after considering departmental Net Profits/ Net Loss. The format of this account is like the normal income state i.e no Department specific columns are there.

Format of Departmental Trading Account, Departmental Profit & Loss Account and General Profit & Loss Account

Departmental Trading & Profit & Loss Account

Dr. **for the year ended...** **Cr**

Particulars	Dept. I	Dept. II	Particulars	Dept. I	Dept. II
To Opening Stock	xx	xx	By Sales	xx	xx
To Purchases	xx	xx	By Transfer	xx	xx
To Wages	xx	xx	By Closing Stock	xx	xx
To Other Direct Expenses	xx	xx			
To Transfer	xx	xx			
To Gross Profit c/d	xx	xx			
	xxx	xxx		xxx	xxx
To Rent	xx	xx	By Gross Profit b/d	xx	xx
To Salaries	xx	xx	By Indirect Incomes	xx	xx
To Depreciation and amortisation	xx	xx			
To Other Indirect Expenses	xx	xx			
To General P/L A/c	xx	xx			
[Dept. Net Profit Transferred]					
	xxx	xxx		xxx	xxx

General Profit & Loss Account

Dr. **for the year ended...** **Cr**

Particulars	(₹)	Particulars	(₹)
To General Expenses	xx	By Departmental P/L A/c [Net Profit]	xx
To Stock Reserve [Provision on Stock]	xx		
To Capital A/c [Net Profit transferred]	xx		
	xxx		xxx

Steps for Preparation of Departmental Final Accounts

Step I. Determination of Departmental Gross Profit/ Loss

Items	Treatment
Directly allocable Direct Expenses	Debited to Departmental Trading A/c
Direct Expenses that cannot be directly allocated	Apportion the expenses on some suitable basis and debit them to Departmental Trading A/c.
Directly Allocable Direct Incomes	Credited to Departmental Trading A/c
Goods transferred from one department to other department	Debited to Transferee(Receiving) Department and credited to Transferor (Sending)Department. (Journal: Transferee Department A/c Dr. To Transferor Department A/c)
After determining Departmental Gross Profit/Loss, it is transferred to Departmental Profit & Loss A/c.	

Step II: Determination of Departmental Net Profit/Loss

Items	Treatment
Directly allocable Indirect Expenses	Debited to Departmental Profit & Loss A/c
Indirect Expenses that cannot be directly allocated	Apportion the expenses on some suitable basis and debit them to Departmental Profit & Loss A/c.
Directly Allocable Indirect Incomes	Credited to Departmental Profit & Loss A/c
Indirect Incomes that cannot be directly allocated	Apportion the Incomes on some suitable basis and credit them to Departmental Profit & Loss A/c.
After determining Departmental Net Profit/Loss, it is transferred to General Profit & Loss A/c.	

Step III: Determination of Overall Net Profit/Loss of the concern

Items	Treatment
Indirect Expenses that could not be allocated to departments	Debited to General Profit & Loss A/c.

Items	Treatment
Indirect Incomes that could not be allocated to departments	Credited to General Profit & Loss A/c.
Provision for Unrealised Profit (if any)	On Closing Inventory, debit them to General Profit & Loss A/c and on Opening Inventory, credit them to .General Profit & Loss A/c
By, Balancing General Profit & Loss A/c, Consolidated or Overall Net Profit / Loss is ascertained.	

Certain Specific Transactions

Items of Income

- Incomes which are directly allocable to a specific department are credited to the respective department.
- Incomes which are common for more than one department are apportioned rationally over all departments.

Income Items common for more than one department	Basis of Apportionment
Discount Received	Net Purchases i.e Purchases less Returns Outward (if any)
Sales Commission	Net Sales i.e Sales less Returns Inward (if any)

Other Indirect Incomes which are of financial in nature viz. Dividend received, Interest earned on Deposits, Profit on sale of fixed assets are credited of General P/L A/c, as these items relate the organisation as whole and cannot be apportioned over the departments.

Items of Expenses

- Expenses which are directly allocable to a specific department are debited to the respective department.
- Expenses which are common for more than one department are apportioned rationally over all departments.

Expense Items common for more than one department	Basis of Apportionment
Commission to Purchase Manager, Carriage inwards	Purchases
Selling expense, Commission to salesman, bad debts, Discount allowed	Sales
Depreciation, Insurance, Repairs and Maintenance	Value of Fixed Assets
Rent and rates, Insurance, Heating	Floor area occupied
Power	Horse power (HP) or HP × Hours Worked

Other indirect expenses which are of general nature viz. General charges, Sundry charges, MD's Remuneration, Miscellaneous expenses etc. as well as expenses which are of financial in nature viz. Bank Charges, Interest on loan/debentures, are debited to General P/L A/c as these items relate the organisation as whole and cannot be apportioned over the departments.

Illustration 14

M/s Unique is a departmental store having three departments – X, Y and Z. Information regarding three departments for the year ended March 31, 2023 are given below:

Particulars	X (₹)	Y (₹)	Z (₹)
Opening Stock	72000	48000	40000
Furniture	40,000	40,000	20,000
Purchases	2,64,000	1,76,000	88,000
Sales	3,60,000	2,70,000	1,80,000
Closing stock	90,000	35,000	42,000
Sundry Debtors	30,000	20,000	20,000
Floor area occupied by each department (in sq. ft)	6,000	5,000	4,000
Number of employees	50	40	30
Electricity Consumed (in units)	600	400	200

The Balances of other revenue items in the books for the year given below (in ₹)

Particulars	(₹)	Particulars	(₹)
Carriage Inwards	6,000	Discount Received	3,600
Carriage Outwards	5,400	Employees Welfare Expenses	4,800
Discount Allowed	4,500	Rent, Rates &Taxes	15,000
Advertisement	5,400	Electricity charges	6,000
Wages	96,000	Depreciation on furniture	2,000

After providing Provision for Bad Debts at 5%, prepare Departmental Trading and Profit and Loss Account

Solution

M/s Unique
Departmental Trading and Profit & Loss Account
Dr. for the year ended 31.03.2023 Cr.

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Opening Stock	72,000	48,000	40,000	By Sales	3,60,000	2,70,000	1,80,000
To Purchases	2,64,000	1,76,000	88,000	By Closing Stock	90,000	35,000	42,000
To Carriage Inwards (WN:1)	3,000	2,000	1,000				
To Gross Profit c/d	1,11,000	79,000	93,000				
	4,50,000	**3,05,000**	**2,22,000**		**4,50,000**	**3,05,000**	**2,22,000**
To Rent, Rates & Taxes (WN:1)	6000	5000	4000	By Gross Profit b/d	1,11,000	79,000	93,000
To Wages (WN:1)	40,000	32,000	24,000				
To Carriage Outwards (WN:1)	2,400	1,800	1,200	By Discount Received	1800	1200	600
To Discount Allowed (WN:1)	2,000	1,500	1,000				
To Electricity Expenses	3,000	2,000	1,000				

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Advertisement (WN:1)	2,400	1,800	1,200				
To Depreciation (WN:1) (WN:1)	800	800	400				
To Employees Welfare Expenses (WN:1)	2000	1600	1200				
To Provision for Bad Debt (WN:2)	1500	1000	1000				
To General P/L A/c (Dept. NP transferred)	52,700	32,700	58,600				
	1,12,800	**80,200**	**93,600**		**1,12,800**	**80,200**	**93,600**

Working Notes

1. Allocation of unallocated income and expenses

Item of Expenses	(₹)	Basis	Ratio	X (₹)	Y (₹)	Z (₹)
Carriage Inwards	6000	Purchases	3:2:1	3,000	2,000	1,000
Rent, Rates & Taxes	15,000	Floor area	6:5:4	6,000	5,000	4,000
Wages	96,000	Number of employees	5:4:3	40,000	32,000	24,000
Carriage Outwards	5,400	Sales	4:3:2	2,400	1,800	1,200
Discount Allowed	4,500	Sales	4:3:2	2,000	1,500	1,000
Electricity expenses	6,000	Electricity consumed	3:2:1	3,000	2,000	1,000
Advertisement	5,400	Sales	4:3:2	2,400	1,800	1,200
Depreciation on Furniture	2,000	Value of Furniture	2:2:1	800	800	400
Employees Welfare Expenses	4,800	Number of employees	5:4:3	2,000	1,600	1,200
Discount Received	3,600	Purchases	3:2:1	1,800	1,200	600

2. Provision for Bad Debt

Dept. X: ₹ 30,000 × 5% = ₹ 1,500,

Dept. Y: ₹ 20,000 × 5% = ₹ 1,000, Dept. Z: ₹ 20,000 × 5% = ₹ 1,000

Inter-Departmental Transfer

When goods/services are transferred from one department (Transferor Department) to another department (Transferee Department), it is known as Inter-Departmental Transfer and such transfers are considered to be as "Purchases" of the Transferee Department and "Sales" of the Transferor Department.

Valuation of Transfer: It can be done on of the following three basis

At Cost	• Transferor Department transfers goods/services to Transferee Department at "Cost to the Transferor Department". • If part of goods transferred remains in the closing inventory of Transferee Department, then the creation of "Provision for Unrealised Profit" is not required.

At Cost plus Profit	Transferor Department transfers goods/services to Transferee Department at a value higher than the Cost. Hence, it is referred as 'Cost plus Profit'. Departments which produce or render intermediate goods/services usually follows this method to ensure that the Transferor Department gets due credit (in the form of profit-booking) out of such transfer. If part of goods transferred remains in the closing inventory of Transferee Department, then the creation of "Provision for Unrealised Profit" is required.
At Normal Selling Price	Transferor Department transfers goods/services to Transferee Department at 'Normal Selling Price' i.e prevailing Market Price. Departments which produce or render marketable goods/services usually follows this method to ensure that the Transferor Department gets due credit (in the form of profit-booking) out of such transfer. Actual profit earning capacity remains undisclosed to the stakeholders. If part of goods transferred remains in the closing inventory of Transferee Department, then the creation of "Provision for Unrealised Profit" is required.

Provision for Unrealised Profit

Based on the concept of Responsibility Accounting, more often than not, departments are considered as 'Profit Centres' and hence, goods are transferred from Transferor Department to Transferee Department at a value which is higher than the cost. The value may be Normal Selling Price or may be higher/lower than Selling Price, but the value will definitely include an element of profit to ensure that the Transferor Department gets due credit (in the form of profit booking). After receiving the goods, Transferee Department carry out necessary processes and eventually transfer/sell them to other department/market. At the end of certain period, it may be found that the closing inventory of Transferee Department holds a part of goods which were earlier received from Transferor Department. It means that part of goods which were transferred from Transferred Department has remained unsold although the profit on it has been booked by the Transferor Department. This leads to the concept of Unrealised Profit.

Unrealised Profit refers to the profit booked (but not earned) by the transferor department out of inter-departmental transfers. Although the due credit is given to Transferor Department and the profit is reflected in the Transferor Department's Profit, this profit cannot be considered as earned/realized by the entity as it is not yet earned from any outside party.

As per the Concept of Prudance, unrealized profit is needed to be adjusted. Hence, "Provision for Unrealised Profit" is maintained both on closing stock as well as on the subsequent opening stock. Moreover, it needs to noted that such Provision is required to be created on goods received at higher than cost from all predecessor departments and not only the immediately preceding department.

Steps for calculation of amount of Provision for Unrealised Profit

Step I: Identification of the 'Value of Transferred Stock' included in the Closing Stock of the Transferee Department

Step II: Ascertainment of the Gross Profit Rate (GP Rate) on Sales of the Transferor Department

Step III: Apply the GP Rate to the 'Value of Transferred Stock'

Provision for Unrealised Profit = Value of Transferred Stock (of Transferor Dept.) × GP Rate(of Transferee Dept.)

Accounting of Transfer:

Transactions	Journal Entry
On transfer of goods/ services	Transferee Department A/c Dr. To Transferor Department A/c
Creation of Provision for Unrealised Profit	**On Closing Stock** General Profit & Loss A/c To Provision for Unrealised Profit A/c
	On Opening Stock (in subsequent period) Provision for Unrealised Profit A/c To General Profit & Loss A/c

Illustration 15

A firm has two departments – Raw Materials and Manufacturing. The finished goods are produced by the Manufacturing Department with raw materials supplied by Raw Materials department at selling price. Using the following information prepare Departmental Trading and Profit and Loss Account for the year ended on 31st March 2023.

	Raw Materials Dept. (₹)	Manufacturing Dept. (₹)
Opening Stock	1,20,000	20,000
Purchases	8,00,000	6,000
Sales	8,80,000	1,80,000
Manufacturing Expenses	--	24,000
Selling Expenses	1,600	800
Raw Materials transferred to Manufacturing Dept.	1,20,000	--
Closing Stock	80,000	24,000

Cost of the closing stock of the manufacturing department consists of 25% for manufacturing expenses and 75% for raw materials. In the preceding year Raw Materials Department earned gross profit at the rate of 10%. Salaries of ₹ 5,000 and Insurance Premium of ₹ 1,600 are allocated between the two departments on the basis of sales ratio. Find out the Net Profit of the firm as a whole.

Solution :

Dr. Departmental Trading and Profit & Loss Account for the year ended 31.3.2023 Cr.

Particulars	Raw Materials	Manufacturing	Particulars	Raw Materials	Manufacturing
To Opening Stock	1,20,000	20,000	By Sales	8,80,000	1,80,000
To Purchases	8,00,000	6,000	By Transfer (Transferred to MF)	1,20,000	-
To Transfer (Received from RM)	-	1,20,000	By Closing Stock	80,000	24,000
To Manufacturing Expenses	-	24,000			

Particulars	Raw Materials	Manufac-turing	Particulars	Raw Materials	Manufac-turing
To Gross Profit c/d	1,60,000	34,000			
	10,80,000	**2,04,000**		**10,80,000**	**2,04,000**
To Salaries (44:9)	4,150	850	By Gross Profit b/d	1,60,000	34,000
To Selling Expenses	1,600	800			
To Insurance Premium (44:9)	1328	272			
To General P/L A/c (Dept. Net Profit transferred)	1,52,922	32,078			
	1,60,000	**34,000**		**1,60,000**	**34,000**

Dr. General Profit & Loss Account for the year ended 31.3.2023 Cr.

Particulars	(₹)	Particulars	(₹)
To Stock Reserve (WN:1)	1380	By Departmental Profit & Loss A/c	1,52,922
To Capital A/c (NP transferred)	1,83,620	By Raw Materials Manufacturing	32,078
	1,85,000		**1,85,000**

Working Notes:

1. **Unrealized Profit in unsold stock:**

Profit rate on transferred goods = GP rate of Raw Materials Dept.

= {Gross profit /(Sales + Transfer)} × 100

= {1,60,000 / (8,80,000 + 1,20,000)} × 100

= 16%

Value of the goods of Manufacturing dept. included in the Closing stock of Raw Materials Dept.

= ₹ 24,000 × 75% = ₹ 18,000

Unrealized Profit in Closing Stock = ₹ 18,000 × 16% = ₹ 2,880

Value of the goods of Manufacturing dept. included in the Opening stock of Raw Materials Dept.

= ₹ 20,000 * 75% = ₹ 15,000

Unrealised Profit in Opening Stock = ₹ 15,000 × 10% = ₹ 1,500

Net Stock Reserve = ₹ 2,880 – ₹ 1,500 = ₹ 1,380

Illustration 16

A & Co. has two departments P & Q. department P sells goods to department Q at normal selling prices. From the following particulars, prepare departmental Trading & PL account for the year ended 31.03.2023 and also ascertain the net profit to be transferred to Balance Sheet:

Particulars	Department P (₹)	Department Q (₹)
Opening stock	5,00,000	NIL
Purchases	28,00,000	3,00,000
Goods from P	NIL	8,00,000
Wages	3,50,000	2,00,000
Travelling expenses	20,000	1,60,000
Closing stock at cost to the department	8,00,000	2,09,000
Sales	30,00,000	2,00,0000
Printing & Stationery	30,000	25,000

The following expenses incurred for both the departments were not apportioned between the departments:

Salaries ₹ 33,000, advertisement expenses ₹ 1,20,000,General expenses ₹ 5,00,000,Depreciation is to be charged @30% on the machinery worth ₹ 96,000.

The advertisement expenses of the departments are to be apportioned in the turnover ratio. Salaries and depreciation are to be apportioned in the ratio 2:1 and 1:3 respectively. General expenses are to be apportioned in the ratio 3:1.

Solution:

A & Co.
Departmental Trading and P/L Account
for the year ended 31.03.2023

Dr. **Cr.**

Particulars	Deptt. P (₹)	Deptt. Q (₹)	Total (₹)	Particulars	Deptt. P (₹)	Deptt. Q (₹)	Total (₹)
To Opening Stock	5,00,000	Nil	5,00,000	By Sales	30,00,000	20,00,000	50,00,000
To Purchases	28,00,000	3,00,000	31,00,000	By Goods transferred to Q	8,00,000		
To Goods from P		8,00,000		By Closing Stock	8,00,000	2,09,000	10,09,000
To Wages	3,50,000	2,00,000	5,50,000				
To Gross Profit c/d	9,50,000	9,09,000	18,59,000				
	46,00,000	22,09,000	60,09,000		46,00,000	22,09,000	60,09,000
To Travelling Expenses	20,000	1,60,000	1,80,000	By Gross Profit b/d	9,50,000	9,09,000	18,59,000
To Printing & Stationery	30,000	25,000	55,000				

Particulars	Deptt. P (₹)	Deptt. Q (₹)	Total (₹)	Particulars	Deptt. P (₹)	Deptt. Q (₹)	Total (₹)
To Salaries (2:1)	2,20,000	1,10,000	3,30,000				
To Advertisement Expenses (3:2)	72,000	48,000	1,20,000				
To General Expenses (3:1)	3,75,000	1,25,000	5,00,000				
ToDepreciation (1:3)	7,200	21,600	28,800				
To, Net Profit c/d	2,25,800	4,19,400	6,45,200				
	9,50,000	**9,09,000**	**18,59,000**		**9,50,000**	**9,09,000**	**18,59,000**
To Provision for unrealised profit on closing stock (note 2)			38,000	By Net Profit b/d			6,45,200
To Capital A/c (net profit transferred)			**6,07,200**				

Working notes:

1. Gross profit ratio of department P = ₹ 9,50,000/₹ (30,00,000 + 8,00,000) × 100 = 25%
2. Proportionate P department's stock in department Q

   (Purchase from department P/total purchases of department Q) × total stock of department Q

   = ₹ (8,00,000/11,00,000) × ₹ 2,09,000 = ₹ 1,52,000

   Unrealised profit = 25% of ₹ 1,52,000 = ₹ 38,000

Illustration 17

A Ltd. manufacturing electronic components operates with two departments. Transfer made between the departments of both purchased goods and manufactured finished goods. Goods purchased are transferred at cost and manufactured goods are transferred only at selling price as is the case with open market.

Transactions for the year ended Mar. 31, 2023 are given below:

Particulars	Dept. X (₹)	Dept. Y (₹)
Opening Stock	20,000	15,000
Sales	1,90,000	1,35,000
Wages	12,500	7,500
Purchases	1,00,000	80,000
Closing stock:		
Purchased goods	2,000	5,000
Manufactured goods	7,000	8,000

The following were the transfers from Dept. X to Dept. Y: Purchased goods ₹ 6,000 and finished goods ₹ 20,000; and from Dept. Y to Dept. X: Purchased goods ₹ 5,000 and finished goods ₹ 35,000. Stocks were valued at cost to the department concerned. It is estimated that the closing stock of manufactured goods of Dept. Y consists of 20% for goods received from Dept. X and closing stock of Dept. X consists of 20% for goods received from Dept. Y.

You are required to prepare Departmental Trading Account and A Ltd.'s Trading Account for the year ended Mar. 31, 2022. Also show the reconciliation of the profits ascertained from these accounts.

Solution :

A Ltd.

Departmental Trading Account

Dr. **for the year ended 31.3.2023** **Cr.**

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Opening Stock	20,000	15,000	By Sales	1,90,000	1,35,000
To Purchases	1,00,000	80,000	By Transfer [Goods sent]:		
To Transfer [Goods received]:			Purchased goods	6,000	5,000
Purchased goods	5,000	6,000	Finished goods	20,000	35,000
Finished goods	35,000	20,000	By Closing Stock:		
To Wages	12,500	7,500	Purchased goods	2,000	5,000
To Departmental Profit [Bal. Fig.]	52,500	59,500	Manufactured goods	7,000	8,000
	2,25,000	**1,88,000**		**2,25,000**	**1,88,000**

Trading Account

Dr. **for the year ended 31.3. 2023** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Opening Stock [20,000 + 15,000]	35,000	By Sales [1,90,000 + 1,35,000]	3,25,000
To Purchases [1,00,000 + 80,000]	1,80,000	By Closing Stock:	
To Wages [12,500 + 7,500]	20,000	Purchased goods [2,000 + 5,000]	7,000
To Gross Profit [Bal. Fig.]	1,11,110	Manufactured goods[WN: 1]	14,110
	3,46,110		**3,46,110**

Reconciliation of Profits:

The departmental profits ascertained from the Departmental Trading & P/L A/c and the company's Gross Profit determined from the Company's Trading A/c can be reconciled as under:

Gross Profit of the company = Profit of Dept. X + Profit of Dept. Y – Unrealised profit in Unsold stock

= ₹ 52,500+ ₹ 59,500 – ₹ (490+400) = ₹ 1,11,110

Working Notes:

1. Value of closing stock of manufactured goods:

	Dept. X (₹)	Dept. Y (₹)
'Profit rate of the transferor' on 'transferred goods' $\left[\frac{\text{Gross Profit}}{\text{Sales + Transfer of Finished Goods}} \times 100\right]$	$\frac{52,500}{1,90,000 + 20,000} \times 100 = 25\%$	$\frac{59,500}{1,35,000 + 35,000} \times 100 = 35\%$
Value of 'transferred goods' included in closing stock	₹ 1,400 [7,000 × 20%]	₹ 1,600 [8,000 × 20%]
Less: Unrealised profits included in closing stock [Transferred goods × Profit rate of transferor]	₹ 490 [1,400 × 35%]	₹ 400 [1,600 × 25%]
∴ Total cost of closing stock of manufactured goods = [7,000 + 8,000] – [490 + 400] = ₹ 14,110		

Illustration 18

Samudra & Co. a partnership firm has three departments viz. K, L, M which are under the charge of the Partners B, C and D respectively. The following Consolidated P&L Account is given below :

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

Particulars	(₹)	Particulars	(₹)
To Opening Stocks (Note i)	81,890	By Sales (Note vii)	4,00,000
To Purchases (Note ii)	2,65,700	By Closing Stocks (Note viii)	89,000
To Salaries and Wages (Note iii)	48,000	By Discounts Received (Note x)	800
To Rent Expenses (Note iv)	10,800		
To Selling Expenses (Note v)	14,400		
To Discount Allowed (Note v)	1,200		
To Depreciation (Note vi)	750		
To Net Profit for the year	67,060		
	4,89,800		**4,89,800**

From the above account and the following additional information, prepare the Departmental P&L Account for the year ended 31st March, 2023.

(i) Break up of Opening Stock Department wise is: K - ₹ 37,890; L - ₹ 24,000 and M - ₹ 20,000.

(ii) Total Purchases were as under: K - ₹ 1,40,700; L - ₹ 80,600; M - ₹ 44,400.

(iii) Salaries and Wages include ₹ 12,000 wages of Department M. The balance Salaries should be apportioned to the three departments as 4:4:1.

(iv) Rent is to be apportioned in the ratio of floor space which is as 2:2:5.

(v) Selling Expenses and Discount Allowed are to be apportioned in the ratio of Turnover.

(vi) Depreciation on assets should be equally charged to the three departments.

(vii) Sales made by the three departments were: K - ₹ 1,80,000; L - ₹ 1,30,000 and M - ₹ 90,000.

(viii) Break up of Closing Stock Department wise is: K - ₹ 45,100; L - ₹ 22,300 and M - ₹ 21,600. The Closing Stock of Department M includes ₹ 5,700 goods transferred from Department K. However, Opening Stock does not include any goods transferred from other departments.

(ix) Departments K and L sold goods worth ₹ 10,700 and ₹ 600 respectively to Department M.

(x) Discounts received are traceable to Departments K, L and M as ₹ 400; ₹ 250 and ₹ 150 respectively.

(xi) Partners are to share the profits as under: (a) 75% of the Profits of Departments K, L and M to the respective Partner in Charge, (b) Balance Profits to be credited as 2:1:1.

Solution:

Dr. Departmental P&L Account for the year ended 31st March, 2023 Cr.

Particulars	K (₹)	L (₹)	M (₹)	Particulars	K (₹)	L (₹)	M (₹)
To Opening Stock	37,890	24,000	20,000	By Sales	1,80,000	1,30,000	90,000
To Purchases	1,40,700	80,600	44,400	By Transfer	10,700	6 0 0	—
To Inter-Dept Trf	—	—	11,300	By Closing Stock	45,100	22,300	21,600
To Wages	—	—	12,000				
To Gross Profit c/d	57,210	48,300	23,900				
	2,35,800	**1,52,900**	**1,11,600**		**2,35,800**	**1,52,900**	**1,11,600**
To Salaries (4:4:1)	16,000	16,000	4,000	By Gross Profit b/d	57,210	48,300	23,900
To Rent (2:2:5)	2,400	2,400	6,000	By Discounts Received	400	250	150
To Selling Exp	6,480	4,680	3,240				
To Disc. (18:13:9)	540	390	270				
To Depreciation	250	250	250				
To Net Profit c/d	31,940	24,830	10,290				
	57,610	**48,550**	**24,050**		**57,610**	**48,550**	**24,050**

Computation of Stock Reserve

From the above profits, Stock Reserve should be eliminated on the Closing Stock.

- GP Rate in Department K = ₹(57,210 × 100) / ₹1,90,700 = 30%.
- Stock Reserve = 30% on ₹ 5,700 = ₹ 1,710.

Profit and Loss Appropriation Account

Dr. Cr.

Particulars		(₹)	Particulars	(₹)
To Stock Reserve		1,710	By Profit b/d	67,060
To Profits transferred to Capital:			(31,940 + 24,830 + 10,290)	
B : 75% of 31,940	23,955			
C : 75% of 24,830	18,623			
D : 75% of 10,290	7,718	50,296		
To Balance profits trfd in 2: 1: 1				
B : 50% of 15,054	7,527			
C : 25% of 15,054	3,763			
D : 25% of 15,054	3,764			
(bal.fig)		15,054		
		67,060		**67,060**

Illustration 19

The following details are available in respect of a business for a year.

Department	Opening Stock	Purchase	Sales
X	120 units	1,000 units	1,020 units at ₹ 20.00 each
Y	80 units	2,000 units	1,920 units at ₹ 22.50 each
Z	152 units	2,400 units	2,496 units at ₹ 25.00 each

The total value of purchases is ₹ 1,00,000. It is observed that the rate of Gross Profit is the same in each department. Prepare Departmental Trading Account for the above year.

Solution:

Computation of Closing Stock Quantity (in units)

Particulars	X	Y	Z
Opening Stock	120	80	152
Add: Purchases	1,000	2,000	2,400
Less : Units Sold	(1,020)	(1,920)	(2,496)
Closing Stock	**100**	**160**	**56**

Computation of Gross Profit Ratio

We are informed that the GP Ratio is the same for all departments. Selling Price is given for each department's products but the Sale Quantity is different from that of Purchase Quantity. To find the Uniform GP Rate, the sale value of Purchase Quantity should be compared with the Total Cost of Purchase, as under. Assuming all purchases are sold, the sale proceeds would be

Particulars		(₹)
Department X	1,000 units @ ₹ 20.00	20,000
Department Y	2,000 units @ ₹ 22.50	45,000
Department Z	2,400 units @ ₹ 25.00	60,000
Total Sale Value of Purchase Quantity	**125,000**	
Less : Cost of Purchase	1,00,000	
Gross Profit Amount	**25,000**	
Gross Profit Ratio	25,000 ÷ 1,25,000	20% of Selling Price

Computation of Profit and Cost for each article

Department	Selling Price	Profit at 1/5 of SP	Cost = Sales – Profit
Department X	₹ 20.00	1/5 of ₹ 20.00 = 4.00	₹ 16.00
Department Y	₹ 22.50	1/5 of ₹ 22.50 = 4.50	₹ 18.00
Department Z	₹ 25.00	1/5 of ₹ 25.00 = 5.00	₹ 20.00

Dr. **Departmental Trading Account for the year ended...** **Cr.**

Particulars	X (₹)	Y (₹)	Z (₹)	Total (₹)	Particulars	X (₹)	Y (₹)	Z (₹)	Total (₹)
To Op. stock	1,920	1,440	3,040	6,400	By Sales	20,400	43,200	62,400	126,000
To Purchase	16,000	36,000	48,000	100,000	By Cl. stock	1,600	2,880	1,120	5,600
To Gross Profit	4,080	8,640	12,480	25,200					
	22,000	**46,080**	**63,520**	**131,600**		**22,000**	**46,080**	**63,520**	**131,600**

Opening and Closing Stocks are valued at Cost as indicated in WN 3 above. Sale Amount in the Trading Account is computed for the Sale Quantity only. Gross Profit is calculated at 20% of Sale Value.

Illustration 20

M/s Auto Garage consists of three departments: Spares, Services and Repairs. Each department being managed by a departmental manager whose commission was respectively 5%, 10% and 10% of the respective departmental profit. In the absence or inadequacy of profit, a minimum commission of ₹ 3,000 is to be paid to managers. Inter-departmental transfers of goods and services are made on the basis of loaded price given as under:

From Spares to Services 5% above cost

From Spares to Repairs 10% above cost

From Repairs to Services 10% above cost

In respect of the year ended 31st March, 2023 the books has already been closed and positions drawn. Subsequently it was discovered that closing stock of departments had included inter-departmental transferred goods at loaded price instead of the correct cost price. From the following information prepare a revised statement recomputing the departmental profit or loss.

	Spares (₹)	Service (₹)	Repairs (₹)
Net Profit/Loss as per accounts	19,000 (loss)	25,200 (profit)	36,000 (profit)
Inter-departmental transfers included at loaded price in the departmental stocks	---	32,500 (₹ 10,500 from Spares and ₹ 22,000 from Repairs)	2,100 (from spares)

Solution:

Statement showing computation of correct departmental profit:

Particulars	Spares (₹)	Service (₹)	Repairs (₹)
Net Profit/ (Loss) as per accounts	(19,000)	25,200	36,000
Add: Managerial Remuneration: [Spares: Higher of (19,000) × 5/95) and 3,000]	3,000		
[Service: Higher of (22,500 × 10/90) and 3,000]	-	3,000	-
[Repairs:Higher of (36,000 × 10/90) and 3,000]	-	-	4,000
∴ Profits before Managerial Remuneration	(16,000)	28,200	40,000
Less: Unrealised Profits of transferor department [WN:1]	691	-	2,000
	(16,691)	28,200	38,000
Less: Managerial Remuneration: [Spares: Higher of (16,691) × 5%) and 3,000]	3,000	-	-
[Service: Higher of (28,200 × 10%) and 3,000]	-	3,000	-
[Repairs:Higher of (38,000 × 10%) and 3,000]	-	-	3,800
∴ Correct departmental profit	(19, 691)	25,200	34,200

Working Notes:

		Transferee		
Transferor		Services (₹)	Repairs (₹)	Total (₹)
	Spares	500 [10,500 × 5/105]	191 [₹ 2,100 × 10/110]	691
	Repairs	2,000 [22,000 × 10/110]	..	2,000

Solved Case(s)

Pal & Co., is a manufacturer of umbrella with their head office at Kolkata. In order to expand their business, Mr. Sourav Pal, grandson of the founder Mr, Suresh Pal, opened a branch of their business at Bangalore in the southern Indian state of Karnataka in the year 2019-20.

