ADVANCED ACCOUNTS

BLOCK : I - IV

BRAOU

Andhra Pradesh Open University
Hyderabad
1991

21504
1-12-93

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Andhra Pradesh Open University
Hyderabad

First Published in 1986
Revised in 1991

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Printed at D.V.R. Press, Hyderabad for A.P.O.U

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PREFACE

This book deals with the topics in 'Advanced Accounts' included in the syllabus for the Third Year of B.Com., course offered by the Andhra Pradesh Open University. These topics generally cover the core area of the subject to be studied in the third year of the three year degree course in commerce. The syllabus for the sake of convenience is divided into blocks, each of which comprises a number of units. Each block generally covers a specific area of the subject. The Units are prepared by specialists in accordance with a format so designed as to enable the student to read and understand them without much difficulty. Each unit begins with a statement of its objectives followed by synopsis. And at the end of each unit assignment intended to test the student's comprehension of its subject matter is given. Technical terms with which the student may not be familiar are given at the end of each unit under the head 'Glossary'.

The purpose of introducing this course is to ensure that the student on graduating from the University will have acquired adequate knowledge in Accounting matters of the Business and Non-Business concerns.

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BLOCK-I : ACCOUNTS FROM INCOMPLETE RECORDS

UNIT-1 : SINGLE ENTRY SYSTEM

Contents

1.0 Aims and Objectives
1.1 Introduction
1.2 Definitions
1.3 Different ways of maintaining records under Single Entry
1.4 Reasons for records being incomplete
1.5 Salient features of Single Entry System
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1.7 Methods of ascertaining Capital and Profit
1.8 Summing Up
1.9 Check Your Progress : Model Answers
1.10 Model Examination Questions
1.11 Recommended Books
1.12 Glossary

1.0 AIMS AND OBJECTIVES

The aims of this unit are to expose you to the concept of single entry, different ways of maintaining accounts under single entry system and the features and defects of single entry system.

After going through this unit, you should be able to:

- define the term single entry system
- explain the ways in which the records can be maintained under single entry system
- list out the reasons for the incompletion of records
- identity the features and defects of the single entry system.

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1.1 INTRODUCTION

In double entry system the fundamental principle is that *"every debit must have a corresponding credit"*. In that system the two fold effect, i.e., the receiving and giving aspects of every business transaction are recorded in two different accounts. In contrast to this, the single entry system falls short of double entry system in practice.

Single entry system is followed by certain business people, who for their convenience ignore the strict rules of the double entry system and only maintain the bare essential records. In other words, under this system some subsidiary records and some ledger accounts are not maintained which are required to be maintained under the double entry system. Thus, the single entry system is *"a defective double entry system adjusted to the convenience of the owner"*.

The expression single entry system is a misnomer. It is neither a system nor does it mean that only one aspect of the transaction is recorded. In a nutshell *"it is incomplete, inaccurate,*

unscientific and unsystematic style of account keeping". Therefore, the accounts prepared under the so called single entry system are generally referred to as *"Accounts from Incomplete Records".* The expression single entry is used to denote the incomplete records or defective double entry. In other words, what can not be strictly considered double entry system, is referred to as single entry system.

1.2 DEFINITIONS

Some definitions are given below to further explain the meaning of single entry.

According to Carter "Single Entry is a method or a variety of methods employed for the recording of transactions, which ignore the two-fold aspect, and consequently fail to provide the businessman with the information necessary for him to be able to ascertain the position".

According to Hrushikesh Chakraborthy, single entry is "a mixture of double entry, single entry and no entry".

E.L. Kohler defines it as "a system for book-keeping, in which as a rule, only records of cash and of personal accounts are maintained, it is always incomplete double entry, varying with circumstances".

It should be obvious from the above definitions that the single entry ingnores the rules of double entry; it has no common method followed by the businessmen who adopt this so called system. Further, there are no fixed rules for maintaining the records under the single entry system and each businessman follows a way which is convenient to him.

1.3 DIFFERENT WAYS OF MAINTAINING RECORDS UNDER SINGLE ENTRY

As there is no common method or fixed rules for maintaining records under this system, we may come across a variety of ways in which the records are maintained. Thus only personal accounts may be maintained but not other types of accounts or personal accounts and real accounts may be maintained leaving nominal accounts or cash account/book and personal accounts alone may be maintained and so forth. However, the last mentioned type is found to be more popular than the others. One common feature of these different ways or methods is that trial balance cannot be prepared as the complete double entry information is not recorded. Consequently, records are incomplete.

1.4 REASONS FOR RECORDS BEING INCOMPLETE

The records are incomplete due to a variety of reasons. It may be taht:

i) due to lack of proper knowledge of double entry system the records are maintained in a haphazard and disjoined manner,

ii) on account of very small nature of business, a full fledged double entry system is not followed,

iii) due to some accident or fire etc., the records which have otherwise been kept on double entry system are partially destroyed,

iv) due to practical convenience, only bare records which are necessary to carry on the business, are maintained; for example, debtors accounts and creditors accounts are maintained.

1.5 SALIENT FEATURES OF SINGLE ENTRY SYSTEM

1. This system is generally followed by small organisations. Sole trader concerns, partnership firms and many of the non-trading or non-profit organisations may keep books under this system. Joint stock companies or corporate bodies cannot keep books under single entry system, because of legal provisions requiring them to maintain the books under the double entry system.
2. Under this system, generally the personal accounts of debtors and creditors are maintained. Credit-sales, Credit-purchases, receipts from and payments to, are recorded only in those accounts but their corresponding entries as required by the double entry system may not be recorded. Moreover, the real and nominal accounts are not maintained.
3. It is also common to keep a cash book, or atleast a cash account. But it may have a mix up of business as well as private transactions.
4. Generally, there may not be uniformity in recording the transactions. For some of the transactions double entry is adopted (e.g. cash received from a debtor is entered in cash book and also in the debtor's a/c.), but for some of the transactions, only one aspect is recorded, i.e., Single entry, (e.g., crefit purchase is entered in the creditor's account only), and some other transactions may not at all be entered i.e., no entry, (e.g., depreciation, bad debts).
5. Even though real and nominal accounts are not maintained, major part of the information can be gathered from vouchers, receipts, invoices, cheque counterfoils, etc.

Check Your Progress - 1

a. What is single entry system?

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b. List out the features of single entry system.

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1.6 DEFECTS OF SINGLE ENTRY SYSTEM

Single entry entry system has many defects which are listed below :

1. **Trial Balance cannot be prepared :** Since both the aspects of all the transactions are not recorded, the arithmetical accuracy of the books cannot be checked by preparing a trial balance.
2. **Trading and Profit and Loss Account cannot be prepared :** In the absence of nominal accounts trading and profit and loss account cannot prepared. Hence, the gross profit and the net result of the business activities (net profit) cannot be accurately known.

3. **Balance Sheet cannot be prepared :** As there are no real accounts balance sheet cannot be readily prepared.

4. **No correct price of the business is available :** In the absence of proper accounts, it is difficult to fix the proper value of assets, especially of goodwill, at the time of sale of the business.

5. **Scope for Errors :** Since single entry system itself is unsystematic there is great scope for the commission of errors. When errors are committed it is very difficult to detect them. It is also not known whether errors are committed or not, unless they come to our notice.

6. **Scope for Frauds :** Since checks and counter-checks in the form of double entry are not available, it is easy to to commmit fraud or misappropriation and difficult to detect them if committed.

7. **Inadequate Information :** As there is no recorded evidence for certain items, the final statements have to be completed with whatever information that is given by the businessman.

8. **Unscientific Method :** The result of business activity i.e., profit is sought to be calculated on the basis of the differance between assets and liabilities which is unscientific and and also unreliable, since the analysis of it is not available.

9. **Causes for Profit not known :** The profit thus ascertained does not provide the necessary statistical information regarding the causes and sources of profit or loss. This hampers comparison, planning, evaluation, control and sound decision-making.

10. **Scope for doubt :** As single entry records are unreliable, any information obtained under this will not be free from doubt, and hence does not carry conviction. Only the information taken out of books of account kept on double entry system would carry conviction.

Inspite of its defects, this system is followed due to simplicity, convenience and less cost.

1.7 METHODS OF ASCERTAINING CAPITAL AND PROFIT

When books are kept under single entry system, profit made during the year and also the networth of the business is ascertained by one of the following two broad methods.

I. Capital Comparison Method.

II. Conversion Method.

These two methods will be taken up in the following two units in that order.

1.8 SUMMING UP

The fundamental rule of double entry system is that every debit must have a corresponding credit. Single entry system ignores the rules of double entry system. It is therefore, a defective or an incomplete double entry. There is no common method or fixed rules for maintaining records under the Single Entry System. We may come across a variety of ways in which the r ›rds are maintained by the businessmen adopting it.

The Single Entry System ignores the two fold aspect of the double entry system, and consequently fails to provide the necessary information. The accounts prepared from such incomplete records

are also called *'Accounts from Incomplete Records'*. The records are incomplete due to a variety of reasons, such as lack of proper knowledge of the double entry system, the smallness of the business concerned and the destruction of records. This system is generally followed by small organisations. Joint stock companies or corporate bodies cannot keep books uner the Single Entry System because of legal provisions requiring them to maintain books on Double Entry System. Under this system, generally the personal accounts of the debtors and creditors, and the cash book are maintained.

Single Entry System has many defects such as :

a) Trial Balance can not be prepared.

b) Trading, Profit and Loss Account, and Balance Sheet can not be prepared.

c) In the absence of proper accounts, correct price of the business can not be calculated.

d) There is scope for the commission of errors and frauds.

e) As single entry records are unreliable, any information obtained from them will not be free of doubt and hence does not carry conviction.

There are two methods of ascertaining the capital and the profit under Single Entry System viz., Capital comparison Method and Conversion Method.

1.9 CHECK YOUR PROGRESS : MODEL ANSWERS

1 (a) It is a mixture of double entry, single entry and no entry. In other words, it is a defective double entry system.

(b) The following are the features of single entry system:

i) Corporate bodies shall not follow this system.

ii) In most of the cases, only personal accounts are maintained.

iii) A cash book is kept clubbing both business and private transactions.

iv) There is no uniformity in recording the two fold aspect of various trasactions.

v) The information in respect of real and nominal accounts is ascertained from vouchers, receipts, invoices, counterfoils, etc.

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1.10 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines each.

1. What do you mean by single entry system? What are its defects?
2. What do you mean by 'Accounts' from Incomplete Records? Why records are incomplete?

B. Answer the following in 10 lines each.

1. What do you mean by single entry system?
2. What are the features of single entry system?
3. What are the various ways of maintaining records under Single Entry System?

1.11 RECOMMENDED BOOKS

1.	Shukla, M.C. & Grewal, T.S.	:	Advanced Accounts, S. Chand & S. Chand Pvt. Ltd., New Delhi.
2.	Jain, S.P. & Narang, K.L.	:	Advanced Accountancy, Kalyani Publishing House, New Delhi.
3.	Gupta, R.L. & Radhaswamy	:	Advaced Accountancy, Sultan Chand & Sons, New Delhi.

1.12 GLOSSARY

Accounts from Incomplete Records	:	It is another name for Single Entry System.
Single Entry System	:	It is a mixture of double entry, single entry and no entry. It is an incomplete double entry system.

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UNIT-2 : CAPITAL COMPARISON METHOD

Contents

2.0 Aims and Objectives
2.1 Introduction
2.2 Statement of Affairs
2.3 Statement of Profit and Loss
2.4 Summing Up
2.5 Check Your Progress : Model Answers
2.6 Model Examination Questions
2.7 Recommended Books
2.8 Glossary

2.0 AIMS AND OBJECTIVES

The aim of this unit is to acquaint you with the manner in which the profit to be ascertained by comparing the capitals at two points of time.

After going through this unit, you should be able to:

- ascertain the capitals at the beginning and at the end of the year
- find out the profit by preparing statement of profit and loss.

2.1 INTRODUCTION

Even though the accounts are not maintained properly and completely the businessman would like to know financial result of his business activities besides the financial position. This is possible by following either the capital comparison method or the conversion method. In this unit we present the capital comparison method.

Capital Comparison Method is also known as Net Worth Method or Statement of Affairs Method.

As we know, profit increases the capital, and loss reduces the capital. Profit, therefore, can be calculated by comparing the capital at the end and that at the beginning. This is the reason for naming this method, as Capital Comparison Method. The excess of closing capital over the opening capital can be considered as profit. On the other hand, the excess of opening capital over the closing capital is loss. However, it must be remembered that, the increase in the closing capital may be due to the addition of capital or the decrease in it may be due to drawings. Therefore, to get a correct picture these adjustments have to be made in the capital at close. The excess of adjusted closing capital over the capital at the beginning, represents profit.

But the word capital may be misleading here, since it includes retained earnings or internal reserves, if any. Therefore, the net worth concept is more appropriate here. In fact, the word capital is used here in the sense of net worth. Net worth is the difference between total assets and total outside liabilities. That is why this method is also called 'Net Worth Method'. In this method, the formula for determining the profit is shown below:

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$$\text{Profit} = \left\{\begin{array}{l}\text{capital or} \\ \text{Net worth} \\ \text{at the end} \\ (NW_1)\end{array}\right. + \text{Drawings (d)} - \left\{\begin{array}{l}\text{Additional} \\ \text{capital} \\ \text{Introduced} \\ \text{during the} \\ \text{year} \\ \text{(c)}\end{array}\right\} - \left\{\begin{array}{l}\text{Capital or} \\ \text{net worth at} \\ \text{the beginning} \\ (NW_o)\end{array}\right.$$

$\therefore$ if $(NW_1 + d - c) = NW_o$, it means, there is no profit no loss.

if $(NW_1 + d - c)$ is more than NW_o, it means profit.

if $(NW_1 + d - c)$ is less than NW_o, it means loss.

In this method, profit or loss can be ascertained by preparing. (i) two Statements of Affairs, one at the beginning, and the other at the end; and (ii) a statement of profit and loss.

2.2 STATEMENT OF AFFAIRS

Capital (Net worth/Net assets) is the difference between the total assets and total outside liabilities. Therefore, to know the net worth at the beginning and at the closing, one has to prepare a statement showing various assets and outside liabilities. Such a statement is called *"Statement of Affairs"* which is similar to a Balance Sheet. It is not called balance sheet, because it does not contain the list of balances of accounts as there are no ledger accounts as such. It contains both actual book figures in respect of some cases and estimates in respect of some other cases.

As the profit is ascertained by comparing the closing and opening capitals, which are found out by preparing two statements of affairs, this method is also called Statement of Affairs method. For the purpose of preparing a statement of affairs the following items are generally taken from the source mentioned against it.

i) Cash balance - from the Cash Book

ii) Bank balance - from the Pass Book

iii) Debtors and Creditors totals - from the Personal Ledger Accounts.

iv) Stock - by actual counting and valuation

v) Fixed Asset Accounts - by physical counting and valuation

vi) Outstanding, Prepaid expenses, Income earned but not received or received in advance - through records, if any, or from what the proprietors remember.

2.3 STATEMENT OF PROFIT AND LOSS

By preparing one statement of affairs at the beginning and another at the end of the accounting period, we can know what the capital is at the beginning as well as at the end. Drawings during the year are to be added to, and additional capital introduced during the year is to be subtracted from, the closing capital. Then the opening capital is subtracted from the adjusted closing capital to get the profit (subject to other adjustments, if any). The profit thus ascertained may be subject to certain other adjustments such as - (i) interest on capital and drawings, (ii) depreciation on assets, (iii) provision for doubtful debts, (iv) outstanding incomes and expenses, (v) incomes received in advance or prepaid expenses etc., which are not taken into account while preparing the statement of affairs. These adjustments should also be made in respect of the profit, which itself is subject to adjustments, so as to arrive at the net profit. All these adjustments are done in a separate statement known as Statement of Profit and Loss.

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Check Your Progress - 1

What is the main difference between Balance Sheet and Statement of Affairs?

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Check Your Progress - 2

How do you treat drawings and additional capital introduced during the year in the statement of profit and loss ?

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Steps under Capital Comparison Method

The steps or Procedure involved in the calculation of profit may be summarised as below:

1. **Calculate Opening Capital :** If opening capital (or net worth or capital fund) is not given, calculate it by preparing an opening statement of affairs. The difference (balancing figure) between total assets and outside liabilities is the capital on that date.

2. **Calculate Capital at the end :** As in step 1, prepare a closing Statement of Affairs and calculate the capital at the end of the year.

3. **Prepare the Statement of Profit and Loss :** In this statement make all adjustments as explained above, i.e.,

   a) adjust the capital at close by adding drawings and subtracting additions to capital,

   b) subtract capital at the beginning to arrive at profit for the year, and

   c) make other adjustments to arrive at net profit.

4. **Prepare a fresh/revised Statement of Affairs at the end :** Prepare a fresh revised statement of affairs, if necessary, incorporating all the adjustments such as depreciation, provistions, interest on drawings and capital, etc.

The above mentioned procedure is illustrated here under :

Illustration - 1 : (when the opening capital is known)

Mr. Shreedhar keeps his books on single entry basis. He started business on the 1st January, 1984 with RS. 20,000. On the 31st of December, 1984 his position was foillow :

Assets : Cash in hand Rs. 500; Cash at bank Rs. 1,000; Furniture Rs. 2,500; Sundry Debtors Rs.8,000; Stock Rs. 10,000; Machinery Rs. 10,000 and Bills Receivable Rs. 1,000.

Liabilities : Bills payable Rs. 500; Sundry creditors Rs. 5,000 and outsanding expenses Rs. 500.

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He has withdrawn at the rate of Rs. 200 per month for his personal use during the year.

Ascertain the profit or loss made by Mr. Shreedhar during the year 1984.

Solution

Mr. Shreedhar's Statement of Affairs
as on 31-12-1984

Liabilities	*Rs.*	*Assets*	*Rs.*
Outstanding expenses	500	Cash in hand	500
Bills Payable	500	Cash at bank	1,000
Sundry Creditors	5,000	Bills Receivable	1,000
Capital (Balancing figure)	27,000	Sundry Debtors	8,000
		Stock	10,000
		Furniture	2,500
		Machinery	10,000
	33,000		33,000

Mr. Shreedhar's Statement of Profit and Loss
for the period ending 31-12-1984

	Rs.	Rs.
Capital at the end (i.e. as on 31-12-1984)	27,000	
Add: Drawings during the years (Rs. 200 × 12)	2,400	
	29,400	
Less: Additional Capital Introduced	—	
Adjusted Closing Capital	29,400	
Less: Capital at the beginning (i.e., on 1-1-1984)	20,000	
Profit subject to adjustments		9.400
Less or Add - Adjustements		—
Net Profit		9,400

Notes :

1. Since opening capital is given, there is no need to prepare opening statement of affairs.
2. Closing capital is ascertained thus: Assets – Liabilities = Capital i.e., Rs. 33,000 – Rs. 6,000 = Rs. 27,000.

Illustration - 2 : (When the opening capital is not known)

From the following information of Mr. Shreekanth, who keeps books on single entry basis, ascertain profit or loss for the year ending on the 30th of June, 1984.

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Particulars	*1-7-1983* Rs.	*30-6-1984* Rs.
Cash in hand	400	1,400
Cash at Bank	5,500	5,000
Stock	20,000	30,000
Sundry Debtors	25,000	28,000
Furniture and fittings	5,000	5,000
Machinery	25,000	50,000
Bills Receivable	4,000	5,000
Bills Payable	8,000	12,000
Sundry creditors	35,000	50,000

During the year Mr. Shreekanth introduced Rs. 5,000 (on 1-1-1984) as further capital and withdrew Rs. 12,000 for domestic purposes. He has also paid Rs. 1,000 towards income tax, and Rs. 1,000 towards his son's college fees.

Calculate depreciation on furniture and fittings @ 10%, and on machinery @ 15% p.a. and provide interest on capital and drawings @ 10% p.a.

Solution

Mr. Shreekanth's Statement of Affairs
as on 1st July, 1983

Liabilities	*Rs.*	*Assets*	*Rs.*
Outstanding expenses	500	Cash in hand	500
Sundry Creditors	35,000	Cash at Bank	5,500
Capital (Balancing figure)	41,900	Bills Receivable	4,000
		Stock	20,000
		Sundry Debtors	25,000
		Furniture and Fittings	5,000
		Machinery	25,000
	84,900		84,900

Mr. Shreekanth's Statement of Affairs
as on 30th June, 1984

Liabilities	*Rs.*	*Assets*	*Rs.*
Bills Payable	12,000	Cash in hand	1,400
Sundry Creditors	50,000	Cash at Bank	5,000
Capital (Balancing figure)	62,400	Bills Receivable	5,000
		Stock	30,000
		Sundry Debtors	28,000
		Furniture and Fittings	5,000
		Machinery	50,000
	1,24,400		1,24,400

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Mr. Shreekanth's Statement of Profit and Loss
for the period ending 30th June, 1984.

	Rs.	Rs.
Capital as on 30th June, 1984	62,400	
Add: Drawings during the year (Rs. 12,000 + 1,000 + 1,000)	14,000	
	76,400	
Less: Capital introduced during the year	5,000	
Adjusted Capital at the end	71,400	
Less: Capital as on 1st July, 1983	41,900	
Profit subject to Adjustments		29,500
Add: Interest on Drawings $\left(Rs.14,000 \times \frac{6}{12} \times \frac{10}{100}\right)$		700
		30,200
Less: Depreciation - on furniture & fittings $\left(5000 \times \frac{10}{100}\right)$	500	
- on machinery	5,625	
Interest on capital	4,440	10,565
Net Profit		19,635

Mr. Shreekanth's Revised Statement of Affairs
as on 30th June, 1984

Liability			Assets		
Bills Payable		12,000	Cash in hand		1,400
Sundry Creditors		50,000	Cash at Bank		5,000
Capital : Op.Balance	41,900		Bills Receivable		5,000
Add: Introduced during the year	5,000		Stock		30,000
Add: Interest on Capital	4,440		Sundry Debtors		28,000
Add: Net Profit	19,635		Furniture and Fittings	5,000	
	70,975		Less: Depreciation	500	
					4,500
Less: Drawings 14,000			Machinery	50,000	
Less: Interest on drawings 700			Less: Depreciation	5,625	
	14,700				44,375
		56,275			
		1,18,275			1,18,275

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Note :

1. Two statements of affairs are prepared to arrive at the Opening Capital and the closing one.

2. Drawings are thus arrived at Rs. 12,000 withdrawn + Rs. 1,000 income tax paid + Rs. 1,000 college fees paid = Rs. 14,000. Since the dates of withdrawal are not given, the interest on drawings is calculated for 6 months (on an average).

3. In the beginning the machinery was worth Rs. 25,000. But at the end it was worth Rs. 50,000. This means that Rs. 25,000 worth of machinery is added during the year, but the date is not known. Therefore, depreciation is calculated @ 15% on the first Rs. 25,000 for the full year and on the next Rs. 25,000 for 6 months. Thus Rs. $25,000 \times \frac{15}{100} = 3,750 + \left\{25,000 \times \frac{15}{100} \times \frac{6}{12}\right\} = 1,875$ is Rs. 5,625. (Rs. 3,750 + Rs. 1,875).

4. Interest on Opening Capital Rs. 41,900 is calculated for the full year and on the Additional Capital of Rs. 5,000 for 6 months.

Illustration - 3 :

Mr. Srinivas keeps his books on single entry. The following information is ascertained from his records:

Particulars	*31-12-1983*	*31-12-1984*
Cash in hand	300	700
Balance at Bank as per cash book	(Cr.)2,700	(Dr.) 5,300
Stock	13,000	22,000
Sundry Debtors	35,000	33,000
Furniture	6,000	6,000
10% Investments	8,000	8,000
12% Loan from Mrs. Srinivas (taken on 1-7-1984)	—	5,000
Sundry Creditors	28,000	30,000
Bills Payable	1,000	1,500
Building less Depreciation	10,500	10,000

Mr. Srinivas transferred Rs.300 each month during the first half year and Rs.250 each month during the remaining period from the business to his private Bank account by way of drawings. In addition, he withdrew Rs.500 for his son's college fees and Rs.5,000 for his daughter's marriage. He also withdrew goods worth Rs.1,800 for his domestic purposes.

During the year he had received a lottery prize of Rs.10,000 out of which he invested in the business Rs.5,000. He sold his personal scooter for Rs.5,000 out of which Rs.4,000 were utilised for the business.

He did not pay the salary of his clerk for the month of December, 1984 amounting to Rs.200, Municipal taxes outstanding were Rs.250. At the end of the year the commission earned but not yet received by him was Rs.2,000. Interest on investments and on loan are due.

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He wants you to write off Rs.1,000 as bad debts and create a provision for doubtful debts at 5%. Depreciate furniture @ 10% p.a.

Prepare a statement of profit or loss for the year 1984.

Solution

Instead of preparing two separate statements of affairs, only one can prepared using the columnar form as shown below :

Mr. Srinivas's Statement of Affairs

Liabilities	1-1-84 Rs.	31-12-84 Rs.	Assets	1-1-84 Rs.	31-12-84 Rs.
Overdraft	2,700	—	Cash in hand	300	700
Bills payable	1,000	1,500	Cash at Bank	—	5,300
Sundry Creditors	28,000	30,000	Stock	13,000	22,000
12% Loan from Mrs. Srinivas	—	5,000	Sundry Debtors	35,000	33,00
Capital (Balancing figure)	41,100	48,500	10% Investments	8,000	8,000
			Furniture	6,000	6,000
			Buildings	10,500	10,000
	72,800	85,000		72,800	85,000

Mr. Srinivas's Statement of Profit or Loss
for the year ending on 31-12-1984

		Rs.	Rs.
Capital as on 31-12-1984		48,500	
Add: Drawings-	Rs. 300 × 6 = 1,800		
	Rs. 250 × 6 = 1,500		
	500		
	5,000		
	1,800		
		10,600	
		59,100	
Less: Additional Capital intruduced (Rs. 5,000 + Rs. 4,000)		9,000	
Adjusted closing capital		50,100	
Less: Capital as on 1-1-1984		41,100	
Profit Subject to adjustments			...9,000
Add : Commission earned but not yet received		2,000	
Add : Interest on Investments @ 10% on 8,000		800	
			... 2,800
			11,800
Less: Interest on Mrs. Srinivas Loan $5000 \times \frac{12}{100} \times \frac{6}{12}$		300	
Salary outstanding		200	
Municipal taxes outstanding		250	
Bad debts		1,000	
Provision for doubtful debts		1,600	
Depreciation on fortinute		600	
			3,950
Net profit for the year			7,850

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Mr. Srinivas's Revised Statement of Affairs
as on 31st December, 1984

Liabilities		Rs.	Rs. Assets		Rs.
Bills Payable		1,500	Cash in hand		700
Interest on loan		300	Cash at Bank		5,300
Salary outstanding		200	Commission due		2,000
Municipal taxes outstanding		200	Interest on Investments due		800
Sundry Creditors		30,000	Stock		22,000
12% loan from Mrs. Srinivas		5,000			
Capital : as on 1-1-1984	41,100		Sundry Debtors	32,000	
Add: Additional capital	9,000		Less: Bad Debts	1,000	
Add: Net Profit	7,850				
	57,950			32,000	
Less: Drawings	10,600		Less: Provision	1,600	
		47,450			30,400
			10% Investments		8,000
			Furniture	6,000	
			Less: Depreciation	600	
					5,400
			Buildings	10,500	
			Less: Depreciation	500	
					10,000
		84,600			84,600

Illustration - 4 : (Showing net loss)

Mr. Eshwar gives you the following information, from which you are requested to find out his profit or loss for the year ending on 31st of March, 1985:

	31.-3-1984 Rs.	31-3-1985 Rs.
Bank balance	(Dr.) 600	(Cr.) 1,000
Cash at Hand	100	150
Stock of goods	5,000	6,000
Sundry Debtors	6,000	4,000
Furniture	2,000	2,000
Building	10,000	10,000
Sundry creditors	3,500	4,000

Mr. Eshwar had introduced fresh capital of Rs.5,000 on 1st July 1984 and had withdrawn Rs. 2,500 during the year. Interest on capital is to be allowed at 10% p.a. Write off depreciation on building at 5% and on furniture at 10%. A provision of 5% on Sundry Debtors is required.

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Mr. Eshwar's Statement of Affairs (in columnar form)

Liabilities	31-3-84	31-3-85	Assets	31-3-84	31-3-85
Bank overdraft	—	1,000	Cash in hand	100	150
Sundry Creditors	3,500	4,000	Bank balance	600	—
Capital (balancing figure)	20,200	17,150	Stock of goods	5,000	6,000
			Sundry Debtors	6,000	4,000
			Furniture	2,000	2,000
			Building	10,000	10,000
	23,700	22,150		23,700	22,150

Mr. Eshwar's Statement of Profit and Loss
for the year ending 31st March, 1985

	Rs.	Rs.
Closing capital (i.e. as on 31-3-1985)	17,150	
Add: Drawings during the year	2,500	
	19,650	
Less: Additional capital introduced	5,000	
Adjusted closing capital	14,650	
Less: Opening capital (i.e. as on 1-4-1984)	20,200	
Loss subject to adjustments		5,550
Add: Interest on capital	2,395	
Depreciation on building at 5%	500	
Depreciation on furniture at 10%	200	
Provision for doubtful debts	200	
		3,295
Net loss		8,845

Notes :

1. The opening capital (Rs. 20,200) is more than the adjusted closing capital (Rs. 14,650). Therefore, the difference (Rs. 5,550) is loss.
2. On the additional capital of Rs. 5,000 the interest is calculated for 9 months.
3. Prepare revised statement of affairs as on 31-3-1985, the total of which would be Rs. 21,250.

2.4 SUMMING UP

Capital comparison method is also called Net Worth Method or Statement of Affairs Method. Under this method, the profit made or loss incurred is ascertained by comparing the closing and opening capitals, which are found out by preparing the Statements of Affairs at the beginning and at the end. Drawings during the year are to be added to, and additional capital introduced during the year is to be subtracted from, the closing capital. Then the opening capital is subtracted from the adjusted closing capital to get the profit. The profit thus ascertained

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may be subjected to certain other adjustments, if any, such as, interest on capital and drawings, depreciation on assets, provision for doubtful debts, outstanding incomes and expenses, incomes received in advance or prepaid expenses, etc.

2.5 CHECK YOUR PROGRESS : MODEL ANSWERS

1. A Balance Sheet is prepared with a list of ledger balances. On the other hand, the statement of Affairs is prepared with some actual book values and estimates in respect of items where the actual book values are not available.
2. Drawings are added to and additional capital introduced is subtracted from the closing capital.

2.6 MODEL EXAMINATION QUESTIONS

A. Anwer the following in 30 lines.

1. Explain the procedure involved in the calculation of profit under Capital Comparison Method.

B. Anwer the following in 10 lines each.

1. Write short notes on the following:
   a) Net worth
   b) Statement of Affairs
2. How is the statement of profit or loss is prepared?
3. What is the adjusted capital at the end?

Problems

1. Mr. Mahesh keeps his books on Single Entry. His position on 31st December, 1983 was as follows:

   Cash in hand Rs. 800; cash at bank Rs. 6,000; Stock in trade Rs. 38,000; Sundry debtors Rs. 20,000; Fixtures & Fittings Rs. 4,000; Plant and Machinery Rs. 28,500; Sundry Creditors Rs. 42,000; outstanding expenses Rs. 2,000.

   On 31st December, 1984 his position was as follows:-

   Cash in hand Rs.6,000; cash at bank Rs.12,000; sundry debtors Rs.16,000; stock in trade Rs.30,000; plant and machinery Rs.25,000; Fixtures and Fittings Rs. 5,000; Sundry creditors Rs.50,000; outstanding expenses Rs.3,000.

   During the year he has introduced Rs. 8,000 as further capital into the business and withdrew Rs. 1,000 per month.

   From the above particulars, you are required to ascertain the profit or loss made by him for the year ended 31st December, 1984.

   (Opening capital Rs. 53,300; Closing capital Rs. 41,000; Net loss Rs. 8,300)

2. Mr. Ramu's financial position as on 1st July 1984 was as under :
   Cash Rs.14,150; Bill Receivable Rs.4,600; Debtors Rs.48,650; Stock Rs.34,000; Plant Rs.80,000; Equipment Rs.5,000; Bills payable Rs.6,000; Creditors Rs.20,000.

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On 30th June 1985, his position stood as under:

Cash Rs.16,200; Debtors Rs.66,300; Stock Rs.37,000; Bills Receivable Rs.8,800; Creditors Rs.21,500; Bills Payable Rs.1,000.

Write off Rs. 300 as bad debts. Provide 5% on debtors for doubtful debts. Plant and Equipment are to be depreciated by 10%. During the year Ramu withdrew Rs. 15,000.

You are required to ascertain the profit or loss for the year 1984-85.

Hint :

Closing plant and equipment balances are same as opening balances. (Opening Capital Rs.1,60,400, closing capital Rs.1,90,800, Net profit Rs.33,300).

3. The following balances appear in the books of Venkatesh, which are kept on single entry basis:

	31-12-83 Rs.	31-12-84 Rs.		31-12-83 Rs.	31-12-84 Rs.
Capital	52,400	52,400	Furniture	4,000	4,000
Creditors	39,800	41,600	Stock	51,000	50,000
			Debtors	34,500	37,500
			Cash and Bank	2,700	2,500
	92,200	94,000		92,200	94,000

Venkatesh has been regularly transferring Rs. 800 a month from his business banking account to his private banking account. He has sent goods worth Rs. 1,400 to his daughter as gift. Depreciation on furniture has to be provided @ 5%. Write off Rs. 500 as bad debts.

You are required to ascertain Venkatesh's profit or loss for the year 1984.

(Net profit Rs. 10,300).

4. Hukam Singh keeps his books on single entry. His position was as follows:

	31-3-1984 Rs.	31-3-1985 Rs.
Cash in hand	200	300
Balance at bank	(Dr.) 3,000	(Cr.) 2,000
Stock in Trade	20,000	19,000
Bills Receivable	4,000	3,000
Sundry Debtors	9,000	14,500
Prepaid insurance	400	400
Plant and Machinery	15,000	25,000
Sundry creditors	22,000	32,000
Bills payable	4,000	2,000
Salary payable	500	1,000
Fixtures and Fittings	1,800	1,500

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During the year Humkum Singh introduced Rs. 5,000 as further capital and withdrew Rs. 750 per month. Provide depreciation on plant and machinery @ 3% on opening balance. Write off Rs. 500 as bad debts. Provide 5% for doubtful debts.

From the above information, prepare a statement showing profit or loss made by him during the year 1984-85.

Hint: Bank credit balance is overdraft.

(Opening capital Rs. 26,900, Closing capital 26,700, Net Profit Rs. 2,150)

5. Trivikram keeps his books of accounts on single entry. The following information is supplied to you.

Assets and Liabilities	1st January 1984	31 Dec. 1984
	Rs.	Rs.
Investments	50,000	80,000
Furniture	15,000	35,000
Stock	35,000	30,000
Debtors	20,000	22,000
Bank	10,000	15,000
Creditors	16,000	21,000
Loan from Nagesh	—	16,000
Bills Payable	5,000	8,000

The addition to furniture is made on July 1, 1984, in exchange of his old car valued at Rs. 20,000. Furniture is to be depreciated at 10% p.a. and debtors are to be provided Rs. 2,000 for doubtful debts.

Trivikram has drawn Rs. 1,000 per month for household expenses. He has also spent Rs. 5,000 from business funds for providing education to his son. The rent of his business-cum-residentail flat is Rs. 900 p.m. and one-third thereof only is used for the business, but the rent is paid in full from the business funds.

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You are requested to prepare profit and loss statement for the year 1984 and the final statement of affairs as on that date.

Hints: i) treat the old car amount Rs. 20,000 as additional capital introduced.

ii) provide depreciation on additional furniture for 6 months only.

(Capital on 1-1-1984 Rs. 1,09,000 and on 31.21.1984 Rs. 1,37,000 Net profit Rs. 27,700; Final statement of affairs total Rs. 1,77,500)

2.7 RECOMMENDED BOOKS

1. Gupta, R.L. & Radhaswamy : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C. & Grewal, T.S. : Advanced Accounts, S.Chand & Co. Ltd. New Delhi.
3. Jain, S.P. & Narang, K.L. : Advanced Accountancty, Kalyani Publishing House, New Delhi

2.8 GLOSSARY

Statement of Affairs	:	To know the capital (or net worth) on a particular date under Single Entry System a statement is prepared showing different assests and outside laibilities which is called a Statement of Affairs'. It is similar to the Balance Sheet. But it is not called 'Balance Sheet' because it does not contain the list of balances of various accounts, as there are no ledger accounts as such.
Statement of profit and loss	:	It is a statement prepared under the statement of affairs method, to ascertain the net profit or loss made during the year.
Net Worth	:	It is the difference between the total assets and the total outside liabilities.

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UNIT-3 : CONVERSION METHOD

Contents

3.0 Aims and Objectives
3.1 Introduction
3.2 Searching for Required Information
3.3 Finding out the Missing Information
3.4 Steps in Coversion
3.5 Comprehensive Illustrations
3.6 Summing Up
3.7 Check Your Progress : Model Answers
3.8 Model Examination Questions
3.9 Recommended Books
3.10 Glossary

3.0 AIMS AND OBJECTIVES

Coversion of accounts maintained under single entry system into double entry system involves the preparation of various accounts. This unit is designed to learn such accounts and the preparation of final accounts.

At the end of this unit, you should be able to:

- identity the information missing for the preparation of final accounts
- explain the steps involved in the conversion of single entry records into double entry
- work out the problems on the basis of conversion method.

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3.1 INTRODUCTION

In the previous unit, the method of ascertaining the profit or loss under single entry system, by comparing the opening and closing capitals is explained. If it is proposed to calculate the profit or loss by preparing the Trading and Profit and Loss Account, then the capital comparison method is not used. Instead, the single entry records are converted into double entry records. It means that the books should be written up so as to give complete information, as is the case under the double entry system. This involves Journalising, Ledger Posting, balancing and preparation of the Trial Balance. This method is called 'conversion of single entry into full-fledged double entry'. Full-fledged conversion is theoretically possible and may be attempted in actual business. Only an abridged conversion, or short-cut conversion method is generally followed, which is explained hereunder.

Under the conversion method, you are expected to prepare the Trading and Profit and Loss Accounts, and the Balance Sheet. It would be helpful to first prepare a Trial Balance to ensure that the conversion into double entry has been completed correctly. For this purpose the required information has to be gathered from various sources.

2. *Finding out opening balance of Debtors or credit sales or closing balance of Debtors.*

In order to find out either the opening balance of debtors or the credit sales or the closing balance of debtors. A 'Total Debtors Account' is prepared, by taking all the information affecting the total debotors position. The difference between the two sides of the account (i.e. balancing figure) is considered as the missing figure. Consider the following illustration:

Illustration - 2

	Rs.
Sundry Debtors (1-1-1984)	20,000
Cash received from Debtors	25,000
bad debts written off	3,000
Bills Received from Debtors	7,000
Bills receivable Dishonoured	2,000
Returns inwards	3,000
Discounts allowed	2,000
Sundry Debtors (31-12-1984)	30,000

Find out the credit sales.

Solution

Dr. **Total Debtors Account** Cr.

	Rs.		Rs.
To Opening Debtors	20,000	By Cash, Received from debtors	25,000
" Bills receivable dishonoured	2,000	" Bad debts written off	3,000
		" Bills Receivable received	7,000
" Credit sales (Balancing figures)	48,000	" Returns Inwards	3,000
		" Discount allowed	2,000
		" Transfers to creditors ledger	—
		" Closing debtors	30,000
	70,000		70,000

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Note: In the above mentioned illustration, assume that the credit sales given as Rs.48,000 and that, opening debtors is not given and work out for yourself.

3. *Finding out missing information regarding Bills Receivable (B/R)*

If there are Bills of Exchange transactions, then a Bills Receivable Account has to be prepared to find out if any item of information is missing. The missing figure may be the opening or closing balance of B/R or B/R received from the debtors during the year or that B/R dishonoured by debtors during the year. We may also need this information for preparing the total debtors account or the opening or closing Statement of Affairs. Bills Receivable account is prepared by taking all the information affecting B/R.

Illustration - 3

	Rs.
B/R on 1-1-1984	10,000
Cash received on B/R presented for payment	12,000
B/R dishonoured during the year	2,000
B/R balance on 31-12-1984	3,000

Find out the amount of B/R received from debtors during the year.

Solution

Dr. **Bills Receivable Account** Cr.

	Rs.		Rs.
To Balance (Opening)	10,000	By Cash (received on bills matured)	12,000
To Debtors (B/R received from debtors during the year) (Balancing figure)	7,000	By Debtors (B/R dishonoured)	2,000
		By Balance (closing)	3,000
	17,000		17,000

4. *Finding out Opening Balance of Creditors or Credit Purchases or Closing Balance of Creditors.*

In or to find out either the opening balance of creditors or credit purchases or closing balance of creditors a 'Total Creditors Account' is to be prepared, by taking all the information affecting the total creditors position, as in the case of Total Debtors Account.

Illustration - 4

	Rs.
Credit purchases during the year	40,000
Bills Payable Accepted during the year	5,000
Cash paid to Creditors during the year	30,000
Bills Payable (B/P) dishonoured during the year	4,000
Discount Received during the year	6,000
Returns outwards during the year	7,000
Closing Balance of creditors at the end	12,000

What is the balance of creditors at the beginning of the year?

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Solution :

Dr. **Total Creditors Account** Cr.

	Rs.		Rs.
To Cash (Paid to creditors)	30,000	By Balance b/d (balancing figure)	16,000
" B/P Accepted	5,000	" Credit purchases	40,000
" Discount received	6,000	" B/P dishonoured	4,000
" Returns outwards	7,000		
" Transfers from Debtors Ledger*	—		
" Balance c/d (closing)	12,000		
	60,000		60,000

* Sometimes certain amounts from Debtors Ledgermay be transferred to Creditors Ledger and vice versa. Depending on the nature of the case. The item would appear on either the debit side or the credit side. Note that similar treatment must be given in the case of Total Debtors Account also.

5. *Finding out information regarding Bills Payable (B/P)*

If there are Bills transactions, a B/P A/c is also to be prepared. This is necessary either to find out the B/P whether accepted or dishonoured during the year, which is necessary for total creditors account as shown above. This is also necessary for ascertaining the balance of B/P either at the beginning or at the end of the year, if that information is not given.

Illustration - 5

	Rs.
Opening Balance of B/P	8,000
B/P accepted during the year	5,000
Cash paid on B/P	7,000
B/P Dishonoured	4,000

What is the closing balance of B/P at the end of the year?

Solution

Dr. **Bills Payable Account** Cr.

	Rs.		Rs.
To Cash (paid on B/P)	7,000	By Balance b/d (Opening)	8,000
" Sundry Creditors (B/P dishonoured)	4,000	By Sundry Creditors (B/P accepted)	5,000
" Balance c/d (closing) (Balancing figure)	2,000		
	13,000		13,000

6. *Finding out Cash and Bank Balances*

Receipts and Payments Account (or Cash Book) should be prepared for cash and bank separately (or in columnar form) to ascertain the cash balance and bank balance at the beginning or at the end of the year. If the preparation of cash and bank accounts separately is not possible, then one combined cash and bank account may be prepared. Quite often this account reveals a missing figure of cash or bank balance in the beginning or at the end. If both these figures are given, even then Cash Book (or a/c) must be prepared. Because, in the case of any difference between the two sides, that difference may be treated as cash purchases/drawings/sundry expenses (if the difference is on credit side) or it may be treated as cash sales/sundry income/additional capital introduced (if the difference is on debit side), as the case may be. Consider the following:

Illustration - 6

	Rs.
Cash and Bank balance on 1-1-1984	5,000
Cash received from Debtors	10,000
Cash received from B/R	4,000
Miscellaneous Income	2,000
Cash paid to creditors	12,000
Cash Purchases	10,000
Payment of expenses	3,000
B/P payments	3,000
Drawings	2,000
Cash and Bank balance on 31-12-1984	3,000

Solution

Dr. **Cash Book** Cr.

	Rs.		Rs.
To Balance b/d	5,000	By Creditors (cash paid)	2,000
" Debtors (cash received)	10,000	" Cash purchases	10,000
" B/R (cash received)	4,000	" B/P (Payments)	3,000
" Miscellaneous Income	2,000	Payment of expenses	3,000
" Cash sales (Balancing figure)	12,000	" Drawings	2,000
		" Balance c/d	3,000
	33,000		33,000

If the problem contains any information regarding capital introduced, that amount would appear on the debit side of the cash a/c. (Book).

7. *Finding out opening capital*

If the Opening Capital is not given, then an Opening Statement of Affairs should be prepared, as indicated in the previous unit, in order to find out the capital at the beginning of the year.

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3.4 STEPS IN CONVERSION

The following steps are necessary to prepare the final accounts i.e., Trading and Profit and Loss Account, and Balance Sheet - from the incomplete information given in the question :

1. Prepare an opening statement of affairs so as to calculate capital at the beginning of the year.
2. Prepare summaries of cash book (cash account and bank acount) separately. If that is not possible a combined cash and bank account may be prepared.

   Prepare the Opening Statement of Affairs and Cash Book (step 1 and 2) simultaneously. It is not always possible to complete them at a stretch. In that case, the student can prepare as much as he can and leave the rest incomplete. When the missing information is found out by preparing other accounts, he can complete them.
3. Prepare other accounts viz., Total Debtors Account, Total Creditors Account, Bills Receivable Account and Bills Payable Account, and Memorandum Trading Account.

   These accounts help us in finding out credit sales, credit purchases or debtors and creditors balances etc., in the beginning or at the end of the year.
4. Calculate total purchases and total sales. The total purchases can be arrived at by adding the credit purchases and cash purchases. Similarly the total sales can be found out by adding credit sales and cash sales.
5. Prepare a trial balance to test the accuracy of accounts. However, the preparation of the trial balance is not compulsory.
6. Now prepare final accounts i.e., Trading and Profit and Loss A/c. and the Balance Sheet, by taking into account various adjustments.

Check Your Progress - 1

Prepare total debtors account of the following information:

	Rs.
Debtors 1-1-1990	50,000
Cash received	40,000
Discount allowed	1,500
Bad debts	500
Bills Receivable received during the year	4,000
Interest charged on debtors	1,600
Bills Receivable dishonoured	1,000
Debtors on 31-12-1990	80,000
Cash Sales	90,000

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Check Your Progress - 2

Prepare total creditors account of the following information:

	Rs.
Balance on 1-4-90	64,000
Cash Purchases	45,000
Credit Purchases	85,000
Discount Received	2,000
Bills Payable accepted during the year	16,000
Interest charged by creditors	1,000
Cash paid to Creditors	25,000

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3.5 COMPREHENSIVE ILLUSTRATIONS

It is now proposed to show the working of conversion method, through the following illustrations.

Illustration - 7

Ramesh keeps his books on the basis of single entry system. He gives you the following information, from which you are required to prepare the Trading and Profit and Loss Account for the year ending 31st December, 1984 and the Balance Sheet as on that date.

	31-12-1983	*31-12-1984*
	Rs.	*Rs.*
Cash in hand	2,200	600
Unpaid expenses	1,200	2,000
Prepaid expenses	--	400
Furniture and fittings	10,000	12,000
Stock of materials	6,000	3,000
Sundry Debtors	12,000	15,000
Sundry Creditors	5,000	1,000

The receipts and payments during the year were:

Furniture purchased for cash	2,000
Sundry expenses	30,000
Drawings	25,000
Cartage	5,000
Paid to creditors	20,000
Received from Debtors	44,000

There was considerable amount of cash sales. Create a provision for doubtful debts @ 10% on debtors.

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Solution

In this problem the stock particulars are given, but not the Bill of Exchange transactions. Therefore, there is no need to prepare the Memorandum Trading a/c, B/R a/c and B/P a/c. However, the information pertaining to the opening capital, sales and purchases is missing. Hence, first we have to prepare Opening Statement of Affairs, Total Debtors account, Cash Book and Total Creditors account in order to find out the missing figures.

1. Calculation of capital on 31-12-1983 (i.e. on 1-1-1984):

Ramesh's Statement of Affairs

as on 31-12-1983

	Rs.		Rs.
Unpaid expenses	1,200	Cash in hand	2,200
Sundry Creditors	5,000	Sundry Debtors	12,000
Capital (Balancing figure)	24,000	Stock of materials	6,000
		Furniture and fittings	10,000
	30,200		30,200

2. Calculation of cash sales:

Cash Book

	Rs.		Rs.
To Balance b/d	2,200	By Furniture purchased	2,000
To Debtors (cash received from debtors)	44,000	By Sundry expenses	30,000
To Cash sales (Balancing figure)	36,400	By Drawings	25,000
		By Cartage	5,000
		By Creditors (paid to creditors)	20,000
		By Balance c/d	600
	82,600		82,600

3. Calculation of credit sales:

Dr. **Total Debtors Account** Cr.

	Rs.		Rs.
To Balance b/d	12,000	By cash	44,000
To Credit sales (Balancing figure)	47,000	By Balance c/d	15,000
	59,000		59,000

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4. Calculation of credit purchases:

Dr. **Total Creditors Account** Cr.

	Rs.		Rs.
To Cash	20,000	By Balance b/d	5,000
To Balance c/d	1,000	By Credit Purchases (Balancing figure)	16,000
	21,000		21,000

5. a) Cash sales + Credit sales = Total sales
Rs. 36,400 + Rs. 47,000 = Rs. 83,400

b) Cash purchases + Credit purchases = Total purchases
Nil + Rs. 16,000 = Rs. 16,000

Note : After finding out the missing information, even without preparing the trial balance, we can now proceed to prepare final accounts of Ramesh.

Trading and Profit and Loss Account of Ramesh
for the year ending 31st December, 1984

		Rs.		Rs.
To Opening Stock		6,000	By Sales	83,400
" Purchases		16,000	" Closing Stock	3,000
" Cartage		5,000		
" Gross profit c/d		59,400		
		86,400		86,400
To Sundry Expenses:			By Gross profit b/d	59,400
paid	30,000			
Add: unpaid for 1984	2,000			
	32,000			
Less: unpaid for 1983	1,200			
	30,800			
Less: Prepaid for 1985	400			
		30,400		
To Provision for Doubtful Debts @ 10% on 15,000.		1,500		
To Net Profit-transferred to capital a/c.		27,500		
		59,400		59,400

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Balance Sheet of Ramesh
as on 31st December, 1984

Liabilities		Rs.	Assets		Rs.
Capital:					
As on 1-1-84	24,000		Furniture and fittings		12,000
Add: Net Profit	27,500		Closing Stock		3,000
			Sundry debtors	15,000	
	51,000		Less: Provision	1,500	
					13,500
Less: Drawings	25,000		Prepaid expenses		400
	26,500		Cash in hand		600
Sundry Creditors		1,000			
Unpaid expenses		2,000			
		29,500			29,500

Illustration - 8

From the following information of Mr. Asif, prepare his Profit and Loss account for the year ended on the 31st of December, 1984 and his Balance Sheet as on that date.

i) Balance as on 1-1-1984:

	Rs.
Fixed Assets	40,000
Stocks	70,000
Sundry Debtors	45,000
Cash in hand	8,000
Cash at Bank	55,000
Asif's capital	2,00,000
Sundry creditors	18,000

ii) During the year the Debtors paid Rs. 1,00,000 in cash and Rs. 3,50,000 by cheques, while the creditors were paid Rs. 50,000 in cash and 3,00,000 by cheque. The closing balance of sundry debtors was Rs. 55,000 and that of sundry creditors Rs. 70,000.

iii) All expenses chargeable to profit and loss account were disbursed by cheques except petty expenses amounting to Rs. 15,000 which were paid in cash. Expenses unpaid at the end of the year amounted to Rs. 5,000.

iv) The closing stock was valued at Rs. 50,000.

v) Provide 10% depreciation on fixed assets.

vi) Asif's drawings during the year were Rs. 20,000 in cash and Rs. 30,000 by cheques.

vii) Cash sales and cash purchases were Rs. 20,000 and Rs. 15,000 respectively. The Bank balance at the end was Rs. 25,000.

Solution

a) Since, opening capital is given, there is no need to prepare opening statement of affairs.

b) Prepare Cash Book (cash a/c and bank a/c separately) to find out the amount of expenses paid by cheque and cash balance at the end.

Cash Book

Particulars	Cash	Bank	Particulars	Cash	Bank
	Rs.	Rs.		Rs.	Rs.
To Balance b/d	8,000	55,000	By Creditors	50,000	3,00,000
To Debtors	1,00,000	3,50,000	By Petty expenses	15,000	—
To Cash sales	20,000	—	By Drawings	20,000	30,000
			By Cash Purchases	15,000	—
			By Expenses	—	50,000 *
			By Balance c/d	28,000*	25,000
	1,28,000	4.05,000		1,28,000	4,05,000

* Balancing figure.

c) Prepare total or (sundry) debtors account to find out credit sales:

Dr. **Total Debtors Account** Cr.

	Rs.		Rs.
To Balance b/d	45,000	By Cash	1,00,000
To Credit sales		By Bank	3,50,000
(Balancing figure)	4,60,000	By Balance c/d	55,000
	5,05,000		5,05,000

d) Cash sales + Credit sales = Total sales

∴ Rs. 20,000 + Rs. 4,60,000 = Rs. 4,80,000

e) Prepare total (or sundry) creditors account to find out credit purchases.

Dr. **Total Creditors Account** Cr.

	Rs.		Rs.
To Cash	50,000	By Balance b/d	18,000
To Bank	3,00,000	By Credit purchases	
		(Balancing figure)	4,02,000
To Balance c/d	70,000		
	4,20,000		4,20,000

f) Cash purchases + Credit purchases = Total purchases

∴ Rs. 15,000 + Rs. 4,02,000 = Rs. 4,17,000

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Now prepare Final Accounts of Mr. Asif.

Trading and Profit and Loss Account of Mr. Asif
for the year ending 31st December, 1984

		Rs.		Rs.
To Opening Stock		70,000	By Sales	4,80,000
To Purchases (Total)		4,17,000	By Closing Stock	50,000
To Gross profit c/d		43,400		
		5,30,000		5,30,000
To Expenses:			By Gross profit b/d	43,000
Paid by Cheques	50,000		By Net Loss transferred	
Add: Paid by cash	15,000		to capital A/c.	31,000
Add: Expenses unpaid	5,000			
		70,000		
To Depreciation on Fixed Assets		4,000		
		74,000		74,000

Balance Sheet of Mr. Asif
as on 31st December, 1984

Liabilities		Rs.	Assets		Rs.
Capital:	2,00,000		Fixed Assets	40,000	
Less: Net loss 31,000			Less: Depreciation	4,000	
Less: Drawings 50,000	81,000				36,000
		1,19,000	Closing stock		50,000
Sundry creditors		70,000	Sundry Debtors		55,000
Expenses unpaid		5,000	Cash at Bank		25,000
			Cash in hand		28,000
		1,94,000			1,94,000

Illustration - 9

The following information relate to the business of Sri Bhagavan Rao, who has asked you to prepare a Trading and Profit and Loss Account for the year ended on the 31st of December, 1984 and a Balance Sheet as on that date.

i) The state of affairs at the beginning and at the end of the year is indicated here-under:

	1-1-1984	*31-12-1984*
	Rs.	*Rs.*
Cash and Bank balances	90,000	52,000
Bills Receivable	16,000	14,000
Bills Payable	14,000	8,000
Sundry Creditors	60,000	?
Sundry Debtors	80,000	?
Stock	?	20,000
Motor car	40,000	40,000
Furniture	30,000	40,000
Building	90,000	1,00,000

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ii) Cash transactions during the year included the following, besides certain other items:

	Rs.
Sale of old papers and other scrap	10,000
Trade expenses including salaries etc.	40,000
Collections from Debtors	1,00,000
Cash purchases	24,000
Payments to creditors	92,000
Cash sales	40,000

iii) Other information:

(a) An item of old furniture the written down value of which on 1-1-1984 was Rs. 10,000 was sold on 30-6-1984 for Rs. 4,000. Depreciation is to be provided on Building and Furniture @ 10 per cent per annum and on Motor car @ 20 per cent per annum.

(b) Bills Receivable drawn during the year amounted to Rs. 10,000 and Bills Payable accepted Rs. 8,000.

(c) Out of Sundry Debtors a sum of Rs. 4,000 should be written off as 'bad debt' and provision for doubtful debts is to be created @ 2 per cent on debtors.

(d) Outstanding salary on 1-1-1984 was Rs. 4,000 and on 31-12-1984 was Rs. 5,000.

(e) 20 per cent of the total sales and the total purchases are to be treated as for cash.

(f) Sri Bhagavan Rao has been maintaining a steady gross profit rate of 30 per cent on turnover.

(g) Profit and Loss account has a credit balance of Rs. 20,000 on 1-1-1984.

Solution

In this problem lot of information is missing: e.g. the opening stock, opening capital, closing debtors and creditors etc. Without finding out the missing information, the Trading and, Profit and Loss Account, and Balance Sheet cannot be prepared. Hence prepare the various accounts to find out the missing information. But we may not be able to complete them at a strech. Therefore, prepare all the necessary accounts at the same time with the available information and complete them as and when the missing information is found out.

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1. Bhagavan Rao's Statement of Affairs
as on 1-1-1984

	Rs.		Rs.
Capital (Balancing figure)	2,88,000	Building	90,000
Sundry Creditors	60,000	Furniture	30,000
Bills Payable	14,000	Motor Car	40,000
Profit and Loss a/c balance	20,000	Stock (Brought from No.9)	40,000
Outstanding salary	4,000	Sundry Debtors	80,000
		Bills Receivable	16,000
		Cash and Bank Balance	90,000
	3,86,000		3,86,000

Dr. 2. **Cash Account** Cr.

	Rs.		Rs.
To Balance b/d	90,000	By Trade expenses (including salaries)	40,000
" Sale of old papers & scrap	10,000	" Cash purchases	24,000
" Collections from Debtors	1,00,000	" Payments to creditors	92,000
" Cash sales	40,000	" Additions to Building (Rs.1,00,000–Rs.90,000	10,000
" Sale of old furniture	4,000	Purchase of furniture	
" Received on Bills Receivable a/c. (brought from No.3.)	12,000	(Rs.40,000–(30,000–10,000)*sold	20,000
		" Bills payable paid (Brought from No.6)	14,000
		" Drawings (Balancing figure)	4,000
		" Balance c/d.	52,000
	2,56,000		2,56,000

* Closing balance Rs. 40,000 – Opening balance 30,000 - sold 10,000) = 20,000

Note: The difference between the two sides of the Cash Account is assumed to to be the drawings made by the owner.

Dr. 3. **Bills Receivable Account** Cr.

	Rs.		Rs.
To Balance b/d	16,000	By Cash (Balancing figure)	12,000
To Debtors (B/R drawn)	10,000	By Balance c/d	14,000
	26,000		26,000

Dr. 4. **Total Debtors Account** Cr.

	Rs.		Rs.
To Balance b/d	80,000	By Cash (collections)	1,00,000
To Credit Sales (brought from No. 5)	1,60,000	" B/R (drawn during the year)	10,000
		" Balance c/d (Balancing figure)	1,30,000
	2,40,000		240,000

5. **Calculation of Credit Sales**

If the total sales (i.e. cash and credit) are 100, then the cash sales are 20% and credit sales are 80%. Therefore, when the cash sales (given) are Rs. 40,000, the credit sales are Rs. 1,60,000 and the total sales are Rs. 2,00,000.

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Dr. **6. Bills Payable Account** Cr.

	Rs.		Rs.
To Cash (Balancing figure)	14,000	By Balance b/d	14,000
To Balance c/d	8,000	By Creditors (B/P accepted)	8,000
	22,000		22,000

Dr. **7. Total Creditors Account** Cr.

	Rs.		Rs.
To Cash (paid to creditors)	92,000	By Balance b/d	60,000
To Bills Payable accepted	8,000	By Credit purchases (Brought from No. 8)	96,000
To Balance c/d (Balancing figure)	56,000		
	1,56,000		1,56,000

8. Calculation of Credit Purchases

If the total purchases (cash and credit) are 100, then the cash purchases are 20% and credit purchases are 80%. Therefore, when cash purchases (given) are Rs. 24,000, then credit purchases are $24,000 \times \frac{80}{20}$ = Rs. 96,000 and the total purchases are Rs. 24,000 + 96,000 = Rs. 1,20,000.

9. Memorandum Trading Account
(to find out opening stock)

Dr. Cr.

	Rs.		Rs.
To Opening stock (Balancing Figure)	40,000	By Total Sales	2,00,000
To Total Purchases	1,20,000	By Closing Stock	20,000
To Gross profit (30% on turnover or sales i.e. $2,00,000 \times \frac{30}{100} = 60,000$)	60,000		
	2,20,000		2,20,000

10. Preparation of Trial Balance

As this problem is a little bit complicated, it is advisable to prepare the trial balance for testing the accuracy of our conversion. The trial balance is as follows :

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Trial Balance of Sri Bhagavan Rao
(as on 31-12-1984)

Dr.	Rs.		Cr. Rs.
Cash and Bank balance	52,000	Bills payable	8,000
Bills Receivable	14,000	Sundry Creditors	56,000
Sundry Debtors	1,30,000	Capital	2,88,000
Stock (Opening)	40,000	Profit and Loss a/c	20,000
Motor Car	40,000	Sales (total)	2,00,000
Furniture	40,000	Sales of old paper and other scrap	10,000
Building	1,00,000	Outstanding salary for 1983 (paid in 1984, but included in Trade expenses)	4,000
Drawings	4,000		
Total purchases	1,20,000		
Trade expenses (including salaries)	40,000		
Loss on sale of old furniture	6,000		
	5,86,000		5,86,000

Adjustments:

(a) Closing stock value Rs. 20,000.
(b) Write off Rs. 4,000 as bad debts.
(c) Create a provision for doubtful debts @ 2%.
(d) Outstanding salaries on 31-12-1984 were Rs. 5,000.
(e) Provide depreciation on building and furniture at 10% and on the motor car at 20% per annum.

Now, final accounts can be prepared as usual.

Bhagavan Rao's Trading and Profit and Loss Account
for the year ending 31st December, 1984

Dr.		Rs.		Cr. Rs.
To Opening Stock		40,000	By Sales	2,00,000
" Purchases		1,20,000	" Closing Stock	20,000
" Gross profit c/d		60,000		
		2,20,000		2,20,000
To Trade Expenses	40,000		By Gross Profit b/d	60,000
Add: Outstanding salaries for 1984	5,000		By sale of old papers and scrap	10,000
	45,000		By Net loss (Transferred to capital account)	4,020
Less: Outstanding salaries for 1983	4,000			
		41,000		

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To Loss on sale of old furniture :				
Book Value	10,000			
Sales proceeds	4,000			
		6,000*		
To Bad debts		4,000		
To Provision for doubtful debts 2% of (1,30,000 – 4,000) i.e. Rs. 1,26,000		2,520		
To Depreciation**		20,500		
		74,020		74,020

* The actual loss on the funiture sold is only Rs. 5,500 i.e. Rs. 6,000 minus depreciation @ 10% for six months from 1-1-1984 to 30-6-1984 on Rs. 10,000.