It was decided by Sourav that the goods will be invoiced from Kolkata head office to their Bangalore branch at 20% less than list price, which is cost plus 100%, with instruction that cash sales are made at invoice price and credit sales at list price.

There were not much transactions between the head office and Bangalore branch during the next to financial years due to the lockdown induced by the COVID-19 outbreak. However, the business started with slowly but steadily in 2022-23.

The following particulars have been made available to you for the year ended 31.03.2023:

	(₹)
Stock at Bangalore branch on 01.04.2022 (at invoice price)	24,000
Amount due from debtors on 01.04.2022	20,000
Goods received from head office (at invoice price)	2,64,000
Goods returned to head office (at invoice price)	2,000
Sales:	
Cash	92,000
Credit	2,00,000
Cash received from debtors	1,71,268
Expenses incurred at Bangalore branch	34,732
Remittance from Bangalore branch to Kolkata head office	2,40,000
Amount due from debtors on 31.03.2023	48,732
Stock at Bangalore branch on 31.03.2023 (at invoice price)	30,800

It is further communicated by the branch manager that there has been some stock shortage at their Bangalore branch which were identified in the month of March 2023.

1. Calculate the amount of stock shortage (at invoice price) that occurred at Bangalore branch.
2. Determine the gross profit or loss made by Bangalore branch for the year ended 31.03.2023.
3. Determine the net profit or loss made by Bangalore branch for the year ended 31.03.2023.

Answer:

1. Calculation of stock shortage:

Particulars	(₹)	(₹)
Stock on 1.4.22 at invoice price		24,000
Goods from head office at invoice price		2,64,000
		2,88,000
Less : Returns to head office at invoice price		2,000
		2,86,000
Less : Cash sales	92,000	
Less: Invoice value of credit sales: [160/200 × 2,00,000]	1,60,000	2,52,000
Stock that should have been on 31.12.23 at invoice price ₹34,000		34,000
Less : Actual stock on 31.12.23 at invoice price		30,800
Stock shortage at invoice price		3,200

2.

Dr. **Branch Stock Adjustment Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Goods Sent to Branch A/c		By Balance b/f	
(load on returns from branch) :		(load on opening stock) :	
[60/160 × ₹2,000]	750	[60/160 × ₹ 24,000]	9,000
" Stock Shortage A/c			
(load on stock shortage) :		By Goods Sent to Branch A/c	
[60/160 × ₹3,200]	1,200	(load on goods sent) :	
" Branch Profit and Loss A/c	1,34,500	[60/160 × ₹2,64,000]	99,000
(gross profit transferred)		" Branch Stock A/c	40,000
(balancing figure)		(apparent gross profit)	
" Balance c/f			
(load on closing stock) :			
[60/160 × ₹30,800]	11,550		
	1,48,000		**1,48,000**

3. **Net profit or loss made by Bangalore branch for the year ended 31.03.2023 - ₹97,768**

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

Particulars	(₹)	Particulars	(₹)
To Branch Expenses A/c	34,732	By Branch Stock Adjustment A/c	1,34,500
" Stock Shortage A/c : [100/160 × 3,200]	2,000	(gross profit)	
" General Profit and Loss A/c	97,768		
(branch net profit transferred)			
	1,34,500		**1,34,500**

Working Note:

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

Particulars	(₹)	Particulars	(₹)
To Balance b/f	24,000	By Bank (cash sales)	92,000
01.04.22		" Branch debtors (credit sales)	2,00,000
To Goods Sent to Branch A/c	2,64,000	" Goods Sent to Branch A/c	2,000
" Branch Adjustment A/c	40,000	(returns from branch)	
(apparent gross profit)		" Stock Shortage A/c (see Note 2)	3,200
		" Balance c/f	30,800
	3,28,000		**3,28,000**

Dr. **Branch Debtors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f	20,000	By Bank	1,71,268
01.04.22		" Balance c/f	48,732
To Branch Stock A/c (credit sales)	2,00,000		
	2,20,000		**2,20,000**

Working Notes:

(1) When cost price is ₹ 100, list price is ₹ 200 (i.e., cost price plus 100%), and invoice price is ₹ 160 (i.e., list price minus 20%).

Exercise

A. Theoretical Questions:

State True or False

1. In Departmental P&L A/c, insurance on stock should be apportioned based on Average Value of Stock ratio.
2. In the final Balance Sheet closing stock of a department receiving goods from another department at cost plus 10% profit, should be shown at the cost to the receiving department
3. For apparent profit or loss (i.e. difference between sales price and invoice price), journal entry is passed involving Branch Stock A/c and Branch Stock Adjustment A/c.
4. Under Stock Debtors System of Branch Accounting, Branch Stock A/c is maintained at cost price.
5. The objective of keeping Branch Stock A/c at invoice price under Stock Debtors System is to ensure control over stock.
6. Branch Stock Adjustment A/c is used to record the loading on stock and on goods sent and to record the apparent profit or loss.
7. Under Final Accounts method, profit or loss of any branch is ascertained by preparing Branch Profit and Loss Account in place of Branch Account.
8. Under Debtors System of maintaining branch accounts, depreciation does not appear in Branch Account.
9. Stock debtor's system of maintaining branch account is used for independent branch.
10. For independent branch, incorporation of branch trial balance is required.

Answers:

1	**True**	**2**	**False**	**3**	**True**	**4**	**False**	**5**	**True**
6	**True**	**7**	**True**	**8**	**True**	**9**	**False**	**10**	**True**

Fill in the Blanks

1. In branch accounts, in debtor's system, opening balances of assets are ________ to branch account.
2. A branch which keeps complete records of ________ all accounting transactions are called ________.
3. A branch which does not keep the full system of accounting is known as ________.
4. Stock and debtor system is popularly known as ________.
5. Branch account is prepared to ascertain ________ of the branch.
6. The system in which profit and loss made by the branch is determined by preparing branch trading and profit & loss account at cost price is ________ .
7. The account prepared for the ascertaining the amount of gross profit earned by the branch under stock and debtor system is ________
8. The account prepared to adjust the loading included in the value of opening and closing stock at branch is termed as ________.

9. The account prepared in the same way as that when goods are invoice at cost, except that all entries are made at invoice price is termed as ________.

10. The goods sent by the head office may be either at ________ or cost plus profit

Answer:

1	**Debited**	**2**	**Independent branch**
3	**Dependent branch**	**4**	**Analytical Method**
5	**Profit and loss**	**6**	**Final account methods**
7	**Branch adjustment account**	**8**	**Stock reserve and surplus account**
9	**Branch stock account**	**10**	**Cost price**

B. Numerical Questions

Comprehensive Numerical Problems

1. Mr. A, a cloth trader of Kolkata opened a Branch at Nagaon on 1.4.2022. The goods were sent by Head Office to the Branch and invoiced at selling price to the Branch, which is 25% of the cost price of Head Office. The following are the particulars relating to the transactions of the Nagaon Branch:

Particulars	(₹)
Goods sent to Branch (at cost to H.O.)	4,50,000
Sales : Cash	2,10,000
Credit	3,20,000
Cash collected from Debtors	2,85,000
Return from Debtors	10,000
Discount Allowed	8,500
Cash sent to Branch -	
for Freight	30,000
for Salaries	8,000
for other expenses	12,000
Spoiled clothes written off at invoice price	10,000
Normal loss estimated at	15,000

Prepare Nagaon Branch Stock Account, Branch Debtors Account and Branch Adjustment Account showing the net profit of the branch for the year 2022-23.

[**Answer:** Stock Shortage ₹ 17,500; Closing Balance of Branch Debtors Account ₹ 16,500; Gross Profit ₹ 92,000; Net Profit ₹ 20,000]

2. A Nagpur merchant has a branch at Noida to which he charges out the goods at cost plus 25%. The Noida branch keeps its own sales ledger and transmits all cash received to the head office every day. All expenses are paid from the head office. The transactions for the Branch were as follows: (all figures in ₹)

Stock on 1.1.2023	22000	Allowances to customers	500
Debtors on 1.1.2023	200	Returns inward	1000
Petty cash on 1.1.2023	200	Cheques sent to branch: Rent: ₹ 1,200; Wages: ₹ 400: Salaries : ₹ 1800	
Cash sales	5300		
Goods sent to branch	40000	Stock on 31.12.2023	26000
Collections on ledger accounts	42000	Debtors on 31.12.2023	4000
Goods returned to head office	600	Petty cash on 31.12.2023 (including miscellaneous income not remitted ₹ 50)	250
Bad debts	600		

Prepare the Noida Branch Trading and Profit and Loss Account for the year ending 31.12.2023 in the head office books.

[**Answer:** Gross Profit ₹23,480; General Profit & Loss ₹19,430]

3. A Mumbai head office passes an entry at the end of each month to adjust the position arising out of inter-branch transactions during the month. From the following inter-branch transactions in April, 2023, make the entry in the books of Mumbai head office:

(a) Jaipur branch:

(i) Received goods from Pune branch ₹ 9,000 and Ajmer branch ₹ 6,000.

(ii) Sent goods to Ajmer branch ₹15,000 and Pune branch ₹ 12,000.

(iii) Received bills receivable from Ajmer branch ₹ 9,000.

(iv) Sent acceptances to Pune branch ₹ 6,000 and Ajmer branch ₹ 3,000.

(b) Kolkata branch [apart from (a) above]:

(i) Received goods from Pune branch ₹ 15,000 and Jaipur branch ₹ 6,000.

(ii) Cash sent to Pune branch ₹ 3,000 and Jaipur branch ₹ 6,000.

(c) Pune branch [apart from (a) and (b) above]:

(i) Sent goods to Ajmer branch ₹ 9,000.

(ii) Received bills receivable from Ajmer branch ₹ 9,000.

(iii) Received cash from Ajmer ₹ 5,000.

[**Answer:** Net Adjustment: Jaipur (+) 12,000, Kolkata (-) 12,000, Pune (-) 2,000, Ajmer (+) 2,000]

4. Mr. P is the proprietor of a retail business which has two main departments which sell respectively Computers and Printers. On 31.12.2023, the balances in the books of the business were as follows:

Particulars		Dr. (₹)	Cr. (₹)
Capital			71,000
Sales:	Computers		59,000
	Printers		29,500
Purchases;	Computers	20,000	
	Printers	10,000	
Stock on 1.1.2023:	Computers	2,320	
	Printers	2,136	
Salaries:	Computers	20.560	
	Printers	15,440	
Advertising		615	
Discount allowed:	Computers	400	
	Printers	200	
Drawings		3,000	
Buildings (Cost)		43.000	
Equipment at W.D.V.:	Computers	18,000	
	Printers	7,000	
Debtors and Creditors		10,200	5,319
Bank		5,600	
Rent and Rates		1.580	
Canteen Charges		875	
Heating and Lighting		880	
Insurance of Stock		940	
General Administrative Expenses		2,073	
Total		1,64,819	1,64,819

Additional information —

(i) At 31.12.2023, the following amounts were outstanding:

Salaries — Computers ₹ 250 and Printers ₹ 170; Heating and Lighting ₹ 20.

(ii) The general administrative expenses and the rent and rates included prepayments of ₹ 33 and ₹ 80 respectively.

(iii) Stocks at 31.12.2023 were: Computers ₹ 2,800; Printers ₹ 2,450.

(iv) Depreciation is to be provided on equipment at 10% on W.D.V.

(v) The managers of the Computers and Printers departments are to be paid a commission of 5% of the net profit (prior to the commission payment) of the respective departments.

(vi) In apportioning the various expenses between the two departments due regard is to be given to the following information:

	Number of Workers	Average Stock Levels (₹)	Floor Area (sq.mt)
Hardware	18	5,000	8,000
Electrical	12	4,400	4,000

(vii) The general administrative expenses are primarily incurred in relation to the processing of purchases and sales invoices.

Prepare a Departmental Trading and Profit and Loss Account and the Balance Sheet.

[**Answer:** Net Profit of Computer ₹11,471 and Printers ₹19,814; Total of Balance Sheet ₹86,663]

5. Department A sells goods to department B at a profit of 25% on cost and to department C at 10% profit on cost. Department B sells goods to A and C at a profit of 15% and 20% on sales, respectively. Department C charges 20% and 25% profit on cost to department A and B respectively.

Department managers are entitled to 10% commission on net profit subject to unrealised profit on departmental sales being eliminated. Departmental profits after charging manager's commission, but before adjustment of unrealised profit are as under:

	(₹)
Department A	36,000
Department B	27,000
Department C	18,000

Stock lying at different departments at the end of the year are as under:

	Dept. A	Dept. B	Dept. C
	(₹)	(₹)	(₹)
Transfer from Department A	–	15,000	11,000
Transfer from Department B	14,000	–	12,000
Transfer from Department C	6,000	5,000	–

Find out the correct departmental profit after charging manager's commission.

[**Answer:** Correct departmental profits Dept. A ₹32,400, Dept. B ₹22,950, Dept. C ₹16,200]

Unsolved Case(s)

M/s Jai Traders, a manufacturer of ceramic utensils has been in business for last 36 years. In the year 2016-17, it decided to open a branch for cater to their customers in the eastern part of India. It was decided by the senior management members to open the branch at Patna. The Patna branch ultimately started its operations from January 1, 2018. Over the years, its business gradually grew in the eastern states of the country. The following particulars relate to Patna branch for the year ending March 31, 2023:

Particulars	(₹)
Balances on April 1, 2022:	
Stock	40,000
Debtors	14,000
Petty cash	1,500
Furniture	12,000
Prepaid fire insurance premium	1,150
Outstanding salaries	2,100
Goods sent to branch	2,80,000
Cash sales	3,30,000
Credit sales	1,83,000
Cash received from debtors	1,35,000
Cash paid by debtors direct to head office	22,000
Discount allowed	1,100
Cash sent to branch for expenses:	

Particulars	(₹)
Rent: ₹ 12,000; Salaries; ₹ 5,400; Petty cash: ₹ 4,000; Insurance premium (from 1.4.2021 to 31.3.2023)	
Goods returned by the branch	4,000
Goods returned by the debtors	7,000
Stock at branch on 31.03.2023	38,000
Petty expenses paid by the branch	2,850
Loss of stock by fire	4,800

It is the policy of the organisation to provide depreciation on furniture @ 10% p.a.

1. Determine the amount due from Branch debtors as at the end of the financial year 2022-23.
2. Ascertain the amount of profit or loss at Kanpur Branch for the year ending 31.03.2023 by preparing Branch Account in the books of Jaipur head office.

Insurance Claim for Loss of Stock and Loss of Profit

7

This Module Includes

Insurance Claim for Loss of Stock and Loss of Profit

SLOB Mapped against the Module

To equip oneself with the detail understanding of accounting of certain special transactions to determine surplus, ensure control on resources, for divisional performance evaluation or acquisition of assets through deferred payments. (CMLO 2a, 4c)

Module Learning Objectives:

After Studying this module, the students will be able to:

- Determine the amount of insurance claim for loss of stock; and
- Ascertain the amount of insurance claim for loss of profit

Insurance Claim for Loss of Stock

7.1

During the course of running the operations, an organization may face different adversities like accidents. Such accidents, may happen in the premises of an organization (viz. factory, godown, shop etc.) and cause damage to various assets used by such organization. The physical assets present in the premises are the fixed assets (viz. building, machineries, furnitures etc.) and stock. To replenish the mutilated assets, the business immediately needs some money. So, to cover the risks of such losses, it takes on a policy with insurance company(s) so as to recover a part or whole of the loss.

The business pays insurance premium yearly or quarterly or as per agreement. If any accidental loss occurs, the business has to compute the amount of loss and file a claim for compensation to the insurance company. The insurance company, in turn, appoints loss assessors to investigate the reasons and extent of the loss. As per the report of the loss assessor, insurance claims are met.

Loss of Stock

Of the different forms of accidental losses, loss by fire is the most common one. A fire insurance policy is usually taken to cover two types of losses: 1. Loss of Stock and 2. Loss of Profits.

As stocks constitute a considerable portion of the working capital of any business and specially for trading concerns, any loss of stock directly affects the solvency of the business. A business has to cover this risk adequately.

Determination of Amount of Insurance Claim

The amount of insurance claim to be made by the organisation which suffered the loss depends on the following factors:

1. **Value of stock present at the time of accident:** If stock records and stock are destroyed, it becomes difficult to ascertain the amount of stock lost. When the loss suddenly occurs, up-to-date value of stock does not become available. In that case, the value of stock present can be ascertained using relevant information, and by drafting a Memorandum Trading Account. A Memorandum Trading Account is actually a statement (not an account) which is prepared following the proforma of a Trading Account. It has to be prepared starting from the first date of the accounting period in which the accident has taken place and ending on the date of accident. Its specimen is as follows:

Memorandum Trading A/c for the period April 1 of year of accident – Date of accident

Particulars	(₹)	Particulars	(₹)
To Opening Stock	***	By Sales	***
To Purchases	***	By Closing Stock	***
To Gross Profit	***	[Balancing Figure]	
[Sales × GP rate]	***		***

It is to be noted that in Memorandum Trading Account, the Gross Profit is estimated by multiplying 'Sales' for this period with the rate of Gross Profit (GP). The GP rate may be known to the entity or it has to be ascertained. The GP rate is usually estimated on the basis of the details of the last accounting period. The organisation determines the GP rate by preparing the Trading Account for the accounting period immediately preceding the period in which the accident has occurred.

NB: Adjustments may be necessary while preparing the Trading Accounts of the current period and preceding accounting years for slow-moving items, abnormal or defective items not fetching same rate of gross profit, goods distributed as samples, goods taken away by proprietors, over or under valuation of stocks, omission of recording of stocks, etc.

2. **Value of stock salvaged:** It is the quantity of stock that could be saved from the accident. The value of this salvaged stock is to be deducted from the 'value of stock present at the time of accident' for ascertaining the 'value of stock lost by the accident' which represents the 'Gross Claim' to be lodged.

3. **Contents of the insurance policy:** The insurance policy includes details like policy value, average clause etc. Policy Value is the maximum amount that can be realized by the insured from the insurance company on the occurrence of the accident. It influences the amount of net claim that can be lodged by the insured. Average Clause simply states that in the absence of adequate insurance coverage, the insurance company will not shoulder the entire risk. It is a tool of the insurance company to discourage under-insurance by the insured. This clause implies that in case of under-insurance, the insured will also have to share a portion of the loss along with the insurance company. It is to be noted that Average Clause will not be applicable if the policy value is greater than or equal to the value of stock on the date of fire. In case of under-insurance, the net claim from the insurance company will be lower than the Gross Claim. On application of Average Clause, Net Claim will be computed as under:

$$\text{Net Claim} \times \frac{\text{Policy Value}}{\text{Value of stock lost on date of accident}}$$

Certain special situations

Goods-in-Transit or Goods sent to branches/ consignee: The cost of Goods-in-transit is to be deducted from 'Purchases' figure in Trading A/c or Memorandum Trading A/c, as the case may be. Alternatively, the cost of such goods may also be credited to the Trading A/c or Memorandum Trading A/c.

Goods sold but not yet to be delivered: Sale value of such goods is to be deducted from 'Sales' figure in Trading A/c or Memorandum Trading A/c.

Goods sent on approval basis: Cost of such goods is to be deducted from 'Purchases' figure in Trading A/c or Memorandum Trading A/c, as the case may be. Further, deduct the sale value of such goods from 'Sales' figure in Trading A/c or Memorandum Trading A/c.

Change in price level

For applying the GP rate determined sale of the period in which loss has occurred in the Memorandum Trading A/c, the effect of such price changes have to be nullified from the different items of Memorandum Trading A/c. For this purpose the method of stock pricing (i.e. FIFO, LIFO etc.) is to be considered.

Under-valued or Over-valued stock

When the stock is valued at a figure higher or lower than the cost, it affects the normal GP rate. When stock is under-valued, amount of under-valuation is added back to the respective stock to arrive at the cost; while in case of over-valuation, the over-valued amount is to be deducted to arrive at the cost of such stock. Further, for calculation of Gross Claim, the unsold portion of such under/ over-valued stocks is to be considered.

Abnormal/ Defective/ Usual Selling line Items: Goods which cannot fetch the usual rate of gross profit are considered as referred to as unusual or abnormal items. For preparing the Memorandum Trading Account, the portion of the value of such goods which has not yet been written off, should be deducted from the Opening Stock. If any such goods have been purchased in the current period, the Cost Price of such goods should be deducted from purchases. If any portion of such goods have been sold in the current period, the Selling Price should be deducted from current sales. Lastly if any portion of such, goods remains unsold on the date of fire, the agreed value of such portion should be added with the estimated value of normal stock to arrive at the estimated value of (total) stock on that date. Similar adjustments may be required while preparing the Trading Account of the last financial year/s, if abnormal items existed then. As an alternative measure, columnar Trading Account showing normal and abnormal items separately may be prepared.

Illustration 1

A fire occurred on 15th September 2023 in the premises of Sen & Co. from the following figures, calculate the amount of claim to be lodged with the insurance company for loss of stock.

Particulars	(₹)
Stock at cost on 1.1.2022	40,000
Stock at cost on 1.1.2023	60,000
Purchases in 2022	80,000
Purchase from 1.1.2022 to 15.9.2023	1,76,000
Sales in 2022	1,20,000
Sales from 1.1.2023 to 15.9.2023	2,10,000

During the current year cost of purchase has risen by 10% above last years' level. Selling prices have gone up by 5%. Salvage value of stock after fire was ₹ 4,000.

Solution:

Memorandum Trading Account for the period from 1.1.2023 to 15.9.2023

Particulars	Current Year (₹)	Last Year (₹)	Particulars	Current Year (₹)	Last Year (₹)
To Opening Stock	60,000	60,000	By Sales	2,10,000	2,00,000
,, Purchase	1,76,000	1,60,000	By Closing Stock	1,32,000	1,20,000
,, Gross Profit	1,06,000 (B/fig.)	1,00,000 (50% of Sales)			
	3,42,000	**3,20,000**		**3,42,000**	**3,20,000**

Working Notes:

1. Value of Closing Stock

	(₹)
Stock at last years' level	60,000
Add: 10% increase in cost of purchase	6,000
	66,000

Amount of Claim	(₹)
Closing Stock	1,32,000
Less: Stock Salvaged	4,000
Actual Value of Stock last	1,28,000
Actual Value of Stock Loss	

Trading Account (for ascertaining rate of Gross Profit)

Dr. **For the year ended 31.12.2022** **Cr.**

Particulars	(₹)	Particulars	(₹)
To, Opening Stock	40,000	By, Sales (less returns)	1,20,000
To, Purchase (less returns)	80,000	By, Closing Stock	60,000
To, Gross profit (bal. fig.)	60,000		
	1,80,000		**1,80,000**

∴ Percentage of gross profit on sales = (Gross Profit/Sales) × 100

= (₹ 60,000/₹ 1,20,000) × 100

= 50%

Illustration 2

Mr. X's godown was destroyed by fire on 1.6.2023 when the goods in stock were insured for ₹ 60,000. The following particulars are given:

Balance Sheet (Extract)

as at 31st December 2022

Liabilities	(₹)	Asset	(₹)
Creditor for goods	20,000	Stock (including goods held by agent ₹ 2,000)	36,000
		Debtors	70,000

Transactions upto 31st May, 2023 include:

Particulars	(₹)	Particulars	(₹)
Cash Received from Debtors	3,40,000	Cash paid to Creditors	2,20,000
Bad Debt written off	3,500	Discount Received	1,000
Balance on 31.5.2023:			
Debtors	70,000		
Creditors	30,000		

Additional information:

(i) Debtors on 31.5.2023, included an amount owing from the agent from sales to date ₹ 4,000 less 10% commission and his expenses amounting to ₹ 100 on 31.5.2023 – the agent still held the said goods valued at ₹ 3,600 (at selling price).

(ii) Sales (total) for the periods include ₹ 1,600 for goods which have the selling price reduced by 50% and also ₹ 6,000 reduced by 25%.

(iii) The normal mark up is 50% on cost and except the above, all sales can be assumed to be at the full selling price.

(iv) All the goods were destroyed and there was no salvage value of the goods.

Calculate the amount of claim.

Solution:

In the Books of Mr. X

Dr. **Debtors Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2023			2023		
Jan 1	To Balance b/d	70,000	May 31	By Cash Received	3,40,000
May 31	,, Sales (bal. fig.)	3,40,000		,, Bad Debts	3,500
				,, Balance c/d	66,500
		4,10,000		(excluding form agent)	**4,10,000**

Dr. **Creditors Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2023			2023		
May, 31	To Cash paid	2,20,000	Jan. 1	By Balance b/d	20,000
	,, Discount Received	1,000			
	,, Balance c/d	30,000	May 31	,, Purchase (bal. fig)	2,31,000
		2,51,000			**2,51,000**

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

Date	Particulars	(₹)	Date	Particulars	(₹)
2022			2022	By Cost of Goods Sold	2,29,066
May 31	To Balance b/d (₹ 36,000 – ₹ 2,000)	34,000	May 31	,, Stock at Agents	3,067
	,, Purchase from the Creditors)	2,31,000		,, Stock Destroyed by fire (bal. fig)	32,867
		2,65,000			**2,65,000**

Thus, amount of claim which will be lodged for ₹ 32,867.

Working Notes:

1. Bad Debts

Particulars		(₹)
Sales		4,000
Less: Commission @10%	400	
Expenses	100	500
		3,500

2. Cost of Goods Sold

Sales (₹)	Normal Selling Price (₹)	Cost (2/3 of Selling Price) (₹)
1,600	3,200	2,133
6,000	8,000 [6,000 × (100/75)]	5,333
3,32,400 (bal. fig.)	–	2,21,600
3,40,000		2,29,066

3. Stock at Agent

Sales (₹)	Cost (₹)	
4,000	2,667	(₹ 4,000 × 2/3)
—	2,400	(₹ 3,600 × 2/3)
	5,067	
Less: Agents' hand at the beginning	2,000	
	3,067	

Illustration 3

X Ltd. has taken out a fire policy of ₹ 1,60,000 covering its stock. A fire occurred on 31st March, 2023. The following particulars are available :

	₹
Stock as on 01.04.2022	60,000
Purchases to the date of fire	2,60,000
Sales to the date of fire	1,80,000
Carriage Inwards	1,600
Commission on purchase to be paid	@2%
Gross Profit Ratio @ 50% on cost	

You are asked to ascertain (i) total loss of stock; (ii) amount of claim to be made against the Insurance Company assuming that the policy was subject to average clause. Stock salvage amounted to ₹41,360.

Solution:

In the books of X Ltd.

Memorandum Trading Account for the period ended 31st March, 2023

Particulars	(₹)	(₹)	Particulars	(₹)
To Opening Stock		60,000	By Sales	1,80,000
" Purchase	2,60,000		" Closing Stock	2,06,800
Add: Carriage Inward	1,600		(bal. figure)	
Add: Com. on Purchase	5,200	2,66,800		
" Gross Profit		60,000		
(@ 50% on cost or 33 % on sale)				
		3,86,800		**3,86,800**

Note: Carriage Inward and Com. on Purchase are direct expenses and hence, these are added to purchases.

Loss of Stock:

	(₹)
Stock at the date of fire	2,06,800
Less: Stock Salvaged	41,360
Loss of Stock	**1,65,440**

Amount of claim applying Average Clause

$$\text{Amount of Claim} = \text{Actual Loss} \times \frac{\text{Amount of Policy}}{\text{Value of stocks at the date of fire}}$$

$= ₹\ 1{,}65{,}440 \times (₹\ 1{,}60{,}000 / ₹\ 2{,}06{,}800)$

$= ₹\ 1{,}28{,}000$

Illustration 4

A fire occurred in the premises of Sri. G. Vekatesh on 1.4.2023 and a considerable part of the stock was destroyed. The stock salvaged was ₹ 28,000. Sri Venkatesh had taken a fire insurance policy for ₹ 17,10,000 to cover the loss of stock by fire.

You are required to ascertain the insurance claim which the company should claim from the insurance company for the loss of stock by fire. The following particulars are available:

	(₹)		(₹)
Purchases for the year 2022	9,38,000	Stock on 1.1.22	1,44,000
Sales for the year 2022	11,60,000	Stock on 31.12.2022	2,42,000
Purchases from 1.1.23 to 1.4.23	1,82,000	Wages paid during 2022	1,00,000
Sales from 1.1.23 to 1.4.23	24,00,000	Wages paid 1.1.23 to 1.4.23	1,80,000

Sri Venkatesh had in June 2022 consigned goods worth ₹ 50,000, which unfortunately were lost in an accident. Since there was no insurance cover taken, the loss had to be borne by him full.

Stocks at the end of each year for and till the end of calendar year 2021 had been valued at cost less 10%. From 2022, however there was a change in the valuation of closing stock which was ascertained by adding 10% to its costs.

Solution:

In order to find the rate of gross profit on sales for the year 2022, the following Trading Account is to be prepared for the same year as:

Trading Account

Dr. **For the year ended 31st Dec. 2022** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Opening Stock	1,60,000	By Sales	11,60,000
1,44,000 × (100/90)		By Stock lost by Accident	50,000
To Purchases	9,38,000	By Closing Stock (2,42,000 ×100/110)	2,20,000
To Wages	1,00,000		
To Profit & Loss A/c (G.P. transferred)	2,32,000		
	14,30,000		**14,30,000**

Rate of Gross Profit on Sales = 2,32,000/11,60,000 × 100 = 20%

Dr. **Trading Account for the period (from 1.1.23 to 1.4.23)** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Opening Stock	2,20,000	By Sales	2,40,000
To Purchases	1,82,000	By Closing Stock	2,28,000
To Wages	18,000		
To Profit & Loss A/c (G.P. @20% of sales)	48,000		
	4,68,000		**4,68,000**

Amount of Claim = Stock destroyed – Stock salvaged

= ₹ 2,28,000 – ₹ 28,000

= ₹ 2,00,000

As the policy amount is less than the value of stock destroyed, average clause is applicable. Here, the amount of claim will be:

Net Claim = Loss of Stock × (Amount of Policy / Stock at the date of fire)

= ₹ 2,00,000 × (1,71,000 / 2,28,000)

= ₹ 1,50,000/-

Illustration 5

On 1.4.2022, godown of Y Ltd. was destroyed by fire. The records of the company revealed the following particulars:

	(₹)
Stock on 1.1.2022	75,000
Stock on 31.12.2022	80,000
Purchases during 2022	3,10,000
Sales during 2022	4,00,000
Purchase from 1.1.2023 to the date of fire	75,000
Sales from 1.1.2023 to the date of fire	1,00,000

In valuing Closing Stock of 2022, ₹ 5,000 was written off whose cost was ₹ 4,800. Part of this stock was sold in 2023 at a loss of ₹ 400, at ₹ 2,400. Stock salvaged was ₹ 5,000. The godown and the cost of which was fully insured.

Indicate from above amount of claim to be made against the insurance company.

Solution:

(a) For ascertaining the rate of Gross Profit

In the books of Y Ltd.