**** Calculation of Depreciation:**

	Rs.	Rs.
On Building @ 10% :		
On opening balance for full year $90,000 \times \frac{10}{100}$	= 9,000	
On additions to building for 6 months Rs. $10,000 \times \frac{10}{100} \times \frac{1}{2}$	= 500	
		9,500
On Furniture @ 10% :		
On old furniture (30,000 – 10,000) for full year $20,000 \times \frac{10}{100}$	= 2,000	
On new purchase of furniture for 6 months. $20,000 \times \frac{10}{100} \times \frac{1}{2}$	= 1,000	
		3,000
On Motor Car @ 20% :		
On opening balance for full year $40,000 \times \frac{20}{100}$		8,000
Total Depreciation		20,500

Bhagavan Rao's Balance Sheet
as on 31st December 1984

Liabilities		Rs.	Assets		Rs.
Capital:			Building	1,00,00	
Opening Balance	2,88,000		Less: Depreciation	9,500	
					90,500
Less Drawings	4,000				
		2,84,000	Furniture: on 1-1-84	30,000	

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Profit & Loss a/c:			Less: Sold on		
Balance on 1-1-84	20,000		30-6-84	10,000	
Less: Net loss for 84	4,020			20,000	
		15,980	Add: New Purchases	20,000	
				40,000	
Sundry Creditors		56,000	Less: Depreciation	3,000	
Bills Payable		8,000			37,000
Salaries outstanding		5,000	Motor Car	40,000	
			Less: Depreciation	8,000	
					32,000
			Stock		20,000
			Sundry Debtors	130,000	
			Less: Bad debts	4,000	
				1,26,000	
			Less: Provision for doubtful debts	2,520	
					1,23,480
			Bills Receivable		14,000
			Cash and Bank balance		52,000
		3,68,980			3,68,980

Now that the final accounts are prepared, as per the principles of double entry, henceforth the books of accounts can be maintained on double entry principles.

3.6 SUMMING UP

In the Conversion Method, the single entry records are converted into double entry records and the final accounts viz., Trading and Profit and Loss account and the Balance Sheet are prepared. For this purpose the required information has to be gathered from various sources and missing information has to be found out.

3.7 CHECK YOUR PROGRESS : MODEL ANSWERS

Total Debtors Account

Dr.	Rs.		Cr. Rs.
To Balance b/d	50,000	By Cash A/c	40,000
To B/R dishonoured A/c	1,000	By Discount A/c	1,500
To Interest A/c	1,600	By Bad debts A/c	500
To Credit Sales (Bal. fig.)	73,400	By B/R A/c	4,000
		By Balance c/d	80,000
	1,26,000		1,26,000

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Dr. **Total Creditors Account** Cr.

	Rs.		Rs.
To Discount A/c	2,000	By Balance b/d	64,000
To B/P A/c	16,000	By Purchases A/c	85,000
To Cash A/c	25,000	By Interest A/c	1,000
To Balance A/c	1,07,000		
	1,50,000		1,50,000

3.7 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines.

1. What do you mean by conversion method? What is the procedure/steps involved in this conversion process?

B. Answer the following in 15 lines.

1. Write short notes on the following.
   a) Total Creditors Account
   b) Total Debtors Accounts
   c) Bills Receivables Account
2. What is Memorandum Trading Account?

i. Ahmed did not keep proper books of account. However, he gives you the following information to the year 1984.

Particulars	*1-1-1984*	*31-12-1984*
	Rs.	*Rs.*
Sundry Creditors	40,000	37,000
Machinery	80,000	80,000
Sundry Debtors	50,000	58,000
Stock	60,000	52,000
Cash at Bank	4,000	7,200

Summary of Cash Transactions

Receipts	Rs.	Payments	Rs.
Balance b/d	4,000	Payments to Creditors	1,10,000
Received from Debtors	1,73,000	Wages	20,200
Cash Sales	8,400	Salaries and expenses	14,200
Sale of old newspapers	400	Building purchased	30,000
Loan from Mrs. Ahmed taken on 1-7-84 @ 12% p.a.		Drawings	9,200
		Balance c/d	7,200
	1,90,800		1,90,800

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Adjustments

i) Rs. 1,000 has to be written off as bad debt,

ii) Machinery is to be depreciated at 15%, and

iii) Expenses outstanding at the end were Rs. 1,600.

Prepare Ahmed's trading and profit and loss account for the year ending 31st December, 1984 and a Balance Sheet as on that date.

(Credit purchases Rs. 1,07,000; Credit Sales Rs. 1,81,000; Opening capital Rs. 1,54,000; Gross profit Rs. 54,200; Net profit Rs. 25,500; B/S Total Rs. 2,14,200).

2. The following information is provided by Ghanasyam Das who does not know accounting. You are requested to prepare the profit and loss account for the year ending 31-3-1985 and a Balance Sheet as on that date.

His financial position as on 31-3-1984 was as follows:

Cash Rs. 18,500; Stock Rs. 3,000; Plant Rs. 15,000; Buildings Rs. 40,000; Furniture Rs. 2,500; Crerditors Rs. 19,000.

He has also provided the following information pertaining to cash transactions:

Loan from Nishanth Rs. 5,000, Miscellaneous receipts Rs. 4,200, Capital added Rs. 25,000, Sale of plant on 1-10-1984, Rs. 4,000 (Book value Rs. 5,000), Office salaries, Rs. 25,000. Drawings Rs. 8,200, General charges Rs. 7,500, paid to creditors Rs. 1,10,000 and plant purchased on 1-1-1985 Rs. 15,000. Cash in hand on 31-3-1985 Rs. 4,000

On 31-3-1985, stock on hand was valued at Rs. 32,500. Provide 10% depreciation on plant, opening and closing debtors balances are nil, since all the sale transactions are for cash.

Purchases ledger shows a brought forward balance of Rs. 19,000 and purchases during the year Rs. 1,00,000, payments to suppliers Rs. 1,10,000, returns to suppliers Rs. 3,000. The loan is taken on 1-1-1985 @ 12% interest p.a.

Hint:

Depreciation on Plant @ 10%: On Opening balance of Rs. 15,000 for 6 months, and thereafter on Rs. 10,000 only. On newly purchased plant for 3 months only.

(Opening capital Rs. 60,000, cash sales Rs. 1,13,000, Sundry creditors on 31-3-1985 Rs. 6,000, G.P. Rs. 45,500, N.P. Rs. 14,425, B/s Rs. 1,02,375).

3. Prasad & Co. Supplies you the following information:

		30-6-1984	*30-6-1985*
		Rs.	*Rs.*
a)	Furniture	8,000	8,000
	Stock	30,000	28,000
	Sundry Debtors	36,200	38,600
	Sundry Creditors	5,000	25,000
	Machinery	50,000	?

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b) Summary of Cash transactions for 1984-85 were :

Receipts	Rs.	Payments	Rs.
Opening balance	800	Machinery purchased on 1-1-1985	20,000
Received from Debtors	1,50,600	Salaries	30,000
Cash sales	13,500	Wages	32,000
Miscellaneous receipts	400	Expenses	25,000
Loan from Raju (@ 9% on 1-1-1985)	20,000	Paid to creditors	70,000
		Drawings	5,000
		Closing balance	3,300
	1,85,300		1,85,300

c) Other information:

Discounts allowed Rs. 1,500, and discounts received were Rs. 600, Bad debts written off 1,600. Depreciate furniture at 5% and machinery at 10%. Expenses include insurance Rs. 1,000 paid upto 30th Sept. 1985. Wages Rs. 5,000 are outstanding.

Prepare Trading and Profit and Loss Account for 1984-85 and Balance Sheet as on 30th June, 1985.

Hints: 1. Prepaid insurance Rs. 250/-

2. Depreciation on additional machinery for 6 months only.

3. Interest on loan to be calculated for 6 months only.

(Opening Capital Rs. 1,20,000, Credit Sales Rs. 1,56,100, Credit Purchases Rs. 90,600, G.P. Rs. 40,000, Net loss Rs. 24,150, B/S Rs. 1,41,750)

4. Mr. Sanjeev Reddy keeps his books on single entry. He requests you to prepare a trading and profit and loss account of his business for the year ended 31st March, 1985, and a balance sheet as on that date.

His statement of affairs as on 31st March, 1984 was as follows:

	Rs.		Rs.
Capital	1,10,000	Business premises	50,000
Creditors	24,000	Office furniture	5,000
Bank Overdraft	8,000	Stock	27,000
		Sundry debtors	60,000
	1,42,000		1,42,000

On analysing his Cash Book for the year, you find the following information:

	Rs.		Rs.
Receipts from Debtors	75,000	Wages paid	5,000
Cash sales	20,000	Salaries	6,000
Paid to creditors	55,000	General expenses	600
Paid for cash purchases	21,000	Rent and taxes	1,400
Interest on overdraft	500	Drew for personal use	1,000
Miscellaneous receipts	5,000		

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A scrutiny of the Personal accounts showed that he had allowed Rs. 4,000 as discount and allowances to debtors, and had earned Rs. 3,500 as discount from his creditors. On 31st March, 1985 his position was:

Debtors Rs. 50,000; Bills Receivable Rs. 4,000; Creditors Rs. 10,000; Bills payable Rs. 3,000 and expenses owed Rs. 500.

You are to charge 5% depreciation on furniture and premises, provide 5% on debtors for doubtful debts and allow interest on capital @ 5%.

He is consistently making a Gross Profit of 20% on sales.

(Closing cash balance Rs. 1,500, Credit Sales Rs. 73,000, Credit Purchases Rs. 47,500, Closing stock Rs. 26,100, G.P. Rs. 18,600, N.P. Rs. 3,350, B/S total Rs. 1,31,350.)

5. Mr. Robert maintains his accounts on the single entry system. His balances for the year ended 31-3-1984 and 31-3-1985 were as follows:

	31-3-1984	*31-3-1984*
	Rs.	*Rs.*
Furniture	4,000	4,000
Debtors	18,500	17,500
Bills Payable	7,000	10,100
Cash	7,900	3,900
Creditors	18,800	16,700
Stock	?	17,800
Bills Receivable	8,000	5,000

From his cash book for the year 1984-85, you are given the following information:

Bills Receivable 8,500, Sales 3,000, received from debtors Rs. 5,000.

Miscellaneous expenses Rs. 1,500, Salary Rs. 1,800, Investments purchased Rs. 4,000, Purchases Rs. 1,600, paid to creditors Rs. 3,000, drawings Rs. 3,000, Wages Rs. 1,200.

On enquiry you are told that in 1984-85 discount allowed and received were Rs. 600 and Rs. 800 respectively.

During the year Robert accepted bills for Rs. 8,100, and received bills for Rs. 6,000. His bad debts were Rs. 1,100, and bills receivable dishonoured Rs. 500. He maintained a Gross Profit at the rate of 25% on sales.

Give the Trading and Profit and Loss Account for the year ended 31-3-1985 and the balance sheet as on that date, of Mr. Robert.

(Opening Stock Rs. 15,850, opening capital Rs. 28,450, Credit Sales Rs. 11,200, Credit Purchases Rs. 9,800, Gross Profit Rs. 3,550, Net loss Rs. 50, B/S Rs. 52,200.)

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6. Sri Rama Krishna keeps his books on single entry system:

a) An analysis of his cash book reveals the following particulars:

	Rs.
Bank overdraft on 1-1-1984	8,500
Salaries	6,500
Drawings	5,500
Interest and bank charges	300
Payments to Creditors	1,05,600
Receipts from Debtors	1,53,500
Cash Sales	70,000
Insurance charges	600
Rent	2,400
Receipts of fire claim from Insurance Co.	5,700
Stationery	500
Bills Payable	16,000
Bills Receivable	15,000
Freight and Duty	1,300
Carriage inwards	2,500
Carriage outwards	1,600
Machinery Repairs	1,300
Wages	7,000
Miscellaneous Income	2,000
Bank Balance on 31-12-1984	36,600

b) A Scrutiny of the various accounts reveals the following balance:

	1-1-1984	*31-12-1984*
	Rs.	Rs.
Stock in hand	3,500	4,500
Sundry Debtors	20,000	25,600
Sundry Creditors	4,500	15,700
Bills Receivables	25,400	30,500
Bills Payable	22,500	13,200
Furniture	5,000	5,000
Machinery	26,000	26,000
Motor Car	35,500	35,500

c) Ramakrishna had allowed Rs. 600 as discounts and received Rs. 500 as discounts. Bills receivable dishonoured Rs. 1,000, bills payable dishonoured Rs. 600. Bad debts written of Rs. 500. There was provision for doubtful debts at 5% at the beginning of the year, and the same percentage is desired to be maintained.

d) Only 75 per cent of the cost of stock lost in fire was recovered.

e) Depreciation has to be provided at 5 per cent on Machinery, 10 per cent on Furniture and 20 per cent on Motor Car.

You are required to prepare his trading and profit and loss account for the year ended 31st December 1984, and the balance sheet as on that date.

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Hints:

1. If 75% of cost of the stock lost recovered is Rs. 5,700, total stock lost is Rs. 7,600. Show Rs. 7,600 on the credit side of Trading A/c and show only Rs. 1,900 in the P & L A/c. (debit side) because that is the loss. Claim amount received Rs. 5,700, show it on the receipt side of cash book. You need not show it any where else, as it is already included in cash balance.
2. Bad debts are already written off. Just show this item on the debit side of P & L A/c. But don't deduct it from the closing debtors in the balance sheet.
3. On 31-12-1984 Provision for Doubtful Debts required is Rs. 1,280, but charge only Rs. 280 to P & L A/c.

   (Opening capital Rs. 78,900, Cash purchases Rs. 50,000, Bills receivable received during the year Rs. 21,100, Credit sales Rs. 1,80,300, Bills payable accepted during the year Rs. 7,300, Credit Purchases Rs. 1,24,000, G.P. Rs. 74,100, Net profit Rs. 51,220, B/S Rs. 1,53,520.)

3.9 RECOMMENDED BOOKS

1. Gupta, R.L. & Radhaswamy : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C. & Grewal, T.S. : Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P. & Narang, K.L. : Advanced Accountancy, Kalyani Publishing House, New Delhi.

3.10 GLOSSARY

Total Creditors	:	It is another name for sundry creditors.
Total Debtors	:	It is another name for sundry debtors.
Total Purchases	:	It is equal to cash and credit purchases.
Total Sales	:	It is equal to cash and credit sales.
Turnover	:	It means the total sales of a business during a particular period.

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BLOCK-II : ACCOUNTS OF NON-TRADING ORGANISATIONS

UNIT-4 : ACCOUNTS OF NON-TRADING ORGANISATIONS-I

Contents

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4.0 AIMS AND OBJECTIVES

Whether it is business or non-business organisations, there must be a proper accounting system fulfilling their requirements. The aim of this unit is to provide a theoretical background regarding the method of maintaining accounts by non-trading organisations.

On completion of this unit, you should be able to:

- explain the features of non-trading organisations
- identify the various accounts to be prepared by the non-trading organisations
- distinguish between Receipts and Payments Account, and Income and Expenditure Account
- draw the distinction between capital and revenue items

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4.1 INTRODUCTION

Organisations may be broadly divided into two categories as business organisations and non-business organisations. The primary objective of business organisations is to earn profit, whereas the primary objective of non-business organisations is to render service. The non-business organisations are generally referred to as non-trading organisations or non-profit organisations or not-for-profit organisations.

People join together and form voluntary organisations like sports clubs, recreation clubs, libraries, educational institutions, charitable institutions, welfare institutions, hospitals, literary associations, cultural associations, cooperative societies, trade unions, political associations, professional associations, etc. The reason for forming such an organisation may be the promotion of art, science, culture, music, sports, games, education, protection of their rights or propogation of

their philosophy, ideology, etc. The purpose of such organisations is the pursuit of some interest other than financial gain and to render some sort of service to its members in particular and to the society in general. These organisations may be constituted as Registered Societies or Trusts or even as Joint Stock Companies (under Section 25 of the Companies Act, 1956). As per the provisions of the concerned Act, the organisation is required to maintain necessary books of account.

Non-trading concerns need not necessarily mean that they are non-trading; some of them do undertake trading, for example, clubs, where eatables, beverages, etc., are purchased and sold, consumers' cooperative societies, etc., but they do it without profit motive. Further, the phrase, 'non-profit'. does not mean that these organisations should not make any profit at all. It only means that they are not exclusively meant for making profits but for achieving a certain objective which is of primary importance to it. In that process they may earn profits, too.

Not only the above mentioned voluntary organisations but also individuals and firms like medical practitioners, legal practitioners, solicitors, chartered accountants, etc., come under this category. The terms 'non-trading concerns' or 'non-profit concerns', therefore, refers to non-business type institutions. In other words, in order to distinguish them from business type organisations they are generally called 'non-trading or non-profit organisations.'

Nevertheless, these organisations too must have money in order to promote or pursue their activities and that money must be properly accounted for. The office bearers elected for this purpose called the Treasurer - collects subscriptions from the members and spends money on such activities as are considered necessary for achieving the objective of the organisation. At the Annual General Meeting the Treasurer submits the accounts to the members. In this unit (in this unit and in the following one) it is proposed to explain the preparation of final accounts suitable for such organisations.

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4.2 FEATURES OF NON-TRADING ORGANISATIONS

The main features of non-profit organisations (i.e. organisations without profit motive) are:

1. Their main objective is not to make profit but to render service to their members and/or to the society as a whole. Therefore, the statement showing the net result of activities is called 'Income and Expenditure Account' instead of 'Profit and Loss Account'. The net result is termed 'excess of income over expenditure' or 'surplus' instead of 'profit'. In the case of loss it is termed 'excess of expenditure over income' or 'deficit'.
2. In many non-profit organisations, there will be no owner/owners but only members. These organisations do not have formal capital like that of trading concerns. In such cases the capital account is called 'Capital Fund', which is generally built up from (i) excess of income over expenditure, (ii) capital receipts, and (iii) other receipts that are capitalised. Thus, 'capital fund' is the excess of assets over liabilities (i.e., net assets).
3. These organisations, genrally, survive on subscriptions from members, fees from users, donations and aid from others.

4.3 ACCOUNTS OF NON-TRADING CONCERNS

Just like business concerns these concerns too like to know the financial result of their activities during the year and the financial position at the end of the year. This is also necessary either for tax purposes or for submitting them to members in the Annual General Meeting. All these

organisations have, therefore, to prepare the financial statements at the end of the year. They may prepare the final accounts on the basis of cash or mercantile system. But generally they prepare them on the basis of mercantile system, i.e., Accrual basis of Accounting. Hence, the principles underlying the preparation of final accounts of business are equally applicable to them also.

In fact, there is nothing special about the accounts of non-trading or non-profit organisations except that often they do not keep a full set of books, with the result that they do not extract a trial balance from their books of account. If they do so, they can easily prepare their final accounts, as explained earlier. Usually they maintain a cash book only and on the basis of entries made in it, prepare a summary of cash transactions (including bank transactions). When presented in an account form, this summary is called *'Receipts and Payments Account'*.

Generally, with the help of Receipts and Payments Account, and other information, the final accounts viz., Income and Expenditure Account and Balance Sheet are prepared. In the case of non-trading concerns too (i) an account similar to Profit and Loss Account is prepared to know the net result of their activities, which is known as *'Income and Expenditure Account* instead of P & L A/c (since there is no trading and manufacturing activity, no trading or manufacturing account is prepared), and (ii) a *Balance Sheet* is prepared to know the financial position of the concern.

4.4 RECEIPTS AND PAYMENTS ACCOUNT (R & P A/c.)

It is mere summary of cash and bank transactions under important headings prepared in an account form. It is prepared at the end of the year from the cash book, the debit side recording the receipts and the credit side, the payments. It consists of all receipts and payments irrespective of the period to which they belong, i.e., they may pertain to the past, present or future; and irrespective of their nature, i.e., capital or revenue.

4.5 INCOME AND EXPENDITURE ACCOUNT (I & E A/c.)

This is a Revenue Account (similar to the Profit and Loss Account of trading concerns) prepared by non-trading concerns to find out the financial result of the activities. It covers all revenue expenses, paid as well as payable, and all revenue incomes, received as well as receivable, pertaining to a particular accounting year. No income or expenditure pertaining to the past or future period is included in this account. So also capital incomes or capital expenditures do not figure in this account. This account thus consists of only revenue items of the current year.

4.6 DISTINCTION BETWEEN R & P A/c and I & E A/c.

	Receipts and Payments Account		*Income and Expenditure Account*
1.	It is a real account.	1.	It is a nominal account.
2.	It is a summary of cash and bank transactions	2.	It is a summary of incomes earned and expenses incurred during the year.
3.	It includes only cash transactions.	3.	It includes cash as well as non-cash transactions.
4.	It includes receipts and payments of past, present and future periods.	4.	It includes incomes and expenses pertaining only to the current year.
5.	It includes both capital and revenue items.	5.	It includes only revenue items.

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6.	It does not include accrued items, i.e., accrued incomes and expenses.	6.	It does include accrued incomes and expenses.
7.	It does not include depreciation, bad debts, provisions, etc.	7.	It does include depreciation, bad debts, provisions, etc.
8.	It has opening balance (of cash & Bank).	8.	It has no opening balance.
9.	The closing balance is cash in hand and cash at bank or overdraft	9.	The closing balance may be surplus or deficit.

4.7 BALANCE SHEET

The Income and Expenditure Account is to be accompanied by the Balance Sheet (B/S). The Balance Sheet is to be prepared even by non-trading organisations (just as in trading organisations) to complete the double entry and also to know the financial position. It consists of all liabilities and capital fund on the liabilities side and all properties and assets on the assets side.

4.8 CAPITAL Vs. REVENUE

Before we proceed further we should understand the distinction between capital and revenue items.

Receipt and Income

A receipt is different from income. Receipt means actual cash or cheque received. Such a receipt may belong to the past, present or future or it may be of capital or revenue nature. But income is what is earned, whether actually received or not. Thus, receipt falls under real account, and income comes under nominal account.

Capital Receipt and Revenue Receipt

If it is a capital receipt it must be treated as a liability. If it is a revenue receipt it must be treated as income. If the receipt is (a) repayable or (b) is due to sale of an asset or (c) is of permanent nature which is to be capitalised, it is treated as a capital receipt. A capital receipt should be shown as liability in the Balance Sheet. On the other hand, if the receipt is not repayable or it is earned through the regular activities, it is a revenue receipt. A Revenue receipt should be shown as income in the Income and Expenditure Account.

Payment and Expenditure

Payment means actual cash paid. It may be for the current year or for a past period or for a future period. Further, it may also be capital or revenue in nature. Payment is different from expenditure. A payment may be an expenditure, but an expenditure need not necessarily be a payment. Expenditure includes all expenses incurred, whether paid in cash or not.

Capital and Revenue Expenditure

Capital expenditure is that expenditure the benefit of which is available for a number of accounting years. It is immaterial whether such expenditure is actually paid or not. Capital expenditure results in acquisition of assets or improvement of assets or increasing the capacity or efficiency or life or economy of operations of the existing assets. It is, therefore, shown as an asset in the Balance Sheet. On the other hand, revenue expenditure is that expenditure the benefit of which is exhausted in the same accounting year in which it is incurred. it is the expenditure incurred in the normal course of operations to meet the day-to-day expenses of the organisation,

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whether actually paid or not. Such expenditure should be shown as an expense in the Income and Expenditure A/c.

Deferred Revenue Expenditure

When heavy or unusual expenditure of revenue nature is incurred in a particular year the benefit of which extends beyond that year, it is treated as deferred revenue expenditure. In other words, it is spread over a number of years instead of being charged to one particular year. Such expenditure is written off over a period of time during which the benefit is likely to be available. That part of the deferred revenue expenditure which is being written off is debited to the Income and Expenditure Account and the remaining balance is to be shown on the assets side of the Balance Sheet.

Check Your Progress - 1

1. State the distinction between capital receipt and revenue receipt.

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.....

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2. What is the difference between payment and expenditure?

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3. Explain the difference between capital expenditure and revenue expenditure.

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4.9 SOME SPECIAL TERMS PERTAINING TO NON-PROFIT ORGANISATIONS

While preparing final accounts of non-profit organisations the following items are often used.

1. **Legacy :** When an amount is received as per the will of some person it is called 'Legacy'. If the sum is small it is treated as income otherwise, it is capitalised.

2. **Donation :** Donations are often received by these organisations from both individuals and institutions. A 'donation' is the amount received as a gift. Donations may be broadly classified into two categories, viz., specific donations and general donations.

(a) **Specific Donations :** A donation received for a specific purpose, whether big or small, is capitalised and is taken to the liabilities side of the Balance Sheet. For example, a donation for the construction of a stadium or a building or a donation for a specific purpose in the library

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Solution

Young Men's Club Income and Expenditure Account

Dr. for the year ending on 31-12-1988 Cr.

Expenditure	*Rs.*	*Income*	*Rs.*
To Printing & Stationery	200	By Entrance Fees	700
To Newspapers	600	By Subscriptions from members	7,000
To Salaries	1,100	By Proceeds from Entertainment	1,000
To Excess of Income over Expenditure (transferred to Capital Fund)	7,500	By sale of old Newspapers	300
		By Miscellaneous Receipts	500
	9,500		9,500

Young Men's Club Balance Sheet

Dr. as on 31st December, 1988 Cr.

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital Fund:			Furniture	1,000
Opening Balance	—		Books	4,000
Add: Excess of Income over Expenditure	7,500	7,500	Sports Materials	5,000
Building Fund a/c		5,000	Cash in hand	2,500
		12,500		12,500

Note: Since the Depreciation on furniture and books, and the consumption of sports materials is not mentioned, the entire amounts are shown as assets.

5.4 PREPARATION OF INCOME AND EXPENDITURE ACCOUNT AND BALANCE SHEET WITH ADJUSTMENTS

Illustration-1 is a simple one, since no adjustments are involved. Let us consider the accounts of the same club for the second year by introducing some adjustments.

Illustration - 2

The following is the balance sheet of Young Men's Club as on 1-1-1989.

Dr. Cr.

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Fund	7,500	Furniture	1,000
Building Fund	5,000	Books	4,000
		Sports Materials	5,000
		Cash in hand	2,500
	12,500		12,500

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The following is the summary of cash book for the year 1989:

Receipts	*Rs.*	*Payments*	*Rs.*
To Balance b/d	2,500	By Books	5,000
To Entrance Fees	500	By Furniture	2,000
To Donations for Building Fund	4,000	By Sports Materials	5,000
To Donation for Prize Fund	2,500	By Printing & Stationery	1,000
To Subscriptions	11,000	By Newspapers	900
To Receipts from Entertainment Programmes	2,000	By Prize Fund Expenses	500
To Sale of old News Papers	400	By Entertainment programme expenses	1,000
To Miscellaneous Receipts	600	By Salaries	1,200
		By Balance c/d	6,900
	23,500		23,500

Other Information

1. Subscriptions received Rs. 11,000 include Rs. 1,000 received in advance for 1990. But subscriptions to the extent of Rs. 2,000 are outstanding for 1989.
2. Entertainment programme proceeds to the extent of Rs. 500 are still due from the ticket sellers.
3. Provide depreciation at the following rates on their opening balances:- on books 25%; on furniture 10%; on sports materials 50% per annum, and on the additions to the above, provide depreciation for 6 months.
4. Unused stationery stock amounted to Rs. 400.
5. Salaries outstanding for 1989 Rs. 400. Advance salary paid to one employee Rs. 200.

You are required to prepare Young Men's Club's Income and Expenditure Account for the year ending on the 31st of December, 1989 and the Balance Sheet as on that date.

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5.8 PREPARATION OF BALANCE SHEETS WITH THE HELP OF RECEIPTS AND PAYMENTS ACCOUNT AND, INCOME AND EXPENDITURE ACCOUNT, AND ACCOMPANYING NOTES

We can also prepare the balance sheets both opening and closing if Receipts and Payments account, Income and Expenditure account, and other information is given. While doing so the following points should be noted:

(i) Show the opening balance of Receipts and Payments Account as an asset in the opening balance sheet.

(ii) Show the closing balance of Receipts and Payments Account as an asset in the Closing balance sheet.

(iii) The closing balance of the Income and Expenditure Account is added to the Capital Fund (if it is a surplus) or deducted from the capital fund (if it is a deficit) in the closing Balance Sheet.

(iv) Compare the items on the debit side of the Income and Expenditure Account with those on the credit side of the Receipts and Payments Account.

Similarly, compare the items on the credit side of the Income and Expenditure Account with those on the debit side of the Receipts and Payments Account.

Items appearing in Receipts and Payments Account but not appearing in Income and Expenditure Account are (a) either receipts received in advance or payments made in advance; or (b) receipts for previous year or payments for previous year.

On comparison, item by item, you can conclude whether they are assets or liabilities, and then show them in the relevant Balance Sheet.

(v) Assets at the end should be taken to the closing balance sheet with due consideration to depreciation and additions during the year.

Illusration - 6

The following are the Receipts and Payments Account, and Income and Expenditure Account of Book Lovers Association, Hyderabad.

Receipts and Payments Account

Dr. for the year ending on 31-12-1984 Cr.

Receipts		*Rs.*	*Payments*		*Rs.*
To Balance b/d		1,400	By Salaries:		
To Interest		800	1983 -	200	
To Donation for special			1984 -	2,200	2,400
Fund		300			
To Subscriptions			By Printing		
1983 -	1,600		and Stationery		300
1984 -	7,000	8,600	By Books		3,000
			By Miscellaneous Expenses		600
To Rent:			By Balance c/d		5,590
1983 -	260				
1984 -	520	780			
		11,880			11,880

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Dr. **Income and Expenditure Account** Cr.
for the year ending on 31-12-1984

		Rs.		*Rs.*
To Salaries		2,400	By Interest on 10% Investments	1,000
To Printing & Stationery		300	By Subscriptions	8,000
To Insurance		240	By Rent	600
To Miscellaneous Expenses		600		
To Depreciation:				
Building @ 2%	700			
Books @ 10%	3,000			
Furniture @ 10%	200	3,900		
To Excess of Income over Expenditure		2,160		
		9,600		9,600

Depreciation is provided on the opening balance of asset. You are required to prepare the balance sheet of Book Lovers Association as on 31-12-1983 and on 31-12-1984.

Solution

Book Lovers Association
Balance Sheet
as on 31st December, 1983

Liabilities	*Rs.*	*Assets*	*Rs.*
Salaries outstanding	200	Cash in hand	1,400
Capital Fund: (Balancing Figure)	80,060	Subscriptions outstanding	1,600
		Rent oustanding	260
		Building $(\frac{100}{2} \times 700)$	35,000
		Books $(\frac{100}{10} \times 3,000)$	30,000
		Furniture $(\frac{100}{10} \times 200)$	2,000
		10% Investments $(\frac{100}{10} \times 1000)$	10,000
	80,260		80,260

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Dr. BRAOU LIBRARY
Acc. No: 21504
Class No: 657 AGN

Balance Sheet
as on 31st December, 1984

		Rs.			Rs.
Capital Fund	80,060		Building	35,000	
Add: Surplus	2,160		Less: Depreciation	700	
		82,220			34,300
Special Fund		300	Furniture	2,000	
Salaries outstanding		200	Less: Depreciation	200	
Insurance Outstanding		240			1,800
			Books	30,000	
			Less: Depreciation	3,000	
				27,000	
			Add: Addl. Purchases	3,000	
					30,000
			10% Investments		10,000
			Interest on Investments outstanding		200
			Rent outstanding		80
			Subscriptions outstanding		1,000
			Cash in hand		5,580
		82,960			82,960

Notes:

1. On comparing the debit side items of R & P a/c and the credit side items I & E a/c the following differences are noticed:

   Interest received is only Rs. 800 but Rs. 1,000 is shown in I & E a/c. Therefore, Rs. 200 is treated as outstanding at the end of the year. Similarly, for 1984 subscriptions and rent received are Rs. 7,000 and Rs. 520 respectively but I & E a/c shows Rs. 8,000 and Rs. 600 respectively. Therefore, Rs. 1,000 on subscriptions and Rs. 80 on rent is outstanding at the end of the year.

2. Salaries paid for 1984 are Rs. 2,200 but Rs. 2,400 is charged to I & E a/c. That means Rs. 200 are yet to be paid for 1984.

3. Depreciation is provided on the opening balance of assets. On the basis of depreciation the value of assets at the beginning is arrived at. For example, depreciation @ 2% on building is Rs. 700. Then what would be the value of building?

   Rs. 2 is provided for every Rs. 100
   If Rs. 700 is provided, then what is its value? $2 - 100$

   $$700 \times \frac{100}{2} = \text{Rs. } 35{,}000 \qquad 700 - ?$$

   Similarly, the value of books, furniture and investements is arrived at.

5.9 SUMMING UP

The method of preparing the final accounts of non-trading organisations viz., Income & Expenditure account and Balance Sheet, is explained. They are prepared with the help of Opening

Balance Sheet, other relevant information and summary of the cash book. The relevant information necessary for the preparation of these accounts is given in a variety of ways. Sometimes, the information is clearly given and sometimes the information has to be inferred by making necessary adjustments.