Dr. **Trading Account for the year ended 31.12.2022** **Cr.**

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		75,000	By Sales		4,00,000
" Purchases	3,10,000		" Closing Stock	80,000	
Less: Purchase of Abnormal items of goods	4,800	3,05,200	Add: Loss on value of abnormal items	200	80,200
" Gross Profit (bal. fig.)		1,00,000	(₹ 5,000 – ₹ 4,800)		
		4,80,200			**4,80,200**

$$\text{Percentage of Gross Profit on sales} = \frac{₹\ 1,00,000}{₹\ 4,00,000} \times 100$$

$$= 25\%$$

Memorandum Trading Account

for the period ended 31st March, 2023

Particulars	(₹)	Particulars	(₹)	(₹)
To Opening Stock	80,200	By Sales	1,00,000	
" Purchases	75,000	Less: Sale of abnormal Stock (₹ 2,400 – ₹ 400)	2,000	98,000
" Gross Profit (@25% on ₹ 98,000)	24,500	" Closing Stock (bal. fig.)		81,700
	1,79,700			**1,79,700**

Alternative approach

In a combined form

Trading Account

Dr. **for the year ended 31st December, 2023** **Cr.**

Particulars	Normal Items (₹)	Abnormal Items (₹)	Total (₹)	Particulars	Normal Items (₹)	Abnormal Items (₹)	Total (₹)
To Opening Stock	75,000	---	75,000	By Sales	4,00,000	---	4,00,000
,, Purchase				,, Closing Stock	80,200	(-) 200	80,000
,, Gross Profit @25% on	3,05,200	4,800	3,10,000	,, Gross Loss			
sales	1,00,000	---	1,00,000		---	5,000	5,000
	4,80,200	**4,800**	**4,85,000**		**4,80,200**	**4,800**	**4,85,000**

Memorandum Trading Account

for 3 months ending 31st March, 2023

Particulars	Normal Items (₹)	Abnormal Items (₹)	Total (₹)	Particulars	Normal Items (₹)	Abnormal Items (₹)	Total (₹)
To Opening Stock	80,200	(-) 200	80,000	By Sales	98,000	2,000	1,00,000
,, Purchase				,, Closing Stock	81,700	2,400	84,100
,, Gross Profit	75,000	---	75,000	(bal. fig)			
	24,500	4,600	29,100				
	1,79,700	**4,400**	**1,84,100**		**1,79,700**	**4,400**	**1,84,100**

1. 50% of ₹ 4,800 i.e., remaining abnormal stocks are valued at cost.

Amount of Claim	(₹)
Value of Stock at the date of fire	84,100
Less: Stock Salvaged	5,000
	79,100

Illustration 6

On 30.09.2023 the stock of Harshvardhan was lost in a fire accident. From the available records the following information is made available to you to enable you to prepare a statement of claim of the insurer:

Particulars	(₹)	Particulars	(₹)
Stock at cost on 1.4.2022	75,000	Sales less returns for the year ended 31.3.2023	6,30,000
Stock at cost on 31.3.2023	1,04,000	Purchase less returns up to 30.09.2023	2,90,000
Purchases less returns for the year ended 31.3.2023	5,07,500	Sales less returns up to 30.09.2023	3,68,100

In valuing the stock on 31.03.2023 due to obsolescence 50% of the value of the stock which originally cost

₹ 12,000 had been written-off. In May 2023, ¾th of these stocks had been sold at 90% of original cost and it is now expected that the balance of the obsolete stock would also realize the same price, subject to the above, G.P had remained uniform throughout stock to the value of ₹ 14,400 was salvaged.

Solution:

Memorandum Trading Account
for the period ended 30.09.2023

Particulars	Normal Items (₹)	Abnormal Items (₹)	Total (₹)	Particulars	Normal Items (₹)	Abnormal Items (₹)	Total (₹)
To Opening Stock	98,000	6,000	1,04,000	By Sales	3,60,000	8,100	3,68,100
,, Purchase	2,90,000	---	2,90,000	(Less returns)			
(Less: Returns)				,, Closing Stock	1,18,000	2,700	1,20,700
,, Gross Profit	90,000	4,800	94,800				
(25% on Normal Sales)	**4,78,000**	**10,800**	**4,88,800**		**4,78,000**	**10,800**	**4,88,800**

∴ **Amount of Claim** (₹)

	(₹)
Stock at the date of fire	1,20,700
Less: Stock Salvaged	14,400
	1,06,300

Working Notess:

Trading Account
Dr. for the year ended 31.03.2023 Cr.

Particulars	(₹)	Particulars	(₹)
To Opening Stock	75,000	By Sales (Less: Returns)	6,30,000
,, Purchase (Less: Returns)	5,07,500	,, Closing Stock	1,10,000
,, Gross Profit	1,57,500		
	7,40,000		**7,40,000**

So, Percentage of Gross Profit on sales $= \frac{₹\ 1,57,500}{₹\ 6,30,000} \times 100$

$= 25\%$

1. **Closing Stock**

Particulars	(₹)
Closing Stock	1,04,000
Add: Stock Written off	6,000
	1,10,000

2. **Sale of Abnormal Items of goods**

₹ 12,000 × $\frac{3}{4}$ × (90/100) = ₹ 8,100

3. **Closing Stock of Abnormal Items**

   $₹\ 12,000 \times \frac{1}{4} \times (90/100) = ₹\ 2,700$

Illustration 7

A fire occurred in the premises of M/s Bad Luck Traders twice during the accounting year 2022-23 that is on 31st August 2022 and again on 30th November, 2022. From the following particulars, calculate the claim to be lodged in respect of the goods lost by fire on the aforementioned date:

1. The stock as at 31st March, 2022 was valued at ₹ 59,000.
2. The purchases from 1st April, 2022 to 31st August, 2023 amounted to ₹ 3,45,000.
3. The purchases from 1st September, 2022 to 30th November, 2022 amounted to ₹ 1,90,000 of which goods costing ₹ 45,000 were received on 10th December, 2022.
4. Sales for the period from 1st April, 2022 to 31st August, 2022 amounted to ₹ 4,71,000.
5. The sales for the period from 1st September, 2022 to 30th November, 2022 amounted to ₹ 2,25,000. It includes sale of old furniture of ₹ 27,000.

The company earns a steady rate of Gross profit at 20% at the beginning of the year 2022. However, the selling price was raised by 20% from the month of April.

The value of the goods salvaged was ₹ 30,000 and ₹ 2,000 on 31st August, 2022 and on 30th November, 2022 respectively.

The firm had taken out a fire insurance policy of ₹ 45,000 on 1st April, 2022. At the time of receiving the insurance claim on 31st August, 2022, no additional premium was paid for restoration of the insurance policy to its original amount. The policy was subject to average clause.

Solution:

Amount of stock lost on August 31, 2022

Particulars	(₹)
Value of stock on date of fire (WN-2)	90,000
Less: Value of stock salvaged	30,000
∴ **Actual Loss of Stock**	60,000

Applicability of Average Clause (for first insurance claim)

Here, Insurable Value = Value of stock on date of fire = ₹90,000; Policy Value = ₹45,000. There is under-insurance.

∴ Average clause will be applicable.

$$\therefore \text{Net Claim} = \text{Actual loss of Stock} \times \frac{\text{Policy Value}}{\text{Insurable Value}}$$

$$= 60,000 \times \frac{45,000}{90,000} \qquad = ₹\ 30,000$$

Amount of stock lost on November 30, 2022

Particulars	(₹)
Goods destroyed by fire (WN-3)	43,000
Less: Value of stock salvaged	2,000
∴ **Actual Loss of Stock**	41,000

Applicability of Average Clause (for second insurance claim)

Here, Insurable Value = Value of stock on date of fire = ₹ 43,000; Policy Value = ₹ 15,000 [WN: 4]

In this case also there is under-insurance.

∴ Average clause will be applicable.

$$\therefore \text{ Net Claim} = \text{Actual loss of Stock} \times \frac{\text{Policy Value}}{\text{Insurable Value}}$$

$$= 41{,}000 \times \frac{15{,}000}{43{,}000}$$

$$= ₹\ 14{,}302 \text{ (approx,)}$$

Working Notess:

1. New Rate of GP in 2022-23:

	Sale price	Gross Profit
Normal Price	100	20
Add: Increase in sale Price	20	20
	120	40

$$\therefore \text{ Rate of GP in 2022-22} = \frac{40 \times 100}{120} = 33.33\ \%$$

2. Stock on the date of first accident i.e. August 31, 2022

Memorandum Trading Account for the period Apr. 1 – Aug. 31, 2022

Particulars	(₹)	Particulars	(₹)
To Opening Stock	59,000	By Sales	4,71,000
To Purchases	3,45,000	By Closing Stock [Bal. Fig.]	90,000
To Gross Profit [₹ 4,71,000 × 33.33% (WN: 1)	1,57,000		
	5,61,000		**5,61,000**

3. **Stock on the date of second accident i.e. November 30, 2022**

Memorandum Trading Account
for the period Sept. 1 – November 30, 2022

Particulars	(₹)	(₹)	Particulars	(₹)	(₹)
To Opening Stock		30,000	By Sales	2,25,000	
To Purchases	1,90,000		Less: Sale of furniture	27,000	1,98,000
Less: Goods-in-Transit	45,000	1,45,000			
			By Closing Stock [Bal. Fig.]		43,000
To Gross Profit		66,000			
[₹ 1,98,000 × 33.33%]		**2,41,000**			**2,41,000**

4. **Policy Value of the fire insurance policy**

- **For the first insurance claim**

  The value of fire insurance policy taken = ₹ 45,000

- **For the second insurance claim**

  As the original policy was not restored at the time of receiving the insurance claim on 31.8.2022, the subsequent 'Policy Value' will get reduced by the amount of insurance claim received.

  ∴ revised policy value = Original policy value – Compensation received on first insurance claim
  = ₹ 45,000 – ₹ 30,000
  = ₹ 15,000

Insurance Claim for Loss of Profit

7.2

During regular course of operations an organization may suffer from different types of accidents. Such accidents may occur due to natural calamities, human induced accidents. Such accidents usually hamper the regular operations of the organisation, and thus in turn affecting the organisation's profitability. To cover such risk, the organization usually enters into a contract with insurance company to cover the risk of loss of profit. Such a policy is known as 'Loss of Profit policy' or 'Consequential Loss policy'.

For determination of the amount of claim for 'Loss of Profit policy', the organization needs to ascertain the amount of profit which the organization could have earned. In relation to determination of such loss of profit, the following terms are significant:

- **Indemnity period:** The period for which normal activities of the business is interrupted is known as indemnity period.
- **Standard turnover:** The turnover of the previous year corresponding to the period of indemnity after adjustment of trend in turnover.
- **Adjusted annual turnover:** Turnover during 12 months immediately preceding the date of damage (taking trend into consideration).
- **Standing charges:** Unavoidable fixed expenses which have to be paid even if there is reduction in sale.

Calculation of the Net Claim under Loss of Profit Policy

The amount of net claim is determined through the following steps:

Step 1	Ascertainment of Gross Profit (GP) for previous accounting period: **1. In case of existence of Net profit** GP = Net Profit for Previous Accounting Period + Insured Standing Charges. **2. In case of existence of Net loss** $GP = \text{Insured standing charges} - \left[\text{Net Loss} \times \frac{\text{Insured Standing Charges}}{\text{All Standing Charges}}\right]$
Step 2	Determination of GP rate $\text{GP rate} = \frac{\text{GP}}{\text{Sales}} \times 100$
Step 3	Calculate Short Sales Short Sales = Standard Turnover – Actual Turnover for Indemnity Period.

Step 4	Calculate GP Lost on Short Sales: GP Lost = Short Sale × GP rate
Step 5	Determine admissible additional expenses for insurance claim: Least of the following: i. Actual additional expenses ii. Sales due to additional expenses × GP rate iii. Actual additional expenses × $\frac{\text{Net Profit} + \text{Insured Standing Charges}}{\text{Net Profit} + \text{All Standing Charges}}$
Step 6	Calculation of Gross Claim Gross claim = GP lost + Admissible Expenses for Insurance Claim – Saving in Standing Chages.
Step 7	Insurable value = Adjusted Annual Turnover × GP rate
Step 8	Claim to be lodged: **Situation 1: When average clause is applicable(insurable value > policy value)** $\text{Net Claim} = \frac{\text{Policy Value}}{\text{Insurable Value}} \times \text{Gross Claim}$ **Situation 2: When average clause is Not applicable (insurable value is < policy value)** Net Claim = Gross Claim

NB: Some of the important points relating to the variables are as under:

- If additional Sales due to additional expenses is not given, assume that entire sale has been attained due to additional expenses.
- All standing charges = insured standing charges + uninsured standing charges.
- In absence of specific information assume that all standing charges are insured.
- If sales for past years is given we need to determine the trend of sales.

Illustration 8

On account of fire on June 15, 2023, in business house of a company, the working remained disturbed up to December 15, 2023 as a result of which it was not possible to affect any sales. The company had taken out an insurance policy with an average clause against consequential losses for ₹ 1,40,000 and a period of 7 months has been agreed upon as indemnity period. An increase of 25% was marked in the current year's sales as compared to last year. The company incurred an additional expenditure of ₹ 12,000 to make sales possible and made a saving of ₹ 2,000 in insured standing charges.

Ascertain the claim under the consequential loss policy keeping the following additional information in view:

Particulars	(₹)	Particulars	(₹)
Actual sales from 15.6.23 to 15.12.23	70,000	Total standing charges for last financial year	1,20,000
Sales from 15.6.22 to 15.12.22	2,40,000	Turnover for last financial year	6,00,000
Net profit for the financial year	80,000	Turnover from 16.6.22 to 15.6.23	5,60,000
Insured standing charges for last financial year	70,000		

Solution:

GP for previous accounting period = Net profit for previous accounting period + Insured standing charges. = ₹ 80,000 + ₹ 70,000 = ₹ 1,50,000
GP rate = $\frac{\text{GP}}{\text{Sales}} \times 100 = \frac{₹1,50,000}{₹6,00,000} \times 100 = 25\%$
Short sale = standard turnover – actual turnover for indemnity period. = ₹(2,40,000 × 125%) – ₹ 70,000 = ₹ 2,30,000
GP Lost = Short sale × GP rate = ₹ 2,30,000 × 25% = ₹ 57,500
Admissible additional expenses for insurance claim (see below)
Gross claim = GP lost + admissible expenses for insurance claim – Saving in standing charges. = ₹ (57,500 + 9,000 – 2,000) = ₹ 64,500
Insurable value = adjusted annual turnover × GP rate = (₹ 5,60,000 × 125%) × 25% = ₹ 1,75,000
Net Claim = $\frac{\text{Policy Value}}{\text{Insurable Value}} \times$ Gross claim = $\frac{₹1,40,000}{₹1,70,000} \times$ ₹ 64,500 = ₹ 53,118

Admissible additional expenses for insurance claim

Least of the following:	(₹)
i. Actual additional exp.	12,000
ii. Sales due to additional expenses × GP rate (₹ 70,000 × 25%)	17,500
iii. Actual additional expenses × $\frac{\text{Net Profit + Insured standing charges}}{\text{Net Profit + All standing charges}}$	
₹ (12000 × $\frac{80,000 + 70,000}{80,000 + 1,20,000}$)	9,000
Admissible additional expenses	**9,000**

Illustration 9

From following details, calculate consequential loss claim:

- Date of fire: Sept. 1
- Indemnity period: 6 months
- Period of disruption September 1 to February 1
- Sum insured ₹ 1,08,900
- Sales were ₹ 6,00,000 for preceding financial year ended 31st march.
- Net profit for preceding financial year ₹ 36,000 plus insured standing charges ₹ 72,000
- Rate of gross profit 18%
- Turnover during disruption period ₹ 67,500
- Uninsured standing charges ₹ 6,000

- Annual turnover for 12 months immediately preceding the date of fire ₹ 6,6,0000
- Standard turnover i.e. for corresponding months in the year preceding the date of fire ₹ 2,25,000
- Increase in the cost of working capital ₹ 12,000 with a saving of insured standing charges ₹ 4,500 during the disruption period;
- Reduced turnover avoided through increase in working capital ₹ 30,000
- A special clause stipulated:
  - Increase in rate of GP by 2%
  - Increase in turnover (standard and annual) 10%

Solution:

GP rate = 18% + 2% = 20%

Short sale = standard turnover – actual turnover for indemnity period.
= (₹ 2,25,000 × 110%) – ₹ 67,500 = ₹ 1,80,000

GP Lost = Short sale × GP rate
= ₹ 1,80,000 × 20% = ₹ 36,000

Admissible additional expenses for insurance claim

Least of the following:	(₹)
i. Actual additional exp.	12,000
ii. Sales due to additional expenses × GP rate (₹ 30,000 × 20%)	6,000
iii. Actual additional expenses × $\frac{\text{Net Profit + Insured standing charges}}{\text{Net Profit + All standing charges}}$	
₹ $\left(12000 \times \frac{36,000 + 72,000}{[36,000 + (72,000 + 6,000)]}\right)$	11,368
Admissible additional expenses	**6000**

Gross claim = GP lost + admissible expenses for insurance claim – saving in standing charges
= ₹ (36,000 + 6,000 – 4,500) = ₹ 37,500

Insurable value = adjusted annual turnover × GP rate = (₹ 6,60,000 × 110%) × 20% = ₹ 1,45,200

Net Claim = $\frac{\text{Policy Value}}{\text{Insurable Value}}$ × Gross claim = $\frac{₹1,08,900}{₹1,45,200}$ = × ₹ 37,500 = ₹ 28,125

Illustration 10

A fire occurred on Mar. 15, 2023 in the premises of Omega Ltd. A Loss of Profit policy was taken by Omega Ltd. for ₹ 80,000. The indemnity period was for 3 months. Net Profit for the year ending Dec. 31, 2021 was ₹ 56,000 and standing charges (all insured) amounted to ₹ 49,600. Determine insurance claim from the following details available from quarterly sales tax returns:

Sales	**2019**	**2020**	**2021**	**2022**
	(₹)	(₹)	(₹)	(₹)
From Jan.1 to Mar.31	1,20,000	1,30,000	1,42,000	1,30,000
From Apr.1 to June 30	80,000	90,000	1,00,000	40,000
From July 1 to Sept.30	1,00,000	1,10,000	1,20,000	1,00,000
From Oct.1 to Dec.31	1,36,000	1,50,000	1,66,000	1,60,000

	(₹)
Sales from 16.3.2022 to 31.3.2022	28,000
Sales from 16.3.2023 to 31.3.2023	Nil
Sales from 16.6.2022 to 30.6.2022	24,000
Sales from 16.6.2023 to 30.6.2023	6,000

Solution:

Statement of Claim for Loss of Profit

Particulars	(₹)
GP lost on Short Sales [WN: 4]	16,080
Less: Savings in Standing Charges	Nil
∴ Gross Claim	16,080

∴ **Net Claim** (under "Average clause") $= \text{Gross Claim} \times \dfrac{\text{Policy Value}}{\text{Insurable Value}}$

$$= ₹\ 16{,}080 \times \frac{80{,}000}{1{,}19{,}680}$$

$$= ₹\ 10{,}749 \text{ (Approx.)}$$

Working Notes:

WN: 1 Trend of Turnover of last few years

Sales of: 2020 = ₹ (1,20,000 + 80,000 + 1,00,000 + 1,36,400) = ₹ 4,36,400

2021 = ₹ (1,30,000 + 90,000 + 1,10,000 + 1,50,000) = ₹ 4,80,000

2022 = ₹ (1,42,000 + 1,00,000 + 1,20,000 + 1,66,000) = ₹ 5,28,000

$$\text{Rate of Turnover change} = \frac{\text{Turnover of the current year} - \text{Turnover of the previous year}}{\text{Turnover of the previous year}} \times 100$$

$$\text{For 2022} = \frac{5{,}28{,}000 - 4{,}80{,}000}{4{,}80{,}000} \times 100 = 10\%$$

$$\text{For 2021} = \frac{4{,}80{,}000 - 4{,}36{,}400}{4{,}36{,}400} \times 100 = 10\% \text{ (approx.)}$$

Thus, we observe a 10% upward trend in turnover over the last few years.

2. Calculation of GP Rate

Particulars	(₹)
Net Profit of 2022	56,000
Add: Insured Standing Charges	49,600
∴ Insured Gross Profit	1,05,600

Sales of 2022 = ₹ 5,28,000 (as computed above)

$$\therefore \text{ Rate of Gross Profit in 2022} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$= \frac{1,05,600}{5,28,000} \times 100$$

$$= 20\ \%$$

3. Calculation of Short Sales

Particulars	(₹)	(₹)
Standard Turnover (from March 15, 2023 to June 15, 2023):		
Turnover from April 1, 2022 to June 30, 2022	1,00,000	
Add: Turnover from March 16, 2022 to March 31, 2022	28,000	
	1,28,000	
Less: Turnover from June 16, 2022 to June 30, 2022	24,000	1,04,000
Add: Upward trend @ 10% [WN: 1]		10,400
		1,14,400
Less: Actual Turnover (from March 15, 2023 to June 15, 2023)		
Turnover from April 1, 2023 to June 30, 2023	40,000	
Add: Turnover from March 16, 2023 to March 31, 2023	Nil	
	40,000	
Less: Turnover from June 16, 2023 to June 30, 2023	6,000	34,000
∴ Short Sales		80,400

4. GP lost on Short Sales

Short sales × Rate of GP = ₹ 80,400 × 20%

= ₹ 16,080

5. Annual Turnover i.e. Sale for the year ending March 15, 2022

	(₹)
From March 16, 2022 to March 31, 2022	28,000
From April 1, 2022 to June 30,2022	1,00,000
From July 1, 2022 to September 30,2022	1,20,000
From October 1, 2022 to December 31, 2022	1,66,000
From January 1, 2023 to March 31, 2023	1,30,000
	5,44,000
Less: March 16, 2023 to March 31, 2023	Nil
	5,44,000

6. Applicability of Average Clause

Insurable Value = Adjusted Annual Turnover × GP Rate = (₹ 5,44,000 × 110%) × 20% = ₹ 1,19,680

Policy Value = ₹ 80,000 (Given)

In this case, as Policy Value < Insurable Value, there is 'under insurance' and so Average Clause is applicable.

Exercise

A. Theoretical Questions:

State True or False

1. Salvage of stock means stock saved during accident.
2. Unusual item and defective item is separate under insurance claim
3. Defective items mean goods which cannot fetch the usual rate of gross profit.
4. Average clause is applicable in case of under insurance.
5. A memorandum trading account is to be prepared to ascertained the value of stock on the date of fire.
6. A marine insurance policy is taken to cover the claims for loss of stock.
7. The amount paid by insured to insurer as a consideration is known as premium.
8. Gross profit must always be calculated as a percentage on purchase.

Answers:

1	True	2	False	3	True	4	True
5	True	6	False	7	True	8	False

Fill in the Blanks

1. Standard turnover corresponds with the_____________ period.
2. Under insurance claim 'Standing charges' means______________ Standing charges only.
3. If the policy value is _____________ the value of stock lost, is called over insurance.
4. In case of Loss of Profit Policy, Gross Profit is the sum of Net Profit plus ________________ Standing Charges.
5. If value of stock on the date of fire is ₹4,29,000, salvage is ₹15,70,000 then stock destroyed by fire will be ______________.
6. Goods costing ₹ 1,0,000 were insured for ₹50,000. Out of these goods,3/4th are destroyed by fire. The amount of average clause will be —————.
7. Loss of stock is calculated by deducting ———— from book value of stock as on date of fire.
8. The difference between the value of stock on the date of fire and stock salvaged is ————.

Answer:

1	indemnity	2	insured
3	more than	4	Insured
5	₹ 2,71,500	6	₹ 37,500
7	Stock salvaged	8	Claim for loss of stock

B. Numerical Questions

Comprehensive Numerical Problems

1. From the following information, calculate the amount of claim for loss of stock with Insurance Company B Ltd:

Particulars	Amount (₹)
Purchase for the year 2022	9,15,000
Sales for the year 2022	12,00,000
Purchase from 1.1.2023 to 30.6.2023	8,00,000
Sales from 1.1.2022 to 30.6.2023	9,90,000
Stock on 1.1.2022	1,35,000
Stock on 1.1.2023	1,50,000

You are informed that:

(i) In 2023, the purchase prices raised by 20% above the level prevailing in 2022.

(ii) In 2023, the selling prices hiked by 10% over the level prevailing in 2022.

(iii) Salvaged value of stock ₹20,000.

(iv) Fire insurance policy for ₹1,48,750 to cover the loss of stock by fire.

[**Answer:** Actual stock lost by fire ₹1,50,000, Claim to be made after applying Average Clause ₹1,31,250]

2. X & Co. suffered a loss of stock due to fire on 31.3.2023. From the following information prepare a statement showing the claim for the loss to be submitted:

Particulars	Amount (₹)
Purchase for the year 2022	3,20,000
Sales for the year 2022	4,05,200
Purchase from 1.1.2023 to 31.3.2023	1,08,000
Sales from 1.1.2023 to 31.3.2023	1,22,800
Stock on 1.1.2022	76,800
Stock on 1.1.2023	63,600

An item of goods purchased in 2021 at a cost of ₹20000 was valued at ₹12,000 on 31.12.2021. Half of these goods were sold during 2022 for ₹5,200 and the remaining stock was valued at₹4,800 on 31.12.2022. ¼th of the original stock was sold for ₹2,800 in February 2023 and the remaining stock was valued at 60% of the original cost. With the exception of this item, the rate of gross profit remained fixed. The stock salvaged was estimated at ₹24,000. The insurance policy value was for ₹3,00,000.

[**Answer:** Actual stock lost by fire ₹48,000]

3. A fire occurred on 1st February, 2023, in the premises of Legend Ltd., a retail store and business was partially disorganized upto 30th June, 2023. The company was insured under a loss of profits for ₹ 1,25,000 with a six months period indemnity. From the following information, compute the amount of claim under the loss of profit policy.

Actual turnover from 1st February to 30th June, 2023	₹	80,000
Turnover from 1st February to 30th June, 2022	₹	2,00,000
Turnover from 1st February, 2022 to 31st January, 2023	₹	4,50,000
Net Profit for last financial year	₹	70,000
Insured standing charges for last financial year	₹	56,000
Total standing charges for last financial year	₹	64,000
Turnover for the last financial year	₹	4,20,000

The company incurred additional expenses amounting to ₹ 6,700 which reduced the loss in turnover. There was also a saving during the indemnity period of ₹ 2,450 in the insured standing charges as a result of the fire.

There had been a considerable increase in trade since the date of the last annual accounts and it has been agreed that an adjustment of 15% be made in respect of the upward trend in turnover.

[**Answer:** Amount of claim under the policy ₹ 39,390]

Hire Purchase and Installment Sale Transactions

8

SLOB Mapped against the Module

To equip oneself with the detail understanding of accounting of certain special transactions to determine surplus, ensure control on resources, for divisional performance evaluation or acquisition of assets through deferred payments. (CMLO 2a, 4c)

Module Learning Objectives:

After studying this module, the students will be able to:

- Understand the accounting related to acquisition of high value items (both in the books of hire purchaser and hire vendor);
- Equip themselves with the accounting of acquisition of large quantities of low value items (under Debtors method, Stock-Debtor's method and Final Accounts method).

Hire Purchase and Installment Sale Transactions

8

It is not always possible by a purchaser to meet up the higher demand for goods due to immediate cash payment. To meet this demand the concept of Hire Purchase is very popular in the market.

Under this system the purchaser (Hirer) pays the entire amount in staggered way viz. monthly, quarterly or yearly with some interest. Under this system the goods are sold with the following conditions:

Possession of goods is delivered to a hirer but the title to the goods (Ownership) are transferred only when the agreed sum (Hire Purchase price) is paid by the hirer.

Such hirer has a right to terminate the agreement at any time before the property so passes. That means he has the option to return the goods in which case he need not pay installments falling due thereafter. However, the hirer cannot recover the sums already paid as such sums legally represent hire charges of the goods in question.

The hire-purchaser, during that period of possession of goods, cannot damage, destroy, pledge or sell such goods. He is supposed to take all such care of goods as a prudent person does in his own goods.

In case of Installment Sale, it is not only the possession of goods but also the ownership in goods is transferred to the buyer immediately at the time of agreement.

Further, in installment system if the buyer stops the payment of dues, then he does not have the right of seizing his goods. The differences between installment sale and hire-purchase are as below:

Particulars	Hire Purchase	Installment Sale
Ownership	Stipulates the time at which the ownership passes to the buyer. It is usually on the payment of last installment.	Ownership passes at the time of sale.
Default in making payment	Seller can repossess the goods. In that case the installment so far paid is treated to be Hiring charges.	Seller does not have any other right except the right of suing the buyer for the non-payment of price.
Right of sale or other wise	No right to sale or otherwise transfer the goods since the legal position of the hirer is bailee.	Right to sale or otherwise transfer the goods.
Loss or damages to the goods.	Any loss occurring to goods has to be borne by the seller if the buyer takes reasonable care.	Any loss occurring to goods has to be borne by the buyer.

Situation – I : when rate of interest, total cash price and in stallments are given

Illustration 1

X purchases a car on hire-purchase system on 01.01.2021. The total cash price of the car is ₹4,50,000 payable ₹ 90,000 down and three installments of ₹1,70,000, ₹1,50,000 and ₹1,08,460 payable at the end of first, second and third year respectively. Interest is charged at 10% p.a.

You are required to calculate interest paid by the buyer to the seller each year.

Solution:

Following table is useful for calculating interest paid with each installment :

Analysis of Installments

Year	Opening Balance of Cash Price (₹)	Installments (₹)	Payment towards Principal/Cash Price (₹)	Payment towards Interest (₹)	Closing Balance of Cash Price (₹)
01.01.21	4,50,000	90,000	90,000	-	3,60,000
31.12.21	3,60,000	1,70,000	1,34,000	36,000	2,26,000
31.12.22	2,26,000	1,50,000	1,27,400	22,600	98,600
31.12.23	98,600	1,08,460	98,600	9,860	-

Situation – II : When rate of interest and installments are given but total cash price is not given

Illustration 2

X purchased a T.V on hire-purchase system. As per terms he is required to pay ₹ 3000 down, ₹4000 at the end of first year, ₹ 3000 at the end of second year, and ₹ 5000 at end of third year. Interest is charged at 12% p.a.

You are required to calculate total cash price of T.V and interest paid with each installment.

Solution :

Calculation of Cash Price	Installment (₹)	Analysis of Installments	
		Interest (₹)	Cash Price (₹)
3rd Installment	5,000		
(-) Interest (12/112 × 5,000)	536		
	4,464	536	4,464
Balance of Cash Price	3,000		
(+) 2nd Installment	7,464		

Calculation of Cash Price	Installment (₹)	Analysis of Installments	
		Interest (₹)	Cash Price (₹)
(-) Interest (12/112 × 7,464)	800	800	2,200
Balance of Cash Price	6,664		
(+) 1st Installment	4,000		
	10,664		
(-) Interest (12/112 × 10,664)	1,143	1,143	2,857
Balance of Cash Price	9,521		
(+) Down Payment Total Cash Price	3,000	-	3,000
	12,521	2,479	12,521

Situation – III : When only installments are given, but cash price and rate of interest are not given

Illustration 3

X & Co. purchased a Motor car on April 1, 2023 on hire-purchase paying ₹ 60,000 cash down and balance in four annual installments of ₹ 55,000, ₹ 50,000, ₹ 45000 and ₹ 40,000 each installment comprising equal amount of cash price at the end of each accounting period. You are required to calculate total cash price and amount of interest in each installment.