5.10 CHECK YOUR PROGRESS : MODEL ANSWERS

		Rs.
1. Subscriptions received during the year		1,05,000
Add: Subscriptions received in advance in the previous year	10,000	
Add: Subscriptions outstanding at the end of the year	14,000	
		24,000
		1,29,000
Less: Subscriptions received in advance	16,000	
Less: Subscriptions outstanding at the end of the year	5,000	
		21,000
Amount to be shown in I & E a/c		1,08,000

2. All the items which are shown on the debit side of Receipts and Payments Account shall not be shown on the credit side of Income and Expenditure Account. Only the items, which are revenue in nature pertaining to the current year are shown on the credit side of Income and Expenditure Account.

5.11 MODEL EXAMINATION QUESTIONS

PROBLEMS

Preparation of Receipts and Payment Account:

1. Prepare a Receipts and Payments Account of the Friends Club for the year ended 31st December, 1984, from the following particulars:

	Rs.
Cash in hand and at bank on 1-1-1984	5,400
Purchase of Furniture	400
Printing and Stationery	200
Sundry expenses	150
Subscriptions for the year 1984	2,800
Subscriptions received in advance for 1985	100
Entertainment programme ticket collections	1,200
Entertainment programme expenses	1,000
Advertisement expenses	200
Interest received on bank deposit	200
Salaries to staff	3,000
(Cash balance on 31-12-1984 Rs. 4,750)	

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2. From the following particulars of Telugu Prachra Sabha prepare a Receipts and Payments Account for the year ending 31st December, 1984.

	Rs.
Entrance fees	500
Subscriptions	8,750
Interest on Investments	500
Donations	1,500
Printing and Stationery	200
Meeting Expenses	2,400
Honorarium to speakers	250
Postage of Telegrams	75
Purchase of Telugu books	2,100
Salary to clerk	3,600
Balance of cash on 31-12-1984	5,000

(Balance of cash on 1-1-1984 was Rs. 2,425)

Preparation of Income and Expenditure Account

3. From the following particulars prepare an income and expenditure account for the year 1984.

Dr. Cr.

Receipts		*Rs.*	*Payments*	*Rs.*
To Balance b/d		3,600	By Rent	1,000
To Sale of Investments		4,000	By Stationery & postate	400
To sale of old furniture			By Salaries	9,6000
(Book value Rs. 800)		600	By Bycycle purchased	600
To Subscriptions:			By National Savings	
1983 -	1,000		Certificates	6,000
1984 -	16,600		By Books donated to	
1985 -	1,200	18,800	students	4,000
			By Balance c/d	5,400
		27,000		27,000

Subscription for 1984 still receivable were Rs. 1,400, Interest due on National Savings Certficates Rs. 200 and Rent unpaid was Rs. 120. (Excess of Income over Expenditure Rs. 2,880)

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4. The following is the Receipts and Payments Account of the Deccan Sports Club for the year ending 31-12-1983:

Dr. Cr.

Receipts	*Rs.*	*Payments*	*Rs.*
To Balance 1-1-1983	1,000	By Grounds Maintenance Expenses	9,600
To Entrance fees	520	By Wages to Groundsmen	9,200
To Interest on Investments	800	By Electricity charges	200
To Subscriptions	13,600	By Printing & Stationery	1,000
To Income from Sports events	5,000	By postage & telegrams	320
		By Balance c/d	600
	20,920		20,920

Grounds maintenance expenses Rs. 9,600 included Rs. 600 applicable to 1982. Printing & Stationery Rs. 1,000 includes Rs. 200 of 1982. Entrance fees are to be capitalised. The outstanding payments as on 31-12-1983 were printing Rs. 400, wages to groundsmen Rs. 200.

From the above a particulars, prepare an income and expenditure account of the club for the year 1983.

(Excess of expenditure over income Rs. 720)

Preparation of Income and Expenditure Account and Balance Sheet

5. From the following particulars of Music Lovers Association, prepare an income and expenditure account for the year ending and the balance sheet as on 31st December 1983:

Receipts and Payments Account for the year 1983

		Rs.			Rs.
To Balance b/d 1-1-1983		20,000	By Purchase of Land		8,000
To Entrance fees		1,600	By Interest on loan		800
To Rent from Auditorium		1,400	By Music concerts expenses		4,000
To Income from music concerts		8,000	By Expenses:		
To Subscriptions:			1982	2,400	
1982	400		1983	4,000	
1983	4,200				6,400
1984	300		By Balance c/d		16,700
		4,900			
		35,900			35,900

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Balance Shee as on 31st December, 1982

	Rs.		Rs.
Capital Fund	64,000	Building	60,000
Loan	10,000	Subscriptions outstanding	760
Subscriptions received in advance	1,200	Auditorium rent outstanding	480
Expenses outstanding	2,800	Cash in hand	20,000
Excess of Income over Expenditure	3,240		
	81,240		81,240

Hint: While preparing income and expenditure account for 1983 due consideration should be given to outstanding and received in advance items appearing in the opening B/S.

(Excess of income over expenditure Rs. 7,120, B/s Rs. 85,060).

6. From the following particulars relating to Musical Society of Hyderabad, prepare an Income and Expenditure Account and a Balance Sheet as on 31st December, 1984.

Receipts and Payments Account for the year 1984

	Rs.		Rs.
To Balance b/d	3,200	By Rent	600
To Subscriptions	2,500	By Printing	150
To Proceeds from entertainment	1,000	By Advertising	200
To Interest on Securities	475	By Sundry Expenses	55
To Entrance Fees	500	By Government Securities	2,500
To Sale of old furniture (Book value Rs. 100)	75	By Furniture	400
		By Library Books	300
		By Entertainment Expenses	750
		By Balance c/d	2,595
	7,550		7,550

Balance Sheet as at 31st December, 1983

	Rs.		Rs.
Capital Fund	15,575	Library Books	1,000
Oustanding rent	425	Funiture and fittings	1,475
		Govt. Securities	10,000
		Accrued Interest	125
		Outstanding subscription	400
		Cash in hand	3,000
	16,000		16,000

The following were outstanding as an 31st December 1984: Rent Rs. 100, Printing Rs. 75, subscriptions Rs. 325 and Interest on securities Rs. 150.

(Excess of Income Rs. 2,895, B/s Rs. 18,645)

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7. The Goodfellows Club prepared the following receipts and payments account for the year ending 31st March 1984:

Dr. **Receipts and Payments Account** Cr.

	Rs.		Rs.
To Cash balance from last year	1,890	By Prize & Competition expenses	1,145
To Subscriptions	3,240	By Printing and & Stationery	280
To Competition fees	1,300	By Rent	1,500
To Entrance fees	675	By Wages to Staff	1,900
To Interest on Investment	35	By Purchase of furniture	480
To Sundry receipts	82	By Trademen's bill	300
		By Purchase of Investements	800
		By Cash balance carried forward	817
	7,222		7,222

At the beginning of the year the club had investments of Rs. 1,200, Furniture Rs. 1,150, Subscriptions outstanding Rs. 300 (received during the year) and trademen's bills outstanding Rs. 300 (Paid during the year).

At the end of the year, subscriptions outstanding came to Rs. 210 and there were outstanding bills for Printing & Stationery Rs. 45.

Prepare income and expenditure account of club for the year ending 31st March, 1984 and a balance sheet as on that date.

(Excess of income over expenditure Rs. 372. Capital fund at the beginning Rs. 4,240, B/S total Rs. 4,657.)

8. Given below is the Receipts and Payments account of the Hari Om Charitable Trust, for the year ended 31st December, 1983:

		Rs.			Rs.
To Balance - Cash	100		By Honorarium to Secretary		3,600
Bank	4,000		By Salary		4,800
		5,000	By Charities		3,000
To Legacies		100	By Printing & Stationery		800
To sale of old newspapers		100	By Concert expenses		600
To Endowment fund receipts		15,000	By Payments from poor fund		3,000
To Proceeds from concerts		1,000	By Subscription to newspapers etc.		500
To Advertisements in the year book		2,000	By Advance to building construction		8,000
To Poor fund receipts		4,000	By Rent & Taxes		1,800
To Interest on investments		1,200	By Balance - Cash	300	
To Donation for Building Fund		5,000	- Bank	12,000	
To Other donations		1,000			12,300
		38,400			38,400

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Other Information:

	As on 31-12-1982
Building fund	5,000
Endowment fund	2,000
Poor fund	1,000
10% Investments	15,000
Furniture	3,000

Capitalise legacies. Interest on ivestments due at the end was Rs. 300. Treat the general donations as revenue. Provide 10% depreciation on furniture. Prepare I & E a/c for the year ended 31st December, 1983 and a B/S as on that date.

Hint: Payments from Poor fund should be deducted from poor fund in the B/S. Show Building fund on the liabilities side and building construction advance on the asset side of B/S.

(Excess of Expenditure Rs. 9,800, opening capital fund Rs. 14,100. B/S total Rs. 38,300).

9. From the following particulars of Premier Sports Club, Secunderabad, prepare an income and expenditure account for the year ended 31st Dec. 1980 and a balance sheet as on that date.

Dr. **Receipts and Payments Account** Cr.

		Rs.			Rs.
To Entrance fees		10,000	By Investements (at 10% Purchased on 1-7-80)		12,000
To Donations		50,000	By Land & Buildings		49,000
To Tournament Fund receipts		3,000	By Tournament Expenses		2,200
To Prize Fund receipts		4,000	By Prizes distributed out of Prize Fund		3,000
To Life membership fees		8,000	By Furniture		3,000
To Revenue Receipts:			By Sports materials		2,400
			By Revenue Payments:		
Subscriptions	4,400		Salaries	2,400	
Canteen receipts	2,600		Printing	250	
Interest on investments	600		Gardening	660	
Cricket fees	1,000		Insurance	240	
Tennis fees	900		Cricket Expenses	500	
Billiards fee	600		Tennis Expenses	800	
Sundry receipts	550		Billiards	960	
		10,650	Canteen purchases	3,000	
			Sundry expenses	200	
					9,010
			By Cash in hand and at Bank		5,040
		85,650			85,650

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Other Information

Subscriptions outstanding for the year 1980 amounted to Rs. 900. Subscriptions received include Rs. 250 for 1981. Salaries unpaid for 1980 Rs. 350 and insurance prepaid amounted to Rs. 60. One half of entrance fees and, full amount of donations and life membership fees are to be capitalised. Sports materials are valued at Rs. 1,500 and canteen stock at Rs. 800. Depreciate furniture by 5% and land and Building by $2\frac{1}{2}$%.

Hints:

i) Tournament expenses, prize distribution expenses should be directly adjusted from the respective funds in the B/S.

ii) Calculate depreciation on Building and Furniture for six months only as the date of purchase is not given.

(Excess of of income Rs. 6,212.50, B/S total Rs. 71,612.50).

Preparation of R & P A/c, I & E A/c and B/S:

10. From the following information of Vijayawada Sports Club Prepare an Income and Expenditure Account for the year ending on 31st December, 1984 and the Balance Sheet as on that date:

The Assets on 1st January 1984 include Buildings Rs. 20,000, 6% Investments Rs. 10,000 (including prize fund investments of Rs. 8,000), furniture Rs. 1,000. The liabilities as on 1st January, 1984 include Prize Fund Account Rs. 8,000.

The cash transactions during the year were:

Receipts: Subscriptions for 1983 Rs. 200, for 1984 Rs. 7,500 and for 1985 Rs. 400. Sale of funiture at book value Rs. 200, donation for construction of stage Rs. 4,000, charges for refreshments Rs. 4,300. The payments were: Printing and stationery Rs. 1,750, Salaries Rs. 5,600, 6% investments Rs. 4,000, Expenditure on refreshments Rs. 3,200, Building expansion Rs. 3,000, Expenses of 1983 Rs. 200, Cost of prizes Rs. 350, Cash and bank balance on 31-12-1984 Rs. 1,400.

Of the salaries paid Rs. 400 pertains to 1983. At the end of the year salaries of Rs. 500 outstanding. Subscriptions outstanding at the end were Rs. 400. Stock of refreshments at the end of the year was valued at Rs. 100. Printers bill Rs. 100 is outstanding on 31-12-1984 and also a bill for purchase of furniture Rs. 500 is oustanding. Sports equipment worth Rs. 1,000 was donated during the year by a member. The additional investments of Rs. 4,000, were purchased on 1-7-1984 and the interest has not been collected.

Hints:

1. To ascertain opening cash balance prepare R & P a/c.
2. Donation of Sports equipment may be treated as general donation.

(Excess of Income over Expenditure Rs. 2,920, opening capital fund Rs. 25,500, B/S total Rs. 41,920.)

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11. From the following particulars of Nava Bharathi, a literary and cultural organisation, prepare I & E a/c and B/S:

Balance Sheet as on 31st December, 1983

	Rs.		Rs.
Capital Fund	31,150	Furniture	2,950
Expenses outstanding	850	Library books	2,000
		Investments	20,000
		Interest accrued	250
		Subscriptions outstanding	800
		Cash at Bank	6,000
	32,000		32,000

The following are the cash transactions during the year 1984 :

Receipts: Subscriptions Rs. 5,000, Proceeds from Cultural Programmes Rs. 2,000, Sale of old furniture Rs. 150, Entrance fees Rs. 1,000, Interest on investments Rs. 950.

Payments: Cultural programme expenses Rs. 1,500, Library books Rs. 600, furniture Rs. 800, Expenses outstanding Rs. 850, Purchase of Investments Rs. 5,000, Sundry expenses Rs. 100, advertisements Rs. 400, printing Rs. 300, and rent Rs. 1,200.

On 31st December, 1984 Rs. 150 for printing and Rs. 200 for rent were outstanding; on the same day Rs. 300 interest on investments was accrued due, and subscription outstanding for 1984 were Rs. Rs. 650.

Hint: To ascertain cash balance on 31-12-1984 prepare R & P a/c. (Cash balance on 31-12-1984 Rs. 4,350. Excess of Income over Expenditure Rs. 5,000, B/S total Rs. 36,500).

12. Preparation of R & P A/c and B/S, when I & E a/c and other information are given:

The following is the income and expenditure account of Kakatiya Club.

Income and Expenditure Account for the year ended 31-12-1984

	Rs.		Rs.
To Salaries	4,750	By Entrance fees	250
To Printing & Stationery	450	By Subscriptions	7,500
To Secretary's honorarium	1,000	By Contributions for annual dinner	1,000
To Audit fees	250	By Surplus from annual sports	800
To General expenses	500		
To Annual dinner expeneses	1,500		
To Bank and insurance charges	150		
To Depreciation on sports equipments	300		
To Excess of income over expenditure	650		
	9,550		9,550

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This account is prepared after taking into account the following:

	Rs.
Subscriptions outstanding as on 31-12-1983	600
Subscriptions received in advance as on 31-12-1983	450
Subscriptions received in advance as on 31-12-1984	270
Subscriptions outstanding as on 31-12-1984	750

Salaries outstanding on 31-12-1983 were Rs. 400 and on 31-12-1984 Rs. 450. Insurance prepaid at the end of 1984 was Rs. 60. Audit fees for 1984 Rs. 250 is not yet paid. But during 1984 Audit fees for the year 1983 was paid amounting to Rs. 200.

The club owned a play ground valued at Rs. 10,000. The club had sports equipment on 1-1-1984 valued at Rs. 2,600. At the end of the year, after depreciation this equipment amounted to Rs. 2,700. In 1983 the club had taken a bank loan of Rs. 2,000. This was not repaid in 1984. On 31-12-1984 the cash in hand and at bank amounted to Rs. 1,650.

Prepare R & P a/c for the year 1984 and a B/S at the end of the year.

(Opening Capital Fund Rs. 11,540, B/S total Rs. 15,160).

13. From the following Income and Expenditure Account of Bharateeya Yuvatha Club for the year ending 31st December, 1984 and a Balance Sheet as on that date, you are required to prepare the Receipts and Payments Account of the Club for the year 1984.

Income and Expenditure Account for the year ended 31st December, 1984.

	Rs.		Rs.
To Salaries	8,320	By Subscriptions	9,000
To Rates & Taxes	2,400	By Surplus on sports events	6,200
To Telephone charges	540	By Dividend on Investments	4,000
To Stationery	1,440		
To Sundry Expenses	3,420		
To Depreciation on Building	2,000		
To Excess of income	1,080		
	19,200		19,200

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Balance Sheet as on 31st December, 1984

		Rs.			Rs.
Capital Fund	1,24,800		Building		
On 1-1-84			(1-1-84)	40,000	
Add: Surplus for			Less : Depreciation	2,000	
1984	1,080				38,000
		1,25,880	Investments on		
Subscriptions			1-1-84	80,000	
received in			Add: Purchased		
advance for 1985		320	during the year	5,000	
Telephone charges					85,000
outstanding		140	Stock of Stationery		360
			Rates & taxes prepaid		600
			Subscriptions		
			outstanding for 1984		580
			Cash at Bank		
			and hand		1,800
		1,26,340			1,26,340

You are further informed that on January 1, 1984:

1. Stock of stationery was worth Rs. 200.
2. Rates & Taxes prepaid were Rs. 600.
3. Subscription of Rs. 180 was in arrears.
4. Sundry expenses outstanding were Rs. 280.
   (R & P a/c opening balance Rs. 4,100).

Preparation of Balance Sheets from the given R & P a/c and I & E a/c.

14. The following particulars pertain to Navayuga Sports Club.

Income and Expenditure Account for the year ended 31-12-1984

Dr. Cr.

		Rs.		Rs.
To Secretary's Salary		1,500	By Entrance fees	10,500
To Printing &			By Suscriptions	15,600
Stationery	2,000		By Interest on	
Add: Outstdg. bill	400		investments received	
		2,400	and receivable	4,000
To Advertisement		1,600		
To Audit fees		500		
To Fire Insurance		1,000		
To Depreciation		4,940		
To Excess of income				
over expenditure		18,160		
		30,100		30,100

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Receipts and Payments Account for the year ended 31-12-1984

Dr. Cr.

		Rs.		Rs.
To Balance b/d		4,200	By Secretary's Salary	1,000
To Entrance fees			By Printing & Stationery	2,600
1983	1,000		By Advertisement	1,800
1984	10,000		By Fire Insurance	1,200
		11,000	By Purchase of Investments	20,000
To Subscriptions :			By Balance c/d	7,600
1983	600			
1984	15,000			7,600
1985	400			
		16,000		
To Interest on investment received		3,000		
		34,200		34,200

On Jan. 1, 1984 the assets were - building Rs. 44,000, Sports equipment Rs.25,000, furniture Rs. 4,000. Depreciate building by 5%, Sports equipment by 10% and furniture by 6%. There is no liability on advertisement at the end of the year.

Prepare opening and closing balance sheets of the club.

(Opening B/S total Rs. 78,800 Closing B/S total Rs. 97,960).

15. From the following accounts, prepare balance sheet of Colony Recreation Club as at 31st December, 1983 and 1984.

Receipts and Payments Account for the year ended 1984

Dr. Cr.

Receipts	Rs.	Payments	Rs.
To Balance b/d	8,000	By Salaries	12,000
To Endowment Fund	4,000	By Advertisement (including prepaid Rs. 400)	2,400
To Subscriptions including Rs. 400 for 1985 Books)	20,400	By Canteen provisions	13,600
To Entrance Fees	1,600	By Printing and Stationery	1,400
To Donation for Books	2,600	By Bank Deposit	2,000
To Entertainment income	8,000	By Sports Materials	5,600
To Sale of furniture (Book value Rs. 1,600)	1,400	By Creditors (1983)	2,600
		By Investments (@ Rs. 96 purchased on 1-1-1984 Interest @ 4%)	3,840
		By Balance c/d	2,560
	46,000		46,000

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Income and Expenditure Account for the year ended 31-12-1984

Dr. Cr.

Expenditure	Rs.	Income	Rs.
To Sale of Furniture	200	By subscriptions	20,000
To Salaries	13,400	By Entrance fees (50% is	
To Advertisement	2,000	only to be treated as	
To Audit fees	600	revenue receipt)	800
To Canteen provisions	12,000	revenue receipt)	800
To Printing & Stationery	1,500	By Interest on investment	160
To Sports Materials	4,000	By Entertainment income	8,000
		By Excess of Expenditure	
		over income	4,740
	33,700		33,700

(B/S total (31-12-1983) Rs. 9,600; B/S total (31-12-1984) Rs. 12,160).

5.12 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C. & Grewal, T.S. : Advanced Accounts, S.Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

5.13 GLOSSARY

Deficit : It is the excess of expenditure over income.

Surplus : It is the excess of income over expenditure.

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BLOCK-III : SELF-BALANCING AND SECTIONAL BALANCING

UNIT-6 : SELF-BALANCING AND SECTIONAL BALANCING-I

Contents

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6.0 AIMS AND OBJECTIVES

This unit is devised to acquaint you with the need for Self/Sectional Balancing Systems and the accounting aspects thereof.

After going through this unit, you should be able to:

- list out the objectives of Self/Sectional Balancing Systems
- describe the scope of sub-divided ledgers
- check the accuracy of Sectional Ledgers
- prerpare total accounts
- transfer the balance from one ledger to another.

6.1 INTRODUCTION

In a big business organisation, there will be a number of transactions and if we enter all these transactions in a journal and post them in a single ledger it becomes voluminous. Further, one person may not be able to handle it comfortably. If any mistake takes place, it would be very difficult to locate it. With a view to avoiding these problems and facilitate the location of errors without much loss of time, Self-balancing system has been devised. In this unit, we discuss both theoretical and practical aspects of this system.

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6.2 NEED FOR SECTIONAL/SELF-BALANCING SYSTEMS

As we know, business transactions are first recorded in subsidiary journals and then posted to ledger. Later, trial balance is prepared to test the arithmetical accuracy of the accounts maintained. If the trial balance agrees (or tallies), we can proceed to prepare final accounts. But, if the trial balance does not agree, it means that there are errors which must be located. In a small organisation, where there is only one ledger book, and the number of accounts is small it may be easy to trace the errors. In a big organisation where the number of transactions and the number of accounts are more and if the trial balance has not agreed, it is very difficult to locate the errors. Further, if all the accounts are maintained in one ledger book, it becomes bulky and voluminous. If there are numerous accounts, it is almost impossible to find out errors quickly, in case trial balance has not agreed. Even a small difference in the trial-balance might involve errors of compensatory nature. Therefore, to make it possible to locate the error easily without much waste of time and energy, the system of self balancing, sectional balancing is devised.

6.3 OBJECTIVES OF SELF/SECTIONAL-BALANCING SYSTEMS

The objectives of both these systems are as follows:

1. To ensure the accuracy of the ledger accounts,
2. To detect the accounting errors, if any, and to pinpoint the place of error without much waste of time and energy,
3. To exercise proper internal control, and
4. To help in the preparation of final accounts within a short period.

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6.4 NEED FOR SUB-DIVISION OF LEDGER

The ledger, as we know, is the book of final entry, in which all accounts are maintained. The system of having only one ledger may work in a small business where the number of accounts is small. But, when the number of accounts is large, it is practically impossible to keep all the accounts in one ledger book. Moreover, if there is only one ledger book, it can be handled by one person only and the work becomes too heavy for him, with the result the accounts may not be up-to-date. In order to overcome this difficulty and to facilitate speedy posting into large number of accounts, the ledger is usually divided into three separate sections or ledgers viz., Debtors Ledger, Creditors Ledger and General Ledger. Debtors and Creditors ledgers are subsidiary ledgers and the General Ledger is the main/principal ledger.

The division of ledger 1. facilitates division of work, 2. improves efficiency of posting, 3. makes reference easy, 4. facilitates the fixing of responsibility for maintaining a particular ledger to a person, and 5. makes internal check or control easier.

6.5 SCOPE OF SUB-DIVIDED LEDGERS

Debtors' Ledger : This ledger is used for recording the personal accounts of trade debtors only. Trade debtors are the persons to whom goods are sold on credit. That is why this ledger is also called Sales Ledger, Sold Ledger or Customers Ledger. Accounts of debtors other than trade debtors (e.g. sale of assets on credit) are not recorded in this ledger.

Creditors's Ledger : This ledger is maintained for recording the personal accounts of trade creditors only. Trade creditors are the persons from whom goods are purchased on credit. Therefore, this ledger is also called as Purchasers Ledger, Bought Ledger or Suppliers Ledger. Accounts of creditors other than trade creditors (e.g. Purchase of assets on credit, loans) are not recorded in this ledger.

General Ledger : This is the main ledger from which trade debtors and trade creditors are now taken out. It, therefore, contains all other accounts other than trade debtors and trade creditors. In other words, it contains all the nominal accounts, all the real accounts, and all other personal accounts except trade debtors and trade creditors. It must be rememebered that cash book must be treated as a part of General Ledger. This ledger is also known as Main Ledger, Principal Ledger, Nominal Ledger, and Impersonal Ledger (because it contains mostly impersonal accounts).

Having sub-divided the ledger into three sections or three ledgers, the accuracy of each ledger may be tested by following either the sectional balancing system or the self-balancing system. First, let us consider the sectional-balancing system.

6.6 SECTIONAL-BALANCING SYSTEM

The system of sectional-balancing means that the ledger is divided into sections trade debtors, trade creditors and general and the accuracy of each sectional ledger is separately proved by means of a Total Account.

As you know, the transactions are first recorded in subsidiary journals and later posted into the ledger. But now, there is not one ledger, but there are three. Therefore, the transactions which are recorded in the subsidiary journals will have to be posted into these three ledgers. As said earlier, the Debtors' Ledger consists of accounts of trade debtors only,the Creditors' Ledger consists of accounts of trade creditors only and the General Ledger consists of rest of the accounts. Hence, transactions relating to trade debtors are posted in the debtors ledger, transactions relating to trade creditors are posted in the creditors' ledger and rest of the transactions are posted in the general ledger. In this process, what is happening is that, in case of rest of the accounts the double entry is complete in the general ledger itself. But in the case of transactions relating to trade debtors and trade creditors the double entry is completed by posting in two ledgers. For example, if there is a credit sale, sales account (in general ledger) is credited and debtor's account (in debtors ledger) is debited. Similar is the case with credit purchases. As the posting of the two aspects of debit and credit is given to two different ledgers, it is difficult to prove the accuracy of these ledgers independently, and it is also very difficult to locate errors, if any.

In order to check the accuracy of each subsidiary ledger (viz., debtors ledger and creditors ledger) separately, an account is opened in the General Ledger (usually at the end of it) in respect of each of the subsidiary ledger. The account which represents the creditors ledger is called "Total Creditors Account" or "Purchase Ledger Adjustment Account" or "Purchase Ledger Control Account". The account which represents Debtors Ledger is called as "Total Debtors Account" or "Sales Ledger Adjustment Account" or "Sales Leder Control Account". In case of sectional balancing, these accounts are generally referred to as "Total Accounts". The object of keeping these Total Accounts in the General Ledger is that, each Total Account should represent (in terms of totals) the ledger to which it relates, so that the balance of 'Total Debtors Account' is equal to the total of all the balances contained in the individual accounts of the Debtors Ledger, and the balance of 'Total Creditors Account' is equal to the total of all the balances contained in the individual accounts of the Creditors Ledger.

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6.7 CHECKING THE ACCURACY OF SECTIONAL LEDGERS

The accuracy of the three ledgers can be checked with the help of Control Accounts (viz., Total Debtors and Total Creditors Account) in the General Ledger, in the following way:

(i) The General Ledger will be checked by taking out a trial balance containing the balance of all real, nominal and rest of the personal accounts together with the balances of the two Total Accounts.

(ii) The Debtors Ledger will be checked by comparing the total of its individual balances, with the balance of the Total Debtors Account (in General Ledger).

(iii) The Creditors Ledger will be checked by comparing the total of its individual balances, with the balance of the total creditors account (in General Ledger).

In the sectional-balancing, it must be noted that, with the help of Total Accounts, double entry is complete only in respect of General Ledger and not in respect of Debtors and Creditors Ledgers. Hence, a trial balance of only the General Ledger can be prepared and not of the Debtors and Creditors Ledgers. In this system, thus, only one section of the ledger can be balanced. Sectional-balancing is, therefore, self-balancing of a section (or one ledger).

However, it is possible to determine which ledger contains an error, and who is responsible for it. For example, assuming that there are no errors in the book of original entry, errors if any can be determined in the following way.

1. If the General Ledger trial balance agrees, and also the total of the individual balances in the Debtors Ledger (or Sales Ledger) tallies with the balance of the Total Debtors Account, but the total of the individual balances in the creditors (or purchases) ledger does not tally with the balance of the total creditors account, then the error(s) is in creditors ledger only.
2. If the General Ledger trial balance agrees, and also the total of the individual balances in the Creditors Ledger tallies with the balance of the total creditors account, but the total of the individual balances in the debtors ledger does not tally with the balance of the total debtors account, then the error(s) is in Debtors Ledger only.
3. If the subsidiary (i.e. Debtors and Creditors) Ledgers agree with their corresponding total accounts, but the General Ledger trial balance does not agree, the error(s) lies in General Ledger itself (though not in the Total Accounts).

6.8 TOTAL ACCOUNTS

The Total Debtors Account and the Total Creditors Account, which contain a summary of the transactions relating to the Debtors Ledger and Creditors Ledger, are prepared from the information provided by the books of original entry. It is, therefore, necessary that no entry should be made in any personal account, uneless it has been first recorded in one of the books of original entry. The Total Accounts are prepared with periodical (say weekly, monthly, quarterly) totals. The following are the specimen of Total Debtors Account and Total Crerditors Account.

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Dr. **Total Debtors Account (in the General Ledger)** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
?	To Balance b/d (debit balance)	xx	?	By Balance b/d (credit balance if any)	xx
	To (credit) Sales	xx		By Cash received from debtors	xx
	To B/R dishonoured	xx		By B/R (received from debtors)	xx
	To Interest (charged to debtors)	xx		By sales returns	xx
	To Balance c/d (credit balance if any)	xx		By discsount allowed	xx
				By bad debts	xx
				By transfers (if any, to Creditors Ledger)	xx
				By Balance c/d (debit balance)	xx
		xxx			xxx

Dr. **Total Creditors Account(in the General Ledger)** Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
?	To Balance b/d (debit balance, if any)	xx	?	By Balance b/d (credit balance)	xx
	To Cash (paid to crs.)	xx		By (credit) Purchases Purchases	xx
	To B/P (accepted)	xx			xx
	To Purchase returns	xx		By B/P dishonoured	xx
	To discount received	xx		By Balance c/d (debit balance, if any)	xx
	To Transfers (if any, from Debtors)	xx			
	To Balance c/d (credit balance)	xx			
		xxx			xxx

At the end of the period (say, week, month or quarter as the case may be) the balance in each total account will have to be compared with the total of the balances of debtors or creditors prepared from their respective ledgers. Such a comparison will help in determining the accuracy or otherwise of the postings made in the Debtors or Creditors Ledger.

Check Your Progress - 1

(a) What do you mean by Sectional-balancing?

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.....

.....

(b) What do you mean by 'Total Accounts'?

.....

.....

The working of the sectional-balancing system can be explained with the following illustration:

Illustration - 1

Following are the details for the month of January, 1985 pertaining to Debtors.

Customers	Credit sales Rs.	Cash Received Rs.	Discount Allowed Rs.	Sales Returns Rs.
A	9,100	6,500	300	–
B	7,300	4,000	–	2,000
C	8,800	8,500	200	–
D	11,200	4,100	–	1,000
Total	36,400	23,100	500	3,000

Record this information in Debtors Ledger and General Ledger, and test the accuracy of these ledgers.

Solution

The following entries will be made in the books of accounts in case of Sectional-Balancing System.

In the Debtors Ledger.

(i) For credit sales - The Accounts of A,B,C & D will be debited.

(ii) For cash received, discount allowed and sales returns-the accounts of A,B,C and D will be credited.

It must be noted that, the Debtors Ledger contains only one aspect of the above transactions. Further, the above entries are to be made in the personal accounts of the debtors as and when the transactions take place.

Debtors Ledger

Dr. **A's Account** Cr.

1985		Rs.	1985		Rs.
Jan. ?	To Sales a/c.	9,100	Jan. ?	By Cash a/c.	6,500
			?	By Discount Allowed a/c.	300
			31	By Balance c/d.	2,300
		9,100			9,100
Feb. 1	To Balance b/d	2,300			

Dr. **B's Account** Cr.