Solution : Hire-purchase Price **(₹)**

Down Payment	60,000
1st installment	55,000
2nd installment	50,000
3rd installment	45,000
4th installment	40,000
Total	2,50,000

As each installment comprises equal amount of cash price the differences in installment amounts are due to interest amount only. Assuming X is the amount of Cash Price in each installment and I is the amount of interest.

Thus for the installments, starting from last installment, we have the following equations:

			(₹)
(i)	X + I	=	40,000
(ii)	X + 2I	=	45,000
(iii)	X + 3I	=	50,000
(iv)	X + 4I	=	55,000

Subtracting any preceding equation from the following equation we get I = ₹ 5,000 and by substituting the value of I in any equation we get X = ₹ 35,000.

The hire-purchase price is divided into cash price and interest parts as under :

Particulars	Cash Price (₹)	Interest (₹)	Installment (₹)
Down Payment	60,000	-	60,000
First installment	35,000	20,000	55,000
Second installment	35,000	15,000	50,000
Third installment	35,000	10,000	45,000
Fourth installment	35,000	5,000	40,000
Total	2,00,000	50,000	250,000
Total Cash Price	2,00,000		
Hire Purchase Price	2,50,000		
Total Interest	50,000		

Situation – IV : When reference to annuity table rate of interest and installments are given but total cash price is not given

In such questions the reference to annuity table gives the present value of the annuity for a number of years at a certain rate of interest. This present worth is equal to total cash price. Therefore, with the help of annuity tables the total cash price of the total installments given can be calculated and then question can be solved by the first method.

Illustration 4

On 01.01.2023 X purchase a plant from Y on hire purchase system. The hire purchase rate was settled at ₹60,000, payable as to ₹ 15,000 on 01.01.2023 and ₹ 15,000 at the end of three successive year. Interest was charged @5% p.a. The asset was to be depreciated in the books of the purchaser at 10% p.a. on Reducing Balance Method. Given the present value of an annuity of ₹1 p.a. @5% interest is ₹2.7232.

Ascertain the cash price.

Solution :

Amount of Interest	Present value
₹ 1	₹ 2.7232
₹ 15,000	$\frac{₹\ 15{,}000 \times 2.7232}{1} = ₹\ 40{,}848$

$\therefore$ Cash Price = ₹ 40,848 + ₹ 15,000 (down) = ₹ 55,848.

Accounting Treatment

Accounting treatment in the books of buyer is presented in below :

In the Books of the Hire-Purchaser

The following methods are followed:

(1) Cash Price Method

(2) Interest Suspense Method

Cash Price Method:

	Particulars		Debit (₹)	Credit (₹)
1.	Hire Purchase Asset A/c	Dr.	xxxx	
	To Hire Vendor A/c [Cash price]			xxxx
2.	Hire Vendor A/c	Dr.	xxxx	
	To Bank A/c [Down payment]			xxxx
3.	Interest A/c	Dr.	xxxx	
	To Hire Vendor A/c			xxxx
4.	Hire Vendor A/c	Dr.	xxxx	
	To Bank A/c [Installment amount]			xxxx
5.	P/L A/c	Dr.	xxxx	
	To Interest A/c			xxxx
	To Depreciation A/c			xxxx

Interest Suspense Method:

	Particulars		Debit (₹)	Credit (₹)
1.	Hire Purchase Asset A/c [Cash Price]	Dr.	xxxx	
	Interest Suspense A/c [Total Interest]	Dr.	xxxx	
	To Hire Vendor A/c [H.P price]			xxxx
2.	Hire Vendor A/c	Dr.	xxxx	
	To Bank A/c [Down payment]			xxxx
3.	Interest A/c	Dr.	xxxx	
	To Interest Suspense A/c			xxxx
4.	Hire Vendor A/c	Dr.	xxxx	
	To Bank A/c [Installment amount]			xxxx
5.	P/L A/c	Dr.	xxxx	
	To Interest A/c			xxxx
	To Depreciation A/c			xxxx

Illustration 5

On 1.1.2019 Mr. X took delivery from Mr. Y of 5 machines on a hire purchase system. ₹ 4,000 being paid on delivery and the balance in five installments of ₹ 6,000 each, payable annually on 31st December. The vendor company charges 5% interest p.a. on yearly balances. The cash price of 5 machines was ₹ 30,000. Show the entries (without narration) Assets Account, Mr. Y Account for 5 years assuming that the purchaser charges depreciation @20% on straight line method.

Solution:

Computation of Interest

	(₹)	(₹)
Hire-purchase price		
Down payment	4,000	
Intallment ₹ 6,000 × 5 =	30,000	34,000
Less: Cash Price		30,000
∴ **Interest**		**4,000**

Analysis of Payments of Vendors

Year	Opening Balance of Cash Price (₹)	Towards Principal (₹)	Towards Interest (₹)	Installment (₹)	Closing balance of Cash Price (₹)
01.01.2019	30,000	4,000	---	---	26,000
31.12.2019	26,000	4,700	1,300	6,000	21,300
31.12.2020	21,300	4,935	1,065	6,000	16,365
31.12.2021	16,365	5,182	818	6,000	11,183
31.12.2022	11,183	5,441	559	6,000	5,742
31.12.2023	5,742	5,742	258 (bal. fig.)	6,000	NIL
			4,000		

In the Books of Mr. X

Journal (without narrations) **Dr.** **Cr.**

Date	Particulars		L/F	(₹)	(₹)
2019 Jan. 1.	Assets A/c	Dr.		30,000	
	To Mr. Y A/c				30,000
	Mr. Y A/c	Dr.		4,000	
	To Bank A/c				4,000
Dec. 31.	Interest A/c	Dr.		1,300	
	To Mr. Y A/c				1,300
	Mr. Y A/c	Dr.		6,000	
	To Bank A/c				6,000
	Depreciation A/c	Dr.		6,000	
	To Assets A/c				6,000

Date	Particulars		L/F	(₹)	(₹)
	Profit & Loss A/c	Dr.		7,300	
	To Interest A/c				1,300
	To Depreciation A/c				6,000
2020	Interest A/c	Dr.		1,065	
Dec. 31.	To Mr. Y A/c				1,065
	Mr. Y A/c	Dr.		6,000	
	To Bank A/c				6,000
	Depreciation A/c	Dr.		6,000	
	To Assets A/c				6,000
	Profit & Loss A/c	Dr.		7,065	
	To Interest A/c				1,065
	To Depreciation A/c				6,000
2021	Interest A/c	Dr.		818	
Dec. 31.	To Mr. Y A/c				818
	Mr. Y A/c	Dr.		6,000	
	To Bank A/c				6,000
	Depreciation A/c	Dr.		6,000	
	To Assets A/c				6,000
	Profit & Loss A/c	Dr.		6,818	
	To Interest A/c				818
	To Depreciation A/c				6,000
2022	Interest A/c	Dr.		559	
Dec. 31.	To Mr. Y A/c				559
	Mr. Y A/c	Dr.		6,000	
	To Bank A/c				6,000
	Depreciation A/c	Dr.		6,000	
	To Assets A/c				6,000
	Profit & Loss A/c	Dr.		6,559	
	To Interest A/c				559
	To Depreciation A/c				6,000
2023	Interest A/c	Dr.		258	
Dec. 31.	To Mr. Y A/c				258

Date	Particulars		L/F	(₹)	(₹)
	Mr. Y A/c	Dr.		6,000	
	To Bank A/c				6,000
	Depreciation A/c	Dr.		6,000	
	To Assets A/c				6,000
	Profit & Loss A/c	Dr.		6,258	
	To Interest A/c				258
	To Depreciation A/c				6,000

Dr. **Asset Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
2019			2019		
Jan. 1.	To Mr. Y A/c	30,000	Dec. 31.	By Depreciation A/c.	6,000
				By Balance c/d.	24,000
		30,000			30,000
2020			2020		
Jan. 1.	To Balance b/d.	24,000	Dec. 31.	By Depreciation A/c.	6,000
				By Balance c/d.	18,000
		24,000			24,000
2021			2021		
Jan. 1.	To Balance b/d.	18,000	Dec. 31.	By Depreciation A/c.	6,000
				By Balance c/d.	12,000
		18,000			18,000
2022			2022		
Jan. 1.	To Balance b/d.	12,000	Dec. 31.	By Depreciation A/c.	6,000
				By Balance c/d.	6,000
		12,000			12,000
2023			2023		
Jan. 1.	To Balance b/d.	6,000	Dec. 31.	By Depreciation A/c.	6,000
		6,000			6,000

Note:

It has been observed that Hire Purchase Trading Account (Debtors) method and Stock and Debtors method of ascertaining profit or loss on sale of goods of small value under hire purchase system based on the simplified approach are not fully compliant with AS 19 "Leases" since loading amount contains both profit as well as interest element.

As both companies and other than companies are involved in Hire Purchase Trading it is necessary to prepare the company accounts in compliance with Accounting Standards as per Companies Act, 2013.

Accordingly it is proposed to follow the methods other than Hire Purchase Trading Account (Debtors) Method and Stock and Debtors Method in case of Companies.

Meaning of Sales Method

Sales method follows a practical approach and practically (of course not technically) treats the hire purchaser as owner of the asset. Under this method, the asset is recorded at full cash price on the basis of 'substance over form'. This method is more appropriate since the intention all along is to buy the asset.

Journal Entries

The various accounting entries in the books of the hire purchaser and hire vendor are shown below:

Case	In the Books of Hire Purchaser	In the Books of Hire Vendor
1. On transfer of Possession	Asset A/c Dr. To Hire Vendor's A/c	Hire Purchaser's A/c Dr. To H.P. Sales A/c
2. On making Down Payment	Hire Vendor's A/c Dr. To Bank A/c	Bank A/c Dr. To Hire Purchaser's A/c
3. On making Interest due on unpaid balance	Interest A/c Dr. To Hire Vendor's A/c	Hire Purchaser's A/c Dr. To Interest A/c
4. On making payment of Installment	Hire Vendor's A/c Dr. To Bank A/c	Bank A/c Dr. To Hire Purchaser's A/c
5. On providing Depreciation	Depreciation A/c Dr. To Asset A/c	No Entry
6. On closure of Depreciation A/c	Profit & Loss A/c Dr. To Depreciation A/c	No Entry
7. On closure of Interest A/c	Profit & Loss A/c Dr. To Interest A/c	Interest A/c Dr. To Profit & Loss A/c

Disclosure in Balance Sheet

At the end of each accounting period the balances of relevant accounts appear in the Balance Sheet as shown below:

Disclosure in Balance Sheet

Balance Sheet of Hire Purchaser				Balance Sheet of Hire Vendor			
Liabilities	**(₹)**	**Assets**	**(₹)**	**Liabilities**	**(₹)**	**Assets**	**(₹)**
		Fixed Assets:				Current Assets:	
		Asset (at full cash price)	xxx			Hire Purchase Debtors	xxx
		Less: Depreciation till date	xxx				
		Less: Balance in Hire Vendor's Account	xxx				
			xxx				**xxx**

Illustration 6

On 01.01.2020 A purchased five Machines each costing ₹ 1,58,500 each from B Payment was to be made 20% down and the remainder in four equal annual installments commencing from 31.12.2020 with interest at 10% p.a. A writes off depreciation @20% on the diminishing balance.

Give the necessary journal entries and ledger accounts in the books of A and B under Sales Method. Also show how the relevant of items will appear in the Balance Sheet.

Solution:

Journal

Journal A		Journal B		Dr. (₹)	Cr. (₹)
01.01.2020					
(a) Machines A/c	Dr.	(a) A A/c	Dr.	7,92,500	
To B A/c		To HP Sales A/c			7,92,500
(b) B A/c	Dr.	(b) Bank A/c	Dr.	1,58,500	
To Bank A/c		To A A/c			1,58,500
31.12.2020					
(c) Interest A/c	Dr.	(c) A A/c	Dr.	63,400	
To B A/c		To Interest A/c			63,400
(d) B A/c	Dr.	(d) Bank A/c	Dr.	2,21,900	
To Bank A/c		To A A/c			2,21,900
(e) Depreciation A/c	Dr.	(e) No Entry		1,58,500	
To Machines A/c					1,58,500
(f) Profit & Loss A/c	Dr.	(f) No Entry		1,58,500	
To Depreciation A/c					1,58,500
(g) Profit & Loss A/c	Dr.	(g) Interest A/c	Dr.	63,400	
To Interest A/c		To Profit & Loss A/c			63,400
31.12.2021					
(a) Interest A/c	Dr.	(a) A A/c	Dr.	47,550	
To B A/c		To Interest A/c			47,550
(b) B A/c	Dr.	(b) Bank A/c	Dr.	2,06,050	
To Bank A/c		To A A/c			2,06,050
(c) Depreciation A/c	Dr.	(c) No Entry		1,26,800	
To Machines A/c					1,26,800

Journal A		Journal B		Dr. (₹)	Cr. (₹)
(d) Profit & Loss A/c	Dr.	(d) No Entry		1,26,800	
To Depreciation A/c					1,26,800
(e) Profit & Loss A/c	Dr.	(e) Interest A/c	Dr.	47,550	
To Interest A/c		To Profit & Loss A/c			47,550
31.12.2022					
(a) Interest A/c	Dr.	(c) A A/c	Dr.	31,700	
To B A/c		To Interest A/c			31,700
(b) B A/c	Dr.	(b) Bank A/c	Dr.	1,90,200	
To Bank A/c		To A A/c			1,90,200
(c) Depreciation A/c	Dr.	(c) No Entry		1,01,440	
To Machines A/c					1,01,440
(d) Profit & Loss A/c	Dr.	(d) No Entry		1,01,440	
To Depreciation A/c					1,01,440
(e) Profit & Loss A/c	Dr.	(e) Interest A/c	Dr.	31,700	
To Interest A/c		To Profit & Loss A/c			31,700
31.12.2023					
(a) Interest A/c	Dr.	(d) A A/c	Dr.	15,850	
To B A/c		To Interest A/c			15,850
(b) B A/c	Dr.	(b) Bank A/c	Dr.	1,74,350	
To Bank A/c		To A A/c			1,74,350
(c) Depreciation A/c	Dr.	(c) No Entry		81,152	
To Machines A/c					81,152
(d) Profit & Loss A/c	Dr.	(d) No Entry		81,152	
To Depreciation A/c					81,152
(e) Profit & Loss A/c	Dr.	(e) Interest A/c	Dr.	15,850	
To Interest A/c		To Profit & Loss A/c			15,850

Dr. **Machinary Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.20	To B A/c	7,92,500	31.12.20	By Depreciation A/c	1,58,500
				By Balance c/d	6,34,000
		7,92,500			**7,92,500**
01.01.21	To Balance b/d	6,34,000	31.12.21	By Depreciation A/c	1,26,800
				By Balance c/d	5,07,200
		6,34,000			**6,34,000**
01.01.22	To Balance b/d	5,07,200	31.12.22	By Depreciation A/c	1,01,440
				By Balance c/d	4,05,760
		5,07,200			**5,07,200**
01.01.23	To, Balance b/d	4,05,760	31.12.23	By Depreciation A/c	81,152
				By Balance c/d	3,24,608
		4,05,760			**4,05,760**

Dr. **B's Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.20	To Bank A/c [Down Payment]	1,58,500	01.01.20	By Machines A/c	7,92,500
31.12.20	To Bank A/c [₹ 1,58,500 + ₹ 63,400]	2,21,900	31.12.20	By Interest A/c [(₹ 7,92,500 - ₹ 1,58,500) × 10/100]	63,400
	To Balance c/d	4,75,500			
		8,55,900			**8,55,900**
31.12.21	To Bank A/c [₹ 1,58,500 + ₹ 47,550]	2,06,050	01.01.21	By Balance b/d	4,75,500
	To Balance c/d	3,17,000	31.12.21	By Interest A/c [₹ 4,75,500 × 10/100]	47,550
		5,23,050			**5,23,050**
31.12.22	To Bank A/c [₹ 1,58,500 + ₹ 31,700]	1,90,200	01.01.22	By Balance b/d	3,17,000
	To Balance c/d	1,58,500	31.12.22	By Interest A/c [₹ 3,17,000 × 10/100]	31,700

Date	Particulars	(₹)	Date	Particulars	(₹)
		3,48,700			**3,48,700**
31.12.23	To Bank A/c [₹ 1,58,500 + ₹ 15,850]	1,74,350	01.01.23	By Balance b/d	1,58,500
			31.12.23	By Interest A/c [₹ 1,58,500 × 10/100]	15,850
		1,74,350			**1,74,350**

An Extract of Balance Sheet of A

Liabilities	1st yr (₹)	2nd yr (₹)	3rd yr (₹)	4th yr (₹)	Assets	1st yr (₹)	2nd yr (₹)	3rd yr (₹)	4th yr (₹)
					Fixed Assets:				
					Machines	7,92,500	7,92,500	7,92,500	7,92,500
					Less: Depreciation till date	1,58,500	2,85,300	3,86,740	4,67,892
					Less: Balance due To B	4,75,500	3,17,000	1,58,500	-
						1,58,500	**1,90,200**	**2,47,260**	**3,24,608**

In the Books of B

Dr. **A's Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.20	To Sales A/c	7,92,500	01.01.20	By Bank A/c [Down payment]	1,58,500
31.12.20	To Interest A/c	63,400	31.12.20	By Bank A/c	2,21,900
				By Balance c/d	4,75,500
		8,55,900			**8,55,900**
01.01.21	To Balance b/d	4,75,500	31.12.21	By Bank A/c	2,06,050
31.12.21	To Interest A/c	47,550	31.12.21	By Balance c/d	3,17,000
		5,23,050			**5,23,050**
01.01.22	To Balance b/d	3,17,000	31.12.22	By Bank A/c	1,90,200
31.12.22	To Interest A/c	31,700		By Balance c/d	1,58,500
		3,48,700			**3,48,700**
01.01.23	To Balance b/d	1,58,500	31.12.23	By Bank A/c	1,74,350

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12.23	To Interest A/c	15,850			
		1,74,350			**1,74,350**

An Extract of Balance Sheet of B

Liabilities	1st yr (₹)	2nd yr (₹)	3rd yr (₹)	4th yr (₹)	Assets	1st yr (₹)	2nd yr (₹)	3rd yr (₹)	4th yr (₹)
					Current Assets:				
					Hire Purchase Debtors – A	4,75,500	3,17,000	1,58,500	-

Default and Repossession

Depending on the number of items repossessed as compared to the number of items sold on hire purchase basis, repossession can be of two types, namely (1) Complete or Full Repossession and (2) Partial Repossession.

If a hire purchaser fails to pay any installment on the stipulated date, the hire purchaser is said to be at default. In case of default by the hire purchaser, the hire vendor may repossess the goods. Repossession means taking back the possession of goods by the hire vendor. Subject to agreement, the repossession may be either complete or partial.

Meaning of Complete or Full Repossession

In case of complete or full repossession the hire vendor takes back the possession of all the goods.

Journal Entries under Complete or Full Repossession

All Entries till the date of default are passed in the usual manner. The additional Entries are as follows:

Books of Hire Purchaser	Books of Hire Vendor
1. For Closing Hire Vendor's Account Hire Vendor's A/c Dr. To Asset A/c **Note:** This entry is passed with the amount due to the hire-vendor.	**1. On Repossession of goods** Goods Repossessed A/c Dr. P/L A/c Dr. To Hire Purchaser's A/c **Note:** This entry is passed with the revalued amount of goods repossessed.
2. For Closing Asset Account **(i) If the Book Value of the Asset exceeds the amount due to Hire-Vendor** Profit & Loss A/c Dr. To Asset A/c **(ii) If the amount due to Hire-Vendor exceeds the Book Value of the Asset** Asset A/c Dr. To Profit & Loss A/c	**2. For amount spent on reconditioning of Goods Repossessed** Goods Repossessed A/c Dr. To Cash A/c/Bank A/c **3. For sale of Goods Repossessed** Cash A/c/Bank A/c /Debtors A/c Dr. To Goods Repossessed A/c **4. For loss on sale of Goods Repossessed** Profit & Loss A/c Dr. To Goods Repossessed A/c **Note:** In case of profit, a reverse entry will be passed.

Illustration 7

On 1.1.2021, A purchased 5 Machines from B. Payment was to be made — 20% down and the balance in four annual installments of ₹ 2,80,000, ₹ 2,60,000, ₹ 2,40,000 and ₹ 2,20,000 commencing from 31.12.2021. The vendor charged interest @ 10% p.a. A, writes off depreciation @ 20% p.a. on the original cost.

On A's failure to pay the installment due on 31.12.2022, B repossessed all the machines on 01.01.2023 and valued them on the basis of 40% p.a. depreciation on W.D.V. basis. B after incurring ₹6,000 on repairs sold the machines for ₹ 2,66,000 on 30th June 2023. Prepare the relevant accounts in the books of A and B.

Solution:

Computation of Cash Price and Periodic Interest

A Installment Number	B Closing Balance after the Payment of Installment	C Installment Amount	D = B + C Closing Balance before the payment of Installment	E = D×R/(100 + R) Interest D× 10/110	F = D-E Opening Balance
IV	—	2,20,000	2,20,000	20,000	2,00,000
III	2,00,000	2,40,000	4,40,000	40,000	4,00,000
II	4,00,000	2,60,000	6,60,000	60,000	6,00,000
I	6,00,000	2,80,000	8,80,000	80,000	8,00,000

Let the cash price be 'X

X = ₹ 8,00,000 + 20% of X (i.e. down payment) 0.8X = ₹ 8,00,000

X = ₹ 8,00,000/0.8 = ₹10,00,000

In the Book of A

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

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To B's A/c	10,00,000	31.12.21	By Depreciation A/c	2,00,000
				By Balance c/d	8,00,000
		10,00,000			**10,00,000**
01.01.22	To Balance b/d	8,00,000	31.12.22	By Depreciation A/c	2,00,000
				By, Balance c/d	6,00,000
		8,00,000			**8,00,000**
01.01.23	To Balance b/d	6,00,000	01.01.23	By B's A/c	6,60,000
	To P&L A/c (Profit)	60,000			
		6,60,000			**6,60,000**

Dr. **B's Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To Bank A/c (Down payment)	2,00,000	01.01.21	By Machinery A/c	10,00,000
31.12.21	To Bank A/c [₹ 2,00,000 + ₹ 80,000]	2,80,000	31.12.21	By Interest A/c [(₹ 10,00,000 - ₹ 2,00,000) × 10/100]	80,000
	To Balance c/d	6,00,000			
		10,80,000			**10,80,000**
31.12.22	To Balance c/d	6,60,000	01.01.22	By Balance b/d	6,00,000
				By Interest A/c (₹ 6,00,000 × 10/100)]	60,000
01.01.23	To Machinery A/c	6,60,000	01.01.23	By Balance b/d	6,60,000

In the Books of B

Dr. **A's Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To H.P. Sales A/c	10,00,000	01.01.21	By Bank A/c (Down Payment)	2,00,000
31.12.21	To Interest A/c [(₹ 10,00,000 - ₹ 2,00,000) × 10/100]	80,000	31.12.21	By Bank A/c (₹ 2,00,000 + ₹ 80,000)	2,80,000
				By Balance c/d	6,00,000
		10,80,000			**10,80,000**
01.01.22	To Balance b/d	6,00,000	31.12.22	By Balance c/d	6,60,000
31.12.22	To Interest A/c [₹ 6,00,000 × 10/100]	60,000			
		6,60,000			**6,60,000**
01.01.23	To Balance b/d	6,60,000	01.01.23	By H.P. Goods Repossessed A/c	3,60,000
				By Profit & Loss A/c	3,00,000
		6,60,000			**6,60,000**

Dr. **H.P. Goods Repossessed Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.23	To A's A/c	3,60,000	30.06.23	By Bank A/c	2,66,000
	To Bank A/c	6,000		By P&L A/c	1,00,000
		3,66,000			**3,66,000**

Partial Repossession

In case of partial repossession, the hire vendor takes back the possession of a part of the goods.

Practical Steps under Partial Repossession

Step1: Calculate Book value of Goods Repossessed

A. Cost

B. Less: Depreciation upto date of repossession

C. Book value of Goods Repossessed

Step 2: Calculate Agreed Value of Goods Repossessed

Step 3: Loss on default = Book Value – Agreed Value

Journal Entries Under Partial Repossession

Entries till the date of default are passed in the usual manner. The additional Entries are as follows:

Books of Hire Purchaser	Books of Hire Vendor
1. For transfer of the agreed value of Goods Repossessed Hire Vendor's A/c Dr. To Asset A/c	1. On Repossession of Goods at agreed value H.P. Goods Repossessed A/c Dr. To Hire Purchaser's A/c
2. For Transfer of Loss on default Profit & Loss A/c Dr. To Asset A/c Note: In case of profit on default, the reverse entry will be passed	2,3,4—Same entries as in case of complete repossession.

Illustration 8

On 1.1.2021, A purchased 5 Machines from B. Payment was to be made—20% down and the balance in four annual installments of ₹2,80,000, ₹ 2,60,000, ₹ 2,40,000 and ₹ 2,20,000 commencing from 31.12.2021. The vendor charged interest @ 10% p.a. A, writes off depreciation @ 20% p.a. on the original cost.

On A's failure to pay the installment due on 31.12.2022, after negotiations on 01.01.2023 B agreed to leave two machines with A adjusting the value of the other three machines against the amount due. The machines being valued at cost less 40% p.a. depreciation on W.D.V basis, B after spending ₹6000 on repairs of each of such machines sold @ ₹70,000 on 30th June 2023. Prepare the relevant accounts in the books of A and B.

Solution:

A Installment Number	B Closing Balance after the payment of Installment	C Installment	D= B+C Closing Balance before the payment of Installment	E = D×R/(100 +R) Interest D× 10/110	F = D-E Opening Balance
	(₹)	(₹)	(₹)	(₹)	(₹)
IV	-	2,20,000	2,20,000	20,000	2,00,000
III	2,00,000	2,40,000	4,40,000	40,000	4,00,000
II	4,00,000	2,60,000	6,60,000	60,000	6,00,000
I	6,00,000	2,80,000	8,80,000	80,000	8,00,000

Let the cash price be 'X'

X= ₹8,00,000 +20% of X (i.e. down payment)

0.8X = ₹8,00,000

X = ₹8,00,000/0.8 = ₹10,00,000

In the Books of A

Dr. Machinery Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To B A/c	10,00,000	31.12.21	By Depreciation A/c	2,00,000
				By Balance c/d	8,00,000
		10,00,000			**10,00,000**
01.01.22	To Balance b/d	8,00,000	31.12.22	By Depreciation A/c	2,00,000
				By Balance c/d	6,00,000
		8,00,000			**8,00,000**
01.01.23	To Balance b/d	6,00,000	01.01.23	By B A/c	2,16,000
				By P&L A/c [loss on default]	1,44,000
				By Depreciation A/c	80,000
				By Balance c/d	1,60,000
		6,00,000			**6,00,000**

Dr. **B's Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To Bank A/c (Down payment)	2,00,000	01.01.21	By Machinery A/c	10,00,000
31.12.21	To Bank A/c [₹ 2,00,000 + ₹ 80,000] To Balance c/d	2,80,000 6,00,000	31.12.21	By Interest A/c [(₹ 10,00,000 - ₹ 2,00,000) × 10/100]	80,000
		10,80,000			**10,80,000**
31.12.22	To Balance c/d	6,60,000	01.01.22	By Balance b/d	6,00,000
			31.12.22	By Interest A/c [(₹ 6,00,000 × 10/100)]	60,000
01.01.23	To Machinery A/c	6,60,000	01.01.23	By Balance b/d	6,60,000

Working Notes:

1. **Calculation of Book value of Goods Repossessed** (₹)

A. Cost [₹ 2,00,000 × 3]	6,00,000
B. Less: Depreciation for 2 years [₹ 6,00,000 × 20% × 2]	2,40,000
	3,60,000

2. **Calculation of Agreed value of Goods Repossessed** (₹)

A. Cost [₹ 2,00,000 × 3]	6,00,000
B. Less: Depreciation for 1st Year [40% of ₹ 6,00,000]	2,40,000
C. Book Value in the beginning of 2nd year	3,60,000
D. Less: Depreciation for 2nd year [40% of ₹ 3,60,000]	1,44,000
E. Book Value at the end of 2nd Year	2,16,000

3. **Loss on Default = Book Value – Agreed Value = ₹ 3,60,000 - ₹ 2,16,000 = ₹ 1,44,000**

In the Books of B

Dr. **A's Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To H.P. Sales A/c	10,00,000	01.01.21	By Bank A/c (Down payment)	2,00,000
31.12.21	To Interest A/c [(₹ 10,00,000 – ₹ 2,00,000) × 10/100]	80,000	31.12.21	By Bank A/c [₹ 2,00,000 + ₹ 80,000]	2,80,000

				By Balance c/d	6,00,000
		10,80,000			**10,80,000**
01.01.22	To Balance b/d	6,00,000	31.12.22	By Balance c/d	6,60,000
31.12.22	To Interest A/c [₹ 6,00,000 × 10/100]	60,000			
		6,60,000			**6,60,000**
01.01.23	To Balance b/d	6,60,000	01.01.23	By H.P. Goods Repossessed A/c	2,16,000
				By Balance c/d	4,44,000
		6,60,000			**6,60,000**

Dr. **H.P. Goods Repossessed Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.23	To A's A/c	2,16,000	30.06.23	By Bank A/c	2,10,000
	To Bank A/c (Repairs) [₹ 6,000 × 3]	18,000		By P&L A/c (Loss)	24,000
		2,34,000			**2,34,000**

Illustration 9

A Transport purchased from Kolkata Motors 3 Tempos costing ₹ 50,000 each on the hire purchase system on 1.1.2021. Payment was to be made ₹ 30,000 down and the remainder in 3 equal annual installments payable on 31.12.2021, 31.12.2022 and 31.12.2023 together with interest @ 9%. p.a. A Transport writes off depreciation at the rate of 20% p.a. on the diminishing balance. It paid the installment due at the end of the first year i.e. 31.12.2021 but could not pay the next on 31.12.2022. Kolkata Motors agreed to leave one Tempo with the purchaser on 31.12.2022 adjusting the value of the other 2 Tempos against the amount due on 31.12.2022. The Tempos were valued on the basis of 30% depreciation annually on W.D.V. basis.

Required: Show the necessary accounts in the books of A Transport for the year 2021, 2022, 2023.

Solution:

In the Books of

Dr. **Tempos Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To Kolkata Motors' A/c (₹ 50,000 × 3)	1,50,000	31.12.21	By Depreciation A/c (20% on ₹ 1,50,000)	30,000
				By Balance c/d	1,20,000
		1,50,000			**1,50,000**
01.01.22	To Balance b/d	1,20,000	31.12.22	By Depreciation A/c	24,000

			31.12.22	By Kolkata Motors' A/c (Value of 2 tempos taken away)	49,000
			31.12.22	By P&L A/c (Loss on Default)	15,000
			31.12.22	By Balance c/d (value of one tempo left)	32,000
		1,20,000			**1,20,000**
01.01.23	To Balance b/d	32,000	31.12.23	By Depreciation A/c	6,400
			31.12.23	By Balance c/d	25,600
		32,000			**32,000**

Dr. **Kolkata Motor's Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To Bank A/c (Down Payment)	30,000	01.01.21	By Tempos A/c (₹ 50,000 ×3)	1,50,000
31.12.21	To Bank A/c	50,800	31.12.21	By Interest A/c (9% on ₹ 1,20,000)	10,800
31.12.21	To Balance c/d	80,000			
		1,60,800			**1,60,800**
31.12.22	To Tempos A/c	49,000	01.01.22	By Balance b/d	80,000
31.12.22	To Balance c/d	38,200	31.12.22	By Interest A/c (9% on ₹ 80,000)	7,200
		87,200			**87,200**
31.12.23	To Bank A/c	41,638	01.01.23	By Balance b/d	38,200
			31.12.23	By Interest A/c (9% on ₹ 38,200)	3,438
		41,638			**41,638**

Working Notes:

1. Value of a tempo left with the buyer = ₹ 50,000 × 80/100 × 80/100 = ₹ 32,000
2. Value of Tempos taken away by the seller = ₹ 50,000 × 2 × 70/100 × 70/100 = ₹ 49,000
3. Loss on Tempos taken away = Book Value – Agreed Value

   = [2 × ₹ 50,000 × 80/100 × 80/100] - ₹ 49,000

   = ₹ 15,000.

Illustration 10

On 1 January 2022, A purchased from B a plant valued at ₹7,45,000; payment to be made by four semi-annual installments of ₹2,10,000 each; interest being charged at 5% per half year. A paid the first installment on 1st July 2022 but failed to pay the next. B repossessed the plant on 4 January 2023.On 5 January 2023, after negotitation, A was allowed to retain the plant of which the original cash price was ₹3,90,000 and he was to bear the loss on the remainder which was taken over by B on that date for ₹3,75,000. B waived the interest after 31st December 2022. Another agreement was signed for payment of the balance amount.

Show by ledger accounts the necessary records in the books of A charging depreciation at 10% per annum half yearly on the written down value.

Solution:

In the Books of A

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

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.22	To B's A/c	7,45,000	30.06.21	By Depreciation A/c By Balance c/d	37,250 7,07,750
		7,45,000			**7,45,000**
01.07.22	To Balance b/d	7,07,750	31.12.22	By Depreciation A/c By Balance c/d	35,388 6,72,362
		7,07,750			**7,07,750**
01.01.23	To Balance b/d To Profit & Loss A/c (Balancing Figure) [3,75,000 – 3,20,387]	6,72,362 54,613	05.01.23	By B's A/c By Balance c/d	3,75,000 3,51,975
		7,26,975			**7,26,975**

Dr. **B's Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
30.6.22	To balance c/d	7,82,250	01.01.22	By Plant on Hire Purchase A/c	7,45,000
			30.06.22	By Interest A/c [₹7,45,000 × 5%]	37,250
		7,82,250			**7,82,250**
01.07.22	To Bank A/c	2,10,000	01.07.22	By Balance b/d	7,82,250
31.12.22	To Balance c/d	6,00,863	31.12.22	By Interest A/c [₹5,72,250 × 5%]	28,613
		8,10,863			**8,10,863**

05.01.23	To Machinery A/c	3,75,000	01.01.23	By Balance b/d	6,00,863
	To Balance c/d	2,25,863			
		6,00,863			**6,00,863**

Working Note:

Calculation of Book Value of Plant Repossessed and Retained

Particulars	Repossessed (₹)	Retained (₹)
A. Cash Price of the Plant	3,55,000	3,90,000
B. Less: Depreciation @10% for 6 months	(17,750)	(19,500)
C. Book Value	3,37,250	3,70,500
D. Less: Depreciation @10% for 6 months	(16,863)	(18,525)
E. Book Value	3,20,387	3,51,975

Illustration 11

Z sold 3 Machinery for a total cash sale price of ₹ 6,00,000 on hire purchase basis to X on 01.01.2021. The terms of agreement provided for 30% as cash down and the balance of the cash price in three equal installments together with interest at 10% per annum compounded annually. The installments were payable as per the following schedule:

1st installment on 31.12.2021; 2nd installment on 31.12.2022 and 3rd installment on 31.12.2023. X paid the 1st installment on time but failed to pay thereafter. On his failure to pay the second installment, Z repossessed two machineries and valued them at 50% of the cash price. X charges 10% p.a. depreciation on straight line method.

Prepare necessary ledger accounts in the books of X for 2020-2022.

Solution:

In the Books of X

Dr. Machinery Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To Z's A/c	6,00,000	31.12.21	By Depreciation A/c By Balance c/d	60,000 5,40,000
		6,00,000			**6,00,000**
01.01.22	To Balance b/d	5,40,000	31.12.22	By Depreciation A/c By Balance c/d	60,000 4,80,000
		5,40,000			**5,40,000**
01.01.23	To Balance b/d	4,80,000	31.12.23	By Depreciation A/c By Z's A/c By Profit and Loss A/c (balancing figure) By Balance c/d	60,000 2,00,000 80,000 1,40,000
		4,80,000			**4,80,000**

Dr. **Z's Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.21	To Bank A/c	1,80,000	31.12.21	By Machinery A/c	6,00,000
31.12.21	To Balance c/d	4,62,000		By, Interest A/c [10% on (₹,00,000 – ₹1,80,000)]	42,000
		6,42,000			**6,42,000**
31.12.22	To Bank A/c (1,40,000 + 42,000 + 46,200) To Balance c/d	2,28,200 2,80,000	01.01.22 31.12.22	By Balance c/d By Interest A/c [10% on ₹4,62,000]	4,62,000 46,200
		5,08,200			**5,08,200**
31.12.23	To Machinery A/c To Balance c/d	2,00,000 1,08,000	01.01.23 31.12.23	By Balance b/d By Interest A/c	2,80,000 28,000
		3,08,000			**3,08,000**

Working Notes:

1. Book value of machine left and repossessed

Particulars	1 left	2 repossessed
A. Costs	**2,00,000**	**4,00,000**
B. Less: Depreciation for 3 years @10%	**(60,000)**	**(1,20,000)**
	1,40,000	**2,80,000**

2. Agreed Value of 2 Machinery Repossessed = Cash Price – 50% of cash price
   = ₹(4,00,000 – 2,00,000)
   = ₹2,00,000

3. Loss on Default = Agreed Value – Book Value
   = ₹(2,00,000 – 2,80,000)
   = ₹80,000

Illustration 12

X purchased a truck for ₹ 2,80,000, payment to be made ₹ 91,000 down and 3 installments of ₹ 76,000 each at the end of each year. Rate of interest is charged at 10% p.a. Buyer depreciates assets at 15% p.a. on written down value method.

Because of financial difficulties, X, after having paid down payment and first installment to the end of 1st year could not pay second installment and seller took possession of the truck. Seller, after spending ₹ 9,200 on repairs of the asset sold it for ₹150,000. Show the relevant accounts in the books of the purchaser & the vendor.

Solution:

Particulars	Total Cash Price (₹)	Installment Paid @ 10% Int (₹)	Interest Paid (₹)	Paid towards Cash Price (Installment-Interest) (₹)
	280,000			
Down Payment	91,000	91,000	0	91,000
	189,000			
End of 1st year	57,100	76,000	18,900	57,100
	131,900			
End of 2nd Year	62,810	76,000	13,190	62,810
	69,090			
End of 3rd Year	69,090	76,000	6,910	69,090
Total	0	3,19,000	39,000	2,80,000

In the Books of X

Dr. **Truck Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
1st Year	To Vendor A/c	2,80,000		By Depreciation A/c	42,000
				By Bal c/d	2,38,000
		2,80,000			2,80,000
2nd Year	To Bal b/d	2,38,000		By Depreciation A/c	35,700
				By Vendors A/c	1,45,090
				By P/L A/c (Bal. figure)	57,210
		2,38,000			2,38,000

Dr. **Vendors Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
1st Year	To Bank (Down Payment)	91,000		By Truck (Cash Price) A/c	2,80,000
	To Bank (Installment)	76,000		By Interest A/c	18,900
	To Bal c/d	1,31,900			
		2,98,900			2,98,900
2nd Year	To Asset A/c (Default- Assets taken over)	1,45,090		By Balance b/d	1,31,900
				" Interest A/c	13,190
		1,45,090			1,45,090

In the Books of Vendor

Dr. **X Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
1st Year	To Hire Purchase Sales A/c	2,80,000		By Bank (Down) A/c	91,000
	To Interest A/c	18,900		By Bank (Installment) A/c	76,000
				By Balance c/d	1,31,900
		2,98,900			2,98,900
2nd Year	To Balance b/d	1,31,900		By Goods Repossessed A/c	1,45,090
	To Interest A/c	13,190			
		1,45,090			1,45,090

Dr. **Goods Repossessed Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
	To X A/c (Purchaser) A/c	1,45,090		By Bank (Sales) A/c	1,50,000
	To Bank (Repairing Charge) A/c	9,200		By P/L A/c (Bal Figure)	4,290
		1,54,290			1,54,290

Illustration 13

Z Associates purchased seven trucks on hire purchase on 1st July, 2022. The cash purchase price of each truck was ₹ 1,00,000. The company has to pay 20% of the cash purchase price at the time of delivery and the balance in five half yearly installment starting from 31st December, 2022 with interest at 5% per annum at half yearly rates. On the Company's failure to pay the installment due on 30th June 2023, it was agreed that the Company would return 3 trucks to the vender and the remaining four would be retained. The vendor agreed to allow him a credit for the amount paid against these 3 trucks less 25%. Show the relevant Accounts in the books of the purchaser and vendor assuming the books are closed in June every year and depreciation @ 20% p.a. is charged on Trucks. Vendor after spending ₹ 2,000 on repairs sold away all the three trucks for ₹ 80,000.

Solution :

In Books of Hire-Purchaser

Dr. **Truck Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.07.22	To Hire Vendor's A/c (Cost of Trucks @ ₹ 1,00,000 each)	7,00,000	30.06.23	By Depreciation A/c	1,40,000
				By Hire Vendor's A/c (Value of 3 Trucks returned to Vendor)	81,000
				By P & L A/c (Loss on surrender)	1,59,000
				By Balance c/d [4/7 of (₹ 7,00,000 - ₹ 1,40,000)	3,20,000
		7,00,000			**7,00,000**

Dr. **Hire Vendor's Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.07.22	To Bank A/c	1,40,000	01.07.22	By Truck A/c	7,00,000
	(7,00,000 × 20/100)		31.12.22	By Interest A/c	14,000
				[5,60,000 × 2.5%]	
31.12.22	To Bank A/c	1,26,000	30.06.23	By Interest A/c	11,200
	[(20% of 5,60,000 +14,000]			[4,48,000 × 2.5%]	
30.06.23	To Truck A/c	81,000			
	(Value of Truck surrendered)				
30.06.23	To Balance c/d	3,78,200			
		7,25,200			7,25,200

Rate of interest is [5% ÷ 2] = 2.5% for half year.

Working Notes :

		(₹)
(i)	Credit allowed by Vendor against 3 trucks	
	Total amount of principal paid against 7 trucks	
	(₹ 1,40,000 + ₹ 1,12,000)	2,52,000
	Total amount of principal paid against 3 trucks (₹ 2,52,000 × 3/7) Credit allowed by Vendor	1,08,000
	(₹ 1,08,000 – 25% of ₹ 1,08,000)	81,000
(ii)	Loss on surrender of 3 trucks	
	Book value of 3 turcks surrendered [(₹ 1,00,000 × 3) less 20% of ₹ 3,00,000]	2,40,000
	Less : Credit allowed by Vendor against these 3 Trucks	81,000
	Loss on surrender of 3 Trucks	1,59,000

In Books of Hire Vendor

Dr. **Z Associates Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.07.22	To H.P. Sales A/c	7,00,000	01.07.23	By Bank A/c	1,40,000
31.12.22	To Interest A/c	14,000	31.12.22	By Bank A/c	1,26,000
30.06.23	To Interest A/c	11,200	30.06.23	By Goods Repossessed A/c	81,000
			30.06.23	By Balance c/d	3,78,200
		7,25,200			**7,25,200**

Dr. **Goods Repossessed Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
30.6.23	To Banerjee & Co.	81,000	30.6.23	By Bank A/c (Sales)	80,000
30.6.23	To Cash A/c (expenses)	2,000	30.6.23	By Profit & Loss A/c (Loss on Sale)	3,000
		83,000			**83,000**

Illustration 14

On 1.1.2020, B & Brothers bought 5 computers from Chirag Computers on hire-purchase. The cash price of each computer was ₹ 20,000. It was agreed ₹ 30,000 each at the end of each year. The Vendor charges interest @ 10% p.a. The buyer depreciates computers at 20% p.a. on the diminishing balance method.

B&Brothers paid cash down of ₹5,000 each and two installments but failed to pay the last installment. Consequently, the Computer Traders repossessed three sets, leaving two sets with the buyer and adjusting the value of 3 sets against the amount due. The sets repossessed were valued on the basis of 30% depreciation p.a. on the written down value. The sets repossessed were sold by the Chirag Computers for ₹ 30,000 after necessary rapairs amounting to ₹5,000 on 30th June 2023.

Required : Open the necessary ledger account in the books of both the parties.

Solution :

In the Books of B & Brothers

Dr. **Computers Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.20	To Chirag Computers A/c	1,00,000	31.12.20	By Depreciation A/c	20,000
				By Balance c/d	80,000
		1,00,000			1,00,000
01.01.21	To Balance b/d	80,000	31.12.21	By Depreciation A/c	16,000
				By Balance c/d	64,000
		80,000			80,000
31.12.22	To Balance b/d	64,000	31.12.22	By Depreciation A/c	12,800
				By Chirag Computers (computers surrendered)	20,580
				By P & L A/c - Loss on surrender	10,140
				By Balance c/d	20,480
		64,000			64,000

Dr. **Chirag Computers Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.20	To Cash A/c	25,000	01.01.20	By Computers A/c	1,00,000
31.12.20	To Cash A/c	30,000	31.12.20	By Interest A/c	
	To Balance c/d	52,500		[(₹1,00,000–₹25,000)×10%]	7,500
		1,07,500			1,07,500
31.12.21	To Cash	30,000	01.01.21	By Balance b/d	52,500
	To Balance c/d	27,750	31.12.21	By Interest A/c [52,500×10%]	5,250
		57,750			57,750
31.12.22	To Computers A/c (surrendered)	20,580	01.01.22	By Balance b/d	27,750
	To Balance c/d	9,420	31.12.22	By Interest A/c	2,250
		30,000			30,000

Working Notes :

(i) Total Interest = Hire Purchase Price – Cash Price

= [₹ 25,000 + (₹ 30,000 × 3)] – (₹ 20,000 × 5)

= ₹ 1,15,000 – ₹ 1,00,000 = ₹ 15,000

(ii) Interest for 3rd year = ₹ 15,000 – ₹ 7,500 – ₹ 5,250 = ₹ 2,250

(iii) Agreed Value of 3 Computers Repossessed on the basis of depreciation @ 30% p.a.

	₹
Cost (Cash Price) of 3 Computers	60,000
Less : Depreciation @ 30% p.a. for 3 years [₹ 18,000 + ₹ 12,600 + ₹ 8,820]	39,420
	20,580

(iv) Book Value of 3 Computers Repossessed on the basis of depreciation @ 20% p.a

	₹
Cost (Cash Price) of 3 Computers	60,000
Less : Depreciation @ 20% WDV for 3 years [₹ 12,000 + ₹ 9,600 + ₹ 7,680]	29,280
	30,720

(v) Loss on Surrender = Book value – Agreed Value = ₹ 30,720 – ₹ 20,580 = ₹ 10,140

In the Books of Chirag Computers

Dr. **B & Brothers Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.20	To H.P. Sales A/c	1,00,000	01.01.20	By Cash A/c	25,000
31.12.20	To Interest A/c	7,500	31.12.20	By Cash A/c	30,000
				By Balance c/d	52,500
		1,07,500			1,07,500
01.01.21	To Balance b/d	52,500	31.12.21	By Cash A/c	30,000
31.12.21	To Interest A/c	5,250	31.12.21	By Balance c/d	27,750
		57,750			57,750
01.01.22	To Balance b/d	27,750	31.12.22	By Goods Repossessed A/c	20,580
31.12.22	To Interest A/c	2,250		By Balance c/d	9,420
		30,000			30,000

Dr. **Goods Repossessed Account** **Cr.**

Date	Particulars	(₹)	Date	Particulars	(₹)
30.06.23	To B & Brothers A/c	20,580	30.06.23	By Cash A/c (sales)	30,000
30.06.23	To Cash A/c (Repairs)	5,000			
30.06.23	To Profit & Loss A/c (Profit)	4,420			
		30,000			30,000

Debtors Method, Stock-Debtors Method & Final Accounts Method

When the per unit sale price of the goods sold under hire purchase is small, but the number of items sold is large, it becomes infeasible for the Hire vendor to maintain a separate account for individual hire purchaser. So Hire Vendor maintains a Day book for recording the hire purchase transactions. This is called the Hire Purchase Sales Register. The Hire Vendor can ascertain the profit using the information contained in the Hire Purchase Sales Register by adopting any of the following methods:

[A] Debtors Method

[B] Stock-Debtors Method

[C] Final Accounts Method

In such transactions no separate accounting is done for the interest element. In other words, no distinction is done between trading profit and interest charged.

[A] DEBTORS METHOD or HIRE PURCHASE TRADING (Stock Approach)

Under this method both double entry ledger accounts and memoranda accounts are maintained for recording hire purchase transactions. The double entry accounts maintained are H.P. Trading A/c, General Trading A/c (if any), Goods sold on H.P. A/c, and the Memorandum accounts are Memorandum H.P. Stock A/c, Memorandum H.P. Debtors A/c, Memorandum Shop/ Godown Stock A/c (if any). The profit/ loss from hire purchase transaction gets determined through H.P. Trading A/c.

Under this method, the hire purchase transactions are accounted for as under:

Transaction/Items	Journal entry
Opening Balance of 'Shop Stock' or 'Godown Stock'	General Trading A/c Dr. To Shop/Godown Stock A/c
Opening balance of 'Stock out on hire' or 'Stock with H.P. Customers' or 'H.P. Stock'	H.P Trading A/c Dr. To H.P Stock A/c (at H.P. price)
Load on 'Stock out on hire' or 'Stock with H.P. Customers' or 'H.P. Stock' (Opening)	Stock Reserve A/c Dr. To H.P. Trading A/c
Opening balance of 'Overdue Installments' or 'Installments Due (customers still paying)' or 'H.P. Debtors'	H.P. Trading A/c Dr. To H.P. Debtors A/c
Good sold on H.P. basis (at H.P. price)	H.P. Trading A/c Dr. To Goods sent on H.P. A/c (at H.P. price)
Load on 'Goods sold on H.P.'	Goods sent on H.P. A/c Dr. To H.P. Trading A/c
Transfer of Purchases A/c	General Trading A/c Dr. To Purchases A/c (at cost)
Installments matured	No journal entry
Cash received from H.P. customers	Bank A/c Dr. To H.P. Trading A/c
Expenses relating H.P. Transactions (Hire Expenses)	H.P. Trading A/c Dr. To Hire Expenses A/c
Repossession of goods : • Unmatured Installments on repossessed goods	Repossessed Stock A/c Dr. To H.P. Trading A/c
• Matured Installments / Installments due on repossessed goods	Repossessed Stock A/c Dr. To H.P Trading A/c
• Resale of repossessed goods	Bank A/c To Repossessed Stock A/c
• Value of repossessed stock	No journal entry **N.B.:** It is used to ascertain the 'Loss on Repossession'
• Loss on repossession	H.P. Trading A/c Dr. To Loss on Repossession A/c

Transaction/Items	Journal entry
Closing of 'Goods sent out on H.P. A/c'	Goods sold on H.P. A/c Dr. To Shop/Godown Stock A/c
Closing balance of 'Shop Stock' or Godown Stock'	Shop/Godown Stock A/c Dr. To General Trading A/c
Closing balance of 'Stock out on hire' or 'Stock with H.P. Customers' or 'H.P. Stock	H.P. Stock A/c Dr. To H.P. Trading A/c (at H.P. price)
Load on 'Stock out on hire' or Stock with H.P. Customers or 'H.P. Stock (Closing)	H.P. Trading A/c Dr. To Stock Reserve A/c
Closing balance of 'Overdue Installments' or 'Installments Due (customers still paying)' or 'H.P. Debtors'	H.P. Debtors A/c Dr. To H.P. Trading A/c
Transfer of Profit earned from hire purchase	H.P. Trading A/c Dr. To General Profit & Loss A/c
Transfer of Loss suffered from hire Purchase	General Profit & Loss A/c Dr. To H.P. Trading A/c

Transaction/Items	Recording in Memoranda Accounts
Opening Balance of 'Shop Stock' or 'Godown Stock'	Opening balance in the left side of Memorandum Shop Stock A/c or Memorandum Godown Stock A/c as 'To Balance b/f'.
Opening balance of 'Stock out on hire' or 'Stock with H.P. Customers' or 'H.P. Stock'	Opening balance in the left side of Memorandum H.P. Stock A/c as 'To Balance b/f'.
Load on 'Stock out on hire' or 'Stock with H.P. Customers' or 'H.P. Stock' (Opening)	No recording
Opening balance of 'Overdue Installments' or 'Installments Due (customers still paying)' or 'H.P. Debtors'	Opening balance in the left side of Memorandum H.P. Debtors A/c as 'To Balance b/f'.
Good sold on H.P. basis (at H.P. price)	Left side of Memorandum H.P. Stock A/c as 'To Goods sold on H.P'..
Load on 'Goods sold on H.P.'	No recording
Transfer of Purchases A/c	Left side of Memorandum Shop Stock A/c as 'To Purchases'.

Transaction/Items	Recording in Memoranda Accounts
Installments matured	Right side of Memorandum H.P. Stock A/c as 'By Matured Installments'. Left side of Memorandum H.P. Debtors A/c as 'To Matured Installments'.
Cash received from H.P. customers	Right side of Memorandum H.P. Debtors A/c as 'By Cash Received'.
Expenses relating H.P. Transactions (Hire Expenses)	No recording
Repossession of goods : • Unmatured Installments on repossessed goods	Reflected in the right side of Memorandum H.P. Stock A/c as 'By Goods Repossessed'.
• Matured Installments / Installments due on repossessed goods	Right side of Memorandum H.P Debtors A/c as 'By Goods Repossessed'.
• Resale of repossessed goods	No recording
• Value of repossessed stock	No recording
• Loss on repossession Closing of 'Goods sent out on H.P. A/c'	No recording Right side of Memorandum Shop Stock A/c as 'By Goods sold on H.P. (at cost)'.
Closing balance of 'Shop Stock' or Godown Stock'	Closing balance in the right side of Memorandum Shop Stock A/c or Memorandum Godown Stock A/c as 'By Balance c/f'.
Closing balance of 'Stock out on hire' or 'Stock with H.P. Customers' or 'H.P. Stock	Closing balance in the right side of Memorandum H.P. Stock A/c as 'By Balance c/f'.
Load on 'Stock out on hire' or Stock with H.P. Customers or 'H.P. Stock (Closing)	No recording
Closing balance of 'Overdue Installments' or 'Installments Due (customers still paying)' or 'H.P. Debtors'	Closing balance in the right side of Memorandum H.P. Debtors A/c as 'By Balance c/f'.
Transfer of Profit earned from hire purchase	No recording
Transfer of Loss suffered from hire Purchase	No recording

Proforma of H. P. Trading Account:

Books of Hire Vendor

Dr. Hire Purchase Trading A/c for the year ended …. Cr.

Particulars	(₹)	Particulars	(₹)
To H.P. Stock [at H.P. price: Opening Balance]	xx	By Stock Reserve [Load on Opening Stock]	xx
To H.P. Debtors[Opening Balance]	xx	By Goods sent on H.P. [Load on goods sent]	xx
To Goods sold on H.P. A/c [at H.P.]	xx	By Bank A/c [Cash Received]	xx
To Hire Expenses	xx	By Repossessed Stock A/c	xx
To Loss on Repossession	xx	By H.P. Stock A/c [at H.P. Price: Closing Balance]	xx
To Stock Reserve [Load on Closing Stock]	xx	By H.P. Debtors [Closing Balance]	xx
To General P/L A/c [Profit on H.P transferred (Bal. Fig)]	xx	By General P/L A/c [Loss on H.P transferred (Bal. Fig.)]	xx
	xxx		xxx

[B] STOCK - DEBTORS METHOD

Under this method, the basic principle is to do complete accounting of all hire purchase transactions under double entry system. The ledger accounts that are maintained in this case are: H.P. Stock A/c, H.P. Stock Adjustment A/c, H.P. Debtors A/c, Shop/ Godown Stock A/c (if any) and Goods sold on H.P A/c. In case of repossession of goods by hire vendor, Repossessed Stock A/c is maintained. The profit/loss is determined through H.P. Stock Adjustment A/c.

Under this method, the hire purchase transactions are accounted for as under:

Transaction /Items	Journal Entry/ Treatment
Opening balance of 'Shop Stock' or 'Godown Stock'	Opening balance in Debit side of Shop Stock A/c or Godown Stock A/c or General Trading A/c as 'To, Balance b/f'.
Opening balance on 'Stock out on hire' or 'Stock with H.P. Customers' or 'H.P. Stock	Opening balance in Debit side of H.P Stock A/c as 'To, Balance b/f'.
Opening balance of 'Overdue Installments' or 'Installments Due (customers still paying)' or 'H.P. Debtors	Opening balance in Debit side of H.P. Debtors A/c as 'To, Balance b/f'.
Goods sold on H.P basis (at H.P.price)	H.P. Stock A/c Dr. To Goods sent on H.P. A/c

Transaction /Items	Journal Entry/ Treatment
Transfer of purchases A/c	Shop stock/Godown Stock /General Trading A/c Dr. To Purchases A/c
Installments matured	H.P. Debtors A/c Dr. To H.P. Stock A/c
Cash received from H.P. customers	Bank A/c Dr. To H.P. Debtors A/c
Expenses relating to H.P transactions (Hire Expenses)	H.P. Stock Adjustment A/c Dr. To Bank A/c
Repossession of goods ● Unmatured Installments on repossessed goods	Repossessed Stock A/c Dr. To H.P. Stock A/c
● Matured Installments/ Installments due on repossessed goods	Repossessed Stock A/c Dr. To H.P. Debtors A/c
● Resale of repossessed goods	Bank A/c Dr. To Repossessed Stock A/c
● Value of repossessed stock	Closing balance in Credit side of Repossessed Stock A/c
● Loss of repossession	H.P. Stock Adjustment A/c Dr. To Repossessed Stock A/c
Closing of 'Goods sent out on H.P. A/c'	Goods sent on H.P. A/c Dr. To Shop Stock A/c
Closing balance of 'Shop Stock' or 'Godown Stock'	Closing balance in Credit side of Shop Stock A/c or Godown Stock A/c or General Trading A/c as 'By Balance c/f.'
Closing balance of 'Stock out on hire' or 'Stock with H.P. Customers' or 'H.P. Stock	Closing balance in Credit side of H.P. Stock A/c as 'By Balance c/f'.
Closing balance of 'Overdue Installments' or 'Installments Due (customers still paying)' or 'H.P. Debtors'	Closing balance in Credit side of H.P. Debtors A/c as 'By Balance c/f'.
Transfer of Profit earned from hire purchase	H.P. Stock Adjustment A/c Dr. To General Profit & Loss A/c
Transfer of Loss suffered from hire purchase	General Profit & Loss A/c Dr. To H.P. Stock Adjustment A/c

[C] FINAL ACCOUNTS METHOD or HIRE PURCHASE TRADING (Transaction Approach)

This method is based on the basic principle of complete double entry accounting of all hire purchase transactions. Double entry ledger accounts that are maintained are – H.P. Trading A/c, H.P. Debtors A/c, H.P. Sales A/c.

H.P. Sales Account: It records value of goods sold on hire purchase basis and installments matured during the period. Thus, the closing balance reflects the amount of 'Unmatured installments'.

H.P. Debtors Account: It records value of goods sold on hire purchase basis and the collection from the customers. Closing balance reflects both 'Matured Installments but not yet received (customers paying)' and ' Unmatured Installments'.

Under this method, the operating result (i.e Profit/Loss) gets determined through H.P. Trading Account.

Hire Purchase transactions under this method are accounted as follows:

Transaction /Items	Journal Entry/Treatment
Opening balance of 'Shop Stock' or 'Godown Stock'	Opening balance in Debit side of H.P. Trading A/c as 'To Balance b/f''.
Opening balance of 'Stock out on hire' or 'Stock with H.P. Customers' or 'H.P. Stock	Opening balance in Debit side of H.P. Trading A/c as 'To Balance b/f' at 'Cost Equivalent'. Opening balance in Debit side of H.P. Debtors A/c as 'To Balance b/f'; and Opening balance in Credit side H.P sales A/c as 'By Balance b/f'.
Opening balance of 'Overdue Installments' or Installments Due (customers still paying)' or 'H.P. Debtors	Opening balance in Debit side of H.P. Debtors A/c as 'To Balance b/f'
Goods sent on H.P basis (at H.P. price)	H.P. Debtors A/c Dr. To H.P. Sales A/c
Transfer of Purchases A/c	H.P. Trading A/c Dr. To Purchases A/c
Installments matured (i.e. Recognition of matured installments)	H.P. Sales A/c Dr. To H.P Trading A/c
Cash received from H.P. customers	Bank A/c Dr. To H.P. Debtors A/c
Expenses related to H.P. transactions (Hire Expenses)	H.P. Trading A/c Dr. To Expenses A/c
Repossession of goods • Unmatured installments on repossessed goods	H.P. Trading A/c Dr. To H.P. Debtors A/c
• Matured installments/ Installments due on repossessed goods	H.P. Sales A/c Dr. To H.P. Debtors A/c

Transaction /Items	Journal Entry/Treatment
• Resale of repossessed goods	Bank A/c Dr. To H.P. Trading A/c
• Value of repossessed stock	Closing balance in Credit side of H.P. Trading A/c as 'By Balance c/f'.
• Loss of repossession	No Journal Entry
Closing balance of 'Shop Stock' or 'Godown Stock'	Closing balance in Credit side of H.P. Trading A/c as 'By Balance c/f'.
Closing balance of 'Stock out on hire' or 'Stock out with H.P. Customers' or 'H.P. Stock'	Closing balance in Credit side of H.P. Trading A/c as 'By Balance c/f'.
Closing balance of 'Overdue Installments' or 'Installments Due (customers still paying) or 'H.P. Debtors'	Closing balance in Credit side of H.P. Debtors A/c as ' By Balance c/f'.
Transfer of Profit earned from hire purchase	H.P. Trading A/c Dr. To General Profit & Loss A/c
Transfer of Loss suffered from hire purchase	General Profit & Loss A/c Dr. To H.P. Trading A/c

Format of H.P Trading A/c:

Books of Hire Vendor

Dr. Hire Purchase Trading A/c for the year ended ….. Cr.