1985		Rs.	1985		Rs.
Jan. ?	To Sales a/c.	7,300	Jan. ?	By Cash a/c.	4,000
			?	By Sales returns a/c.	2,000
			31	By Balance c/d.	1,300
		7,300			7,300
Feb. 1	To Balance b/d	1,300			

Dr. **C's Account** Cr.

1985		Rs.	1985		Rs.
Jan. ?	To Sales a/c.	8,800	Jan. ?	By Cash a/c.	8,500
			?	By Discount allowed a/c.	200
			31	By Balance c/d.	100
		8,800			8,800
Feb. 1	To Balance b/d	100			

Dr. **D's Account** Cr.

1985		Rs.	1985		Rs.
Jan. ?	To Sales a/c.	11,200	Jan. ?	By Cash a/c.	4,100
			?	By Sales Returns a/c.	1,000
			31	By Balance c/d.	6,100
		11,200			11,200
Feb. 1	To Balance b/d	6,100			

The total of Debtors Ledger balances (or schedule of Debtors) will be as below:

	Rs.
A	2,300
B	1,300
C	100
D	6,100
	9,800

GENERAL LEDGER

Dr. **Sales Account** Cr.

1985		Rs.	1985		Rs.
Jan. 31	To Balance a/c.	36,400	Jan. 31	By Total Debtors a/c.	36,400
			Feb. 1	By Balance b/d.	36,400

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Cash Account

Dr.					Cr.
1985		Rs.	1985		Rs.
Jan. 31	To Total Debtors a/c.	23,100	Jan. 31	By Balance c/d.	23,100
Feb. 1	To Balance b/d.	23,100			

Discount Allowed A/c.

Dr.					Cr.
1985		Rs.	1985		Rs.
Jan. 31	To Total Debtors a/c.	500	Jan. 31	By Balance c/d.	500
Feb. 1	To Balance b/d.	500			

Sales Returns A/c.

Dr.					Cr.
1985		Rs.	1985		Rs.
Jan. 31	To Total Debtors a/c.	3,000	Jan. 31	By Balance c/d.	3,000
Feb. 1	To Balance b/d.	3,000			

Total Debtors Account

A's Account

Dr.					Cr.
1985		Rs.	1985		Rs.
Jan. 31	To Sales a/c.	36,400	Jan. 31	By Cash a/c.	23,100
			31	By Discount Allowed a/c.	500
			31	By Sales Returns a/c.	3,000
			31	By Balance c/d.	9,800
		36,400			36,400
Feb. 1	To Balance b/d	9,800			

To test the accuracy of General Ledger, Trial Balance can now be prepared which is as follows:

	Dr. Rs.	Cr. Rs.
Sales A/c.	–	36,400
Cash A/c.	23,100	–
Discount Allowed a/c.	500	–
Sales Returns a/c.	3,000	–
Total Debtors a/c.	9,800	–
	36,400	36,400

The balance, in the Total Debtors Account in the General Ledger Rs. 9,800 tallys with the total of Debtors Ledger balances, thus proving the accuracy of entries made in Debtors ledger.

In a similar way, transactions relating to trade creditors viz., credit purchases, cash paid, discount received, purchase returns, etc., are recorded in creditors ledger and general ledger. Periodically, a schedule of creditors is prepared from the Creditors Ledger and tallied with the balance in the Total Creditors Account, in order to check the accuracy of the entries made in the creditors Ledger.

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6.9 SUB-DIVISION OF DEBTORS AND CREDITORS LEDGERS

In a big organisation if there are numerous debtors and creditors accounts, instead of keeping all these accounts in one debtors ledger and in one creditors ledger, separate ledgers may be kept for them. It means that the debtors and creditors ledger will have to be further sub-divided according to areas, or in an alphabetical order. Such a sub-division increases the number of control or total accounts. For example, if the Debtors and Creditors Ledgers are sub-divided, on the basis of alphabetical order, into two categories as (a) A-M and (b) N-Z, the following total accounts will have to be kept in the general ledger:

i) Total Debtors Account (A - M)
ii) Total Debtors Account (N - Z)
iii) Total Creditors Account (A - M)
iv) Total Creditors Account (N - Z)

The process of balancing or testing the accuracy of each ledger is the same as explained earlier.

6.10 TRANSFERS FROM ONE LEDGER TO ANOTHER LEDGER

Some times, the same person may be trade debtor as well as trade creditor of the business. For example, one variety of goods may be purchased from him and another variety sold to the same person. In such a case there are two accounts on his name, one in the creditors (or purchases) ledger and the other in Debtors (or sales) Ledger. But, for the purpose of final settlement, the balance in one account must be deducted from the balance in the other and the net balance only is paid or received as the case may be. Therefore, to get the balance payable or receivable it is necessary to transfer the account showing a smaller balance to the account showing a bigger balance. This means that one account is transferred from the the Debtors Ledger to the Creditors Ledger or vice-versa. Such transfers should always be made by means of journal entries. The total accounts should also record this transfer.

For example, Narahari's account shows Rs. 1,000 in Creditors Ledger and Rs. 2,500 in Debtors Ledger. That means he has to pay only Rs. 1,500 for settling his account. The necessary transfer will be made by means of the following journal entry.

Narahari's A/c. (in Creditors Ledger)	Dr.	1,000	
To Narahari's A/c. (in Debtors Ledger)			1,000

This transfer will naturally be recorded in the total accounts, as shown below:

Dr. **Total Debtors Account** Cr.

			Rs.		
	By Transfer from Creditors ledger		1,000		

Dr. **Total Creditors Account** Cr.

			Rs.		
	To Transfer to Debtors ledger		1,000		

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Some-times, a transfer becomes necessary from one account to another account in the same ledger. This too should be done by means of a journal entry. However, such transfers will not affect the Total Accounts.

6.11 DEBTORS AND CREDITORS LEDGERS HAVING BOTH DEBIT AND CREDIT BALANCES

Generally speaking, all the balances in the Creditors Ledger should be credit balances and all the balances in the Debtors Ledger should be debit balances. But, in actual practice. Sometimes, it may, so happen that some of the accounts in the Debtors Ledger may have credit balance while some of the accounts in the Creditors Ledger may have debit balance. This may be due to excess payments or late return of goods or delayed grant of allowances or discount etc.

When the Creditors Ledger shows both credit and debit balances and the Debtors Ledger shows both debit and credit balances, the corresponding Total Accounts in the General Ledger will have to contain both debit and credit balances of both these ledgers. The total creditors account will have a credit balance representing the gross-trade creditors and also a small debit balance representing the accounts showing a debit balance. Similarly, the Total Debtors Account will have a debit balance representing the gross debtors and also a small credit balance, representing some accounts, showing a credit balance.

However, for the purpose of Balance Sheet, all debit balances are trade debtors and all credit balances are trade creditors whether they appear in the Debtors Ledger or Creditors Ledger.

Check Your Progress - 2

1. When does the total debtors account will have a credit balance?

.....

.....

2. When does the total creditors account will have a debit balance?

.....

.....

Illustration - 2

From the following particulars write up the Total Debtors Account and Total Creditors Accoun for the month of June, 1985.

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		Rs.
Debtors (on 1-6-1985)	Dr.	17,500
Debtors (on 1-6-1985)	Cr.	350
Creditors (on 1-6-1985)	Cr.	27,500
Creditors (on 1-6-1985)	Dr.	250
Credit Purchases		25,500
Credit Sales		30,000
Sales returns		300
Purchase returns		700
Cash paid to creditors		13,000
Bills received from debtors		9,500
Bills receivable dishonoured		200
Bills accepted for creditors		7,500
Discount allowed to debtors		260
Discount allowed to debtors but later on disallowed		60
Cash received from Debtors		10,000
Discount allowed by creditors		1,000
Cash paid to debtors		50
Cash received from creditors		30
Transfers from debtors ledger to creditors ledger		1,250
Cash purchases		5,000
Cash sales		7,000
Bad debts written off		250
Provision for doubtful debts		500
Debtors (on 30-6-1985)	Cr.	450
Creditors (on 30-6-1985)	Dr.	150

Solution

D1. **Total Debtors Account** Cr.

1985		Rs.	1985		Rs.
June 1	To Balance b/d.	17,500	June 1	By Balance c/d.	350
30	To Sales	30,000	30	By Sales returns	300
	To Bills receivable dishonoured	200		By Bills receivable	9,500
	To Discount disallowed	60		By Discount allowed	260
	To Cash (paid to Drs).	50		By Cash	10,000
	To Balance c/d (Cr.)	450		By Transfers	1,250
				By Bad debts written off	250
				By Balance c/d.	26,350
		48,260			48,260
July 1	To Balance b/d.	26,350	July 1	By Balance b/d.	450

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Dr. **Total Creditors Account** Cr.

1985		Rs.	1985		Rs.
June 1	To Balance b/d.	250	June 1	By Balance b/d.	27,500
30	To Purchase returns	700	30	By Purchases	25,500
	To Cash	13,000		By Cash (received	
	To Bills payable	7,500		from crs.)	30
	To Discount received	1,000		By Balance c/d (Dr.)	150
	To Transfers	1,250			
	to Balance c/d	29,480			
		53,180			53,180
July 1	To Balance b/d.	150	July 1	By Balance b/d.	29,480

Note :

1. While writing the Total Accounts only those items which affect the Debtors and Creditors should be taken into account. The items such as cash purchases, cash sales, provision for doubtful debts and Provision for doscounts on debtors and creditors, trade discount etc., should not be considered for the purpose of writing the Total Accounts.
2. The exceptional balances (i.e. credit balance in debtors account, and debit balance in creditors account) should be written on their correct sides if they are opening balances, and reverse sides if they are closing balances. The closing credit balance in Total Debtors Account should be put on debit side of that account before totalling and balancing. Similarly, the closing debit balance in Total Creditors Account should be written on the credit side of that account before totalling and balancing.

6.12 SUMMING UP

The system of sectional/self balancing is devised to locate errors easily without much waste of time. It helps in pinpointing the place of error, if any, and the preparation of final accounts within a short period. To facilitate speedy posting into large number of accounts, the ledger is usually devided into three separate sections or ledgers viz., Debtors Ledger, Creditors Ledger and General Ledger.

In case of sectional balancing, the ledger is devided into sections and the accuracy of each sectional ledger is separately proved by means of a total account. The accuracy of the three ledgers can be checked with the help of control accounts viz., Total Debtors Account, and Total Creditors Account, opened for this purpose in the General Ledger.

6.13 CHECK YOUR PROGRESS : MODEL ANSWERS

1. (a) It is a method of dividing the ledger into sections viz., trade debtors, trade creditors and general and proving the accuracy of each of these ledgers by means of a total account or a control account.

   (b) An extra account inserted at the end of the ledger to complete the double entry of the ledger and thus the ledger is self-balance.

2. (a) The total debtors account shows a credit balance due to granting allowances or return of goods etc., after the settlement of the accounts of some debtors.

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asset is charged to Income and Expenditure Account. In case of gain on the sale of an asset, if the amount is small, it is taken to the Income and Expenditure Account, but if it is a big amount it is treated as a capital gain and shown in the Balance Sheet.

10. **Sale of old Newspapers or old sports materials :** The amount received on account of selling old newspapers or old sports materials, etc., is treated as revenue income.

In addition to the above mentioned terms, depending upon the nature of the organisation, we come across some more special terms. For example, in the case of an educational institution, application fees, registration fess, tution fees, examination fees, etc., come under this category. They are to be treated appropriately in the accounts.

Having seen the nature of non-trading or non-profit organisations, it is now proposed to take up the preparation of their final accounts, which is the objective of the next unit.

Check Your Progress - 2

1. In the absence of specific instructions, how do you treat donations and entrance fees?

.....

.....

.....

2. How do you treat the sale of old assets?

.....

.....

.....

4.10 SUMMING UP

The primary objective of non-business organisations is to render service to its members in particular and to the society in general. People join together in the form of voluntary organisations to achieve a common objective. Such service organisations are generally referred to as non-trading or non-profit organisations. These organisations too must have money to promote or pursue their activities and that money must be properly accounted for.

Like the business concerns the non-trading concerns too want to know their financial result and financial position at the end of the year. There is nothing special about the accounts of non-trading organisations, except they often do not keep a full set of books and do not extract a trial balance. Generally, with the help of Receipts and Payments Account and other information, the final accounts viz., Income and Expenditure Account and Balance Sheet are prepared.

Non-profit organisations generally survive on subscriptions from members, fees from users and donations from others.

Because of the peculiar nature of non-profit organisations we come across some special terms like legacy, donations, subscription, entrance fees, honorarium, etc.

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These organisations may prepare their final accounts on cash or mercantile system. But generally, they prepare them on mercantile system i.e., Accrual basis of Accounting. Hence, the principles underlying the preparation of final accounts of business concerns are equally applicable to them also.

4.11 CHECK YOUR PROGRESS : MODEL ANSWERS

1. a) A receipt which is repayable or received by the sale of asset or received as a permanent source is known as capital receipt. It appears on the liabilities side of Balance Sheet. On the other hand, a revenue receipt is a recurring in nature and it is not repayable. It is shown on the income side of Income and Expenditure Account.

   b) Any cash paid irrespective of its nature and period, is called payment. Expenses are those which are actually incurred whether paid or not.

   c) Capital expenditure is one whose benefit is available for a number of years and it is shown on the assets side of Balance Sheet. Contrary to this, the benefit of revenue expenditure exhausts in the year in which it has been incurred and appears on the debit side of Income and Expenditure Account.

2. a) Both are treated as income and shown on the credit side of Income and Expenditure Account.

   b) When an asset is sold, the asset value is to be reduced to the extent of its book value. If there is a gain, in the absence of instructions, such gain is shown on the credit side of and if there is a loss, such loss is shown on the debit side of Income and Expenditure Account.

4.12 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines each.

1. What is the nature of non-trading organisations? What are their features?
2. Distinguish between Receipts and Payments Account and Income and Expenditure Account.
3. Bring out the distinction between capital and revenue items by giving suitable examples.

B. Answer the following in 15 lines each.

1. a) Receipts and Payments Account
   b) Income and Expenditure Account
2. a) Capital and Revenue Receipts
   b) Capital and Revenue Expenditure
3. Distinguish between capital payments, and revenue payments.
4. Explain the following:

   a) Legacy
   b) Capital Fund
   c) Deferred Revenue Expenditure

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4.13 RECOMMENDED BOOKS

1. Gupta, R.L — Advanced Accountacy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C & Grewal, T.S. — Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P. & Narang, K.L — Advanced Accountancy, Kalyani Publishing House, New Delhi.

4.14 GLOSSARY

Admission or Entrance Fees : It is the amount received from a member at the time of his admission into the organisation.

Donation : It is the amount received as a gift.

Endowment Fund : It is the money or property given by parties so as to provide a permanent source of income to support the institution.

Honorarium : It is a token payment made to managing committee members, artists, speakers, sportsmen etc., for their services.

Income and Expenditure Account : It is the account prepared by the non-profit organisations to ascertain the financial result of their activities. It is similar to the profit and loss account of business concerns.

Legacy : It is the amount received as per the will of some person.

Receipts and Payments Account : It is the summary of cash book put in the form of an account.

Subscription : It is the amount agreed to be contributed by the members of an organisation. It is paid at periodical intervals.

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UNIT-5 : ACCOUNTS OF NON-TRADING ORGANISATIONS-II

Contents

5.0 Aims and Objectives
5.1 Introduction
5.2 Final Accounts
5.3 Preparation of Income and Expenditure Account and Balance Sheet without Adjustments
5.4 Preparation of Income and Expenditure Account and Balance Sheet with Adjustments
5.5 Preparation of Income and Expenditure Account and Balance Sheet from the given Receipts and Payments Account and Accompanying Notes
5.6 Preparation of Receipts and Payments Account, Income and Expenditure Account and Balance Sheet from the given information
5.7 Preparation of Receipts and Payments Account from the given Income and Expenditure Account and other information
5.8 Preparation of Balance Sheets with the help of Receipts and Payments Account, Income and Expenditure Account and other Accompanying Notes
5.9 Summing Up
5.10 Check Your Progress : Model Answers
5.11 Model Examination Questions
5.12 Recommended Books
5.13 Glossary

5.0 AIMS AND OBJECTIVES

This unit aims at explaining the method of preparing final accounts of non-trading organisations with all accounting adjustments.

On completion of this unit, you should be able to:

- prepare Income and Expenditure Account and Balance Sheet with adjustments
- prepare final accounts with the help of Receipts and Payments Account and other information
- explain the preparation of Receipts and Payments Account with the help of Income and Expenditure Account and other information
- draw the Balance Sheets with the help of Receipts and Payments Account, Income and Expenditure Account and other notes.

5.1 INTRODUCTION

As we have stated in unit-4, the final accounts of non-trading organisations include Income and Expenditure Account and Balance Sheet. In order to prepare final accounts, sometimes we may have to gather information from Receipts and Payments Account and other notes or Income and Expenditure Account and Receipts and Payments Account, and other information, etc. In this unit, how various accounts are to be prepared effecting the adjustments will be shown with illustrations.

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5.2 FINAL ACCOUNTS

The final accounts of non-trading organisations viz., Income and Expenditure Account and Balance Sheet are prepared generally with the help of (i) Opening Balance Sheet, (ii) other relevant information and (iii) summary of the Cash Book, i.e., Receipts and Payments Account. The assets and liabilities as at the beginning of the year, are known from the opening balance sheet i.e., the Balance Sheet at the beginning of the accounting year. Additions and subtractions to assets, liabilities, receipt of income and payment of expenses in cash during the year are recorded in the Cash Book. Non-cash additions and subtractions, if any, to assets, liabilities, incomes and expenses, during the year are available in the form of adjustments or other information.

While preaparing the Income and Expenditure Account, the adjustments are to be carried out keeping in view the Matching Principle. In other words, all Incomes received or receivable and all expenses paid or payable pertaining to the current year are to be finally shown in the Income and Expenditure Account of the current year. All other Incomes and Expenses pertaining to a previous period or a future period but received or paid during the year are to be excluded from the current year's Income and Expenditure Account.

5.3 PREPARATION OF INCOME AND EXPENDITURE ACCOUNT AND BALANCE SHEET WITHOUT ADJUSTMENTS

Illustration - 1

The Young Men's Club was started on 1-1-1988. Fromt the following Receipts and Payments Account of the Club prepare their final accounts for the year ending on 31st of December, 1988.

Dr. **Receipts and Payments Account** for the year ending on 31-12-1988 Cr.

Receipts	*Rs.*	*Payments*	*Rs.*
To Entrance Fees	700	By Printing and Stationery	200
To Donation for Building Fund	5,000	By Newspapers	700
To Subscriptions from members	7,000	By Books	4,000
To Proceeds from Entertainment	1,000	By Sports Materials	5,000
To Sale of Old Newspapers	300	By Furniture	1,000
To Miscellaneous Receipts	500	By Salaries	1,100
		By Balance c/d	2,500
		By Salaries	1,100
	14,500		14,500

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Solution

Young Men's Club Income and Expenditure Account
for the year ending on 31-12-1988

Dr. Cr.

Expenditure	*Rs.*	*Income*	*Rs.*
To Printing & Stationery	200	By Entrance Fees	700
To Newspapers	600	By Subscriptions from members	7,000
To Salaries	1,100	By Proceeds from Entertainment	1,000
To Excess of Income over Expenditure (transferred to Capital Fund)	7,500	By sale of old Newspapers	300
		By Miscellaneous Receipts	500
	9,500		9,500

Young Men's Club Balance Sheet
as on 31st December, 1988

Dr. Cr.

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital Fund:			Furniture	1,000
Opening Balance	—		Books	4,000
Add: Excess of Income over Expenditure	7,500	7,500	Sports Materials	5,000
Building Fund a/c		5,000	Cash in hand	2,500
		12,500		12,500

Note: Since the Depreciation on furniture and books, and the consumption of sports materials is not mentioned, the entire amounts are shown as assets.

5.4 PREPARATION OF INCOME AND EXPENDITURE ACCOUNT AND BALANCE SHEET WITH ADJUSTMENTS

Illustration-1 is a simple one, since no adjustments are involved. Let us consider the accounts of the same club for the second year by introducing some adjustments.

Illustration - 2

The following is the balance sheet of Young Men's Club as on 1-1-1989.

Dr. Cr.

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Fund	7,500	Furniture	1,000
Building Fund	5,000	Books	4,000
		Sports Materials	5,000
		Cash in hand	2,500
	12,500		12,500

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Young Men's Club Balance Sheet
as on 31st December, 1989

Dr. Cr.

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital Fund balance	7,500		Funiture	1,000	
Add: Excess of income over Expenditure	6,525	14,025	Add: Purchased during the year	2,000	
				3,000	
Building Fund - balance	5,000		Less: Depreciation	200	2,800
Add: Donations during the year	4,000	9,000	Books	4,000	
Prize Fund -	2,500		Add: Purchased during the year	5,000	
Less: Prize Fund Expenses	500			9,000	
		2,000	Less: Depreciation	1,625	7,375
Subscriptions Received in Advance		1,000	Sports Materials	5,000	
Salaries outstanding		400	Add: Purchased during the year	5,000	
				10,000	
			Less: Depreciation	3,750	6,250
			Unused stationery stock		400
			Advance salary paid		200
			Subscriptions outstanding		2,000
			Entertainment programme proceeds due		500
			Cash in hand		6,900
		26,425			26,425

Notes:

1. Depreciation is calculated as shown below:

	Rs.	Rs.
a) On books @ 25% on opening balance Rs. 4,000 p.a.	1,000	
on Rs. 5,000 for 6 months	625	
		1,625
b) On Sports Materials @ 50%. On Opening balance Rs. 5,000 p.a.	2,500	
On Rs. 5,000 for 6 months	1,250	
		3,750
c) On Furniture @ 10% on opening balance Rs. 1,000 p.a.	100	
on Rs. 2,000 for 6 months	100	
		200
		5,575

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Secunderabad Public Library Income and Expenditure Account
for the year ended 31st December, 1984

Expenditure		*Rs.*	*Income*		*Rs.*
To Salaries paid	3,600		By Subscriptions	12,500	
Add: Oustanding	500	4,100	Add: Outstanding at the end	1,800	
To Electric Lighting expenses		300		14,300	
To Municipal taxes		1,100	Less: Outstanding at the beginning	1,000	13,300
To Repairs to Building		800	By Proceeds from lectures and entertainments		1,500
To Insurance	350		By Interest on Investments	200	
Add: Prepaid last year	100		Add: Outstanding	350	550
	450		By Sale of old newspapers		450
Less: Prepaid this year	75	375	By Rent for use of Lecture hall	1,500	
To Printing & Stationery	500		Add: Receivable at the end	250	
Add: Outstanding	75	575		1,750	
To Sundry Expenses		250	Less: Receivable at the beginning	400	1,350
To Postage		420			
To Subscriptions to Periodicals		1,400			
To Depreciation:					
On Building @ 2%	800				
On furniture & fittings @ 5%	175				
On library Books @ 10%	2,000	2,975			
To Excess of Income over Expenditure		7,855			
		20,150			20,150

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Secunderabad Public Library

Balance Sheet

as on 31st December, 1984

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital Fund	72,000		Building	40,000	
Add: Excess of income over expenditure	7,855		Less: Depreciation	800	39,200
Add: Entrance Fees	1,200	81,055	Furniture and fittings :	3,500	
			Less: Sale of furn.	100	
Creditors		1,750	Less: Depreciation	175 275	3,225
Salaries oustanding		500			
Stationery Expenses outstanding		500	Steel Shelves		1,750
		75	Electric Installations		2,000
			Library Books	20,000	
			Add: Purchased during the year	1,400	
				21,400	
			Less: Depreciation	2,000	19,400
			Investments at cost:		
			5% Government Loan	8,000	
			10% Investments	3,000	11,000
			Subscriptions outstanding		1,800
			Rent receivable		250
			Interest accrued due		350
			Prepaid Insurance		75
			Cash at Bank		4,330
		83,380			83,380

Notes:

1. The problem requires the preparation of only the Income and Expenditure account and the Balance Sheet (as on 31-12-1984). But the capital Fund as on 1-1-1984 and bank balance as on 31-12-1984 are not given. In order to ascertain the capital Fund on 1-1-1984 the Opening Balance Sheet is prepared and to ascertain bank balance on 31-12-1984 Receipts and Payments account is prepared.
2. Interest on investments is calculated at 5% on Rs. 8,000 for full year (Rs. 400) and on Rs. 3,000 at 10% for six months (Rs. 150). But the amount received is only Rs. 200. Therefore, Rs. 350 is shown as accrued and due.
3. Depreciation has to be calculated on the opening balances of the assets. Hence, on Electric Installations, which were not there at the beginning depreciation is not calculated.
4. Steel shelves were acquired during the year for which payment is not made. Hence, Rs. 1,750 is shown as liability and also as asset.

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5.7 PREPARATION OF RECEIPTS AND PAYMENTS ACCOUNT FROM THE GIVEN INCOME AND EXPENDITURE ACCOUNT AND OTHER INFORMATION

Illustration - 5

Public Health Care Centre
Income and Expenditure Account
for the year ending 31st March, 1984

Dr. Cr.

Expenditure		*Rs.*	*Income*	*Rs.*
To Salaries		23,500	By Entrance Fees	700
To Office expenses		800	By Donations	5,000
To Insurance		200	By Subscriptions	25,000
To Rent and Taxes		500	By Miscellaneous Receipts	300
To Dispensary Expenses		3,000	By Interest	9,000
To Depreciation:				
Building	3,750			
Furniture	150			
Instruments	100			
		4,000		
To Excess of income over Expenditure		8,000		
		40,000		40,000

Other items of information pertaining to the Health Centre are as follows:

	31-3-1983	*31-3-1984*
	Rs.	Rs.
Land and Building	2,00,000	1,96,250
Furniture	2,000	2,100
Instruments	3,500	4,000
4.5% Investments in Securities	2,00,000	2,00,000
Cash at bank	?	18,700
Stock of Medicines	300	100
Dispensary expenses due	200	300
Subscriptions outstanding	7,000	10,000
Subscriptions received in Advance	200	600
Salaries outstanding	1,000	1,500

You are required to prepare the Receipts and Payments account for the year ending 31st March, 1984.

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Public Health Care Centre Receipts and Payments Account

Dr. for the year ended 31st March, 1984 Cr.

Receipts	*Rs.*	*Payments*		Rs.
To Balance b/d (on 1-4-83) (Balancing figures)	9,350	By Salaries[1] : as shown in I & E a/c.	23,500	
To Entrance fee[6]	700	Add: Paid for last year	1,000	
To Donations	5,000		24,500	
To Subscriptions[2]	22,400	Less: Payable at the end of the year	1,500	23,000
To Miscellaneous receipts	300	By office expenses		800
To Interest	9,000	By Insurance		200
		By Rent and Taxes		500
		By Dispensary expenses[3]		2,700
		By Furniture[4]		250
		By Instruments[5]		600
		By Balance c/d (31-3-84)		18,700
	46,750			46,750

Notes:

1. In the I & E a/c the amount paid or payable on account of salaries for the accounting year is shown. In order to arrive at the actual amount paid during the year, salaries outstanding at the beginning of the year are to be added (because they are paid this year) and salaries outstanding at the end of the year are to be deducted (because they are not yet paid).
2. Subscriptions received during the year can be ascertained as shown below:

Subscriptions Statement

	Rs.		Rs.
To Subscriptions outstanding on 31-3-1983	7,000	By Subscriptions received in Advance as on 31-3-1983	200
To Subscriptions received in advance as on 31-3-1984	600	By Subscriptions outstanding as on 31-3-1984	10,000
To I & E A/c (Amount shown)	25,000	By Subscriptions received during the year (Balancing figures)	22,400
	25,000		
	32,600		32,600

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3. The amount paid towards dispensary expenses is ascertained as shown below:

Dispensary Expenses Statement

	Rs.		Rs.
To Opening stock of Medicines	300	By Expenses outstanding as on 31-3-1983	200
To Expenses outstanding as on 31-3-1984	300	By Amount charged to I & E a/c.	3,000
To Amount paid during the year (Balancing figure)	2,700	By closing stock of Medicine	100
	3,300		3,300

4. Furniture as on 31-3-1983 was Rs. 2,000. Rs. 150 is deducted as depreciation. Then the balance should be Rs. 1,850 (Rs.2,000–150). But the balance as on 31-3-1984 was Rs. 2,100. That means furniture worth Rs. 250 (i.e. 2,100–1,850) is purchased during the year.

5. Similar is the case with instruments:

Instruments Account

	Rs.		Rs.
To Balance b/d (31-3-83)	3,500	By Depreciation	100
To Cash (Balancing figure)	600	By Balance c/d (31-3-84)	4,000
	4,100		4,100

6. If the Opening balance of cash is given, you would have just balanced the R & P a/c by ascertaining the closing balance of cash. But the closing balance of cash (as on 31-3-1984) is given in this problem. Prepare the R & P a/c as usual. Put the debit side items on debit side leaving space for opening balance of cash. Put the credit side items on the credit side including closing balance of cash. First total the credit side and then subtract it from the debit side total. The balance is the opening balance of cash.

Even though balance sheet is not asked in this problem, we can also prepare balance sheet (s) from the given information as shown below:

Public Health Care Centre Balance Sheet
as on 31st March, 1984

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital Fund:			Land and Buildings	1,96,250
Balance as on 31-12-83	4,20,750		Furniture	2,100
Add: Surplus	8,000	4,28,750	Instruments	4,000
Salaries unpaid		1,500	4.5% Investments	2,00,000
Dispensary Expenses unpaid		300	Stock of Medicines	100
Subscriptions Received in advance		600	Subscriptions	10,000
			Cash at bank	18,700
		4,31,150		4,31,150

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Balance Sheet
as on 1-4-1983

	Rs.		Rs.
Subscriptions Received in Advance	200	Land and Buildings	2,00,000
Salaries unpaid	1,000	Furniture	2,000
Dispensasry Expenses unpaid	200	Instruments	3,500
Capital Fund		4.5% Investments	2,00,000
(Balancing figure)	4,20,750	Stock of Medicines	300
		Subscriptions outstanding	7,000
		Cash at Bank (See R & P a/c)	9,350
	4,22,150		4,22,150

Check Your Progress - 1

Ascertain the amount of subscriptions to be credited to Income and Expenditure Account.

	Rs.
Subscriptions received during the year.	1,05,000
Subscriptions received in advance in the previous year.	10,000
Subscriptions outstanding at the beginning of the year.	5,000
Subscriptions outstanding at the end of the year.	14,000
Subscriptions received in advance.	16,000

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Check Your Progress - 2

Will you say that the items appearing on the debit side of Receipts and Payments Account should appear on the credit side of Income and Expenditure Account? Give reasons for your argument?

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5.8 PREPARATION OF BALANCE SHEETS WITH THE HELP OF RECEIPTS AND PAYMENTS ACCOUNT AND, INCOME AND EXPENDITURE ACCOUNT, AND ACCOMPANYING NOTES

We can also prepare the balance sheets both opening and closing if Receipts and Payments account, Income and Expenditure account, and other information is given. While doing so the following points should be noted:

(i) Show the opening balance of Receipts and Payments Account as an asset in the opening balance sheet.

(ii) Show the closing balance of Receipts and Payments Account as an asset in the Closing balance sheet.

(iii) The closing balance of the Income and Expenditure Account is added to the Capital Fund (if it is a surplus) or deducted from the capital fund (if it is a deficit) in the closing Balance Sheet.

(iv) Compare the items on the debit side of the Income and Expenditure Account with those on the credit side of the Receipts and Payments Account.

Similarly, compare the items on the credit side of the Income and Expenditure Account with those on the debit side of the Receipts and Payments Account.

Items appearing in Receipts and Payments Account but not appearing in Income and Expenditure Account are (a) either receipts received in advance or payments made in advance; or (b) receipts for previous year or payments for previous year.

On comparison, item by item, you can conclude whether they are assets or liabilities, and then show them in the relevant Balance Sheet.

(v) Assets at the end should be taken to the closing balance sheet with due consideration to depreciation and additions during the year.