Particulars	(₹)	Particulars	(₹)
To Balance b/f:		By H.P Sales [Matured Intsalments]	xx
Stock at shop	xx	By Balance c/f:	
Stock with customer [C.P]	xx	Stock at Shop	xx
To Purchases	xx	Stock with Customer [C.P.]	xx
To Hire Expenses	xx	Repossessed Goods	xx
To General P/L A/c [Profit on H. P transferred (Bal. Fig.)]	xx	By General P/L A/c [Loss on H. P transferred (Bal. Fig.)]	xx
	xxx		xxx

Illustration 15

Beta Ltd. sells its products only on hire purchase terms, the hire purchase price being 'cost plus 33.33%'. From the given information, you are required determine the operating results from the hire purchase transactions by drafting necessary accounts under each of the following methods:

[A] Debtors Method

[B] Stock-Debtors Method

[C] Final Accounts Method

	1.4.2022 (₹)	1.4.2023 (₹)
Stock out on hire at H.P price	2,40,000	?
Stock in hand at shop	30,000	42,000
Installments due from customers	18,000	30,000

Further information:

- Goods repossessed (installments not yet matured ₹ 12,000) valued at ₹ 4,800;
- Purchases made during the year 2022-23 amounted to ₹ 4,08,000;
- Cash collected from customers during 2022-23 was ₹ 4,80,000.

From the given information, you are required independently determine the operating results from the hire purchase transactions by drafting necessary accounts under each of the following methods:

[A] Debtors Method;

[B] Stock-Debtors Method; and

[C] Final Accounts Method.

Method A: Debtors Method

Solution: **Books of Beta Ltd.**

Hire Purchasing Trading Account

Dr. **for the year ended 31.3.2023** **Cr.**

Particulars	(₹)	Particulars	(₹)
To H.P. Stock [at H.P. price: 1.4.2022]	2,40,000	By Stock Reserve [2,40,000 × 1/4]	60,000
To H.P. Debtors [1.4.2022]	18,000	By Goods sent on H.P. [Load: 5,28,000 × ¼]	1,32,000
To Goods sent on H.P. [at H.P. Price – W.N:1]	5,28,000	By Cash Received	4,80,000
		By Goods Repossessed [Unmatured Installments]	12,000
To Loss on Repossession [WN:4]	7,200	By H.P. Stock [at H.P. Price: 31.3.2023-WN:3]	2,64,000
To Stock Reserve [2,64,000 × 1/4]	66,000	By H.P. Debtors [31.3.2023]	30,000
To General P/L A/c [Profit on H.P transferred	1,18,800		
	9,78,000		**9,78,000**

Working Notes:

1. Goods sent on H.P. basis (at H.P. price)

Memorandum Shop Stock Account

Particulars	(₹)	Particulars	(₹)
To Opening Balance	30,000	By Goods sent on H.P [at cost: Bal. Fig.]	3,96,000
To Purchases	4,08,000	By Closing Balance	42,000
	4,38,000		**4,38,000**

Therefore, Goods Sent on H.P [at H.P price] = 3,96,000 + 33 1/3% = ₹ 5,28,000.

2. **Installments Matured during the year**

Memorandum H.P Debtors Account

Particulars	(₹)	Particulars	(₹)
To Opening Balance [Installments due]	18,000	By Cash Received	4,80,000
To Installments Matured [Bal. Fig.]	4,92,000	By Closing Balance [Installments due]	30,000
	5,10,000		**5,10,000**

3. **Balance of H.P. Stock on 31.3.2023**

Memorandum H.P. Stock Account

Particulars	(₹)	Particulars	(₹)
To Opening Balance [stock out on hire purchase at H.P price]	2,40,000	By Intsalments Matured [WN:2]	4,92,000
To Goods sent on H.P [WN:1]	5,28,000	By Goods Repossessed [Unmatured installments]	12,000
		By Closing Balance [Stock with customers at SP – Bal. fig.]	2,64,000
	7,68,000		**7,68,000**

4. **Loss on Repossession** = Installments not yet matured on repossessed goods – Value on repossession = ₹ [12,000 – 4,800] = ₹ 7,200. It is to be debited to H.P. Trading A/c.

   Alternatively, Instead of recording value of "Goods Repossessed" and "Loss on Repossession", the value on repossession ₹ 4,800 may be reflected on the credit side of H.P. Trading A/c.

Method B: Stock-Debtors Method

Books of Beta Ltd.

Dr. Shop Stock Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
1.4.22	To Balance b/f [Opening Stock at Shop]	30,000	31.3.23	By Goods Sent on H.P A/c [Cost Price of goods sent: Bal. Fig.]	3,96,000
31.3.23	To Purchases A/c	4,08,000	31.3.23	By Balance c/f [Closing Stock at shop]	42,000
		4,38,000			**4,38,000**

Dr. Goods Sent on H.P Account Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.3.23	To Shop Stock A/c [Cost of goods sent]	3,96,000	31.3.23	By H.P. Stock A/c [Goods sent at H.P Price]	5,28,000
31.3.23	To H.P Stock Adjustment A/c [Loading on goods sent: 3,96,000 × 1/3]	1,32,000			
		5,28,000			**5,28,000**

Dr. **H.P Stock Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
1.4.22	To Balance b/f [stock with customers at H.P Price]	2,40,000	31.3.23	By H.P. Debtors A/c [Matured Installments]	4,92,000
31.3.23	To Goods sent on H.P A/c [at H.P Price]	5,28,000	31.3.23	By Goods Repossessed A/c	12,000
			31.3.23	By Balnace c/f [Stock with customers at H.P Price: Bal. Fig]	2,64,000
		7,68,000			**7,68,000**

Dr. **H.P. Debtors Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
1.4.22	To Balance b/f [Installments overdue]	18,000	31.3.23	By Bank A/c [Cash Received]	4,80,000
31.3.23	To H.P Stock A/c [Matured Installments: Bal. Fig]	4,92,000	31.3.23	By Balance c/f [Installments overdue]	30,000
		5,10,000			**5,10,000**

Dr. **H.P. Stock Adjustment Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.3.23	To Goods Repossessed A/c [Repossession Loss]	7,200	1.4.22	By Balance b/f [Load on opening H.P Stock: 2,40,000 × ¼]	60,000
31.3.23	To General P/L A/c [H.P Profit transferred]	1,18,800	31.3.23	By Goods Sent on H.P A/c [Load on goods sent: 5,28,000 × ¼]	1,32,000
31.3.23	To Balance c/f [Load on Closing H.P Stock: 2,64,000 × ¼]	66,000			
		1,92,000			**1,92,000**

Dr. **Goods Repossessed Account** Cr.

Date	Particulars	(₹)	Date	Particulars	(₹)
31.3.23	To H.P Stock A/c [Installments not matured]	12,000	31.3.23	By H.P. Stock Adj. A/c [Repossession Loss]	7,200
			31.3.23	By Balance c/f	4,800
		12,000			**12,000**

Method C: Final Accounts Method

Books of Beta Ltd.
Hire Purchase Trading Account
Dr. **for the year ended 31.3.2023** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f:		By H.P Slaes	4,92,000
Stock at shop	30,000	[Matured Intsalments – WN:1]	
Stock with customer	1,80,000	By Balance c/f:	
[2,40,000 × ¾]		Stock at Shop	42,000
To Purchases	4,08,000	Stock with Customer [2,64,000 × ¾] (WN:2)	1,98,000
To General P/L A/c	1,18,800		
[Profit on H. P. transferred]		Repossessed Goods	4,800
	7,36,800		**7,36,800**

Working Notes:

1. **Matured Installments during 2022-23:**

Dr. **H.P. Sales Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To H.P. Trading A/c	4,92,000	By Balance b/f: Stock with customer	2,40,000
[Matured Installments- B/Fig]			
To H.P. Sales A/c [Installment due on repossessed goods]	12,000	By H.P. Debtors A/c	5,28,000
		[Goods sold on H.P. basis – WN:3]	
To Balance c/f:	2,64,000		
Stock with Customer			
	7,68,000		**7,68,000**

2. **Stock with customers at H.P. Price on 31.3.2023:**

Dr. **H.P. Debtors Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/f:		By Cash A/c [Received during the year]	4,80,000
Stock with Customer	2,40,000		
Installment overdue	18,000	By H.P. Sales A/c [Installment due on repossessed goods]	12,000
To H.P. Sales A/c	5,28,000		
[Goods sold on H.P. basis – WN:3]		By Balance c/f:	
		Stock with Customer [Bal. Fig.]	2,64,000
		Installments due	30,000
	7,86,000		**7,86,000**

3. Goods sent on H.P basis (at H.P. Price) during 2022-23

Cost of goods sent under H.P basis :

Opening Shop Stock + Purchases – Closing Shop Stock

= ₹ [30,000 + 4,08,000 - 42,000] = ₹ 3,96,000

∴ Goods sold on H.P. basis at H.P. Price = Cost of goods sold under H.P. basis + Profit

= ₹ 3,96,000 + 33.33 % = ₹ 5,28,000

Exercise

A. Theoretical Questions:

⊙ Multiple Choice Questions

1. In the hire purchase system interest charged by vendor is calculated on the basis of
   (a) Outstanding cash Price
   (b) Hire purchase Price
   (c) Installment amount
   (d) None of the above

2. Excess of hire purchase price over cash price is know as
   (a) Installment
   (b) Cash down payment
   (c) Interest
   (d) Capital value of asset

3. In Hire Purchase system cash price plus interest is know as
   (a) Capital value of asset
   (b) Book value of asset
   (c) Hire purchase price of asset
   (d) Hire purchase charges

Answer:

1	A	2	C	3	C

⊙ State True or False

1. The buyer gets immediate possession but not ownership of the asset under installment payment system on signing of contract.
2. The possession and ownership of the asset is immediately transferred to the buyer under Hire- purchase system on signing the contract.
3. Down payment plus installments including interest is termed as cash price .
4. The Hire-purchaser records the asset at Hire-purchase price .
5. Repossession of the asset is done by Hire-vendor due to non-payment of installments in due time.
6. Hire purchase price = Cash price + Total Interest
7. In hire purchase system, ownership of the goods passes from the seller to the buyer only when the full and final payment is made.
8. The difference between the hire purchase price and cash price of the asset is known is known as Total Interest.

9. There is no difference between hire purchase and installment purchase system.
10. Each installment is treated as hire charges till the last installment is paid.

Answers:

1	**False**	**2**	**False**	**3**	**False**	**4**	**False**	**5**	**True**
6	**True**	**7**	**True**	**8**	**True**	**9**	**False**	**10**	**True**

Fill in the Blanks

1. Selling price under Hire-purchase basis is___________ than selling price under cash basis.
2. In case of a Hire-purchase sale the act of revival of custody of the asset is called ___________.
3. The buyer gets possession and ownership of the asset under_____________system right from signing the contract.
4. Under Hire- purchase system ownership of the asset is transferred as soon as _______________ last installment is paid.
5. Every installment paid under Hire-purchase system consists of partly ______________ and partly interest charge.
6. A machinery was purchased on Hire Purchase System. Its cash price was ₹ 5,20,000 which was payable in annual installments of ₹ 1,80,000 each including interest @ 15 per cent per annum. The amount of interest included in 2nd installment would be _______________.
7. The persons who obtained delivery of possession of goods from the owner under the hire purchase agreement is known as _______________.
8. The different between the net hire purchase price and net cash price of the goods is termed as __________.
9. When an asset is acquired on hire purchase system, the asset account is debited with _______________ of the asset in the book of the hire purchaser.
10. The initial amount paid in hire purchase system is called _______________.

Answer:

1	**more**	2	**repossession**
3	**installment**	4	**last**
5	**capital payment**	6	**₹ 62,700**
7	**Hirer**	8	**Hire purchase charges**
9	**Cash price**	10	**Down payment**

B. Numerical Questions

Multiple Choice Questions

1. Shiva purchased a laptop on hire-purchase system. As per terms, he is required to pay ₹ 7,500 down,

₹10,000 at the end of first year, ₹7,500 at the end of second year, and ₹12,500 at the end of third year. Interest is charged at 12% per annum. The interest payable with the installment at the end of second year will be

(a) ₹900

(b) ₹1,999

(c) ₹804

(d) ₹1,760

2. Arti Ltd. purchased a machine on hire purchase system for a cash price ₹5,00,000 to be paid as ₹78,700 cash down and the balance by three equal annual installment of ₹ 2,00,000 each. If interest is charged @ 20% per annum then amount of interest payable in second installment will be

(a) ₹1,00,000

(b) ₹61,112

(c) ₹33,328

(d) ₹84,260

Answer:

1	**B**	**2**	**B**

Comprehensive Numerical Problems

1. On 01.01.2021 Dola Ltd. purchased a Taxi from Sayan Ltd., on hire purchase system. A Down payment of ₹15,000 and 3 equal installments together with interest @ 5% per annum on the outstanding balance of capital sum are to be made. The amount of last installment payment was ₹15,750. Depreciation has to be provided @ 10% under reducing balance method.

   At the end of 3rd year the taxi was sold for ₹25,000 in cash.

   Prepare Taxi Account and Vendor Account in the books of Dola Ltd.

   [Answer Hint: Depreciation on 31.12.2020 — 31.12.2021 ₹6,000

   31.12.2022 ₹5,400

   31.12.2023 ₹4,860

   Interest for 2021 — ₹2,250

   2022 — ₹1,500

   2023 — ₹750]

2. On 1st April, 2021 Gauru & Co. purchased a machinery on hire purchases system from Machinery Mart for a cash price of ₹ 7,50,000 to be paid as ₹ 1,18,050 cash down and the balance by three equal annual installments of ₹ 3,00,000 each. Interest is charged @ 20% per annum. Gauru & Co. has decided to write off depreciation on machinery @ 15% per annum on diminishing balance method. Gauru & Co. paid the installment due at the end of the first year but could not pay the next installments. On 31st March, 2023 the Machinery Mart took the possession of the machinery. On 15th April, 2023 the Machinery Mart spent ₹30,000 on the repairs of the machinery and sold it for ₹1,80,000 on 20th April, 2023. Installment due on 31.03.2023 was paid by Gauru & Co. on 10th April. You are required to prepare:

(i) Gauru & Co.'s Account and Returned Stock Account in the books of Machinery Mart.

(ii) Machinery Account and Machinery Mart's Account in the books of Gauru & Co.

Answer Hint:

Calculation of Interest included in each installment.

Installment	Amount of Installment (₹)	Interest (₹)	Payment of Cash Price (₹)
1	3	4	(3 - 4)= 5
Cash down on 1-04-2021	1,18,050	—	1,18,050
(i) 31-03-22	3,00,000	6,31,950 × (20/100) = 1,26,390	1,73,610
(ii) 31-3-23	3,00,000	4,58,340 × (20/100)	2,08,332
(iii) 31-03-24	3,00,000	49,992	2,50,008

3. On 1st April, 2020 Guru purchased a machinery for cash price of ₹5,06,872 on hire purchase system from Machinery Mart. Payment to be made ₹1,50,000 down and the balance by four equal annual installments. Interest is charged @ 15% per annum. Guru depreciates machinery at 20% per annum on written down value method. Guru paid down payment and first two installments but could not pay the remaining installments. On 31st March, 2023 the Machinery Mart took possession of machinery.

   You are required to prepare Machinery Account and Machinery Mart Account in the books of Guru.

   Since the problem is silent regarding the amount of equal installment, it is assumed that the balance of cash price will be paid equally along with the interest on the amount outstanding.

Answer:

Calculation of Interest

Opening Cash Price (₹)	Installment (₹)	Interest (₹)	Payment of Principle (₹)
5,06,872	1,50,000	—	1,50,000
3,56,872	1,42,749	3,56,872 × 15% = 53,531	89,218
2,67,654	1,29,366	2,67,654 × 15% = 40,148	89,218
1,78,436	1,15,972	1,78,436 × 15% = 26,754	89,218
89,218	1,02,601	89,218 × 15%= 13,383	89,218

4. Exe Ltd. purchased a vehicle for ₹2,80,000, down payment to be made ₹91,000 and 3 installments of ₹76,000 each at the end of each year. Rate of interest is charged at 10% p.a.

   Buyer depreciates assets at 15% on written down value method.

   Because of financial difficulties, Exe Ltd. after having paid the down payment and first installment at the end of 1st year, could not pay the second installment. Hence, the seller took possession of the vehicle. The Seller after spending ₹ 9.200 on repairs of the asset, sold it for ₹1,50,000. Show the relevant accounts in the books of the purchaser and the vendor.

Answer:

Calculation on Interest

Particulars	Total Cash Price (₹)	Installment Paid @10% Int. (₹)	Interest Paid (₹)	Paid towards Cash Price (installment -Int.) (₹)
	2,80,000			
Down Payment	91,000	91,000	NIL	91,000
	1,89,000			
End of 1st year	57,100	76,000	18,900	57,100
	1,31,900			
End of 2nd year	62,810	76,000	13,190	62,810
	69,090			
End of 3rd year	69,090	76,000	6,910	69,090
TOTAL	Nil	3,19,000	39,000	2,80,000

5. Rudra Transporter purchases a truck on hire purchase from Sarkar Motor for ₹56,000 on January 1, 2021. Payment to be made as ₹15,000 down cash and 3 installments of ₹15,000 each at the end of each year. Rate of interest is charged at 5% p.a. Buyer depreciates assets at 10% p.a. on written down value method, because of financial difficulties Rudra Transporter after having paid the down cash and the first installment at the end of the first year could not pay the second installment and Sarkar Motors took possession of the Truck.

   Prepare (a) Truck Account (b) Seller's Account in the books of the buyer assuming that year ends on 31st December.

   [**Answer:** Value of Surrendered Asset ₹29,453, Transfer to Profit & Loss A/c ₹15,907]

6. Ashis purchased seven Machines on hire-purchase on 1st July 2022. The Cash Price of each Machine was ₹50,000. He was to pay 20% of Cash Price at the time of delivery and the balance of five half- yearly installments starting from 31.12.2022 with interest at 5% per annum. On his failure to pay the installment due on 30th June, 2023, it was agreed that Ashis would return three machines to the vendor and the remaining four machines would be retained by him. The returning price of three machines was ₹40,500. Ashis charges depreciation @ 20% per annum. Vendor after spending ₹ 1,000 on repairs sold away all the three machines for ₹40,000.

   Show Machines Account and Vendor's Account in the books of Ashis and Ashis' Account and Goods Repossessed Account in the books of the Vendor assuming that their books are closed on 30th June each year.

[**Answer:** Loss on Surrender ₹79,500, Transfer to Profit & Loss A/c ₹1,500]

7. Go-kart Logistics acquired a delivery van on hire purchase on 01.04.2023 from Ashima Enterprises. The terms were as follows:

Particulars	Amount (₹)
Hire Purchase Price	180,000
Down Payment	30,000
1st installment payable after 1 year	50,000
2nd installment after 2 years	50,000
3rd installment after 3 years	30,000
4th installment after 4 years	20,000

Cash price of van ₹ 1,50,000. You are required to calculate Total Interest and Interest included in each installment.

[**Answer:** Total Interest ₹30,000, Interest rate implicit on lease (IRR) 11.39%, Interest included in each installment ₹30,182]

SECTION-F

Accounting Standards

Accounting Standards 9

This Module Includes

Accounting Standards

SLOB Mapped against the Module

To gain application-oriented knowledge on identifying the impact of various standards on treatment of certain transactions to ensure appropriate reporting. (CMLO 4a, c)

Module Learning Objectives:

After studying this module, the students will be able to:

- Understand the basic concept of Accounting Standards;
- Get an overview of certain specified accounting standards (namely AS 1, AS 3, AS 10, AS 11, AS 12, AS 16 and AS 22) along withtheir comparative provisions with Indian Accounting Standards (Ind AS).

Introduction to Accounting Standards

9.1

Accountancy is often referred to as an art of recording, classifying and summarizing financial information, which involves the use of accountant's creative skills. However, if full independence is provided to the accountants regarding the accounting system and practices to be followed, it is bound to result in lack of uniformity, and in some cases may end up in manipulation of accounts. Thus, there arises a need for an accounting framework on the basis of which the financial transactions should be recorded in the books of accounts and ultimately make the resulting financial statements comparable. This need led to the framing of the Generally Accepted Accounting Principles (GAAP).

9.1.1 Generally Accepted Accounting Principles (GAAP)

The main objective of accounting is to provide financial information to the stakeholders, thus helping them in taking informed decisions. This financial information is normally communicated via the financial statements, which happen to be the interface between an organisation and its stakeholders. The financial statements are prepared from the information contained in the books of accounts, which are based on certain Generally Accepted Accounting Principles (GAAP).

In simple terms, Generally Accepted Accounting Principles (GAAP) is a collection of commonly followed accounting rules and standards meant for accounting of transactions and ultimately their reporting. It is an embodiment of rules and standards which are accepted and practiced by the accountants. GAAP contains a set of accounting standards, principles, and procedures that accountants must follow. These are basic accounting principles and guidelines which provide the framework for more detailed and comprehensive accounting rules, standards and other industry-specific accounting practices.

9.1.2 Accounting Standards (AS)

Accounting Standards are written policy documents which discuss the aspects of recognition, measurement and treatment of specific accounting transactions, along with the presentation and disclosure thereof in the financial statements of an entity. These are usually issued by specified professional accounting bodies, or by the government, or other regulatory bodies. In India, accounting standards are governed by The Institute of Chartered Accountants of India (ICAI). In the US, the American Institute of Certified Public Accountants (AICPA) is responsible to lay down the standards. The Financial Accounting Standards Board (FASB) is the body that sets up the International Accounting Standards. These standards basically deal with accounting treatment of business transactions and disclosing the same in financial statements.

In India, the Accounting Standards for non-corporate entities including Small and Medium sized Enterprises, are issued by the Accounting Standards Board (ASB) of Institute of Chartered Accountants of India (ICAI), to establish uniform standards for preparation of financial statements, in accordance with the Indian GAAP (Generally Accepted Accounting Practices), for better understanding of the users. However, in the case of corporate entities, the Accounting Standards notified by the MCA are applicable. These standards are mandatory on and from the dates specified either in the respective document or as may be notified by the ICAI/ MCA.

It may be noted that MCA also issues the Accounting Standards for companies, based on recommendations made by the ICAI. Accordingly MCA notifies such Accounting Standards vide Companies (Accounting Standards) Rules and amendments thereto, applicable for companies including Small and Medium Sized Companies to whom Indian Accounting Standards (Ind AS) are not applicable.

9.1.3 Convergence to Indian Accounting Standards (Ind AS) – Applicability and Scope

In the context of financial accounting and reporting, convergence refers to the process of harmonising the accounting standards issued by various regulatory bodies of different countries of the world. It refers to the goal of establishing a single set of high quality accounting standard that will be used internationally , and in particular the effort to reduce differences between the local generally accepted accounting practice and International Financial Reporting Standards (IFRS). IFRS are a set of accounting standards developed by the International Accounting Standards Board (IASB). These are the global standards for the preparation of public company financial statements

The objective of the convergence exercise is to produce a common set of high quality accounting standards to enhance the consistency, comparability and efficiency of financial statements.

There are two aspects to the concept of convergence of accounting standards:

- **International-level Convergence:** It is the process within which the International Accounting Standards Board (IASB) and National Standard-Setters (NSS) converge their respective accounting standards into one global set of accounting regulations. This concept of a single global comprehensive set of accounting standards is a conceptual ideal. It would help to ensure the comparability of financial statements. Further, it would allow companies to enjoy a lower cost of capital as a result of their financial statements being more readily comprehended and understood. A single set of accounting standards would also ensure lower barriers to the free movement of accountants in business across jurisdictions.
- **National-level Convergence:** This involves the adoption of the international accounting standards as national GAAP. For example, the Institute of Chartered Accountants of India (ICAI) has converged its accounting standards with those of the IASB. The two aspects are clearly intertwined, the IASB works with the national standard setting body in one country to converge IFRS and local generally accepted accounting practices, which has implications for the convergence of local GAAP in another country with IAS.

In the Indian context, convergence means that the Indian Accounting Standards and the International Financial Reporting Standards would, over time, continue working together to develop high quality, compatible accounting standards. It would be worth noting here that conceptually 'convergence of accounting standards' is different from that of 'adoption of accounting standards' which means full-fledged use of IFRS as issued by the IASB by the Indian public companies.

The Indian Accounting Standards (Ind AS), as notified under section 133 of the Companies Act 2013, have been formulated keeping the Indian economic & legal environment in view and with a view to converge with IFRS Standards as issued by the IFRS Foundation.

Applicability and Scope of Ind AS

Ind AS are the Indian version of IFRS which are global standards governing the accounting aspects. These are basically standards that have been harmonised with the IFRS to make reporting by Indian companies more globally accessible. The Ministry of Corporate Affairs (MCA), in 2015, had notified the Companies (Indian Accounting Standards) Rules 2015, which stipulated the adoption and applicability of IND AS in a phased manner beginning from the Accounting period 2016-17. The MCA has since issued seven Amendment Rules, one each in year 2016, 2017, 2018, 2019, 2020, 2021 and 2022 to amend the original 2015 rules.

Following is the timeline of applicability of Ind AS:

A. For Companies other than the Banks, Non-banking Financial Companies, and Insurance Companies

Phase-I

1. 1st April 2015 and onwards: Application on a voluntary basis for all the companies along with comparatives.
2. 1st April 2016: Mandatory for the following companies:
   - Companies listed or in the process of listing in India or outside India with a net worth equal to or more than ₹ 500 crores
   - Unlisted companies having a net worth equal to or more than ₹ 500 crores
   - Holding, subsidiary, joint venture, and associate of the above companies

Phase-II: From 1st April 2017

- All the companies that are listed or in the process of listing in India or outside India that are not covered in Phase-I
- Unlisted companies with a net worth of ₹ 250 crores or above but less than ₹ 500 crores
- Holding, subsidiary, joint venture, and associate of the above companies

In this respect, the following points are to be noted:

- Companies that are listed on the SME exchange are not required to apply Ind AS on a mandatory basis
- Once the company starts to follow Ind AS, whether voluntarily or mandatorily, then it shall follow Ind AS for all the subsequent financial statements even though any of the criteria does not subsequently apply to it.
- The companies who satisfy the above criteria in an accounting year shall immediately apply the Ind AS in subsequent accounting year with comparatives. The Ind AS shall be applicable on both standalone and consolidated financial statements.
- The remaining companies not covered above shall continue to apply the existing Accounting Standards as notified in the Companies (Accounting Standards) Rules, 2006.

B. For Scheduled Commercial Banks (excluding Regional Rural Banks), Non-Banking Financial Companies, Insurers, and Insurance Companies

(1) Non-Banking Financial Companies (NBFCs)

Phase-I: From 1st April 2018:

- Listed or unlisted NBFCs with a net worth of ₹ 500 crores or more
- Holding, subsidiary, joint venture, and associate companies of the above companies excluding those that are already covered under the corporate roadmap.

Phase-II: From 1st April 2019

- NBFCs with a net worth of less than ₹ 500 crores whose equity or debt securities are listed or in the process of listing on the stock exchange in India
- Unlisted NBFCs with a net worth of ₹ 250 crores or more but less than ₹ 500 crores
- Holding, subsidiary, joint venture, and associate companies of the above companies excluding those that are already covered under the corporate roadmap.

In this respect, the following points are to be noted:

The Ind AS shall be applied on both standalone and consolidated financial statements. Also, NBFCs with a net worth of less than ₹ 250 crores shall not apply Ind AS on a voluntary basis.

(2) Scheduled Commercial Banks (Excluding Regional Rural Banks)

Ind AS were required to be implemented by Scheduled Commercial Banks (excluding RRBs) from 1st April 2018. However, presently it stands deferred till further notice.

(3) Insurance Companies / Insurers

The insurance companies were required to prepare Ind AS based stand-alone and consolidated financial statements for FY 2018-19 with comparatives of FY 2017-18. The IRDA issued a circular under Section 34 of the Insurance Act, 1938, which mandates insurers to comply with Ind AS and its implementation Roadmap issued by the MCA.

Specified Accounting Standards with Comparative Provisions under Ind AS

9.2

Disclosure of Accounting Policies Accounting Standard (AS) 1

This Standard deals with the disclosure of significant accounting policies followed in preparing and presenting financial statements.

Accounting policies refer to specific accounting principles and the method of applying those principles adopted by an enterprise in preparation and presentation of the financial statements.

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. There are various areas where more than one accounting methods or treatments can be applied.

The choice of the appropriate accounting principles and the methods of applying those principles in the specific circumstances of each enterprise calls for considerable judgement by the management of the enterprise.

Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.

Need for disclosure of Accounting Policies

For proper and better understanding of financial statement, it is necessary to follow all the significant account policies in preparation and presentation of financial statements, because assets and liabilities in balance sheet and profit and loss account are significantly affected by accounting policies followed.

All significant accounting policies followed should be disclosed at one place for the benefit of the reader of the financial statement.

Fundamental Accounting Assumptions

Certain fundamental accounting assumptions are followed in preparation and presentation of financial statements. Disclosure is necessary if they are not followed.

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 the scale of the operations.

b. Consistency

   It is assumed that accounting policies are consistent from one period to another.

c. Accrual

It means that the financial statement is prepared on mercantile system only. Whenever revenues and costs are accrued, that is, recognised as they are earned or incurred and recorded in the financial statements of the periods to which they relate.

Areas in Which Differing Accounting Policies are Encountered

The following are examples of the areas in which different accounting policies may be adopted by different enterprises.

(a) Methods of depreciation, depletion and amortisation

(b) Treatment of expenditure during construction

(c) Conversion or translation of foreign currency items

(d) Valuation of inventories

(e) Treatment of goodwill

(f) Valuation of investments

(g) Treatment of retirement benefits

(h) Recognition of profit on long-term contracts

(i) Valuation of fixed assets

(j) Treatment of contingent liabilities.

The above list of examples is not intended to be exhaustive.

Selection of Accounting Policies

The primary consideration in the selection of accounting policies by an enterprise is 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.

The major considerations governing the selection and application of accounting policies are:

a. Prudence

In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised 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

- 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.
- Such disclosure should form part of the financial statements.
- 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.
- Examples of matters in respect of which disclosure of accounting policies adopted will be required.
- 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.
- Disclosure of accounting policies or of changes therein cannot remedy a wrong or inappropriate treatment of the item in the accounts.

Illustration 1

Jivandeep Ltd. had made a right issue in 2021. In the offer document to its members, it had projected a surplus of ₹ 40 crores during the accounting year to be ended on 31st March 2023. The draft results for the year prepared on the hitherto followed accounting policies and presented for perusal of the Board of Directors showed a deficit of ₹ 10 crores. The Board, in consultation with the Managing Director, decided on the following:

(i) Value year-end inventory at works cost (₹50 crores) instead of the hitherto method of valuation of inventory at Prime Cost (₹ 30 crores).

(ii) Provide depreciation for the year on straight line basis or account of substantial additions in gross block during the year, instead of on the Reducing Balance Method, which had been hitherto adopted. As a consequence, the charge for depreciation at ₹ 27 crores is lower than the amount of ₹ 45 crones -which would have been provided had the old method been followed-by ₹ 18 crores.

(iii) Not to provide for "after-sales expenses" during the warranty period. Till the last year, provision at 2% on sales used to be made under the concept of "matching of cost against revenue" and actual expenses used to be charged against the provision. The Board now decided to account for expenses as and when actually incurred. Sales during the year total to ₹ 600 crores.

(iv) Provide for permanent fall in the value of investment-which fall had taken place over the past 5 years-the provision being ₹ 10 crores. As chief accountant of the company, you are asked by the Managing Director to draft the Notes on Accounts for inclusion in the annual report for 2022-2023.

Solution:

According to AS 1: "in the case of a change in accounting policies which has a material effect in the current period should be disclosd, 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." Naturally, the **Notes on Accounts** must disclose the change.

Notes on Accounts

(i) Till last year, it was the practice of valuing inventory at prime cost but during the year the same was valued at works cost. Due to this change the closing inventory was valued at ₹ 50 crores and, accordingly, profit was increased by ₹ 20 crores (i.e. ₹ 50 crores - ₹ 30 crores) due to the change of the method of valuation.

(ii) During the year the company decided to change the method of providing for depreciation from reducing balance method to straight line method. Due to this change, the amount of depreciation was undercharged i.e., instead of charging ₹ 45 crores it was charged by ₹ 27 crores and, as a consequence, the profit was increased by ₹ 18 crores (i.e., ₹ 45 crores minus ₹ 27 crores).

(iii) It was the practice of the company to make provision of @ 2% on sales for 'After-Sales expenses' during the warranty period. It may be assumed that as a result of improved techniques and methods in production the possibility of defects became very rare. Consequently, the company took decision not to make any provision for after -sales expense' during warranty period. As a result of this change, the profit would be increased by ₹ 12 crores.

(iv) As a result of permanent fall in the value of investments which took place over the last 5 years the company decided to make provision to the extent of ₹ 10 crores. Due to this effect the profit would be reduced by ₹ 10 crores.

Illustration 2

Which one is the correct one? Fundamental accounting assumptions as per AS 1 are:

(a) Going Concern, Matching and Consistency;

(b) Money Measurement, Going Concern and Prudence;

(c) Accounting Period, Going Concern and Entity Concept; and

(d) Going Concern, Consistency and Accruals.

Solution:

As per As 1, the fundamental accounting assumptions are: Going Concern, Consistency and Accruals.

Illustration 3

Explain, in short, the relevant Disclosures of Accounting Policies as per AS 1.

Solution:

As per AS 1, the Disclosures of Accounting Policies are: All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.

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.

Any change in the accounting policies which has a material effect in the current period or 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.

If the fundamental accounting assumptions, viz, Going Concern, Consistency and Accruals, are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

Illustration 4

Explain the methods/criteria for the selection and application of Accounting Policies.

Solution:

The major considerations governing the selection and application of accounting policies are:

Prudence – Generally maker of financial statement has to face uncertainties at the time of preparation of financial statement. These uncertainties may be regarding collectability of recoverable, number of warranty claims that may occur. Prudence means making of estimates that are required under conditions of uncertainty.

Substance over form – It means that transaction should be accounted for in accordance with actual happening and economic reality of the transactions not by its legal form.

Materiality – Financial Statement should disclose all the items and facts which are sufficient enough to influence the decisions of reader or/ user of financial statement.

Property Plant and Equipment (AS 10)

Objective:

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about investment made by an enterprise in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Scope / Applicability:

This Standard should be applied in accounting for property, plant and equipment except when another Accounting Standard requires or permits a different accounting treatment.

This Standard does not apply to:

a) Biological assets related to agricultural activity other than bearer plants. This Standard applies to bearer plants but it does not apply to the produce on bearer plants; and

b) Wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (a) and (b) also.

Other Accounting Standards may require recognition of an item of property, plant and equipment based on an approach which is different from this Standard.

However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

Investment property, as defined in AS 13, Accounting for Investments, should be accounted for only in accordance with the cost model prescribed in this standard.

Important Terminology:

Agricultural Activity is the management by an enterprise of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

Agricultural Produce is the harvested product of biological assets of the enterprise.

Bearer plant is a plant that:

a) is used in the production or supply of agricultural produce;

b) is expected to bear produce for more than a period of twelve months; and

c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

The following are not bearer plants:

i. plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber);

ii. plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and

iii. annual crops (for example, maize and wheat).

When bearer plants are no longer used to bear produce they might be cut down and sold as scrap, for example, for use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a bearer plant.

Biological Asset is a living animal or plant.

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Accounting Standards.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Enterprise -specific value is the present value of the cash flows an enterprise expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

Gross carrying amount of an asset is its cost or other amount substituted for the cost in the books of account, without making any deduction for accumulated depreciation and accumulated impairment losses.

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Property, plant and equipment are tangible items that:

a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

b) are expected to be used during more than a period of twelve months.

Recoverable amount is the higher of an asset's net selling price and its value in use.

The residual value of an asset is the estimated amount that an enterprise would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:

a) the period over which an asset is expected to be available for use by an enterprise ; or

b) the number of production or similar units expected to be obtained from the asset by an enterprise.

Recognition:

- The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:

  a) it is probable that future economic benefits associated with the item will flow to the enterprise; and

  b) the cost of the item can be measured reliably.

- Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Standard when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

- This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to specific circumstances of an enterprise.

- An enterprise evaluates under this recognition principle all its costs on property, plant and equipment at the time they are incurred. These costs include costs incurred:

  a) initially to acquire or construct an item of property, plant and equipment; and

  b) subsequently to add to, replace part of, or service it.

Initial Costs:

The definition of 'property, plant and equipment' covers tangible items which are held for use or for administrative purposes. The term 'administrative purposes' has been used in wider sense to include all business purposes other than production or supply of goods or services or for rental for others. Thus, property, plant and equipment would include assets used for selling and distribution, finance and accounting, personnel and other functions of an enterprise. Items of property, plant and equipment may also be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an enterprise to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the enterprise is unable to manufacture and sell chemicals. The resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with AS 28, Impairment of Assets.

Subsequent Costs:

- Under the recognition principle (as mentioned above), an enterprise does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-today servicing of the item. Rather, these costs are recognised in the statement of profit and loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.

- Parts of some items of property, plant and equipment may require replacement at regular intervals or it may require replacement several times. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement or to make a non-recurring replacement. Under the recognition principle (as discussed above), an enterprise recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the 'derecognition provisions' of this Standard.

- A condition of continuing to operate an item of property, plant and equipment may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection is derecognised.
- The derecognition of the carrying amount occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, it may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

Measurement at Recognition:

An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost.

Elements of Cost:

The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non –refundable purchase taxes,, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'decommissioning, restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Measurement of Cost:

- The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with AS 16.
- One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

The acquired item(s) is/are measured in this manner even if an enterprise cannot immediately derecognise the asset given up. If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.

- An enterprise determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:
  (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
  (b) the enterprise-specific value of the portion of the operations of the enterprise affected by the transaction changes as a result of the exchange;
  (c) and the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.
- For the purpose of determining whether an exchange transaction has commercial substance, the enterprise -specific value of the portion of operations of the enterprise affected by the transaction should reflect post-tax cash flows. In certain cases, the result of these analyses may be clear without an enterprise having to perform detailed calculations.
- The fair value of an asset is reliably measurable if (a) the variability in the range of reasonable fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value. If an enterprise is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.
- Where several items of property, plant and equipment are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition. In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent valuers.

Measurement after Recognition:

An enterprise should choose either the cost model or the revaluation model as its accounting policy and should apply that policy to an entire class of property, plant and equipment. It is discussed hereunder:

(a) Cost Model:

After recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

(b) Revaluation Model:

- After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.
- The fair value of items of property, plant and equipment is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.
- If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an enterprise may need to estimate fair value using an income approach (for example, based on discounted cash flow projections) or a depreciated replacement cost approach which aims at making a realistic estimate of the current cost of acquiring or constructing an item that has the same service potential as the existing item.

- The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.
- When an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:
  a. the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset; or
  b. the accumulated depreciation is eliminated against the gross carrying amount of the asset.
- If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued.
- The items within a class of property, plant and equipment are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.
- An increase in the carrying amount of an asset arising on revaluation should be credited directly to owners' interests under the heading of revaluation surplus. However, the increase should be recognised in the statement of profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in the statement of profit and loss.
- A decrease in the carrying amount of an asset arising on revaluation should be charged to the statement of profit and loss. However, the decrease should be debited directly to owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.
- The revaluation surplus included in owners' interests in respect of an item of property, plant and equipment may be transferred to the revenue reserves when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset issued by an enterprise. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on its original cost. Transfers from revaluation surplus to the revenue reserves are not made through the statement of profit and loss.

Depreciation:

- Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.
- An enterprise allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates each such part separately. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
- A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

- To the extent that an enterprise depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an enterprise has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.
- An enterprise may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.
- The depreciation charge for each period should be recognised in the statement of profit and loss unless it is included in the carrying amount of another asset.
- The depreciation charge for a period is usually recognised in the statement of profit and loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see AS 2). Similarly, the depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognised in accordance with AS 26, Intangible Assets.

Depreciable Amount and Depreciation Period:

- The depreciable amount of an asset should be allocated on a systematic basis over its useful life.
- The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.
- Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Repair and maintenance of an asset do not negate the need to depreciate it.
- The depreciable amount of an asset is determined after deducting its residual value.
- The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.
- Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is retired from active use and is held for disposal and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated. However, under usage methods of depreciation, the depreciation charge can be zero while there is no production.
- The future economic benefits embodied in an asset are consumed by an enterprise principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

  a. expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.

b. expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

c. technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

d. legal or similar limits on the use of the asset, such as the expiry dates of related leases.

- The useful life of an asset is defined in terms of its expected utility to the enterprise. The asset management policy of the enterprise may involve the disposal of assets after as pecified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgment based on the experience of the enterprise with similar assets.
- Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.
- If the cost of land includes the costs of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

Depreciation Method:

- The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.
- The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.
- A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the residual value of the asset does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The enterprise selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits or that the method is changed in accordance with the statute to best reflect the way the asset is consumed.
- A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed.

Changes in Existing Decommissioning, Restoration and Other Liabilities:

- The cost of property, plant and equipment may undergo changes subsequent to its acquisition or construction on account of changes in liabilities, price adjustments, changes in duties, changes in initial estimates of amounts provided for dismantling, removing, restoration and similar factors and included in the cost of the asset. Such changes in cost should be accounted for as under:

If the related asset is measured using the cost model:

- Changes in the liability should be added to, or deducted from, the cost of the related asset in the current period.
- The amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the statement of profit and loss.
- If the adjustment results in an addition to the cost of an asset, the enterprise should consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the enterprise should test the asset for impairment by estimating its recoverable amount, and should account for any impairment loss, in accordance with AS 28.

If the related asset is measured using the revaluation model:

- Changes in the liability alter the revaluation surplus or deficit previously recognised on that asset, so that:
  - a decrease in the liability should be credited directly to revaluation surplus in the owners' interest, except that it should be recognised in the statement of profit and loss to the extent that it reverses a revaluation deficit on the asset that was previously recognised in the statement of profit and loss;

  An increase in the liability should be recognised in the statement of profit and loss, except that it should be debited directly to revaluation surplus in the owners' interest to the extent of any credit balance existing in the revaluation surplus in respect of that asset.
- In the event that a decrease in the liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess should be recognised immediately in the statement of profit and loss.
- A change in the liability is an indication that the asset may have to be revalued in order to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Any such revaluation should be taken into account in determining the amounts to be taken to the statement of profit and loss and the owners' interest. If are valuation is necessary, all assets of that class should be revalued.

The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability should be recognised in the statement of profit and loss as they occur. This applies under both the cost model and the revaluation model.

Impairment:

To determine whether an item of property, plant and equipment is impaired, an enterprise applies AS 28, Impairment of Assets. AS 28 explains how an enterprise reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss.

Compensation for Impairment:

- Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up should be included in the statement of profit and loss when the compensation becomes receivable.

- Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:
    - Impairments of items of property, plant and equipment are recognized in accordance with AS 28;
    - Derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
    - Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and
    - The cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with this Standard.

Retirements:

Items of property, plant and equipment retired from active use and held for disposal should be stated at the lower of their carrying amount and net realizable value. Any write-down in this regard should be recognised immediately in the statement of profit and loss.

Derecognition:

- The carrying amount of an item of property, plant and equipment should be derecognised
    - on disposal; or
    - when no future economic benefits are expected from its use or disposal.
- The gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognised (unless AS 19, Leases, requires otherwise on a sale and leaseback).Gains should not be classified as revenue, as defined in AS 9, Revenue Recognition.
- However, an enterprise that in the course of its ordinary activities, routinely sells items of property, plant and equipment that it had held for rental to others should transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale. The proceeds from the sale of such assets should be recognised in revenue in accordance with AS 9, Revenue Recognition.
- The disposal of an item of property, plant and equipment may occur in a variety of ways (e.g. by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an enterprise applies the criteria in AS 19 for recognizing revenue from the sale of goods. AS 19, Leases, applies to disposal by a sale and lease back.
- If, under the recognition principle, an enterprise recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an enterprise to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.
- The gain or loss arising from the derecognition of an item of property, plant and equipment should be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.
- The consideration receivable on disposal of an item of property, plant and equipment is recognised in accordance with the principles enunciated in AS 9.

Disclosure:

- The financial statements should disclose, for each class of property, plant and equipment:
  - a) the measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;
  - b) the depreciation methods used;
  - c) the useful lives or the depreciation rates used. In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;
  - d) the gross carrying amount and the accumulated depreciation(aggregated with accumulated impairment losses) at the beginning and end of the period; and
  - e) a reconciliation of the carrying amount at the beginning and end of the period showing: additions; assets retired from active use and held for disposal; acquisitions through business combinations; increases or decreases resulting from revaluations and from impairment losses; recognised or reversed directly in revaluation surplus in accordance with AS 28;impairment losses recognised in the statement of profit and loss in accordance with AS 28;impairment losses reversed in the statement of profit and loss in accordance with AS 28;depreciation;the net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11, The Effects of Changes in Foreign Exchange Rates; and other changes.
- The financial statements should also disclose: the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities; the amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction; the amount of contractual commitments for the acquisition of property, plant and equipment; if it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and the amount of assets retired from active use and held for disposal.
- Selection of the depreciation method and estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other enterprises. For similar reasons, it is necessary to disclose: depreciation, whether recognised in the statement of profit and loss or as a part of the cost of other assets, during a period; and accumulated depreciation at the end of the period.
- In accordance with AS 5, an enterprise discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to: residual values; the estimated costs of dismantling, removing or restoring items of property, plant and equipment; useful lives; and depreciation methods.
- If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed: the effective date of the revaluation; whether an independent valuer was involved; the methods and significant assumptions applied in estimating fair values of the items; the extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

- An enterprise is encouraged to disclose the following: the carrying amount of temporarily idle property, plant and equipment; the gross carrying amount of any fully depreciated property, plant and equipment that is still in use; for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; the carrying amount of property, plant and equipment retired from active use and not held for disposal.

Comparative Provisions under Ind AS 16 and AS 10

Presently, in India, Indian Accounting Standard (Ind AS) 16 Property, Plant, and Equipment deal with this issue. Ind AS 16 differs from AS 10, with respect to the following points:

Ind AS 16	AS 10
Does not exclude accounting for real estate developers.	Excludes the accounting for real estate developers
Specific recognition criteria for recognition of fixed assets are laid out.	No recognition criteria for fixed assets are laid out.
Components approach is followed.	Does not require adoption of components approach.
Requires organisation to choose Cost model or Revaluation model.	Recognises the revaluation of fixed assets.
Change in method of depreciation is considered as a change in accounting estimate.	No specific guidance provided.
Does not deal with jointly owned assets.	Deals with fixed assets that are owned jointly with others.
Doesn't deal with assets held for sale.	Deals with fixed assets that have been put up for sale and that have been retired from active use.
Additional costs incurred in construction of self-generated asset should not be considered.	No specific guidance provided.
Revaluation Surplus may be transferred to retained earnings on derecognition of asset.	Guidance note provides recycling to income statement in the ratio of additional depreciation.
Gain on derecognition should be considered as Revenue.	No specific guidance provided.
PPE acquired in exchange of non-monetary asset is recognised at fair value.	PPE acquired in exchange is to be recorded at net book value of asset given up.

Illustration 5

Machineries which appeared in the books of Dee Ltd. at ₹ 86,00,000 has been revalued at ₹ 90,00,000. The accumulated depreciation associated was ₹ 28,00,000. The accountant suggested that revaluation should be accounted for by adjusting accumulated depreciation account. You are required to discuss the treatment as per AS 10.

Solution:

The suggestion of the accountant of Dee Ltd. is incorrect. As per AS 10, when fixed assets are revalued upwards, the increase on account of revaluation should be credited to Revaluation Surplus Account.

Illustration 6

Jay Ltd., a chemical producing company changed a semi-automatic component in an existing machine with a fully-automatic component incurring ₹ 85,000. This new component would result in increasing the output by 150%. The component changing exercise required the company to dismantle a part of the machine and also re-erect the same for which the company incurred ₹ 38,000. How should the costs be treated as per AS 10?

Solution:

Cost of new component: As the new component results in increased output, it would result in increasing the future benefits from the machine. So, the cost incurred ₹ 85,000 should be capitalised.

Cost of dismantling and re-erection: ₹ 38,000 incurred towards dismantling and re-erection should be charged to the Statement of Profit and Loss.

The Effects of Changes in Foreign Exchange Rate (AS 11)

Objective

An enterprise may carry on activities involving foreign exchange in two ways. It may have transactions in foreign currencies or it may have foreign operations. In order to include foreign currency transactions and foreign operations in the financial statements of an enterprise, transactions must be expressed in the enterprise's reporting currency and the financial statements of foreign operations must be translated into the enterprise's reporting currency.

The principal issues in accounting for foreign currency transactions and foreign operations are to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.

This Standard should be applied:

(a) In accounting for transactions in foreign currencies; and

(b) In translating the financial statements of foreign operations.

(c) This Standard also deals with accounting for foreign currency transactions in the nature of forward exchange contracts.

(d) This Standard does not specify the currency in which an enterprise presents its financial statements. However, an enterprise normally uses the currency of the country in which it is domiciled. If it uses a different currency, this Standard requires disclosure of the reason for using that currency. This Standard also requires disclosure of the reason for any change in the reporting currency.

(e) This Standard does not deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

(f) This Standard does not deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation (see AS 3, Cash Flow Statements).

(g) This Standard does not deal with exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs (see AS 16, Borrowing Costs).

What are foreign currency transactions?

Transaction which are denominated in a foreign currency or that require settlement in a foreign currency are called foreign currency transaction, examples of foreign currency transactions are—

- Buying or selling of goods or services priced in foreign currency.

- Acquisition or disposal of fixed assets denominated in foreign currency.
- Incurs or settles liabilities denominated in foreign currency.
- Lending or borrowings when the amounts are denominated in a foreign currency.
- Un-performed forward exchange contract.

Definition

- Reporting Currency: Currency of country where financial state¬ments are reported, is called reporting currency. Reporting cur¬rency of the enterprise operating in India is Indian rupees.
- Foreign Currency: Currency other than reporting currency is called foreign currency.
- Exchange Rate: Rate at which foreign currency is converted into reporting currency or vice versa.
- Average Rate: It is the mean of exchange rate in force during the period. Period may be week, fortnight, months etc.
- Forward Rate: Agreed exchange rate between two parties for exchange of two currencies at a specified future date.
- Closing Rate: Exchange rate at the balance sheet date.
- Monetary items: Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amount of money. For example - cash, receivable and payable.
- Non-Monetary items: Non-monetary items are assets and liabilities other than monetary items. For example - fixed assets, inventories, and investment in equity shares.
- Foreign operations: Operational activities conducted in a country other than the country of the reporting enterprises by the reporting enterprises. These activities may be in the form of a subsidiary, associate, joint ventures or a branch of the reporting enterprises.

Classification for accounting treatment

For the purpose of accounting treatment for the effect of change in foreign exchange rates, the transaction can be classified into following categories—

Category-1 - Foreign currency transactions:

- Buying or selling the goods or services
- Lending and borrowing in foreign currency
- Acquisition and disposition of assets denominated in foreign currency.

Category-2 - Foreign operations:

- Foreign branch
- An associate
- Joint venture
- Foreign subsidiary

For the purpose of accounting these will be further classified in two types—

- Integral operation

- Non-integral operation

Category-3 - Forward exchange contracts

These contracts may be of two types—

- For managing risk/hedging.
- For trading and speculation.

Accounting treatment of foreign currency transactions (Category-1)

The accounting standard prescribes the accounting treatment for the following issues—

- Initial recognition of foreign transaction.
- Valuation at the balance sheet date.
- Contingent liabilities.
- Treatment of exchange difference.

Initial recognition of foreign currency transactions - Initially foreign currency transactions should be recorded by applying an exchange rate between the reporting currency and the foreign currency at the date of the transaction.

Alternatively average rate for a week or a month can be used if there is no significant fluctuation in the exchange rate.

Valuation at the Balance Sheet date - For the purpose of the valuation at the balance sheet date the foreign currency denominated transaction are divided into two categories—

- Monetary Items
- Non-monetary Items

Monetary Items - Monetary items is to be converted at closing rate and reported as such. Closing rate is the exchange rate on the balance sheet date. Examples of monetary items are debtors, creditors etc.

In case the closing rate is unrealistic and it is not possible to effect an exchange of currencies at that rate at the balance sheet date, in such circumstances the conversion should be done at the rate likely to be realized.

As a result the balance sheet date exchange fluctuations gain or loss will arise, which is the difference of the closing exchange rate and exchange rate used for initial recognition.

Non-monetary Item - For the purpose of conversion and reporting on the balance sheet date non-monetary items are further categorized into two categories—

- Items carried at historical cost
- Items carried at fair value.

Non-monetary items carried at historical cost- Examples of such non-monetary items are fixed assets, long-term investment. These items should be continued to be reported at the actual rate used for initial recognition, thereafter in this case no exchange fluctuation gain or loss will arise out of such foreign currency denominated non-monetary items.

Non-monetary items carried at fair value - Examples of such non-monetary items are inventory, current investment which are carried at fair value, these are converted and reported using the exchange rate when such fair value are determined. Fair value is determined at the balance sheet date.

Conversion should be made using exchange rate of the balance sheet date.

Contingent liabilities - These liabilities are reported at the exchange rate of the balance sheet date.

Treatment of exchange difference - Exchange difference arises because of—

- A transaction being reported at a rate different from the rate at which it was initially recorded.
- A transaction in monetary or non-monetary items being settled at a rate different from the rate at which it was initially recorded.
- A transaction being settled at a rate different from the one taken for the reporting in the last financial statement.

Translation of financial statement of foreign operation (Category-2)

For the purpose of the translation of financial statement of foreign operation, AS-11 classifies the foreign operation into two types:

- Integral foreign operation
- Non-integral foreign operation.

Integral Foreign Operation - A foreign operation which is carried as if it were extensions of the reporting enterprise activities like dependent branches, sales depot, foreign arm which produces raw material and transfer it to head office (reporting enterprise) or foreign operation only raises finance to help the reporting enterprise.

Translation of Financial Statements of integral foreign operation - The individual items in the financial statements of the foreign operation are translated as if all these transactions had been entered into by the reporting enterprises. In that case the financial statements should be translated by using the principles as prescribed for foreign currency transactions of the reporting entity. It means—

- Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of the transaction; alternatively, average rate can also be applied.
- The cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost.
- If tangible fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation.
- The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realisable value is translated applying exchange rate when realisable value is determined which is generally closing rate.
- Exchange difference arising on the translation of the financial statement of integral foreign operation should be charged to profit and loss account.
- Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt with as per AS-22 “Accounting for taxes on income”.

Non-integral foreign operation

Accounting Standard -11 does not define the non-integral foreign operation, however it describes the same. As per the accounting standard following are the indications of non-integral foreign operation—

- Control by reporting enterprises - While the reporting enterprise may control the foreign operation; the activities of foreign operation are carried independently without much dependence in reporting enterprise.
- Transactions with the reporting enterprises are not a high proportion of the foreign operation's activities.
- Activities of foreign operation are mainly financed by its operations or from local borrowings. In other words, it raises its finance independently and is in no way dependent on reporting enterprises.
- Foreign operation sales are mainly in currencies other than reporting currency.
- All the expenses by foreign operations are primarily paid in local currency not in the reporting currency.
- Day to day cash flows of the reporting enterprises is independent of the foreign enterprises cash flows.
- Sales prices of the foreign enterprises are not affected by the day to day changes in exchange rate of the reporting currency of the foreign operation.
- There is an active sales market for the foreign operation product.

These are only indicators and not decisive/conclusive factors to classify the foreign operations as non-integral, much will depend on factual information, situations of the particular case and therefore, proper judgment is necessary to be applied to determine the appropriate classification.

In case of branches classified as independent for the purpose of accounting are generally classified as non-integral foreign operations.

Translations of accounts of non-integral foreign operation –

Accounts of non-integral foreign operation are translated using the following principles :

- Balance sheet items i.e. Assets and Liabilities both monetary and non-monetary - apply closing rate.
- Items of income and expenses - at actual exchange rates on the date of transactions. However, accounting standard allows average rate subject to materiality.
- Resulting exchange rate difference should be accumulated in a "foreign currency translation reserve" until the disposal of "net investment in non-integral foreign operation".
- Net investment in a non-integral foreign operation- An item for which settlement is neither planned nor likely to occur in foreseeable future which is in substance a net investment in non-integral foreign operation, which may be calculated as - all assets exclude trade receivable less outside liabilities excluding trade payable.
- Contingent liability - at closing rate.
- Tax effects, if any may be accounted for as per AS-22.

When a non-integral foreign subsidiary, foreign jointly controlled entity (JV) is consolidated with the reporting enterprise, the reporting enterprises follow normal consolidation procedure such as—

- Goodwill/capital reserve arising on the acquisition, as a result of consolidation is translated using closing rate.
- Intra-group transactions are eliminated as per AS-21 and AS-27.
- Exchange difference arising on intra-group monetary items whether short-term or long-term cannot be set-off against a corresponding amount arising on other intra-group balances because the monetary items represents commitments to convert one currency into another and expose the reporting enterprises to gain or loss through currency fluctuation. This difference is to be recognized as income or expense in consolidated financial statements.

If exchange difference arising on monetary items that in substance form part of net investment in non-integral foreign operation, should be accumulated in currency translation reserve.

- Procedure for different reporting date/policies shall be followed as mentioned in AS-21.

Disposal of non-integral foreign operations - When non-integral foreign operation is disposed fully or partially the corresponding exchange difference lying in the exchange translation reserve is recognized as income or expense.

- What is disposal - Disposal of a non-integral foreign operation includes—
  - Sales
  - Liquidation
  - Repayment of its share capital by non-integral foreign opera¬tion
  - Abandonment of all or part of the foreign operation by reporting enterprises
  - Payment of dividend by the non-integral foreign operation if it is treated as return on investment by the reporting enterprises (partial disposal).
- Disposal does not include - Write down of the carrying amount of non-integral foreign operation asset. For example - write down due to impairment of asset (AS-28).
- Treatment of foreign currency translation reserve - On the disposal of non-integral foreign operation the translation reserve is treated as under—
  - On partial disposal proportionate foreign currency translation reserve is recognized as income or expense.
  - On full disposal, whole foreign currency translation reserve is recognized income or expense.

The above treatment of foreign currency translation is done in the period in which gain or loss on disposal is recognized.

When there is a change in classification from—

- Integral to non-integral
- Non-integral to integral.

The accounting treatment is as under—

- Integral to non-integral
  - Translation procedure applicable to non-integral shall be followed from the date of change.
  - Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.
- From non-integral to integral
  - Translation procedure as applicable to integral should be applied from the date of change.
  - Translated amount of non-monetary items at the date of change are treated as historical cost.
  - Exchange difference lying in foreign currency translation reserve is not to be recognized as income or expense till the disposal of the operation even if the foreign operation becomes integral.

Forward Contract - A forward contract is an agreement between two parties whereby one party agrees to buy from or sell to the other party an asset at future date for an agreed price, in case of forward exchange contract the asset is "foreign currency"]

Purposes of accounting treatment of forward exchange contract has been classified in two types—

- Forward exchange contract entered for managing risk (hedging).
- Forward exchange contract entered for trading or speculation.

Disclosures

An enterprise should disclose—

- Amount of exchange difference included in the net profit or loss.
- Amount accumulated in foreign exchange translation reserve.
- Reconciliation of opening and closing balance of foreign exchange translation reserve.
- If the reporting currency is different from the currency of the country in which entity is domiciled, the reason for such difference.
- A change in classification of significant foreign operation needs following disclosures—

- Nature of change in classification
- The reason for the change
- Effect of such change on shareholders fund
- Impact of change on net profit or loss for each prior period presented
- The disclosure is also encouraged of an enterprise's foreign currency risk management policy.

Comparative Provisions between AS 11 and Ind AS 21

Presently, in India, Indian Accounting Standard (Ind AS) 21 The effect of changes in foreign exchange rates deal with the same issue. Ind AS 11 differs from AS 21, with respect to the following points:

Ind AS 21	AS 11
Forward exchange contracts are not covered.	Forward exchange contracts are included within its scope.
Accounting of foreign operations is based on functional currency approach.	Accounting of foreign operations is based on integral and non-integral approach.
No specific guidance provided.	Option to recognise exchange difference arising on translation of certain long-term monetary items over the period is available.
Presentation currency could be different from the local currency.	No such specification provided.

Illustration 7

During the financial year 2022-23, Zeds Ltd., an e-commerce firm entered into a foreign currency transaction relating to fees for technical services paid to a Lucas Ltd., an Atlanta based organisation in the USA. The transaction was for \$24,000, which was entered into on 07.12.2022. The payment for the same was made on 20.05.2023. Given that the exchange rates are: on 07.12.2022: \$1 = ₹ 73.80; on 01.01.2023: \$1 = ₹ 73.95; on 31.03.2023: \$1 = ₹ 75.45; on 20.05.2023: \$1 = ₹ 76.50.

You are required to:

(a) ascertain the amount at which the transaction would get recognised in the books; and

(b) calculate amount of foreign exchange gain/ loss to be recorded in the financial statement for the years 2022-23 and 2023-24.

Solution:

(a) As per AS 11, a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

∴ Fees for technical services $24,000 would be recorded on 07.12.2022 applying the exchange rate existing on that date = 24,000 × ₹ 73.80 = ₹ 17,71,200.

(b) For 2022-23:

On 31.03.2023, Outstanding fess for technical services should be reflected in the balance sheet using the closing rate ($1 = ₹ 75.45) i.e. 24,000 × ₹ 75.45 = ₹ 18,10,800.

∴ Exchange loss to be charged to the Statement of Profit and Loss = ₹ (18,10,800 – 17,71,200) = ₹ 39,600.
For 2023-24:

On 20.05.2023, Outstanding fess for technical services paid should be recognised using the existing rate ($1 = ₹ 76.50) i.e. 24,000 × ₹ 76.50 = ₹ 18,36,000.

∴ Exchange loss on settlement to be charged to the Statement of Profit and Loss = ₹ (18,36,000 – 18,10,800) = ₹ 25,200.

Illustration 8

Subhash Ltd. purchased a machine costing ₹ 224 lakhs on 1.4.2022 and the same was fully financed by foreign currency loan (US $) payable in three annual equal instalments. Exchange rates were $1 = ₹ 70.00 and ₹ 72.95 as on 1.4.2022 and 31.03.2023 respectively. First instalment was paid on 31.03.2023. The entire difference in foreign exchange has been capitalized. Advice how the exchange gain/ loss should be accounted for by the company.

Solution:

Cost of machine (in US$) = ₹ 224,00,000/ 70.00 = $3,20,000.