Illusration - 6

The following are the Receipts and Payments Account, and Income and Expenditure Account of Book Lovers Association, Hyderabad.

Receipts and Payments Account

Dr. for the year ending on 31-12-1984 Cr.

Receipts		*Rs.*	*Payments*		*Rs.*
To Balance b/d		1,400	By Salaries:		
To Interest		800	1983 -	200	
To Donation for special			1984 -	2,200	2,400
Fund		300			
To Subscriptions			By Printing		
1983 -	1,600		and Stationery		300
1984 -	7,000	8,600	By Books		3,000
			By Miscellaneous Expenses		600
To Rent:			By Balance c/d		5,590
1983 -	260				
1984 -	520	780			
		11,880			11,880

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Dr. **Hyderabad Club Receipts and Payments Account** Cr.

Receipts		*Rs.*	*Payments*	*Rs.*
To Balance b/d		14,000	By 7% Investments (Purchased on 1st July 1984)	20,000
To Legacies		12,000	By Furniture	4,400
To Donation for Building		16,000	By Tournament expenses	2,200
To General Donations		400	By Curtains	1,600
To Sale of Old furniture (Book value Rs. 160)		150	By Crockery	800
To Sale of newspapers		800	By Salaries	2,600
To sale of old sports materials		160	By Sports material	2,400
To Endowment Fund Receipts		20,000	By Charities	16,000
To Rent received from the Hall		3,000	By Honorarium	5,200
To Advertisement in the 'Year Book'		800	By Advertisements	500
To Proceeds of concerts		2,400	By Advance against construction of building	10,000
To Tournament Fund		3,000	By Entertainment expenses	2,900
To Subscriptions:			By Payment to crreditors of last year	800
1983	1,200		By Cost of Electric Installations	6,000
1984	28,000		By Library books	1,600
1985	1,600	30,800	By Newspapers	2,600
			By Telephone expenses	1,400
			By Canteen expenses including purchases	3,200
			By Rent & Taxes	2,800
			By Balance c/d	16,910
		1,03,510		1,03,510

Other information

i) Subscriptions outstanding on the 31st of December, 1984 were Rs. 1,400.

ii) Salary outstanding as on 31st December, 1984 was Rs. 100. Salaries paid include Rs. 160 paid for 1983 and Rs. 20 for 1985.

iii) The stock of sports materials on the 31st of December, 1984 was Rs. 200, and canteen stock Rs. 280.

iv) Building Fund as on 1-1-1984 was Rs. 12,000.

v) Investments include investments out of building fund donations Rs. 16,000.

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Hyderabad Club Income and Expenditure Account

Dr. for the year ending on 31st Dec., 1984 Cr.

Receipts		*Rs.*	*Payments*		*Rs.*
To Salaries	2,600		By General Donations		400
Add: Outstanding	100		By sale of newspapers		800
			By sale of old sports		
	2,700		materials		160
Less: Paid for			By Rent from Hall		3,000
1983 - 160			By Advertisements in the		
Paid for			Year Book		800
1985 - 20	180	2,520	By proceeds of concerts		2,400
To Sports materials	2,400		By Subscriptions:		
Less: Stock in			1984	28,000	
hand	200	2,200	Add: Outstanding		
			for 1884	1,400	29,400
To Loss on sale of					
furniture		10	By Interest Accrued on		
To Honorarium		5,200	investments (on Rs. 4,000		
To Charities		16,000	@ 7% for 6 months)		140
To Advertisements		500	By Excess of Expenditure		
To Entertainment expenses		2,900	over income		1,950
To Newspapers		2,600			
To Telephone Expenses		1,400			
To Canteen					
Expenses	3,200				
Less: Stock in					
hand	280	2,920			
To Rent and Taxes		2,800			
		39,050			39,050

Balance Sheet

as on 1st January, 1984

	Rs.		*Rs.*
Capital Fund		Furniture	160
(Balancing Figure)	2,400	Subscriptions	
Building Fund	12,000	Outstanding	1,200
Creditors	800	Cash in hand	14,000
Salary outstanding	160		
	15,360		15,360

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Hyderabad Club Balance Sheet
as on 31st December, 1984

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital Fund	2,400		Electric Installations		6,000
Less: Excess of Expenditure over income for '84	1,950	450	Furniture-balance	160	
			Add: Purchased during the year	4,000	
				4,160	
Building Fund	12,000		Less: Furniture sold	160	4,000
Add: Donation for the fund during the year	16,000		Library Books		1,600
Add: Interest on Investements on Rs. 16,000 @ 7% for 6 months	560	28,560	Crockery		800
			Curtains		1,600
			7% Investments		20,000
			Advance for the construction of Building		10,000
Endowment Fund		20,000	Balance of Stock:		
Legacies		12,000	Sports materials	200	
Tournament Fund	3,000		Canteen stock	280	480
Less: Expenses	2,200	800			
Subscriptions Received in advance		1,600	Subscriptions outstanding		1,400
Salary outstanding		100	Salary paid in advance		20
			Accrued Interest (on 20,000 @ 7% for 6 months)		700
			Cash in hand		16,910
		63,510			63,510

Notes:

1. In order to find out the capital fund at the beginning of the year, the opening Balance Sheet is prepared. It is prepared with the help of bits of information available from Receipts and Payments Account and other information. After putting the assets and liabilities together, the balancing figure is taken as the Capital Fund.
2. Donation for Building Fund, Endowment Fund and Legacies have been capitalised.
3. Tournament expenses are met from the Tournament Fund (if there is no such fund, then such expenses will be charged to Income and Expenditure Account.)
4. The investment of Rs. 20,000 consists of two parts Rs. 4,000 as General investments and Rs. 16,000 as Building Fund Investments. The Interest which was accrued on the first part is taken to the Income and Expenditure a/c and that on the second part is added to Building Fund. However, since the interest which has accrued is not yet received, Rs. 700 is shown as asset.

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5.6 PREPARATION OF RECEIPTS AND PAYMENTS ACCOUNT, INCOME AND EXPENDITURE ACCOUNT AND BALANCE SHEETS FROM THE GIVEN INFORMATION

Illustration - 4

From the particulars given below, prepare an Income and Expenditure Account and a Balance Sheet of Secunderabad Public Library for the year ended on the 31st of December, 1984.

On 31st December, 1983 the following were the assets and liabilities of the Library.

Building Rs. 40,000, furniture and fittings Rs. 3,500, library books Rs. 20,000, investments in 5% Government Loan Rs. 8,000, subscriptions outstanding Rs. 1,000, rent receivable for the use of lecture hall Rs. 400, Prepaid insurance Rs. 100 and cash at bank Rs. 4,000. Outstandings, to creditors Rs. 4,300, outstanding expenses Rs. 700.

The Receipts during the year were: Subscriptions Rs. 12,500, Entrance fees Rs. 1,200, Proceeds from lectures and entertainments Rs. 4,500, interest on investments Rs. 200, rent for the use of the lecture hall Rs. 1,500, sale of old furniture Rs. 100, sale of old newspapers Rs. 450.

The Payments during the year were: Payments to creditors Rs. 4,300, payments to outstanding expenses of last year Rs. 700, Library books Rs. 1,400, Electric lighting expenses Rs. 300, Municipal taxes Rs. 1,100, repairs to building Rs. 800, Insurance Rs. 350, Electric installations expenses Rs. 2,000, Printing & stationery Rs. 500, Sundry expenses Rs. 250, Postage Rs. 420, subscriptions to periodicals Rs. 1,400, cost of 10% Investments Rs. 3,000 (purchased on 1-7-1984), salaries Rs. 3,600.

Insurance was prepaid to the extent of Rs. 75 and subscriptions outstanding amounted to Rs. 1,800, rent receivable for the use of lecture hall Rs. 250. There were creditors outstanding for the steel shelves acquired during the year to the extent of Rs. 1,750, salaries outstanding Rs. 500. Amount due for purchase of stationery Rs. 75. Entrance fees are to be capitalised.

Provide depreciation on building at 2% on electric installations at 5%, on furniture and fittings at 5% and on library books at 10%. The depreciation is to be calculated on opening balances of such assets.

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Solution

Balance Sheet of Secunderabad Public Library
as on 1-1-1984

Liabilities	*Rs.*	*Assets*	*Rs.*
Capital Fund		Building	40,000
(Balancing figure)	72,000	Furniture and fittings	3,500
Creditors	4,300	Library Books	20,000
Outstanding Expenses	700	5% Government Loan Investments	8,000
		Subscriptions outstanding	1,000
		Rent receivable for lecture hall	400
		Prepaid Insurance	100
		Cash at Bank	4,000
	77,000		77,000

Receipts and Payments Account

Dr. for the year ending 31st Dec. 1984 Cr.

Receipts	*Rs.*	*Payments*	*Rs.*
To Bank Balance on 1-1-1984	4,000	By Payments to creditors	4,300
To Subscriptions	12,500	By payments to outstanding expenses of last year	700
To Entrance Fees	1,200	By Library Books	1,400
To Proceeds from Lectures and Entertainments	4,500	By Electric Lighting expenses	300
To Interest on Investments	200	By Municipal taxes	1,100
To Rent for the use of Lecture Hall	1,500	By Repairs to Building	800
To sale of old furniture	100	By Insurance	350
To sale of old newspapers	450	By Electric Installations Expenses	2,000
		By Printing and stationery	500
		By Sundry Expenses	250
		By Postage	450
		By subscriptions to periodicals	1,400
		By 10% Investments (Purchased on 1-7-1984)	3,000
		By Salaries	3,600
		By Bank balance on 31-12-1984	4,330
	24,450		24,450

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Secunderabad Public Library Income and Expenditure Account
for the year ended 31st December, 1984

Expenditure		*Rs.*	*Income*		*Rs.*
To Salaries paid	3,600		By Subscriptions	12,500	
Add: Oustanding	500	4,100	Add: Outstanding at the end	1,800	
To Electric Lighting expenses		300		14,300	
To Municipal taxes		1,100	Less: Outstanding at the beginning	1,000	13,300
To Repairs to Building		800	By Proceeds from lectures and entertainments		1,500
To Insurance	350				
Add: Prepaid last year	100				
	450		By Interest on Investments	200	
Less: Prepaid this year	75	375	Add: Outstanding	350	550
To Printing & Stationery	500		By Sale of old newspapers		450
Add: Outstanding	75	575	By Rent for use of Lecture hall	1,500	
To Sundry Expenses		250	Add: Receivable at the end	250	
To Postage		420		1,750	
To Subscriptions to Periodicals		1,400	Less: Receivable at the beginning	400	1,350
To Depreciation:					
On Building @ 2%	800				
On furniture & fittings @ 5%	175				
On library Books @ 10%	2,000	2,975			
To Excess of Income over Expenditure		7,855			
		20,150			20,150

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Secunderabad Public Library
Balance Sheet
as on 31st December, 1984

Liabilities		*Rs.*	*Assets*		*Rs.*
Capital Fund	72,000		Building	40,000	
Add: Excess of income			Less: Depreciation	800	39,200
over expenditure	7,855				
Add: Entrance Fees	1,200	81,055	Furniture and		
			fittings :	3,500	
Creditors		1,750	Less: Sale of furn.	100	
Salaries oustanding		500	Less: Depreciation	175 275	3,225
Stationery Expenses		500			
outstanding		75	Steel Shelves		1,750
			Electric Installations		2,000
			Library Books	20,000	
			Add: Purchased during		
			the year	1,400	
				21,400	
			Less: Depreciation	2,000	19,400
			Investments at cost:		
			5% Government		
			Loan	8,000	
			10% Investments	3,000	11,000
			Subscriptions		
			outstanding		1,800
			Rent receivable		250
			Interest accrued due		350
			Prepaid Insurance		75
			Cash at Bank		4,330
		83,380			83,380

Notes:

1. The problem requires the preparation of only the Income and Expenditure account and the Balance Sheet (as on 31-12-1984). But the capital Fund as on 1-1-1984 and bank balance as on 31-12-1984 are not given. In order to ascertain the capital Fund on 1-1-1984 the Opening Balance Sheet is prepared and to ascertain bank balance on 31-12-1984 Receipts and Payments account is prepared.
2. Interest on investments is calculated at 5% on Rs. 8,000 for full year (Rs. 400) and on Rs. 3,000 at 10% for six months (Rs. 150). But the amount received is only Rs. 200. Therefore, Rs. 350 is shown as accrued and due.
3. Depreciation has to be calculated on the opening balances of the assets. Hence, on Electric Installations, which were not there at the beginning depreciation is not calculated.
4. Steel shelves were acquired during the year for which payment is not made. Hence, Rs. 1,750 is shown as liability and also as asset.

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5.7 PREPARATION OF RECEIPTS AND PAYMENTS ACCOUNT FROM THE GIVEN INCOME AND EXPENDITURE ACCOUNT AND OTHER INFORMATION

Illustration - 5

Public Health Care Centre
Income and Expenditure Account
for the year ending 31st March, 1984

Dr. Cr.

Expenditure		*Rs.*	*Income*	*Rs.*
To Salaries		23,500	By Entrance Fees	700
To Office expenses		800	By Donations	5,000
To Insurance		200	By Subscriptions	25,000
To Rent and Taxes		500	By Miscellaneous Receipts	300
To Dispensary Expenses		3,000	By Interest	9,000
To Depreciation:				
Building	3,750			
Furniture	150			
Instruments	100			
		4,000		
To Excess of income over Expenditure		8,000		
		40,000		40,000

Other items of information pertaining to the Health Centre are as follows:

	31-3-1983 *Rs.*	*31-3-1984* Rs.
Land and Building	2,00,000	1,96,250
Furniture	2,000	2,100
Instruments	3,500	4,000
4.5% Investments in Securities	2,00,000	2,00,000
Cash at bank	?	18,700
Stock of Medicines	300	100
Dispensary expenses due	200	300
Subscriptions outstanding	7,000	10,000
Subscriptions received in Advance	200	600
Salaries outstanding	1,000	1,500

You are required to prepare the Receipts and Payments account for the year ending 31st March, 1984.

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(b) When we return some goods to the supplier after settling the account, the total creditors account shows a debit balance. Similarly, we might have given some advance to the suppliers but the goods have not been received as yet. In such a case also the total creditors account shows a debit balance.

6.14 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines each:

1. What are the objectives of Sectional Balancing? Explain briefly the sectional balancing.
2. What is the scope of sub-divided ledgers? How the checking of sectional ledgers can be done?

B. Answer the following in 10 lines each:

1. What is the need for self-balancing/sectional balancing system?
2. What are the objectives of self/sectional balancing?
3. Why is the ledger sub-divided?'
4. Why do some of the Debtors Accounts show credit balance and creditors Accounts debit balance?

Problems

1. From the following figures prepare Total Debtors Account for the month of January 1985.

	Rs.
Balance of Debtors on 1st Jan. 1985	30,600
Credit Sales	82,400
Bills Receivable received	8,200
Bills Receivable dishonoured	1,600
Cash received from customers	74,800
Discount allowed to them	1,800
Bad debts written off	1,200
(Balance of Debtors Rs. 28,600)	

2. Prepare Creditors Account from the figures given below, relating to June 1985.

	Rs.
Balance of Creditors as on 1st June 1986	23,600
Cash paid to creditors	33,000
Credit purchases	38,600
Discount allowed by creditors	1,400
Bills payable issued	10,600
Purchase returns	1,000
Transfer to Debtors Ledger	2,200
Interest charged by creditors	1,000
(Balance of creditors Rs. 15,000)	

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3. Mr. Shravan Kumar keeps his books according to Sectional-Balancing System. From the following details, you are required to prepare the Total Creditors Account for the month of Jan. 1985.

	Rs.
Credit balances in creditors accounts on 1-1-85	20,000
Debit balances in creditors accounts on 1-1-85	4,000
Cash purchases	10,000
Credit purchases	20,000
Bills payable accepted	10,000
Bills payable paid	6,000
Purchase returns	2,000
Cash paid to creditors	6,000
Discount and allowances allowed by them	400
Transfers to Debtors ledger	2,000
Bills payable dishonoured	4,000
Debit balances in creditors accounts on 31-12-85	1,000

Hint: Ingnore cash purchases and Bills payable paid.
(Closing creditors balance (Cr.) Rs. 20,600)

4. In the absence of self-balancing system, you are required to compile Total Debtors and Total Creditors Accounts, from the following information.

		Rs.
Debtors Ledger balance on 1-7-1985	Dr.	36,000
Debtors Ledger balance on 1-7-1985	Cr.	600
Creditors Ledger balance on 1-7-1985	Cr.	28,000
Creditors Ledger balance on 1-7-1985	Dr.	400
Figures for the month ending 31st July 1985:		
Cash received from customers		1,60,000
Discounts and allowances allowed to them		5,000
Bad debts written off		6,000
Transfer from debtors ledger to creditors Ledger to settle customers accounts		4,000
Payments to customers		200
Credit sales		1,90,000
Sales returns		3,000
Bills payable accepted		6,000
Payments to creditors		95,000
Discounts and allowances granted by them		4,000
Credit purchases		1,10,000
Purchases returns		1,5000
Bills receivable received		8,000
(Balance on 31-7-85: Total Debtors a/c. Rs. 39,600, Total creditors a/c. Rs. 27,100).		

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6.15 RECOMMENDED BOOKS

1. Gupta, R.L. & Radhaswamy : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C & Grewal, T.S. : Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

6.16 GLOSSARY

Adjustment or Control Account : This is an account opened in a ledger in order to provide the missing information so as to prepare a trial balance of that ledger.

Debtors' Ledger : It is a ledger used for recording the personal accounts of trade debtors only.

Debtors Ledger Adjustment Account : This account is opened in the General Ledger in order to provide missing information in respect of trade debtors.

Creditors Ledger : It is a ledger used for recording the personal accounts of trade creditors only.

Creditors Ledger Adjustment Account : This account is opened in the General Ledger so as to provide the missing information pertaining to trade creditors.

General Ledger : It is the main ledger. It contains all accounts other than trade debtors and creditors accounts.

General Ledger Adjustment Account : One General Ledger Adjustment Account is opened at the end of creditors ledger to self-balance it. This adjustment account provides the missing information relating to trade creditors.

One more General Ledger adjustment account is opened at the back of Debtors Ledger to self-balance it. This account provides the missing information relating to trade debtors.

Sectional Balancing System : In this system one section or one ledger of a group of ledgers is self-balanced.

Self-Balancing Ledger : A self-balancing ledger is one which contains within itself sufficient material for the preparation of a trial balance.

Self-Balancing System : It is a system in which all the ledgers are self-balanced.

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UNIT-7 : SELF-BALANCING AND SECTIONAL BALANCING-II

Contents

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7.0 AIMS AND OBJECTIVES

Under self-balancing system each ledger will have both debit and credit entry in itself. Therefore, when a ledger balances are extracted, it forms a complete Trial Balance.The aim of this unit is to explain the accounting procedure of self-balancing system.

After reading this unit, you should be able to:

- prepare Control Accounts
- pass self-balancing entries
- transfer balance of one account to another.

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7.1 INTRODUCTION

Under the system of sectional-balancing explained in the previous unit, the subsidiary ledgers (i.e. Debtors and Creditors Ledgers) are not self-balancing, but only the General Ledger is self-balancing. This means that trial balance cannot be prepared for the debtors and the creditors ledgers. Under sectional-balancing system it is also not necessarys to make them self-balancing when their accuracy can be checked by means of Total Accounts maintained in the General Ledger.

The draw-back of not having an independent trial balance for the Debtors and the Creditors ledgers is removed under the system of self-balancing ledgers. A self-balancing ledger is one which contains within itself sufficient material for the preparation of a trial balance. Self-balancing, therefore, is a method devised to have an independent trial balance from each ledger without the help of others, so as to localise errors in a particular ledger so that the tedious process of checking the other ledgers can be avoided.

Sectional balancing and self-balancing systems serve the same purpose. The only distinguishing feature is, under sectional balancing system, trial balances cannot be prepared for all the ledgers, whereas under self-balancing system trial balance can be prepared for each ledger.

7.2 ADJUSTMENT OR CONTROL ACCOUNTS

As said earlier, none of the three ledgers contain in itself all the information for the preparation of the trial balance. In order to draw a trial balance of each ledger independently it is essential to provide the missing information in each of such ledgers. This can be achieved by opening adjustments or control accounts at the back of each ledger.

Creditors ledger (or purchase ledger) contains the personal accounts of all trade creditors, but the corresponding accounts of credit purchases, purchase returns, cash paid to creditors, bills payable accepted, discount received etc., are missing in this ledger, as these items are recorded in the General Ledger. In order to self-balance the creditors ledger an adjustment account, to provide the missing information in respect of the above, is to be opened at the end of creditors ledger. The name of that adjustment account is "General Ledger Adjustment Account" (also called General Ledger Self-Balancing Account or General Ledger Control Account.)

In the same way, an adjustment account by name "General Ledger Adjustment Account" (also called General Ledger Self-Balancing Account, General Ledger Control Account) is to be opened in Debtors Ledger to provide it with the missing information pertaining to credit sales, sales returns, cash received from debtors, bills received, bad debts, etc.

As we know, the General Ledger contains all the accounts except trade debtors and trade creditors accounts. In order to self-balance the General Ledger, missing information in respect of trade debtors and trade creditors be provided by opening two adjustment or control accounts at the end of the General Ledger. These are Debtors Ledger Adjustment Account (also called Sales Ledger Adjustment Account), and Creditors Ledger Adjustment Account (also called Purchases Ledger Adjustment Account). These two control accounts are infact the same as "Total Debtors Account" and "Total Creditors Account", explained earlier in the context of Sectional Balancing.

The Four Adjustment accounts stated above are nothing but a summary of the record of transactions already posted in a particular ledger. But, this summary is posted to the contra (or opposite) side of adjustment accounts so as to complete the double entry.

To repeat, the following table gives the adjustment accounts to be opened in the respective ledgers.

Name of the ledger	Name of the adjustment account(s) to be opened to self-balance that ledger
1. Creditors Ledger (C.L)	1. General Ledger Adjustment Account
2. Debtors Ledger (D.L)	2. General Ledger Adjustment Account
3. General Ledger (G.L)	3. i) Creditors Ledger Adjustment Account ii) Debtors Ledger Adjustment Account

7.3 IMPORTANT POINTS RELATING TO SELF-BALANCING ACCOUNTING PROCEDURE

The following points are to be noted in case of the self-balancing ledgers:

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1. Transactions have to be recorded in the subsidiary journals as usual, of course, with special columns to suit self-balancing ledgers.
2. The above transactions have to be posted to various trade debtors, personal accounts maintained in Debtors Ledger and trade creditors personal accounts in creditors ledger. Rest of the transactions will have to be posted to various accounts in the general ledger.
3. For the purpose of self-balancing, special accounts (adjustment/control accounts) are to be opened in the three ledgers.
4. Since these special accounts are opened as extra accounts in each ledger, some extra journal entries are required. These extra entries are called self-balancing entries.
5. Self-balancing entries are passed always with the periodical totals of the subsidiary books.
6. Self-balancing entries are required only in case of transactions relating to trade debtors and creditors. Because, in this case only the double aspect of the transaction is divided between two ledgers-Debtors ledger or Creditors Ledger on one hand and General Ledger on the other hand.
7. In all other cases, since both the aspects of a transaction are there in General Ledger itself, no self-balancing entry is needed.
8. Because of the control accounts, there is a complete double entry in respect of each of the ledgers, trial balance of each one of them can be prepared and the accuracy of postings made therein can be checked.

7.4 SELF-BALANCING (ADJUSTMENT) ENTRIES

In order to Self-balance the Ledgers, adjustment entries in respect of the following groups of items are to be passed and postings made to the respective ledgers.

To Self-Balance Debtors Ledger : a) Items relating to personal accounts of trade debtors affecting **Debit side:**

1. Credit Sales 2. B/R dishonoured 3. Interest charged etc.	**Entry** Debtors Ledger Adjustment A/c (in G.L) Dr. To General Ledger Adustment Account (in D.L.)

b) Items relating to trade debtors affecting **Credit Side**

1. Cash Received 2. B/R received 3. Sales returns 4. Discount allowed 5. Bad debts written off during the year 6. Allowances 7. Transfers	**Entry** General ledger Adjustment A/c. (in D.L) Dr. To Debtors ledger Adjustment A/c. (in G.L)

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To Self-Balance Creditors Ledger : a) Items relating to personal accounts of trade creditors affecting **credit side:**

1. Credit Purchases 2. B/P dishonoured 3. Interest, if any	**Entry** General ledger Adjustment A/c. (in C.L) Dr. To Crerditors ledger Adjustment A/c. (in G.L)

a) Items relating to trade creditors affecting **Debit Side**

1. Cash Received 2. B/R received 3. Purchase returns 4. Discount Receuved 5. Allowances received 6. Transfers	**Entry** Creditors ledger Adjustment A/c. (in G.L) Dr. To General ledger Adjustment A/c. (in C.L)

When these entries are posted to their respective adjustment/control accounts, they appear as shown below:

7.5 PROFORMA ADJUSTMENT ACCOUNTS

In the General Ledger

Dr. **Debtors Ledger Adjustment Account** Cr.

	Rs.		Rs.
To Balance b/d (Dr.)	xxx	By Balance b/d (Cr.)	xxx
To General Ledger		By General Ledger	
Adjustment a/c:	xxx	Adjustment a/c:	
- Credit Sales	xxx	- Cash received	xxx
- B/R Dishonoured	xxx	- B/R received	xxx
- Interest changed	xxx	- Sales returns	xxx
To Balance c/d (Cr.)	xxx	- Discount allowed	xxx
		- Bad debts	xxx
		- Allowances	xxx
		- Transfers to/from G.L	xxx
		By Balance c/d (Dr.)	xxx
	xxx		xxx

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Dr. **Creditors Ledger Adjustment Account** Cr.

	Rs.		Rs.
To Balance b/d (Dr.)	xxx	By Balance b/d (Cr.)	xxx
To General Ledger		By General Ledger	
Adjustment a/c.:		Adjustment a/c:	
- Cash paid	xxx	- Credit purchases	xxx
- B/P accepted	xxx	- B/P Dishonoured	xxx
- Purchase returns	xxx	- Interest	xxx
- Discount received	xxx	By Balance c/d (Dr.)	
- Allowances received	xxx		
- Transfers from/to D.L	xxx		
- To Balance c/d (Cr.)	xxx		
	xxx		xxx

In the Debtors Ledger

Dr. **General Ledger Adjustment Account** Cr.

	Rs.		Rs.
To Balance b/d	xxx	By Balance b/d	xxx
To Debtors Ledger		By Debtors Ledger	
Adjustment Account:	xxx	Adjustment Account:	xxx
- Cash received	xxx	- Credit sales	xxx
- B/R received	xxx	- B/R dishonoured	xxx
- Sales returns	xxx	- Interest charged	xxx
- Discount allowed	xxx	By Balance c/d	xxx
- Bad debts	xxx		
- Allowances	xxx		
- Transfers	xxx		
To Balance b/d (Cr.)	xxx		
	xxx		xxx

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In the Creditors Ledger

Dr. **General Ledger Adjustment Account** Cr.

	Rs.		Rs.
To Balance b/d	xxx	By Balance b/d	xxx
To Creditors ledger		By Creditors ledger	
Adjustment A/c:		Adjustment A/c:	xxx
- Credit purchases	xxx	- cash paid	xxx
- B/P Dishonoured	xxx	- B/P accepted	xxx
- Interest	xxx	- Purchase returns	xxx
To Balance c/d	xxx	- Discount received	xxx
		- Allowances received	xxx
		- Transfers	xxx
		By Balance c/d	xxx
	xxx		xxx

Note: 1. General Ledger Adjustment Account in the D.L. is nothing but the reverse of Debtors Ledger Adjustment Account in the G.L.

2. General Ledger Adjustment Account in the C.L. also is nothing but the reverse of Creditors Ledger Adjustment Account in the G.L.

Illustration - 1

Ramakrishna Steels maintaining Debtors. Creditors and General Ledgers. From the details given below, write the necessary journal entries to self-balance the ledgers and also show the adjustment accounts.

	Rs.
March 1, 1985 Debtors Balance	20,000
March 1, 1985 Creditors Balance	24,000
The following are the totals of the transactions month :	
Credit purchases	8,000
Purchase returns and allowances	320
Credit sales	12,000
Sales returns	200
Cash received from Debtors	10,000
Discount allowed	180
Cash paid to creditors	8,000
Discount received	400
B/R received	3,200
B/P accepted	2,000
B/R dishonoured	800
B/P dishonoured	400
Interest charged to debtors	200
Bad debts	500

Solution

Journal Entries

1. Journal Entries to self-balance the Debtors Ledger

			Dr.	Cr.
1985			Rs.	Rs.
Mar. 31	Debtors Ledger Adjustment A/c. (in G.L.) Dr. To General Ledger Adjustment A/c. (in D.L) (Being the credit sales during the month)		12,000	12,000
"	General Ledger Adjustment A/c. (in D.L.) Dr. To Debtors Ledger Adjustment A/c. (G.L) (Being the sales returns as per sales returns book)		200	200
"	General Ledger Adjustment A/c. (in D.L.) Dr. To Debtors Ledger Adjustment A/c. (G.L) (Being the cash received from debtors as per cash book)		10,000	10,000

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"	General Ledger Adjustment A/c. (in D.L.) Dr. To Debtors Ledger Adjustment A/c. (G.L) (Being the discount allowed to debtors)		180	180
"	General Ledger Adjustment A/c. (in D.L.) Dr. To Debtors Ledger Adjustment A/c. (G.L) (Being the B/R received from debtors)		3,200	3,200
	Debtors Ledger Adjustment A/c. (in G.L.) Dr. To General Ledger Adjustment A/c. (D.L) (Being the B/R dishonoured by debtors)		800	800
"	Debtors Ledger Adjustment A/c. (in G.L.) Dr. To General Ledger Adjustment A/c. (D.L) (Being the interest charged to debtors)		200	200
"	General Ledger Adjustment A/c. (in G.L.) Dr. To Debtors Ledger Adjustment A/c. (in G.L) (Being the bad debts written off durinng the month)		500	500

Journal Entries to Self-Balance the Creditors Ledger

1985			Rs.	Rs.
Mar. 31	General Ledger Adjustment A/c. (in C.L.) Dr. To Creditors Ledger Adjustment A/c. (G.L) (Being the credit purchases during the month)		8,000	8,000
	Creditors Ledger Adjustment A/c. (in G.L.) Dr. To General Ledger Adjustment A/c. (C.L) (Being the purchase returns and allowances as per purchase returns book)		320	320
"	Creditors Ledger Adjustment A/c. (in G.L.) Dr. To General Ledger Adjustment A/c. (C.L) (Being the cash paid to creditors as per cash book)		8,000	8,000
"	Creditors Ledger Adjustment A/c. (in G.L.) Dr. To General Ledger Adjustment A/c. (C.L) (Being the discount received as per cash book)		400	400
"	Creditors Ledger Adjustment A/c. (in G.L.) Dr. To General Ledger Adjustment A/c. (C.L) (Being the B/P accepted as per B/P Book)		2,000	2,000
"	General Ledger Adjustment A/c. (in C.L.) Dr. To Creditors Ledger Adjustment A/c. (in C.L) (Being the B/P dishonoured during the month)		400	400

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Ledger Accounts

Debtors Ledger Adjustment Account

(in the General Ledger)

		Rs.			Rs.
1985	To Balance b/d	20,000	1985	By General Ledger	
Mar. 1	To General Ledger		Mar.	Adjustment	
"	Adjustment A/c.:		" 31	Account:	
	- Sales	12,000		- Sales returns	200
	- B/R Dishonoured	800		- Cash	10,000
	- Interest charged	200		- Discount Allowed	180
				- B/R	3,200
				- Bad debts	500
				By Balance c/d	18,920
		33,000			33,000
Apr. 1	To Balance b/d	18,920			

General Ledger Adjustment Account

(in the Debtors Ledger)

		Rs.			Rs.
			1985		
1985	To Debtors Ledger		Mar.1	By Balance b/d	20,000
Mar. 31	Adjustment A/c.:		Mar. 31	By Debtors Ledger	
"	- Sales returns	200		Adjustment A/c.:	
	- Cash	10,000		- Sales	12,000
	- Discount allowed	180		- B/R Dishonoured	800
	- B/R	3,200		- Interest charged	200
	- Bad debts	500			
	To Balance c/d	18,920			
		33,000			33,000
			Apr. 1	By Balance b/d	18,920

Creditors Ledger Adjustment Account

(in the General Ledger)

		Rs.			Rs.
1985			1985		
Mar. 31	To General Ledger		Mar. 1	By Balance b/d	24,000
	Adjustment A/c.:		Mar. 31	By General Ledger	
	- Purchase returns	320		Adjustment A/c.:	
	- Cash	8,000		- Purchases	8,000
	- Discount received	400		- B/P Dishonoured	400
	- B/P accepted	2,000			
	To Balance c/d	21,680			
		32,400			32,400
			Apr. 1	By Balance b/d	21,680

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General Ledger Adjustment Account
(in the CreditorsLedger)

1985		Rs.	1985		Rs.
Mar. 1	To Balance b/d	24,000	Mar. 31	By General Ledger Adjustment Account:	
Mar. 31	To General ledger Adjustment A/c.:				
	- Purchases	8,000		- Purchase Returns	320
	- B/P dishonoured	400		- Cash	8,000
				- Discount received	400
				- B/P accepted	2,000
				By Balance c/d.	21,680
		32,400			32,400
Apr. 1	To Balance b/d	21,680			

Note:

1. Debtors ledger shows debit balance. The control a/c opened to self-balance it viz., General Ledger Adjustment Account (in the D.L.) shows credit balance, thus self-balancing the Debtors Ledger.
2. Creditors ledger shows credit balance. The control a/c opened to self-balance it viz., General ledger Adjustment Account (in the C.L) shows debit balance, thus self-balancing the creditors ledger.
3. Because the two control accounts viz., Debtors Ledger Adjustment Account and Creditors Ledger Adjustment Account (they are nothing but Total Debtors Account and Total Creditors Account), General Ledger self-balances itself, on the whole. But D.L. Adjustment a/c. (in G.L.) shows debit balance and C.L. Adjustment a/c. (in G.L.) shows credit balance respectively.

Check Your Progress - 1

Pass self-balancing entries to the following transactions:

	Rs.
Credit sales	10,000
Cash sales	15,000
Cash received from debtors	4,000
Bills Receivable received from debtors	2,000
Bills Receivable discounted with the Bank	1,950
Discount allowed	500
Provision for bad debts	400

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7.6 TRANSFER FROM ONE LEDGER TO ANOTHER LEDGER

When the same person happens to be both a debtor as well as a creditor, it is necessary to transfer the balance from one account in the Debtors Ledger to another account in the creditors ledger or vice versa. Since six different accounts are affected, three journal entries will have to be passed, which are as under:

i) To effect transfer in individual accounts:

Creditors Account (in the C.L.) Dr.
To Debtors Account (in the D.L)

ii) To effect transfer in Adjustment Account:

a) General Ledger Adjustment A/c (in the D.L.) Dr.
To Debtors Ledger Adjustment A/c. (in the G.L.)

b) Creditors Ledger Adjustment A/c (in the G.L.) Dr.
To General Ledger Adjustment A/c. (in the C.L.)

Whether the amount is transferred from creditors ledger to Debtors Ledger or vice versa, the ultimate result is reduction in the balance of both total Creditors and Total Debtors

Illustration - 2

From the following particulars, as extracted from the books of M/s. Wills & Co. who keep a sales ledger, a purchase ledger and a general ledger on self-balancing system, show how the various adjustment accounts will appear in each of these ledgers.

1985				Rs.
Jan. 1	Debtors Balance	(Dr.)	...	22,500
	Debtors Balances	(Cr.)	...	1,050
	Creditors Balances	(Cr.)	...	25,500
	Creditors Balances	(Dr.)	...	800
Jan. 31	Purchases		...	65,500
	Purchase returns		..	2,500
	Sales		...	89,000
	Sales returns		...	1,500
	Cash and cheques received from debtors		...	70,000
	Bills Receivable (received)		...	5,500
	Bills Payable (accepted)		...	5,300
	Cash paid to creditors		...	60,000
	Cash discount received		...	1,800
	Cash discount allowed		...	2,400
	Interest charged to debtors		...	600

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Cheques from debtors dishonoured	...	1,500
Interest charged by creditors	...	100
Bills receivable dishonoured	...	800
Bad debts written off	...	1,600
Bills payable honoured	...	6,500
Bills receivable discounted (discount Rs. 100)	...	5,000
Reserve for bad and doubtful debts	...	1,400
Debtors Balance (Cr.)	...	700
Creditors Balance (Dr.)	...	1,700

The closing debtors include an amount of Rs. 1,900 due from Praveen Kumar, from whom goods worth Rs. 900 have been purchased, Mr. Praveen Kumar agreed to set off his claim against the amount due from him.

Solution

Debtors Ledger Adjustment Account
(in the General Ledger)

1985		Rs.	1985		Rs.
Jan. 1	To Balance b/d.	22,500	Jan. 1.	By Balance b/d.	1,050
" 31	To G.L. Adjt.A/c.:		Jan. 31	By G.L. Adjt. A/c.:	
	- Sales	89,000		- Sales returns	1,500
	- Interest			- Cash and Cheques	70,000
	- Interest charged	600		- B/R received	5,500
	- Cheques dishonoured	1,500		- Discount allowed	2,400
	- B/R dishonoured	800		- Bad detbs	1,600
	To Balance c/d	700		- Transfer from C.L.	900
				By Balance c/d	32,150
		1,15,100			1,15,100
Feb.1	To Balance b/d	32,150	Feb. 1	By Balance b/d.	700

Creditors Ledger Adjustment Account
(in the General Ledger)

1985		Rs.	1985		Rs.
Jan. 1	To Balance b/d	800	Jan. 1	By Balance b/d.	25,500
" 31	To G.L. Adjt. A/c.:		" 31	By G.L. Adjt. A/c.:	
	- Purchase returns	2,500		- Purchases	65,500
	- B/P accepted	5,300		- Interest charged	100
	- Cash paid	63,000		By Balance c/d.	1,700
	- discount received	1,800			
	- Transfer to D.L.	900			
	To Balance c/d	21,500			
		92,800			92,800
Feb.1	To Balance b/d	1,700	Feb. 1	By Balance b/d.	21,500

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General Ledger Adjustment Account

(in the Debtors/Sales Ledger)

1985		Rs.	1985		Rs.
Jan. 1	To Balance b/d	1,050	Jan. 1	By Balance b/d.	22,500
" 31	To D.L. Adjt. A/c.:		" 31	By D.L. Adjt. A/c.:	
	- Sales returnts	1,500		- Sales	89,000
	- Cash and Cheques	70,000		- Interest charged	600
	- B/R received	5,500		- Cheques dishonoured	1,500
	- Discount allowed	2,400		- B/R Dishonoured	800
	- Bad debts	1,600		By Balance c/d	700
	- Transfers from C.L.	900			
	To Balance c/d.	32,150			
		1,15,100			1,15,100
Feb.1	To Balance b/d	700	Feb. 1	By Balance b/d.	32,150

General Ledger Adjustment Account

(in the Creditors/Purchases Ledger)

1985		Rs.	1985		Rs.
Jan. 1	To Balance b/d.	25.500	Jan. 1	By Balance b/d.	800
Jan. 31	To C.L. Adjt. A/c.:		Jan. 31	By C.L. Adjt A/c.:	
	- Purchases	65,500		- Purchase returns	2,500
	- Interest charged	100		- B/P accepted	5,300
	To Balance c/d.	1,700		- Cash paid	60,000
				- Discount received	1,800
				- Transfer to D.L.	900
				By Balance c/d.	21,500
		92,800			92,800
Feb.1	To Balance b/d	21,500	Feb. 1	By Balance b/d.	1,700

Note:
1. For the purpose of adjustment accounts, ingnore Bills Payable honoured, Bills Receivable discounted, Reserve for Bad and Doubtful Debts.
2. Notes 1 and 2 at the end of Illustration 2 in Lesson 6 are applicable in case of self-balancing system also.
3. Sometimes in the question all the four adjustment accounts may not be asked. You may be asked to prepare two adjustment accounts. Whether it is four or two, prepare the accounts accordingly.

Check Your Progress - 2

Show the transfer entry.

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7.7 SUMMING UP

Under the sectional balancing system, the debtors and creditors ledgers are not self-balancing, but only the General Ledger is self-balancing. It means that trial balance cannot be prepared from Debtors Ledger and Creditors Ledger. This draw-back is removed under the system of self-balancing ledgers.

Self-balancing is a method devised to have an independent trial balance from each ledger.

Sectional balancing and self-balancing serve the same purpose. But the main difference between the two is that, under sectional balancing trial balance cannot be prepared for all the ledgers, whereas under self-balancing trial balance can be prepared for each ledger.

In order to draw a trial balance of each ledger separately, missing information in each of the ledgers is provided by opening adjustment or control accounts.

In general ledger two control accounts are opened. They are Debtors Ledger Adjustment Account and Creditors Ledger Adjustment Account.

In order to self-balance Debtors Ledger, one control account by name General Ledger Adjustment Account is opened in that Ledger. Similarly, in Creditors Ledger, one control account by name General Ledger Adjustment Account is opened to self-balance Creditors Ledger.

The four adjustment accounts, mentioned above, are nothing but a summary of the transactions already posted in a particular ledger. But this summary is posted to the opposite side of the adjustment accounts so as to complete the double entry, thus facilitating the extraction of a trial balance from each ledger.

7.8 CHECK YOUR PROGRESS : MODEL ANSWERS

		Rs.	Rs.
1. Debtors Ledger Adjustment A/c. (in G.L.)	Dr.	10,000	
To General Ledger Adjustment A/c. (in D.L.)			10,000
General Ledger Adjustment A/c. (in D.L.)	Dr.	4,000	
To Debtors Ledger Adjustment A/c. (in G.L.)			4,000
General Ledger Adjustment A/c. (in D.L.)	Dr.	2,000	
To Debtors Ledger Adjustment A/c. (in G.L.)			2,000
General Ledger Adjustment A/c. (in D.L.)	Dr.	500	
To Debtors Ledger Adjustment A/c. (in G.L.)			500

Note: There shall not be self-balancing entries for cash sales, bills discounted with the bank and provision for bad debts as both aspects of these transactions are relating to General Ledger.

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2. Creditors Ledger Adjustment A/c. Dr.
To Debtors Ledger Adjustment A/c.

Note: This entry is always same whether the transfer is made from debtors to creditors or from creditors to debtors.

7.9 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines each.

1. What is the difference between 'self-balancing' and sectional-balancing?
2. What is self-balancing system? Explain the procedure of self-balancing ledgers.
3. What are different control/adjustment accounts that are opened in the self-balancing ledgers?

B. Answer the following in 15 lines each.

1. Distinguish sectional balancing from self balancing.
2. Why transfers are required from one ledger to another ledger?
3. Write short notes on:
   (a) Control accounts
   (b) Self-balancing ledger

Problems

1. From the following particulars extracted from the books of Naveen & Co., who keeps one sales ledger, you are required to prepare the 'Sales Ledger Adjustment Account' (in the G.L.)and 'General Ledger Adjustment Account' (in the S.L.) as on 30th June 1985.

July 1, 1984 - Debtors balances 11,00,000
The transactions for the year ending 30-6-85:

	Rs.
Sales	26,00,000
Returns from debtors	10,000
Cash received from debtors	23,00,000
Discount allowed to debtors	10,000
Acceptances from debtors	1,00,000
Bad debts written off	8,000
Charges debited to debtors	500
Bills receivable dishonoured	5,000
Cash sales	20,000
Bad debts, previously written of but recovered now	500
Provision for doubtful debts	4,000

Hint: Cash sales, Bad debts previously written off but now recovered, provision for doubtful debts do not concern adjustment accounts.

(S.L. Adjustment A/c. Debit balance Rs. 12,77,500,
D.L. Adjustment A/c. Credit balance Rs. 12,77,500).

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2. Mr. Aswini Kumar has maintained his accounts on self-balancing system. From the following information, prepare the 'Purchases Ledger Adjustment Account' (in the G.L.) and 'General Ledger Adjustment Account' (in the P.L.)

		Rs.
Creditors balance as on 1-1-1985	(Cr.)	90,000
Creditors balance as on 1-1-1985	(Dr.)	5,500
Interest charged by creditors		200
Credit purchases during the year		2,45,200
Cash paid to creditors during the year		1,60,000
Bills payable accepted during the year		1,05,000
Goods returned to creditors		5,200
Discounts received from creditors		5,400
Transfers from creditors ledger to debtors ledger		5,000
Creditors balance on 31-12-1985	(Dr.)	6,800

[(Balance on 31-12-1985 P.L. Adjustment A/c. Rs. 56,100 (Cr.)
G.L. Adjustment Account Rs. 56,100 (Dr.)]

3. For problem 5 and 6, pass necessary journal entries to self-balance the ledgers.

4. A Trader keeps three Ledgers, namely, Debtors Ledger, Creditors Ledger and General Ledger on self-balancing ledger system. From the following particulars prepare necessary adjustment accounts in the General Ledger.

On 1-1-1985	Rs.
Debtors	16,000
Creditors	9,500
Transactions for the year 1985:	
Purchases	45,900
Sales	58,700
Purchase returns	900
Cash received from Debtors	44,500
Cash paid to creditors	32,000
Bills Receivable (received)	3,500
Bills Payable (accepted)	2,800
Sales returns	500
Bad debts	2,100
Discounts allowed	200
Discount received	150
Bills receivable dishonoured	500
Transfers from creditors ledger to debtors ledger	600
Debtors ledger credit balance on 31-12-1985	150
Creditors ledger debit balance on 31-12-1985	100

(D.L. Adjustment A/c. Dr. balance Rs. 23,950.
C.L. Adjustment A/c. Cr. balance Rs. 19,050).

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5. From the following particulars prepare the adjustment accounts in the three ledgers:

August 1, 1985

	Rs.
Debtors Ledger balance (Dr.)	29,240
Debtors Ledger balance (Cr.)	480
Creditors Ledger balance (Dr.)	1,740
Creditors Ledger balance (Cr.)	23,880

August 31, 1985

Sales	1,74,980
Sales returns	2,340
Cash received from customers	1,52,420
Discount Allowed thereon	5,640
Purchases	1,32,360
Purchase returns	5,120
Cash paid to suppliers	1,16,850
Discount received thereon	3,320
Cash paid to customers	260
Bills receivable	8,240
Bills receivable dishonoured	500
Bills payable	4,500
Debtors ledger balance (Dr.)	36,700
Creditors Ledger balance (Dr.)	1,540

Hint: Debit the D.L. Adjustment account with cash paid to Customers and also credit it to G.L. Adjustment A/c. in the D.L.

(D.L. Adjustment A/c. balance (Cr.) Rs. 840 G.L. Adjustment A/c. (in D.L.) balance (Dr.) Rs. 840, C.L. Adjustment A/c. balance (Cr.) Rs. 26,240, G.L. Adjustment A/c. (in C.L) (Dr.) Rs. 26,240).

6. From the following details write General Ledger Adjustment Accounts and, the Debtors and Creditors Ledger Adjustment Accounts as on 31st July, 1985.

		Rs.
Debtors (1-7-85)	Dr.	20,000
Debtors (1-7-85)	Cr.	500
Creditors (1-7-85)	Cr.	30,000
Creditors (1-7-85)	Dr.	300
Purchases		29,000
Sales		35,000
Sales returns		1,000
Purchase returns		1,500
Cash paid to creditors		15,000
Bills received from debtors		10,000
Bills dishonoured		500
Bills accepted for creditors		8,000
Discount allowed to debtors		300
Cash and cheques received from Debtors		12,000

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Customers cheques dishonoured		1,000
Discount allowed to debtors but later on disallowed		100
Discount allowed by creditors		1,500
Cash paid to customers		200
Transfers from creditors ledger to debtors ledger		2,000
Interest charged by creditors		400
Interest charged to debtors		500
Bad debts written off		1,000
Creditors on 31-7-1985	Dr.	300
Creditors on 31-7-1985	Cr.	200

Hint:

Discount allowed to debtors but later on disallowed debit it to D.L. Adjt. A/c. and credit it to G.L. Adjt. A/c. in the D.L.

(Balances : D.L. Adjt. A/c. (Dr.) Rs. 30,700, G.L. Adjt. A/c. in D.L. (Cr.) Rs. 30,700, C.L. Adjt. A/c. (Cr.) Rs. 31,400, G.L. Adjt. A/c. in C.L. (Dr.) 31,400.)

7.10 RECOMMENDED BOOKS

1. Gupta, R.L. Radhaswamy : Advanced Accountancy, Sultan Chand & Sons,New Delhi.
2. Shukla, M.C. & Grewal, T.S. : Aavanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P. & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

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BLOCK-IV : HIRE PURCHASE AND INSTALMENT PURCHASE SYSTEMS

UNIT-8 : HIRE-PURCHASE AND INSTALMENT PURCHASE SYSTEMS - AN INTRODUCTION

Contents

8.0 Aims and Objectives

8.1 Introduction

8.2 Definition and Meaning

8.3 Important Terms

8.4 Summing Up

8.5 Model Examination Questions

8.6 Recommended Books

8.7 Glossary

8.0 AIMS AND OBJECTIVES

The aims of this unit are to discus the term Hire-Purchase, its definition and the terms which we come across in hire-purchase agreements.

Having gone through this unit, you should be able to:

- define Hire-Purchase System
- analyse the legal aspects of Hire-Purchase System
- explain the important terms of Hire-Purchase System.

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8.1 INTRODUCTION

The Hire-Purchase System, as the very name indicates, is a combination of two modes of possessing the goods-by hiring them or by purchasing them (on cash or credit). A farmer may hire a tractor or a contractor may hire a bulldozer because they are wanted for very limited periods. When goods are wanted for permanent use, people usually buy them. But, where they are of very high value in relation to the financial capacity and convenience of the buyer, it helps, if he is allowed to spread the payment over a period of time. This is true in the case of an ordinary person wanting to purchase a costly T.V. Set, as also, in the case of manufacturer who wants to install, costly machinery in his factory. Such need is answered by the Hire-Purchase System and the Instalment System. Under the Hire-Purchase system the seller and the buyer enter into an agreement under which the buyer receives possession of good immediately, but is allowed to pay the price in instalments. The price so paid in instalments, called the hire-purchase price, is usually higher than the cash price i.e., the price paid when goods are bought for cash. This is because the hire-purchase price includes interest for the period covering instalments.

Under the Instalment Purchase System also, the instalment price (similar to the hire-purchase price) will be paid in a number of instalments as per the agreement. The main difference from the

hire-purchase system is that the purchaser under the instalment system acquires the ownership of the property purchased immedialtely on signing the contract and the vendor has no right to take back the property. The Instalment Purchase System will be discussed in detail at an appropriate place. Now, we take up a detailed discussion on the Hire-Purchase System.

8.2 DEFINITION AND MEANING

According to the Hire-Purchase Act, 1972, it is " an greement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which - (i) possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical instalments and (ii) the property or the ownership in the goods is to pass to such person on the payment of the last of such instalments; and (iii) such person has a right to terminate the agreement, at any time, before the property so passes".

The following points emerge from the definition:

a) Possession of goods is given at the time of agreement itself;

b) The ownership passes to the buyer only after payment of the last instalment and in the case of any default in payment of instalments, the owner can re-possess the goods.

c) The hirer may terminate the agreement, at any time, before he becomes the owner i.e., before payment of the last instalment; and

d) The amount paid through instalment is treated as hire until the hirer exercises his option to purchase the goods by paying the last instalment.

The Act further specifies that the agreement must state the following:

(a) the hire-purchase price, (b) the cash price, (c) the date of commencement of the agreement, (d) the number of instalments, with the amount of each instalment (e) other details such as the dates, the manner in which the instalments are to be paid, the person to whom they are payable, the place; and (f) the description of goods covered by the agreement.

From the foregoing discussion it must be clear that under the Hire-Purchase System, the buyer receives possession of goods immediately on signing the agreement and pays the price in instalments. The price payable under this system will be usually higher than the price payable when it is a cash purchase. The excess amount agreed to be paid represents interest which is an income to the hire-vendor and expense to the hire-purchaser. The hirer becomes the owner only when be pays all the instalments including the last instalment. In case of default the seller may reclaim the goods and the amount so far paid by the hirer, will not normally be refunded as it is treated as hire for the use of goods. The hirer has also the option to rescind the contract before the ownership in the goods passes to him. During the period the goods are in his possession, he cannot, he cannot destroy, damage or sell them.

8.3 IMPORTANT TERMS

We will now deal with the important terms that we come across in the hire-purchase transactions:

a) **Hire-Purchase Price :** The total amount payable by the hire-purchaser for the goods he had taken under an agreement of hire-purchase.

b) **Cash Price :** Cash price represents the cash retail price, the hire-purchaser would have paid had he purchased the goods for cash instead of on hire-purchase.

When interest charged by the Hire-Vendor is added to the cash price, the hire-purchase price is obtained.

c) **Hire-Purchaser :** The person who agrees to buy the goods under an agreement of hire-purchase.

d) **Hire-Vendor :** The person who agrees to sell the goods under a hire-purchase agreement.

e) **Cash Down Payment or Down Payment :** This is the initial amount payable in cash by the hire purchase on signing the contracts, according to the terms of the agreement.

f) **Instalment :** This is the periodic payment, the hire-purchaser is required to pay against the hire-purchase price of goods taken, as per the terms of agreement, until the whole of the price is paid off.

Thus the instalment paid from time to time includes part payment towards the cash price (i.e. principal amount) and the balance amount towards interest.

g) **Net Cash price :** The cash price of the goods under the agreement less any initial amount paid or cash down payment is known as net cash price.

h) **Net Hire-Purchase Price :** This is the hire-purchase price less delivery expenses, registration fees, insurance and any other fees payable.

8.4 SUMMING UP

Under both Hire-Purchase and Instalment purchase systems the buyer receives the possession of goods immediately after entering into an agreement with the seller but is allowed to pay the price in instalments. Such price is usually higher than the cash price, i.e., the price paid when goods are bought for cash. The main difference between the Hire-Purchase system and Instalment purchase system is that, the purchaser under the Instalment purchase system acquires the ownership of the property purchased immediately on signing the contract and the vendor has no right to take back the property but under Hire purchase system he can take back the property on the default of the purchaser in paying the instalments.

The important terms that we come accross in the hire-purchase transactions are, Hire-purchase price, Cash price, Hire purchaser, Hire Vendor, Down payment, Instalment, Net Hire-purchase Price, etc.

8.5 MODEL EXAMINATION QUESTIONS

I. Answer the following in 15 lines each.

1. Define a Hire-purchase agreement.
2. What is the main difference between Hire-purchase system and Instalment purchase system?
3. What are the important terms that we come accross in the hire-purchase transactions?

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8.6 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy — Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C. & Grewal, T.S — Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang K.L — Advanced Accountancy, Kalyani Publishing House, New Delhi.

8.7 GLOSSARY

Hire-Purchase System : A system where the price of the goods is paid in instalments along with interest at an agreed rate, the ownership passing to the buyer after payment of last instalment.

Instalment Purchase System : A system where the price and interest are paid in instalments, the ownership passing to the buyer on signing the contract.

Hire-Purchaser : One who buys goods on hire-purchase system.

Instalment Purchaser : One who buys goods on instalment purchase system.

Vendor : The seller of goods under; hire-purchase or instalment purchase system.

Instalment : Periodic payment towards the price of the goods and interest.

Down Payment : The amount paid on signing the contract (initial payment).

Cash Price : The price payable for the goods exclusively without adding interest.

Hire-Purchase Price : Cash price plus interest.

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UNIT-9 : HIRE PURCHASE SYSTEM

Contents

9.1 Aims and Objectives
9.2 Introduction
9.3 Recording the transactions in the Hire-purchaser's Books
9.4 Charging Depreciation in the Books of Hire-Purchaser
9.5 Recording the transactions in the Books of Hire-Vendor
9.6 Procedure for working out the problem when Cash Price is not given
9.7 Procedure for working out the problem when Rate of Interest is not given
9.8 Default and Repossession of Goods
9.9 Hire Purchase Trading Account
9.10 Summing Up
9.11 Check Your Progress : Model Answers
9.12 Model Examination Questions
9.13 Recommended Books
9.14 Glossary

9.0 AIMS AND OBJECTIVES

This unit is designed to explain you the recording of transactions both in the books of Hire-purchaser and Hire-Vendor following different methods. Further, this unit makes you acquaint with the method of ascertaining the amounts of missing items like cash price, rate of interest etc., and also the method of recording transactions both in the boks of Hire-Purchaser and Hire-Vendor when the Hire purchaser is in default of paying instalments.

Having studied and worked through this unit, you should be able to:

- pass journal entries in the books of Hire-purchaser and Hire-vendor
- explian the method of charging drepreciation
- find out the items missed for working out the problem
- identify the accounting procedure to be followed in the case of default and repossession of goods.

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9.1 INTRODUCTION

In unit 8 we have discussed the various concepts relating to Hire purchase and Instalement purchase systems. In this unit, the practical aspect of Hire purchase system i.e., recording the transactions both in the books of Hire-purchaser and Hire-vendor, charging depreciation in the books Hire-purchaser, procedure for recording the transactions in the case of default and repossession of goods etc., will be discussed.

9.2 RECORDING THE TRANSACTIONS IN THE HIRE-PURCHASER'S BOOKS

Having understood the meaning and the terms, let us now proceed to learn how to record the transactions in the books of hire-purchaser and hire-vendor. First, we shall discuss the accounting entries in the books of the hire-purchaser and then the hire-vendor's books.

While recording the entries in the books of hire-purchaser, the question arises whether we should record the asset at its full cash price or only at the cash price actually paid for up-to-date. Some accountants are of the opinion that since the hire-purchaser does not acquire ownership in the goods until the last payment, he should record the assset value in his books only to the extent of the amount paid so far towards its cash price. Some others hold the view that it is wrong to record the asset at part-value as the hire-purchaser acquired it with the clear intention of paying the full price, and therefore, full cash price must be recorded. The latter view appears more logical because if strict legal view is to be taken in terms of ownership, recording the asset at part-value, would equally be incorrect in as much as absolutely no ownership rights are acquired under a hire-purchase agreement until the last instalment is paid. However, in practice, the method followed depends on the choice of the trader. In addition to these two, a third method, known as Interest Suspense Method is also followed by a few. Under this method, the asset is debited with its full cash price, the total interest payable by the hire-purchaser (i.e. the excess of hire-purchase price over its cash price), is debited to a specially opened Interest Suspense Account. Thus there are three methods of recording the transactions in the hire-purchaser's books.

9.3 DIFFERENT METHODS OF RECORDING THE TRANSACTIONS IN THE BOOKS OF HIRE PURCHASER

1) The asset account is debited with the cash price included in each instalment whenever it falls due. The amount paid on taking delivery of the asset, known as down payment, will be fully debited to the asset account as cash price. This method is called **'Asset Accrual Method'.**

2) The asset account, under **Full Cash Price Method**, is debited with full cash price at the time of purchase.

3) The third method is known as **Interest Suspense Method** where total interest payable is debited to Interest Suspense Account in addition to debiting the asset with full cash price at the time of the contract.

Before we proceed to learn the journal entries to be written in the books of hire-purchaser, under each method, certain points which are common to all the methods need to be further emphasised.

The Asset account (Truck A/c., Machinery A/c. etc.) should, under no circumstances, be debited with anything more than the cash price, whether it is debited with the whole of its cash price at one time or with part-value each time when an instalment falls due depending upon the method followed.

The excess amount paid by the hire-purchaser over and above the cash price is towards interest for the facility of instalments and, therefore, this excess amount should be debited to interest account. The hire-purchase price minus the cash price is equal to the total interest amount. Interest account is closed by transferring it to Profit and Loss Account every year.

After the initial cash down payment the trader pays the balance of the hire purchase price in a specified number of instalments over a period of time. Thus, in each instalment there are two components - 1) payment for the asset (principal amount), and (2) the interest payment for the period. The calculation of interest is an important aspect in the hire-purchase problems and you are expected to pay particular attention.

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Interest is always calculated on the amount still due by the hire-purchaser for the asset. When an instalment falls due, the entire amount of instalment should not be treated as a payment for the asset. Interest calculated for the period should be debited to interest account and only the remaining amount is to be treated as payment for the asset.

Let us now take up the entries to be written in the books of the hire-purchaser, under each method with the help of an example.

Illustration - 1

Srikant Trader purchased a Mini-Truck on hire-purchase from Vishnu Vani & Co. on 1st January, 1980. The terms are as follows:

Cash Price	...	Rs. 25,826
Cash down payment	...	Rs. 4,000
Instalments	...	3 instalments of Rs. 8,000/- each at the end of every year for three years.
Rate of interest	...	5 per cent per annum.

Write journal entries in the books of SriKant Traders.

Solution

Before attempting the entries, it is advisable to prepare a table showing the interest and principal amounts separately for each instalment. This will facilitate calculation of interest and splitting of the instalments. Accordingly, the following table is prepared:

Analytical Table

Cash Price Rs. 25,826
H.P. Price .... Rs. 28,000 **

Date	Down Payment or instalment paid	Principal amount	Interest @ 5%	Cash Price still due at the instalment
1	2	3	4	5
1-1-80	I Rs. 4,000	Rs. 4,000	-	Rs. 21,826 (25,826-4,000)
31-12-80	I Rs. 8,000	Rs. 6,909	Rs. 1,091	Rs. 1,091 (25,826-4,000)
31-12-81	II Rs. 8,000	Rs. 7,254	Rs. 746	Rs. 7,663 (14,917-7,254)
31-12-82	III Rs. 8,000	Rs. 7,663	Rs. 337*	— (7,663-7,663)
Total	Rs. 28,000 = Rs. 25,826 + Rs. 2,174			

Interest at the rate provided should be calculated on the amount due for the cash price. For the first year (1980) the amount due is Rs. 21,826, i.e. cash price Rs. 25,826–4000, amount paid as down payment on 1-1-1980. Thus $21,826 \times \frac{5}{100}$ = Rs. 1,091 (Approx.)

Therefore Rs. 1,091 interest represents out of Rs. 8,000 and the balance (Rs. 8,000–Rs. 1,091) Rs. 6,909 is paid for the asset.

* The interest component in the last instalment is the balancing figure i.e., it must be

ascertained by deducting the interest debited so far from the total interest. Thus,

Total Interest = H.P.P. – C P
= Rs. 28,000 – Rs. 25,826
= Rs. 2,174

Therefore, Rs. 2,174 – Rs. 1,091 = Rs. 337

** Somes times, the hire-purchase price may not be specifically given in the problem, it is equal to the total amount paid. i.e. Down Payment + Instalments.

In the Book of Srikant Traders

First Method : Asset Accrual Method: The asset is debited only with the cash price in each instalment whenever the instalment is due.

Journal

1980			Rs.	Rs.
Jan. 1	Mini Truck A/c. Dr.		4,000	
	To Vishnu Vani & Co. A/c.			4,000
	(Being Down Payment due)			
	Vishnu Vani & Co. A/c. Dr.		4,000	
	To Bank A/c.			4,000
	(Being amount paid as down Payment)			
Dec. 31	Mini Truck A/c. Dr.		4,000	
	Interest A/c. Dr.		1,091	
	To Vishnu & Co. A/c.			8,000
	(Being amount due for first instalment)			
	Vishnu Vani & Co. A/c. Dr.		8,000	
	To Bank A/c.			8,000
	(Being first instalment paid)			
1981				
Dec. 31	Mini Truck A/c. Dr.		7,254	
	Interest A/c. Dr.		746	
	To Vishnu Vani & Co. A/c.			8,000
	(Being II instalment due)			
	Vishnu Vani & Co. A/c. Dr.		8,000	
	To Bank A/c.			8,000
	(Being II Instalment paid)			
1982				
Dec. 31	Mini Truck A/c. Dr.		7,663	
	Interest A/c. Dr.		337	
	To Vishnu Vani & Co. A/c.			8,000
	(Being III instalment due)			
	Vishnu Vani & Co. A/c. Dr.		8,000	
	To Bank A/c.			8,000
	(Being III Instalment paid)			

Note : The student is advised to prepare ledger accounts on his own.