∴ Exchange loss on payment of first instalment = 3,20,000 × ₹ (72.95 – 70.00) = ₹ 9,44,000.

This entire loss due to exchange differences amounting ₹ 9,44,000 should be charged to the Statement of Profit and Loss.

Illustration 9

Particulars	Exchange Rate
Goods purchased on 24.02.2022 of US$ 10000	₹76.60
Exchange rate on 31.03.2022	₹77.00
Date of actual payment 5.06.2023	₹77.50

Calculate the loss / gain for the financial years 2021-22 and 2023-24.

Solutions:

As per AS-11 all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore goods purchased on 24.02.2022 and corresponding creditor would be recorded at ₹76.60 = US$1, i.e. 10,000 x 76.60 = ₹7,66,000

As per AS-11 at the balance sheet date all monetary items should be reported using the closing rate therefore creditors of US$10000 outstanding on 31.3.2023 will reported.

10,000 x ₹77.00 = ₹7,70,000

Exchange loss ₹(7,70,000 – 7,66,000) i.e. ₹4,000 should be debited in profit and loss account for 2021-22.

As per As-11 exchange difference on settlement on monetary items should be transferred to profit and loss account as gain or loss therefore 10000 x ₹77.50 = ₹7,75,000 – ₹7,70,000 = ₹5000 will be be debited to profit or loss for the year 2023-24.

Illustration: 10

MM Ltd. purchased fixed assets for US$50 lakhs costing ₹3,825 lakhs on 01.04.2022 and the same was fully financed by the foreign currency loan [i.e. US Dollars] repayment in five equal instalments annually. [Exchange rate at the time of purchase was 1 US Dollar = ₹76.50]. as on 31.03.2023 the first instalment was paid when 1 US Dollar fetched ₹81.50. The entire loss on exchange was included in cost of goods sold etc. MM Ltd. normally provided depreciation on fixed assets at 20% on WDV basis.

Solutions:

In this case AS-11 will be applicable on Accounting for effects of changes in Foreign Exchange rates, as the transaction in foreign currency has been entered into by the reporting enterprises before 01.04.2023. Exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, should be adjusted in the carrying amount of the respectively fixed assets. The carrying amount of such fixed assets to the extent not already so adjusted or otherwise accounted for, also to be adjusted to account for any increase or decrease in the liability of the enterprise, as expressed in the reporting currency by applying the closing rate, for making payments towards the whole or a part of the cost of the assets or for repayment of the whole or a part of the monies borrowed by the enterprise from any person directly or indirectly, in foreign currency specifically for the purpose of acquiring those assets.

Thus the entire exchange loss due to variation of ₹50 lakhs on 31.03.2023 on payment of US$ 10 lakhs should be added to the carrying amount of fixed assets and not to the cost of goods sold.

Further, depreciation on the unamortised depreciable amount should also be provided, in accordance with AS-10.

Calculate Exchange loss:

Foreign currency loan = $\frac{₹\ 3,825 \text{ lakhs}}{₹\ 76.50 \text{ lakhs}}$ = 50 lakhs US Dollars

Exchange loss on outstanding loan on 31.03.2023 = 40 lakhs US$ x ₹(81.50 – 76.50) = ₹200 lakhs should also be added to cost of fixed asset with corresponding credit to outstanding loan.

Calculation of additional depreciation on account of increase in the depreciable amount of fixed assets: 20% of ₹250 lakhs = ₹50lakhs.

Accounting for Government Grants (AS 12)

This Standard deals with accounting for Government grants. Government grants are sometimes called by other names such as subsidies, cash incentives, duty drawbacks, etc.

This Standard does not deal with:

i. the special problems arising in accounting for Government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature;

ii. Government assistance other than in the form of government grants;

iii. government participation in the ownership of the enterprise.

Definitions

Government refers to government, government agencies and similar bodies whether local, national or international.

Government grants are assistance by Government in cash or kind to an enterprise for past or future compliance with certain conditions. They exclude those forms of Government assistance which cannot reasonably have a value placed upon them and transactions with Government which cannot be distinguished from the normal trading transactions of the enterprise.

Accounting Treatment of Government Grants

Capital Approach versus Income Approach

Two broad approaches may be followed for the accounting treatment of government grants: the 'capital approach', under which a grant is treated as part of shareholders' funds, and the 'income approach', under which a grant is taken to income over one or more periods.

Capital approach:

- Many Government grants are in the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in the case of such grants. These should, therefore, be credited directly to shareholders' funds.
- It is inappropriate to recognise Government grants in the profit and loss statement, since they are not earned but represent an incentive provided by government without related costs.

Income approach:

- Government grants are rarely gratuitous. The enterprise earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be taken to income and matched with the associated costs which the grant is intended to compensate.
- As income tax and other taxes are charges against income, it is logical to deal also with Government grants, which are an extension of fiscal policies, in the profit and loss statement.
- In case grants are credited to shareholders' funds, no correlation is done between the accounting treatment of the grant and the accounting treatment of the expenditure to which the grant relates.

It is generally considered appropriate that accounting for Government grant should be based on the nature of the relevant grant. Grants which have the characteristics similar to those of promoters' contribution should be treated as part of shareholders' funds. Income approach may be more appropriate in the case of other grants.

It is fundamental to the 'income approach' that Government grants be recognised in the profit and loss statement on a systematic and rational basis over the periods necessary to match them with the related costs. Income recognition of government grants on a receipts basis is not in accordance with the accrual accounting assumption.

In most cases, the periods over which an enterprise recognises the costs or expenses related to a Government grant are readily ascertainable and thus grants in recognition of specific expenses are taken to income in the same period as the relevant expenses.

Recognition of Government Grants

Government grants available to the enterprise are considered for inclusion in accounts:

- where there is reasonable assurance that the enterprise will comply with the conditions attached to them; and
- where such benefits have been earned by the enterprise and it is reasonably certain that the ultimate collection will be made.
- Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.

Non-monetary Government Grants

Government grants may take the form of non-monetary assets, such as land or other resources, given at concessional rates. In these circumstances, it is usual to account for such assets at their acquisition cost. Non-monetary assets given free of cost are recorded at a nominal value.

Presentation of Grants Related to Specific Fixed Assets

Grants related to specific fixed assets are Government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. Other conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held.

Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to specific fixed assets are regarded as acceptable alternatives.

Method 1: The grant is shown as a deduction from the gross value of the asset concerned in arriving at its book value. The grant is thus recognised in the profit and loss statement over the useful life of a depreciable asset by way of a reduced depreciation charge. Where the whole, or virtually the whole, of the cost of the asset is shown in the balance sheet at a nominal value.

Method 2: Grants related to depreciable assets are treated as deferred income which is recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset. Such allocation to income is usually made over the periods and in the proportions in which depreciation on related assets is charged. Grants related to non-depreciable assets are credited to capital reserve under this method, as there is usually no charge to income in respect of such assets. However, if a grant related to a non-depreciable asset requires the fulfillment of certain obligations, the grant is credited to income over the same period over which the cost of meeting such obligations is charged to income.

Presentation of Grants Related to Revenue

Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense.

Presentation of Grants of the nature of Promoters' contribution

Where the Government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Refund of Government Grants

Government grants sometimes become refundable because certain conditions are not fulfilled. A government grant that becomes refundable is treated as an extraordinary item as per AS 5.

The amount refundable in respect of a Government grant related to revenue is applied first against any unamortised deferred credit remaining in respect of the grant. To the extent that the amount refundable exceeds any such deferred credit, or where no deferred credit exists, the amount is charged immediately to profit and loss statement.

The amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In the first alternative, i.e., where the book value of the asset is increased, depreciation on the revised book value is provided prospectively over the residual useful life of the asset.

Where a grant which is in the nature of promoters' contribution becomes refundable, in part or in full, to the government on non-fulfillment of some specified conditions, the relevant amount recoverable by the government is reduced from the capital reserve.

Disclosure

(i) the accounting policy adopted for government grants, including the methods of presentation in the financial statements;

(ii) the nature and extent of government grants recognised in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

Comparative Provisions under Ind AS 20 and AS 12

Presently, in India, Indian Accounting Standard (Ind AS) 20 Accounting for Government Grants and Disclosure of Government Assistance deal with the issue of government grants. Ind AS 20 differs from AS 12, with respect to the following points:

Ind AS 20	AS 12
Disclosure required in financial statements with indication on other forms of government assistance received	No specific guidance as does not deal with other forms of government assistance
Government grants in the nature of capital contribution are not recognized	Government grants as capital contribution are specifically recognized
Prohibition of recognition of grants directly to the shareholder's fund	Grants for non-depreciable assets are required to be shown as a capital reserve under shareholder's funds
Recognition of non-monetary grants at fair value	Recognition of non-monetary grants at acquisition cost or nominal value
No option to deduct the amount of grant from the book value of the asset.	Optional to deduct the amount of grant from the book value of the asset.

Illustration 11

Dee Ltd. received ₹80,00,000 from the Central Government as subsidy for setting up a factory in a backward area. How would you treat the transaction in the financial statement of the company?

Solution:

When government grants are in the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay and no repayment is ordinarily expected in the case of such grants. These are credited directly to shareholders' funds. So, Dee Ltd. should credit the amount of ₹80,00,000 to capital reserve and the same would get reflected in the Balance Sheet.

Illustration 12

Big Box Ltd., a start-up purchased on April 1, 2020, a machine worth ₹44,85,000 in relation to which it received ₹7,35,000 as grant from Government of India. The company decided to treat this grant as a capital receipt. It is estimated that the realizable value of the machine at the end of its useful life of 4 years will be ₹15,36,000. During the financial year 2022-23, the grant became refundable as the start-up company failed to comply with the necessary terms and conditions of the grant.

You are required to calculate the amount of depreciation that is to be charged to the statement of profit and loss for the years 2022-23 and 2023-24 given that the company follows straight line method of charging depreciation.

Solution:

As per AS 12, the amount refundable in respect of government grant is related to specific fixed asset is recorded by increasing the book value of the asset or by reducing the capital reserve or the deferred income balance, as appropriate, by the amount refundable. In case the book value of the asset is increased, depreciation is provided on the revised book value.

Calculation of Depreciation for the years 2022-23 and 2023-24 **₹ '000**

Cost of machine on 01.01.2020	4,485
Less: Grant from Government of India	735
Net cost of machine	3,750
Estimated useful life	4 years
Depreciation p.a. under straight line method [$\frac{3,750 - 1,536}{4}$]	553.5
Depreciation charged during 2020-21 and 2021-22 [553.5 × 2]	1,107
Book value of machine on 01.04.2022 [3,750 – 1,107]	2,643
Add: Refund of government grant during 2022-23	735
Revised Book value of machine	3,378
Remaining useful life of machine	2 years
Revised depreciation p.a. [$\frac{3,378 - 1,536}{2}$]	921

Illustration 13

Z Ltd. has set up its business in designated backward area which entitles it to receive as per a public scheme announced by the Government of India, a subsidy of 25% of the cost of investment. Having fulfilled the conditions laid down under the scheme, the company on its investment of ₹100 lakhs in capital assets during its accounting year ending on 31st March,2023, received a subsidy of ₹ 25 lakhs in January, 2023 from the Government of India. The Accountant of the company would like to record the receipt as an item of revenue and to reduce the losses on the Profit and Loss Account for the year ended 31st March, 2023. Is his action justified?

Solution:

As per AS-12, the Government grants related to depreciable fixed assets to be treated as deferred income which should be recognized in the Profit and Loss Account on a systematic and rational basis over the useful life of the asset. Such grants should be allocated to income over the periods and in proportions in which depreciation on those assets is charged.

The company has received ₹ 25 lakhs subsidy for investment in capital assets which are depreciable in nature. In view of the provisions under AS-12, the subsidy amount ₹ 25 lakhs received should not be credited to the Profit and Loss Account for the year ended 31st March, 2023. the subsidy should be recognized and credited to the Profit and Loss Account in the proportion of depreciation charge over the life of the subsidized assets.

Illustration 14

Explain the treatment of the following:

(i) A firm acquired a fixed asset for ₹550 lakhs on which the Government grant received was 40%.

(ii) Capital subsidy received from the Central Government for setting up a plant in the notified backward region. Cost of the plant ₹600 lakhs, subsidy received ₹150 lakhs.

(iii) ₹125 lakhs received from the local authority for providing medical facilities to the employees.

Solution:

(i) The total cost of the fixed asset is ₹550 lakhs and the grant is 40% i.e., ₹220 lakhs. In the balance sheet, the asset will be shown at the net amount (₹550 lakhs – ₹220 lakhs) i.e., ₹330 lakhs only. This will be depreciated over the life of the asset.

(ii) In this case, the subsidy received for setting up a plant in the notified region, should be treated as a capital subsidy. The amount of subsidy i.e., ₹150 lakhs be added to the Capital Reserves and the plant should be shown at ₹600 lakhs.

(iii) It is a case of revenue grant and should be shown in the profit and loss account. However, if the medical facilities are to be provided over a period of more than one year, it may be treated as deferred income and then taken to Profit and Loss Account on a systematic basis.

Borrowing Costs (AS 16)

Objective

The objective of this Standard is to prescribe the accounting treatment for borrowing costs.

Scope

This Standard is applicable in accounting for borrowing costs.

Definitions

Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

Qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Borrowing costs may include:

(a) interest and commitment charges on bank borrowings and other short-term and long-term borrowings;

(b) amortisation of discounts or premiums relating to borrowings;

(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

(d) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Examples of Qualifying Assets: Manufacturing plants, power generation facilities, inventories that require a substantial period of time to bring them to a saleable condition, and investment properties.

Other investments, and those inventories that are routinely manufactured or otherwise produced in large quantities on a repetitive basis over a short period of time, are not qualifying assets.

Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

Recognition

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

Borrowing costs are capitalised as part of the cost of a qualifying asset when it is probable that they will result in future economic benefits to the enterprise and the costs can be measured reliably. Other borrowing costs are recognised as an expense in the period in which they are incurred.

Borrowing Costs Eligible for Capitalisation

The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. When an enterprise borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.

The determination of the amount of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset is often difficult and the exercise of judgement is required.

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation should be determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised during a period should not exceed the amount of borrowing costs incurred during that period.

When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realisable value, the carrying amount is written down or written off in accordance with the requirements of other Accounting Standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other Accounting Standards.

The capitalisation of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied:

(a) expenditure for the acquisition, construction or production of a qualifying asset is being incurred;

(b) borrowing costs are being incurred; and

(c) activities that are necessary to prepare the asset for its intended use or sale are in progress.

Expenditure on a qualifying asset includes only such expenditure that has resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. Expenditure is reduced by any progress payments received and grants received in connection with the asset. The average carrying amount of the asset during a period, including borrowing costs previously capitalised, is normally a reasonable approximation of the expenditure to which the capitalisation rate is applied in that period.

The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits prior to the commencement of the physical construction.

However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, borrowing costs incurred while land is under development are capitalised during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalisation.

Suspension of Capitalisation

Capitalisation of borrowing costs should be suspended during extended periods in which active development is interrupted.

Cessation of Capitalisation

Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

A business park comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being used while construction continues for the other parts. An example of a qualifying asset that needs to be complete before any part can be used is an industrial plant involving several processes which are carried out in sequence at different parts of the plant within the same site, such as a steel mill.

Disclosure

(a) the accounting policy adopted for borrowing costs; and

(b) the amount of borrowing costs capitalised during the period.

Comparative Provisions under Ind AS 23 and AS 16

Presently, in India, Indian Accounting Standard (Ind AS) 23 Borrowing Costs deal with this issue. Ind AS 23 differs from AS 16, with respect to the following points:

Ind AS 23	AS 16
Qualifying Assets will never Include Biological Assets.	Qualifying Assets may Include Biological Assets.
No specific definition and explanation on the understanding of substantial period of time has been provided; rather, it is a matter of judgement.	Specific definition and explanation on the understanding of substantial period of time is provided.
Inventories which are produced in large quantities should not be considered as Qualifying Assets. It implies that Inventories which are produced in lower quantity only can be considered as Qualifying assets.	Inventories may be considered as Qualifying assets if condition of substantial period is satisfied.
interest expense which is capitalized or not capitalized during the period should be disclosed separately	Disclosure is required to be made only if capitalization of borrowing cost has been made during the period.
Borrowing costs in hyper-inflationary situation is addressed. If interest cost increase due to hyper inflationary situation then the increase in Interest cost should be written off in income statement.	Inflation in interest rate is not addressed.
Weighted Average capitalisation rate on borrowings should be disclosed in Notes to accounts.	No specific guidance provided.
In consolidated financial statements, weighted average capitalisation rate on total borrowing of Holding & subsidiaries is to be considered.	No specific guidance provided.

Illustration 15

T&L Ltd. is a large construction company which is presently involved in the construction of a railway bridge over the Ganga river at Patna. The project cost is ₹125 crores, 40% of which is financed by borrowing from Asian Development Bank at an interest of 3%. There has been a delay in the completion of the project, and the project manager of the railway bridge construction site has identified that delay construction of the railway bridge has happened due to high water levels during the monsoon months of July to September. Ms. Sonali Mathur, the accountant of T&L Co. has not suspended the capitalisation of the borrowing cost and reflected the same in the cost of the qualifying asset.

You are required to comment on the treatment

Solution:

In this case, the work got suspended due to temporary delay which is a necessary part of the construction process. Capitalisation of borrowing cost would continue during the extended period during which high water levels delay construction of the railway bridge, as such high water levels are common during the monsoon period in the geographic region involved.

So, the treatment done by Ms. Mathur, the company accountant is correct.

Illustration 16

On 14.08.2022, Pushkar Ltd. obtained a loan from RAR Bank of ₹65 lakhs to be utilised as under:

Purchase of equipment: ₹19,50,000;

Construction of factory shed: ₹26,00,000;

Advance for purchase of delivery vehicle: ₹6,50,000;

Working capital: ₹13,00,000.

In March, 2023 installation of the machinery was completed and also construction of factory shed was completed and the machinery installed. However, the truck was not delivered within 31.03.2023. Total interest charged by the bank for the year ending 31.3.2023 was ₹11.70 lakhs. Discuss how the interest amount would be treated in the financial statements of the company as per AS 16.

Solution:

In this case, only the factory shed is a Qualifying Asset (QA) as per AS 16. The amount of interest on borrowings and its treatment is presented below:

Particulars	Nature of asset	Interest capitalised	Interest charged to Income Statement
Purchase of equipment	Not a QA		3,51,000 [11.7 × 19.5/65]
Construction of factory shed	QA	4,68,000 [11.7 × 26/65]	
Advance for purchase of delivery vehicle	Not a QA		1,17,000 [11.7 × 6.5/65]
Working capital	Not a QA		2,34,000 [11.7 × 13/65]
Total		**4,68,000**	**7,02,000**

Illustration 17

	Amount (₹)
Expenditure incurred till 31.03.2023	5,00,000
Interest cost capitalized for the financial year 2022-23 @ 13%	26,000
Amount borrowed till 31.03.23 is	2,00,000
Assets transferred to construction during 2023-24	1,00,000
Cash payment during 2023-24	75,000
Progress payment received	3,70,000
New borrowing during 2023-24 @ 13%	2,00,000

Calculate the amount of borrowing cost to be capitalized.

Solution:

Total borrowing cost = 4,00,000 x 13/100 = ₹52,000

	Amount (₹)
Expenditure incurred including previously capitalized borrowing cost (5,00,000 + 26,000)	5,26,000
Cash payment during 2023-24	75,000
Asset transferred during 2023-24	1,00,000
	7,01,000
Less: Progress payment received	3,70,000
	3,31,000

Money borrowed including previously capitalized interest cost 4,00,000 + 26,000 = 4,26,000

Borrowing cost to be capitalized $= \frac{3,31,000}{4,26,000} \times 52,000 = 40,404$

Illustration 18

On 30-04-2023 MMLtd. obtained a loan from the bank for ₹200 lakhs to be utilized as under:

Construction of a shed	₹80 lakhs
Purchase of Machinery	₹60 lakhs
Working Capital	₹40 lakhs
Advance for Purchase of truck	₹20 lakhs

In March 2024 construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31-03-2024 was ₹36 lakhs. Show the treatment of interest under As-16.

Solution:

As per As-16 borrowing cost (interest) should be capitalized if borrowing cost is directly attributable to the acquisition, construction or production of qualifying asset. In other words, asset acquired must be qualifying asset and borrowing cost should be directly attributable to the acquisition, construction or production of qualifying asset.

In the question ₹200 lakhs borrowed from Bank was utilized for –

Construction of a shed	₹80 lakhs
Purchase of Machinery	₹60 lakhs
Purchase of Machinery	₹40 lakhs
Advance for Purchase of truck	₹20 lakhs

Out of the above four payments only construction of a shed of ₹80 lakhs is a qualifying asset as per AS-16, other three payments are not for the qualifying asset. Therefore, borrowing cost attributable to the construction of a shed should only be capitalized which will be equal to ₹36 lakhs x 80/200 = ₹14.40 lakhs

The balance of ₹21.6 lakhs (₹36 lakhs – ₹14.4 lakhs) should be expensed and debited to Profit and Loss Account.

Accounting for Taxes on Income (AS 22)

The objective of this Standard is to prescribe accounting treatment for taxes on income. Taxes on income are one of the significant items in the statement of profit and loss of an enterprise.

Scope

This Standard 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.

Taxes on income include all domestic and foreign taxes which are based on taxable income.

This Standard 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 enterprise.

Important Definitions

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.

Taxable income is calculated in accordance with tax laws. In some circumstances, the computation of taxable income differs 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.

The differences between taxable income and accounting income can be classified into permanent differences and timing differences.

Permanent differences are those differences between taxable income and accounting income which originate in one period and do not reverse subsequently.

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 coincide with the period in which such items of revenue and expenses are included or considered in arriving at accounting income.

Unabsorbed depreciation and carry forward of losses which can be setoff against future taxable income are also considered as timing differences and result in deferred tax assets, subject to consideration of prudence.

Recognition

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.

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 or as deferred tax liabilities, in the balance sheet.

Permanent differences do not result in deferred tax assets or deferred tax liabilities.

This Standard 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 occurring in that period.

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.

Where an enterprise has unabsorbed 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 convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.

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

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 , that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Measurement

Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.

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. 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.

When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using average rates.

Deferred tax assets and liabilities should not be discounted to their present value.

Carrying amount of deferred tax assets should be reviewed at each balance sheet date.

Disclosure

1. An enterprise should offset assets and liabilities representing current tax if the enterprise:
    (a) has a legally enforceable right to set off the recognised amounts; and
    (b) intends to settle the asset and the liability on a net basis.

2. 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.

3. 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.

4. 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. 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.

5. 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.

Comparative Provisions between AS 22 and Ind AS 12

Presently, in India, Indian Accounting Standard (Ind AS) 12 Income Taxes deal with the same issue. Ind AS 12 differs from AS 22, with respect to the following points:

Ind AS 12	AS 22
Based on Balance Sheet approach.	Based on Income Statement approach
Recognition is done based on difference between carrying amounts of assets and liabilities and their tax base.	Recognises the difference between taxable income and accounting income.
Applies to two types of differences - Timing Differences and Permanent Differences.	Applies to two types of differences - Taxable Temporary Differences and Deductible Temporary Differences. This standard does not address Permanent Differences.
Deductible temporary differences are recognised to the extent that future periods are likely to provide taxable earnings.	Deferred taxes are recognised only when and to the degree that there is a reasonable certainty of its realisation.
No concept of virtual certainty.	When a corporation has unabsorbed depreciation or losses carried forward, the deferred tax asset should be to the degree that there is a virtual certainty backed up by convincing evidence.
Current and deferred tax is recognised on income statement, except for tax that arises from transactions done in Other Comprehensive Income or directly in equity.	No specific guidance provided.
The disparity between carrying the amount of a revalued asset and its tax base is dealt with.	The disparity between carrying the amount of a revalued asset and its tax base is not covered.

No specific guidance provided regarding Minimum Alternate Tax u/s 115JB.	Specific guidance provided regarding tax rates for deferred tax assets/ liabilities Minimum Alternate Tax u/s 115JB.
No specific guidance provided on deferred tax for tax holiday situations and capital gain cases.	Specific guidance provided on deferred tax for tax holiday situations and capital gain cases.

Illustration 19

Classify the following as Timing Difference and Permanent Difference and also state whether they would result in Deferred Tax Asset or Deferred Tax Liability:

(a) Unabsorbed depreciation

(b) Income tax penalty

(c) Interest on loan taken from scheduled bank accounted in the books, but not paid till the date of filing Return of Income.

Solution:

Particulars	Nature of difference	DTA/ DTL
Unabsorbed depreciation	Timing Difference	DTA
Income tax penalty	Permanent Difference	Neither DTA nor DTL to be created
Interest on loan taken from scheduled bank accounted in the books, but not paid till the date of filing Return of Income.	Permanent Difference	Neither DTA nor DTL to be created

Illustration 20

Parshuram Ltd., which commenced its operations in 2019-20, provides the following details:

Financial year	Profit before tax (₹)	Timing Difference (₹)	Permanent Difference (₹)	Corporate tax rate	Remarks
2019-20	28,00,000	+ 3,15,000	+ 3,50,000	40%	Reversible in 2022-23
2020-21	31,50,000	+ 2,10,000	+ 2,80,000	38%	Reversible in 2021-22
2021-22	35,00,000	- 70,000	+ 3,15,000	35%	Reversible in 2022-23
2022-23	24,50,000	Nil	+ 4,20,000	30%	--

You are required to calculate the amount of Current Tax for the four financial years.

Solution:

Calculation of Current Tax (in ₹ Lakhs)

Particulars	2019-20	2020 - 21	2021-22	2022-23
Profit before tax	28.00	31.5	35.00	24.50
Timing Differences	3.15	2.10	(0.70)	Nil
Permanent Differences	3.50	2.80	3.15	4.20

Taxable Income	34.65	36.40	37.45	28.70
Corporate tax rate	40%	38%	35%	30%
Current Tax (Taxable Income Tax rate)	13.86	13.832	13.1075	8.61

Illustration 21

The following information is available from the records of Vishnu Ltd.:

Depreciation charged to income statement ₹ 8,00,000; Depreciation u/s 32 of Income Tax Act ₹ 20,00,000; Unamortised preliminary expenditure as per income tax records ₹ 1,50,000.

It is communicated that there is adequate evidence of future profit sufficiency. Given that the corporate tax rate is 40%, you are required to ascertain the amount of deferred tax asset/ deferred tax liability to be created in this situation.

Solution:

Timing Difference = Additional depreciation as per Income Tax Act (-) Preliminary expenditure to be allowed = ₹ (20,00,000 – 8,00,000) - 1,50,000 = ₹ 10,50,000.

Deferred Tax Liability = ₹ 10,50,000 40% = ₹ 4,20,000.

Illustration 22

AB Ltd. has provided depreciation as per accounting records ₹8,00,000 and as per tax records ₹14,00,000. Unamortized preliminary expenses, as per tax record is ₹11,200. There is adequate evidence of future profit sufficiency. How much deferred tax asset / liability should be recognized as transition adjustment. Tax rate is 40%.

Solution:

As per AS-22 deferred tax should be recognized for all the timing differences. In the instant case the timing difference i.e., difference between taxable income and accounting income is –

Excess depreciation as per tax ₹14,00,000 – ₹8,00,000	= ₹6,00,000
Less: Expenses provided in taxable income	₹11,200
	₹5,88,800

As tax expense is more than the current tax due to timing difference of ₹5,88,800, therefore deferred tax liability = 40% of ₹5,88,800 = ₹2,35,520 shall be credited in accounts.

Exercise

A. Theoretical Questions

Multiple Choice Questions

1. In India, Accounting Standards are governed by

   a. The Institute of Cost Accountants of India

   b. Financial Accounting Standards Board

   c. The Institute of Company Secretaries of India

   d. The Institute of Chartered Accountants of India

2. The Full form of GAAP

   a. Generally Accepted Accounting Principles

   b. Generally Accepted Accountancy Principles

   c. Globally Accepted Accounting Principles

   d. Global Accounting Accepted Principles

3. In India, the Accounting Standards for non-corporate entities including Small and Medium sized Enterprises, are issued by the ____________ of Institute of Chartered Accountants of India

   a. Accounting Standards Board

   b. National Standard Setters

   c. Financial Accounting Standards Board

   d. Accounting Standards Committee

4. The IRDA issued a circular under ______ of the Insurance Act, 1938, which mandates insurers to comply with Ind AS and its implementation Roadmap issued by the MCA

   a. Section 35

   b. Section 34

   c. Section 36

   d. Section 40

5. Full form of IFRS

   a. Indian Financial Reporting Standards

   b. International Financial Reporting Standards

   c. International Financials Reporting Standards

   d. Indian Financial Reporting Standard

Answers:

1	d	2	a	3	a	4	b	5	b

B. Numerical Questions

Comprehensive Numerical Problems

1. Alpha Ltd. contracted with a supplier to purchase machinery which is to be installed in its one department in three months' time. Special foundations were required for the machinery which were to be prepared within this supply lead time. The cost of the site preparation and laying foundations were ₹1,40,000. These activities were supervised by a technician during the entire period, who is employed for this purpose of ₹ 45,000 per month. The machine was purchased at ₹1,58,00,000 and ₹50,000 transportation charges were incurred to bring the machine to the factory site. An Architect was appointed at a fee of ₹30,000 to supervise machinery installation at the factory site. You are required to ascertain the amount at which the Machinery should be capitalized as per AS 10.

[**Answer:** Total Cost of Machinery ₹1,61,55,000]

2. Mrs. A bought a forward contract for three months of US$ 1,00,000 on 1st December at 1 US$ = ₹ 47.10 when exchange rate was US$ 1 = ₹ 47.02. On 31st December when he closed his books exchange rate was US$ 1 = ₹ 47.15. On 31st January, he decided to sell the contract at ₹ 47.18 per dollar. Show how the profits from contract will be recognised in the books as per AS 11.

[**Answer:** Total Profit (1,00,000 × 0.08) ₹ 8,000]

3.

Particulars	Exchange Rate per $
Goods purchased on 1.1.22 × 1 for US $ 15,000	₹ 75
Exchange rate on 31.3.22 × 1	₹ 74
Date of actual payment 7.7.22 × 1	₹ 73

You are required to ascertain the loss/gain to be recognized for financial years ended 31st March, 2023 and 31st March, 2024 as per AS 11.

[**Answer:** Credited to Profit and Loss Account ₹ 15,000]

4. On 1.4.2022, AS Ltd. received government grant of ₹300 lakhs for acquisition of machinery costing ₹1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The Company had to refund the grant in May 20 × 4 due to non-fulfilment of certain conditions. How you would deal with the refund of grant in the books of AS Ltd. as per AS 12 assuming that the company did not charge any depreciation for year 20X4?

[**Answer:** Revised book value ₹ 914.40 lakhs]

5. Ashima Ltd. has obtained Institutional Term Loan of ₹580 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 20 × 2 amounted to ₹ 406 lakhs, ₹58 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹116 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹ 52.20 lakhs incurred during 20X1-20X2 on the entire Institutional Term Loan of ₹ 580 lakhs. Discuss how the interest amount would be treated in the financial statements of the company as per AS 16.

[**Answer:** Total Interest to be capitalised ₹ 41.76 lakhs; Total Interest to be charged to Profit and Loss Account ₹ 10.44 lakhs]

NOTES

NOTES