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Second Method : Full Cash Price Method where the asset is debited with the full cash price at the time of signing the contract i.e., at the beginning itself.

Journal

			Rs.	Rs.
1980				
Jan. 1	Mini Truck A/c. Dr.		25,826	
	To Vishnu Vani & Co. A/c.			25,826
	(Being the mini truck purchased on hire-purchase)			
	Vishnu Vani & Co. A/c. Dr.		4,000	
	To Bank A/c.			4,000
	(Being amount paid as down Payment)			
Dec. 31	Interest A/c Dr.		1,091	
	To Bank A/c.			1,091
	(Being interest due @ 5% per annum)			
	Vishnu Vani & Co. A/c. Dr.		8,000	
	To Bank A/c.			8,000
	(Being I instalment paid)			
1981	Interest A/c Dr.		746	
Dec. 31	To Vishnu Vani & Co. A/c.			746
	(Being interest due @ 5% for the year)			
	Vishnu Vani & Co. A/c. Dr.		8,000	
	To Bank A/c.			8,000
	(Being II instalment paid)			
1982	Interest A/c Dr.		337	
Dec. 31	To Vishnu Vani & Co. A/c.			337
	(Being interest due for the year)			
	Vishnu Vani & Co. A/c. Dr.		8,000	
	To Bank A/c.			8,000
	(Being III & final instalment paid)			

Note : It will be observed that before each instalment falls due interest for the year is credited to the Hire-Vendor A/c. As the asset account is debited and the hire vendor's A/c. credited with the full value of the cash price in the beginning (1-1-1980), there is no need to debit and credit these accounts once again whenever an instalment is due.

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Ledger Accounts

Dr. **Vishnu Vani & Co. A/c.** Cr.

		Rs.			Rs.
1980			1980		
Jan. 1	To Bank A/c.	4,000	Jan. 1	By Mini Truck A/c.	25,826
Dec.31	To Bank A/c.	8,000	Dec.31	By Interest A/c.	1,091
,,	To Balance c/d.	14,917			
		26,917			26,917
1981			1981		
Dec.31	To Bank A/c.	8,000	Jan. 1	By Balance b/d.	14,917
,,	To Balance c/d.	7,663	Dec.31	By Interest A/c.	746
		15,663			15,663
1982			1982		
Dec.31	To Bank A/c.	8,000	Jan. 1	By Balance b/d.	7,663
			Dec.31	By Interest A/c.	337
		8,000			8,000

Dr. **Mini Truck A/c.** Cr.

		Rs.		Rs.
1980				
Jan. 1	To Vishnu Vani Co.	25,826		

Third Method (Interest Suspense Method) : Where the full cash price of the Asset as also the total amount of interest payable are credited to the hire-vendor's account in the beginning:

Journal

			Rs.	Rs.
1980				
Jan. 1	Mini Truck A/c.	Dr.	25,826	
	Interest suspense A/c.	Dr.	2,174	
	To Vishnu Vani & Co. A/c.			28,000
	(Being mini truck purchased on hire purchase and the total interest payable)			
,,	Vishnu Vani & Co. A/c.	Dr.	4,000	
	To Bank A/c.			4,000
	(Being amount paid as down Payment)			
Dec.31	Interest A/c.	Dr.	1,091	
	To Interest Suspense A/c.			1,091
	(Being interest for the year @ 5%)			
,,	Vishnu Vani & Co. A/c.	Dr.	8,000	
	To Bank A/c.			8,000
	(Being I Instalment paid)			

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1981 Dec. 31	Interest A/c. To Interest suspese A/c. (Being interest for the year)	Dr.		746	746
"	Vishnu Vani & Co. A/c. To Bank A/c. (Being II Instalment paid)	Dr.		8,000	8,000
1982 Dec. 31	Interest A/c. To Interest suspese A/c. (Being interest for the year)	Dr.		337	337
"	Vishnu Vani & Co. A/c. To Bank A/c. (Being III & Final instalment paid)	Dr.		8,000	8,000

Explanatory note : As the asset is debited with the full cash price in the beginning, no further debits will be necessary at the time of instalments. Similarly, the hire vendor's a/c. is credited with full amount of cash price as also the total interest payable for all the years in the beginning. As such, no credit to his account is necessary at the time of instalments. His account will be debited whenever any amount is paid.

When the instalment falls due, the interest calculated for the period (year) is transferred from Interest Suspense A/c. to Interest A/c. so that each year's expense towards interest is charged for the same period. After the entire interest is paid the Interest Suspense A/c. will be automatically closed. The Hire Vendor's A/c. will also stand closed when the entire hire-purchase price (cash price + interest) is paid to him.

These points may be better appreciated with the help of ledger accounts given below:

Important Ledger Accounts

Mini Truck A/c.

Dr.				Cr.
		Rs.		Rs.
1980 Jan.1	To Vishnu Vani & Co. A/c.	25,826		

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Dr. **Vishnu Vani & Co. A/c.** **Cr.**

1980			1980		
Jan. 1	To Bank A/c.	4,000	Jan. 1	By Mini Truck A/c.	25,826
Dec. 31	To Bank A/c.	8,000		By Interest	
"	To Balance c/d	16,000		Suspense A/c.	2,174
		28,000			28,000
1981			1981		
Dec. 31	To Bank A/c.	8,000	Jan. 1	By Balance b/d.	16,000
	To Balance c/d	8,000			
		16,000			16,000
1982			1982		
Jan. 1	To Bank A/c.	8,000	Jan. 1	By Balance b/d.	8,000
		8,000			8,000

Dr. **Interest Suspense A/c.** **Cr.**

1980			1980		
Jan. 1	To Vishnu Vani & Co. A/c.	2,174	Dec.31	By Interest A/c.	1,091
				By Balance c/d.	1,083
		2,174			2,174
1981			1981		
Jan. 1	To Balance b/d	1,083	Dec.31	By Interest A/c.	746
				By Balance c/d.	337
		1,083			1,083
1982			1982		
Jan. 1	To Balance b/d	337	Dec.31	By Interest A/c.	337
		337			337

Note :

Interest Suspense A/c. (Balance) will appear as an asset in the Balance Sheet, year after year. This amount represents the interest that is not yet due i.e. interest of the future years.

Balance Sheet on 31st Dec. 1980

Liabilities	Rs.	Assets	Rs.
Hire Vendor	16,000	Interest Suspense A/c.	1083

Balance Sheet on 31st Dec. 1981

Liabilities	Rs.	Assets	Rs.
Hire Vendor	8,000	Interest Suspense A/c.	337

At the end of 1982, there is no balance left in the Interest Suspese A/c. Therefore, Interest Suspense A/c. will not appear in the balance sheet of 1982. Similar the case with hire, Vendor's A/c.

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Similarly, the amount due to the hire-vendor at the end of each accounting year will appear as a liability as this amount represents the balance amount still payable.

In the above illustration observe how Interest Suspense A/c. and Hire Vendor's A/c. appear in the balance sheet:

Which method to follow ?

The student may follow any of the three methods mentioned above unless the problem suggests a particular method. For instance, the examination problem requires preparation of interest suspense a/c., then, necessarily, the student will have to adopt the third method.

Check Your Progress - 1

(a) What are the methods of recording transactions in the books of Hire-purchaser?

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(b) What is the journey for recording the purchase of asset by Hire-purchaser under full cash price method?

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9.4 CHARGING DEPRECIATION IN THE BOOKS OF HIRE-PURCHASER

While recording the hire-purchase transactions in the books of the hire-purchaser, another aspect to be considered is depreciation of the asset. As the student must be well aware, the business man usually provides for depreciation on all the fixed assets employed by him in his business. The property or the asset is charged with depreciation every year, whatever may be the mode or manner of purchasing the asset-whether it is purchased for cash or on credit or on hire purchase basis. Depreciation, it may be recalled, is the reduction in the value of an asset due to wear and tear and obsolescence. Even though the asset does not become the property of the purchaser until the last instalment is paid off, under the hire-purchase system, the purchaser makes use of the whole of the property from the time he takes possession. Therefore, depreciation must be charged on full cash price of the asset at the rate provided. This is irrespective of the fact whether the asset is recorded in the books of account of the hire-purchaser at full cash price or not.

There are a number of methods of charging depreciation. For problems on hire-purchase usually only two methods are followed viz., (1) Straight Line or Fixed Instalment Method, and (2) Diminishing Balance or Reducing Instalment Method.

1. **Straight Line Method :** In this method, a fixed percentage of the original cost of the asset is charged as depreciation every year. Thus, every year the value of the particular asset gets

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reduced by a fixed amount. At the end of the estimated life of the asset its book value finally gets reduced to nil or its scrap value, if any.

For instance, the original cost of a machine is Rs. 24,000 and its estimated life is 10 years. At the end of 10 years, it is expected to fetch Rs. 4,000 when sold as scrap. It can be seen that Rs. 20,000 (24,000-4,000) is expended over a period of 10 years i.e., 2,000 for each year. Thus, the amount of depreciation per annum is Rs. 2,000 or 10 per cent. $\frac{24,000 - 4,000}{10}$. Under the straight line method, Rs. 2,000 is charged every year as depreciation.

2. **Diminishing Balance Method :** This method is also known as Written Down Valume (WDV) Method. Unlike the first method, here the depreciation is charged at a certain percentage every year, not on the original cost of the asset, but on its balance book value, as it appears in the asset account. It needs hardly be emphasised that the book value of the asset gets reduced progressively year after year as each year's depreciation is deducted from the asset value. While under the straight line method, the same amount of depreciation is charged every year, the amount of depreciation under the Dminishing Balance Method progressively decreases from year to year. The amount charged as depreciation will become less and less for each successive year. This is so because the depreciation is calculated on the depreciated value of the asset, under the Diminishing Balance Method.

Whatever be the method, the same journal entries are passed to record depreciation and transfer it to Profit and Loss Account at the end of every accounting period.

a) For charging Depreciation :

Depreciation A/c. Dr.
To Asset A/c. (Name of the asset)

b) For transfer to P & L A/c. :

Profit and Loss A/c. Dr.
To Depreciation

The following instruction will further enable the student to appreciate the difference in the calculations of depreciation under the two different methods, discussed above.

Illustration - 2

On 1st January 1982, the Reliable Transport Company signed an agreement for the purchase of a mini-bus from Progressive Motor Ltd. under hire-purchase system. Rs. 25,000 was paid immediately as down-payment. The balance was to be paid in three equal instalments of Rs. 20,000/- each on 31st December every year for three years. The cash price of the Mini bus is Rs. 76,000/-. Interest was charged at 9 per cent per annum by the hire-vendors. The Reliable Motor Company charges depreciation @ 15 per cert per annum on Written Down Value.

Journalie these transactions, in the books of purchasing company assuming that the asset is not recorded at full cash price but on accrual basis. Write up important ledger accounts and show how the relevant items appear in the balance sheets of the three years.

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Solution :

Analytical Table

				Cash price 76,000 H.P. Price 85,000 (25,000+20,000+20,000+20,000)
Date	Down Payment or instalment paid	Principal amount	Interest @ 9%	Cash Price still due after this instalment
1	2	3	4	5
1-1-81	Rs. 25,000	Rs. 25,000	–	Rs. 51,000 (76,000-25,000)
31-12-81	I Rs. 20,000	Rs. 15,410	Rs. 4,590	Rs. 35,590 (51,000-15,410)
31-12-81	II Rs. 20,000	Rs. 16,797	Rs. 3,203	Rs. 18,793 (35,590-16,797)
31-12-82	III Rs. 20,000	Rs. 18,793	Rs. 1,207*	Nil (18,793-18,793)
Total	Rs. 85,000 =	Rs. 76,000 +	Rs. 9,000	

* Interest for the last year must be adjusted. Instalment amout minus cash price due at the end of the previous year (20,000 – 18,793).

In the Books of Reliable Transport Co.

Journal

1981			Rs.	Rs.
Jan. 1	Mini Bus A/c. Dr.		25,000	
	To Progressive Motors			25,000
	(Being Down Payment due on mini bus Hire-purchased)			
"	Progressive Motors Ltd. A/c. Dr.		25,000	
	To Bank A/c.			25,000
	(Being amount paid as down payment)			
Dec. 31	Mini Bus A/c. Dr.		15,410	
	Interest A/c. Dr.		4,590	
	To Progressive Motors Ltd., A/c.			20,000
	(Being Instalment due)			
"	Progressive Motors Ltd. Dr.		20,000	
	To Bank A/c.			20,000
	(Being I Instalment duly Paid)			
"	Depreciation A/c. Dr.		11,400	
	To Mini Bus A/c.			11,400
	(Being Depreciation at 15% i.e., $76,000 \times \frac{15}{100}$)			

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"	Profit and Loss A/c. To Depreciation A/c. To Interest A/c. (Being depreciation & interest transferred)	Dr.		15,990	 11,400 4,590

Note : Interest and Depreciation being expenses will be transferred to Profit and Loss A/c. every year.

				Rs.	Rs.
1982 Dec. 3	Mini Bus A/c. Interest A/c. To Progressive Motors Ltd. A/c. (Being II Instalment due)	Dr. Dr.		16,797 3,203	 20,000
"	Progressive Motors Ltd. To Bank A/c. (Being II Instalment duly Paid)	Dr.		20,000	 20,000
"	Depreciation A/c. To Mini Bus A/c. (Being Depreciation at 15% i.e., $76,000-11,400 = 64,600 \times \frac{15}{100}$)	Dr.		9,690	 9,690
"	Profit and Loss A/c. To Depreciation A/c. To Interest A/c. (Being depreciation & interest transferred)	Dr.		12,893	 9,690 3,203
1983 Dec. 31	Mini Bus A/c. Interest A/c. To Progressive Motors Ltd. (Being III Instalment due)	Dr. Dr.		18,793 1,207	 20,000
	Progressive Motors Ltd. To Bank A/c. (Being final Instalment Paid)	Dr.		20,000	 20,000
	Depreciation A/c. To Mini Bus A/c. (Being Depreciation @ 15% $64,600-9,690 = 54,910 \times \frac{15}{100}$)	Dr.		8,237	 8,237
	Profit and Loss A/c. To Depreciation A/c. To Interest A/c. (Being depreciation & interest transferred)	Dr.		9,444	 8,237 1,207

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Important Ledger Accounts

Dr. **Mini Bus A/c.** Cr.

		Rs.			Rs.
1981 Jan. 1	To Progressive Motors Ltd. A/c.	25,000	1981 Dec. 31	By Depreciation	11,400
"	To " "	15,410		By Balance c/d.	29,010
		40,410			40,410
1982 Jan. 1	To Balance b/d	29,010	1982 Dec. 31	By Depreciation	9,690
Dec. 31	To Progressive Motors Ltd. A/c.	16,797		By Balance c/d.	36,117
		45,807			45,807
1981 Jan. 1	To Palance b/d	36,117	1983 Dec. 31	By Depreciation	8,237
Dec. 31	To Progressive Motors Ltd. A/c	18,793		By Balance c/d.	45,673
		54,910			54,910

Dr. **Progressive Motors Ltd. A/c.** Cr.

		Rs.			Rs.
1981 Jan. 1	To Bank A/c.	25,000	1981 Jan. 1	By Mini Bus A/c.	25,000
Dec. 31	To Bank A/c.	20,000	Dec. 31	By Mini bus A/c.	15,410
				By Interest A/c.	4,590
		45,000			45,000
1982 Dec. 31	To Bank A/c.	20,000	1982 Dec. 31	By Mini bus A/c.	16,797
				By Interest A/c.	3,203
		20,000			20,000
1983 Dec. 31	To Bank A/c.	20,000	1983 Dec. 31	By Mini bus A/c.	18,793
				By Interest A/c.	1,207
		20,000			20,000

Note : The Hire-Vendor A/c. (Progressive Motors Ltd.) does not show any balance in any year. This is so because full cash price of the asset is not credited to Hire-Vendors under this method. The account does not figure in the balance sheet.

Balance Sheet as on 31st December 1981

Liabilities	Rs.	Assets		Rs.
		Mini bus	40,000	
		Less: Depreciation	11,400	29,600

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Balance Sheet as on 31st December 1982

Liabilities	Rs.	Assets		Rs.
		Mini bus	45,000	
		Less: Depreciation	9,610	36,117

Balance Sheet as on 31st December 1983

Liabilities	Rs.	Assets		Rs.
		Mini bus	54,910	
		Less: Depreciation	8,237	46,673

Illustration - 3

Srinivasa Colliery Co. purchased a wagaon from Srikant Engineering Ltd. on hire purchase basis. The agreement was signed on 1st January, 1980 and the collery company paid Rs. 5,000 in cash on the same day. The remaining amount was paid in five annual instalments of Rs. 5,000, Rs. 7,000, Rs. 8,000, Rs. 10,000 and Rs. 9,000 respectively beginning from 31st Dec. 1980. The cash price of the wagon was Rs. 34,000, the rate of interest being 10% p.a.

Srinivasa Colliery Company depreciates the wagons @ 15% on Straight Line Method. They record the value of the asset at full cash price on the date of purchase.

You are required to write the journal entries and prepare the ledger accounts in the books of the hire purchasers.

Solution :

Hire Purchase price = Rs. 44,000 (Rs. 5,000 + 5,000 + 7,000 + 8,000 + 10,000 + 9,000)
Cash price (given) = Rs. 34,000
Total interest charged by the Hire Vendors = RS. 10,000

Analytical Table

Date		Down Payment or instalment paid	Principal amount	Interest @ 5%	Cash Price still due after this instalment
		Rs.	Rs.	Rs.	Rs.
1		2	3	4	5
1-1-80		5,000	5,000	—	29,000 (34,000-5,000)
31-12-80	I	5,000	2,100	2,900	26,900 (29,000-2,100)
31-12-81	II	7,000	4,310	2,690	22,590 (26,900-4,310)
31-12-82	III	8,000	5,741	2,259	16,849 (22,590-5,741)
31-12-83	IV	10,000	8,315	1,685	8,534 (16,849-8,315)
31-12-84	V	9,900	8,534	466	—
Total		Rs. 44,000	Rs. 34,000 +	Rs. 10,000	

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In the Books of Srinivasa Colliery Co.

Journal

1980				Rs.	Rs.
Jan. 1	Wagons A/c.	Dr.		34,000	
	To Srikant Engg. Ltd. A/c.				34,000
	(Being the cash price due on the wagon hire-purchased)				
"	Srikant Engg. Ltd. A/c.	Dr.		5,000	
	To Cash A/c.				5,000
	(Being Down Payment made)				
Dec. 31	Interest A/c.	Dr.		2,900	
	To Srikant Engg. Ltd. A/c.				2,900
	(Being Interest due @ 10%)				
"	Srikant Engg. Ltd. A/c.	Dr.		5,000	
	To Bank A/c.				5,000
	(Being I Instalment paid)				
"	Depreciation A/c.	Dr.		5,100	
	To Wagons A/c.				5,100
	(Being depreciation @ 15%)				
Dec. 31	Profit & Loss A/c.	Dr.		8,000	
	To Interest A/c.				2,900
	To Depreciation A/c.				5,100
	(Being Depreciation and Interest transferred)				
1981					
Dec. 31	Interest A/c.	Dr.		2,690	
	To Srikant Engg. Ltd. A/c.				2,690
	(Being Interest due for the year)				
"	Srikant Engg. Ltd. A/c.	Dr.		7,000	
	To Bank A/c.				7,000
	(Being II Instalment paid)				
"	Depreciation A/c.	Dr.		5,100	
	To Wagons A/c.				5,100
	(Being depreciation @ 15%)				
"	Profit & Loss A/c.	Dr.		7,790	
	To Depreciation A/c.				5,100
	To Interest A/c.				2,690
	(Being Depreciation and Interest transferred)				

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1982 Dec. 31	Interest A/c. To Srikant Engg. Ltd. A/c. (Being Interest due for the year)	Dr.		2,259	2,259
"	Srikant Engg. Ltd. A/c. To Bank A/c. (Being III Instalment paid)	Dr.		8,000	8,000
"	Depreciation A/c. To Wagons A/c. (Being depreciation @ 15%)	Dr.		5,100	5,100
"	Profit & Loss A/c. To Depreciation A/c. To Interest A/c. (Being Depreciation and Interest transferred)	Dr.		7,359	5,100 2,259
1983 Dec. 31	Interest A/c. To Srikant Engg. Ltd. A/c. (Being Interest due for the year)	Dr.		1,685	1,685
"	Srikant Engg. Ltd. A/c. To Bank A/c. (Being IV Instalment paid)	Dr.		10,000	10,000
"	Depreciation A/c. To Wagons A/c. (Being depreciation @ 15%)	Dr.		5,100	5,100
"	Profit & Loss A/c. To Depreciation A/c. To Interest A/c. (Being Depreciation and Interest transferred)	Dr.		6,785	1,685 5,100
1984 Dec. 31	Interest A/c. To Srikant Engg. Ltd. A/c. (Being Interest due for the year)	Dr.		466	466
"	Srikant Engg. Ltd. A/c. To Bank A/c. (Being V & Final Instalment paid)	Dr.		9,000	9,000
"	Depreciation A/c. To Wagons A/c. (Being depreciation @ 15%)	Dr.		5,100	5,100

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"	Profit & Loss A/c.	Dr.	5,566	
	To Depreciation A/c.			5,100
	To Interest A/c.			466
	(Being Depreciation and Interest transferred)			

Note: It is assumed that Srinivasa Colliery Co. closes its accounts on 31st Dec. every year.

Explanation : The instalment amounts may be uniform or different depending on the agreement.

Dr.

Wagons A/c.

Cr.

		Rs.			Rs.
1980 Jan. 1	To Srikanth Engg. Ltd. A/c.	34,000	1980 Dec. 31	By Depreciation A/c.	5,100
				By Balance c/d.	28,900
		34,000			34,000
1981 Jan. 1	To Balance b/d.	28,900	1981 Dec. 31	By Depreciation A/c.	5,100
				By Balance c/d.	23,800
		28,900			28,900
1982 Jan. 1	To Balance b/d.	23,800	1982 Dec. 31	By Depreciation A/c.	5,100
				By Balance c/d.	18,700
		23,800			23,800
1983 Jan. 1	To Balance b/d.	18,700	1983 Dec. 31	By Depreciation A/c.	5,100
				By Balance c/d.	13,600
		18,700			18,700
1984 Jan. 1	To Balance b/d.	13,600	1984 Dec. 31	By Depreciation A/c.	5,100
				By Balance c/d.	8,500
		13,600			13,600

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Srikant Engg. Ltd. A/c.

Dr.			Cr.		
		Rs.			Rs.
1980			1980		
Jan. 1	To Cash A/c.	5,000	Jan. 1	By Wagons A/c.	34,000
Dec. 31	To Bank A/c.	5,000		By Interest A/c.	2,900
"	To Balance c/d.	26,900			
		36,900			36,900
1981			1981		
Dec. 31	To Bank A/c.	7,000	Jan. 1	By Balance b/d.	26,900
	To Balance c/d.	22,590	Dec. 31	By Interest A/c.	2,690
		29,590			29,590
1982			1982		
Dec. 31	To Bank A/c.	8,000	Jan. 1	By Balance b/d.	22,590
"	To Balance c/d.	16,849	Dec. 31	By Interest A/c.	2,259
		24,849			24,849
1983			1983		
Dec. 31	To Bank A/c.	10,000	Jan. 1	By Balance b/d.	16,849
"	To Balance c/d.	8,534	Dec. 31	By Interest A/c.	1,685
		18,534			18,534
1984			1984		
Dec. 31	To Bank A/c.	9,000	Jan. 1	By Balance b/d.	8,534
			"	By Interest A/c.	466
		9,000			9,000

Depreciation A/c.

Dr.			Cr.		
		Rs.			Rs.
1980			1980		
Dec. 31	To Wagons A/c.	5,100	Dec. 31	By P & L A/c. transferred	5,100
1981			1981		
Dec. 31	To Wagons A/c.	5,100	Dec. 31	By P & L A/c. transferred	5,100
1982			1982		
Dec. 31	To Wagons A/c.	5,100	Dec. 31	By P & L A/c. transferred	5,100
1983			1983		
Dec. 31	To Wagons A/c.	5,100	Dec. 31	By P & L A/c. transferred	5,100
1984			1984		
Dec. 31	To Wagons A/c.	5,100	Dec. 31	By P & L A/c. transferred	5,100

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Dr.

Interest A/c.

Cr.

		Rs.			Rs.
1980 Dec. 31	To Srikant Engg. Ltd. A/c.	2,900	1980 Dec. 31	By P & L A/c. transfer	2,900
1981 Dec. 31	To Srikant Engg. Ltd. A/c.	2,690	1981 Dec. 31	By P & L A/c. transfer	2,690
1982 Dec. 31	To Srikant Engg. Ltd. A/c.	2,259	1982 Dec. 31	By P & L A/c. transfer	2,259
1983 Dec. 31	To Srikant Engg. Ltd. A/c.	1,685	1983 Dec. 31	By P & L A/c. transfer	1,685
1984 Dec. 31	To Srikant Engg. Ltd. A/c.	466	1984 Dec. 31	By P & L A/c. transfer	466

Profit and Loss A/c.
for th year ending 31-12-1980

	Rs.
To Depreciation A/c.	5,100
To Interest A/c.	2,900

Profit and Loss A/c.
for the year ending 31-12-1981

	Rs.
To Depreciation A/c.	5,100
To Interest A/c.	2,690

Profit and Loss A/c.
for the year ending 31-12-1982

	Rs.
To Depreciation A/c.	5,100
To Interest A/c.	2,259

Profit and Loss A/c.
for the year ending 31-12-1983

	Rs.
To Depreciation A/c.	5,100
To Interest A/c.	1,685

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Profit and Loss A/c.
for the year ending 31-12-1984

	Rs.	
To Depreciation A/c.	5,100	
To Interest A/c.	466	

If the student is required to show how the items appear in the Balance Sheets of various years, it should be answered as follows:
(It is not asked in the present problem).

Balance Sheet as on 31st Dec., 1980

Liabilities	Rs.	Assets		Rs.
Creditors for wagons Srikant Engg. Ltd. A/c	26,900	Wagons	34,000	
		Less: Depn.	5,100	28,900

Balance Sheet as on 31st Dec., 1981

Liabilities	Rs.	Assets		Rs.
Creditors for wagons	22,590	Wagons	28,900	
		Less: Depn.	5,100	23,800

Balance Sheet as on 31st Dec., 1982

Liabilities	Rs.	Assets		Rs.
Creditors for wagons	16,849	Wagons	23,800	
		Less: Depn.	5,100	18,700

Balance Sheet as on 31st Dec., 1983

Liabilities	Rs.	Assets		Rs.
Creditors for wagons	8,534	Wagons	18,700	
		Less: Depn.	5,100	13,600

Balance Sheet as on 31st Dec., 1984

Liabilities	Rs.	Assets		Rs.
Creditors for wagons	Nil	Wagons	13,600	
		Less: Depn.	5,100	8,500

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Check Your Progress - 2

1. How do you differentiate Straight-line Method from Reducing Balance Method?

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9.5 RECORDING THE TRANSACTIONS IN THE BOOKS OF HIRE VENDOR

Having learnt the method of recording the hire-purchase transactions in the books of hire-purchaser, we shall now proceed to learn how these transactions are recorded in the books of the hire-vendor. The goods sold by him on hire-purchase are treated as sales in the books of the hire-vendors. However, he may credit hire-purchase sales account instead of sales A/c. to distinguish the hire-purchase sales from the ordinary sales. Cash price of the goods is credited to the sales A/c. (or hire-purchase sales A/c.). Interest charged to the hire-purchaser, being income to the hire-vendor, will be credited in his books to the interest A/c. and is transferred to Profit and Loss A/c. (Cr.) later on.

There are two methods of recording the hire-purchase transactions in the books of the hire-vendor. In the first method, interest due at the time of each instalment will be debited to the hire-purchaser's A/c. and credited to interest A/c In the second method, the total interest payable by the hire-purchaser (i.e., the difference between the hire-purchase Price and the cash price) is credited to an account styled as Interest Suspense A/c. and the amount is debited along with the cash price to the hire-purchaser A/c. at the time of instalment becomes due, interest suspense A/c is debited and interest difference between the two methods is only with regard to recording of the interest. Let us observe the model entries under each method (in the books of Hire-Vendor).

First Method:

(i) *When goods are sold on hire-purchase :*

Hire Purchaser A/c. Dr. (Total cash price)
To Hire-purchase Sales A/c.

(ii) *For receiving cash as Down Payment :*

Cash/Bank A/c. Dr.
To Hire Purchaser's A/c.

(iii) *For interest due on instalment at the end of the year :*

Hire-Purchaser's A/c. Dr.
To Interest A/c.

(iv) *For receipt of the instalment :*

Cash/Bank A/c. Dr.
To Hire-Purchaser's A/c.

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(v) *For transfer of interest to P & L A/c. :*

Interest A/c.	Dr.	
To Profit & Loss A/c.		

Note: While the first two entries arise only in the first year at the time of entering into the contract of sale, entries (iii) (iv) and (v) will be repeated every year till the last instalment is received.

Second Method:

(i) *When goods are sold on hire-purchase :*

Hire Purchaser A/c.	Dr.	(Total HIre-purchase price)
To Hire-purchase Sales A/c.		(Total cash price)
To Interest Suspense A/c.		(Total interest or hire-purchase price–cash price)

(ii) *For receiving cash as Down Payment :*

Cash/Bank A/c.	Dr.	
To Hire Purchaser's A/c		

(iii) *For interest due on instalment at the end of the year :*

Interest Suspense A/c.	Dr.	
To Interest A/c.		

(iv) *For receiving the instalment :*

Cash/Bank A/c.	Dr.	
To Hire-Purchaser's A/c.		

(v) *For transfer of interest to to P & L A/c. :*

Interest A/c.	Dr.	
To Profit & Loss A/c.		

Note: Entries (iii), (iv) and (v) will be repeated every year until the last instalment is received.

The balance in the Interest Suspense A/c. will appear on the liability side of the balance sheet representing the portion of interest, not yet due against the total interest debited to hire purchaser's a/c in the beginning. The balance in the hire-purchaser's a/c representing the cash price as well as interest receivable will appear as an asset.

Illustration - 4

A cement Co., Castle Cement Co. Ltd., purchased three trucks on 1-1-1982 from Globe Vehicles Ltd., on hire-purchase basis. The terms are as follows:

1.	Down Payment	Rs. 2,00,000
2.	Three Annual Instalments payable on 31st Dec. 1982, 1983 and 1984	Rs. 2,00,000 each.
3.	Rate of interest charged	5 per cent per annum.
4.	Cash price	Rs. 7,45,000

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Castle Co. Ltd. depreciates the trucks annually at 10% on diminishing balance.

Write journal entries in the books of both the parties. Prepare the Hire-Purchasesr's A/c. in the Vendor's Ledger.

Solution:

Analytical Table

Date	Down Payment or instalment paid	Principal amount	Interest @ 5%	Cash Price still due after this instalment
	Rs.	Rs.	Rs.	Rs.
1	2	3	4	5
1-1-82	2,00,000	2,00,000	—	5,45,000 (7,45,000–2,00,000)
31-12-82	2,00,000	1,72,750	27,250	3,72,250 (545,000–1,72,750)
31-12-83	2,00,000	1,81,387	18,613	1,90,863 (3,72,250–1,81,387)
31-12-84	2,00,000	1,90,863	9,137	Nil
Total	8,00,000	7,45,000	55,000	

In the Books of Castle Cement Co. Ltd.
(Hire-purchaser's)

Journal

			Rs.	Rs.
1982 Jan. 1	Trucks A/c.	Dr.	2,00,000	
	To Globe Vehicle Ltd. A/c.			2,00,000
	(Being down payment due on trucks)			
"	Globe Vehicles Ltd. A/c.	Dr.	2,00,000	
	To Bank A/c.			2,00,000
	(Being down payment paid)			
1982 Dec. 31	Truck A/c	Dr.	1,72,750	
	Interest A/c	Dr.	27,250	
	To Globe Vehicles Ltd. A/c			2,00,000
	(Being Ist instalment due)			
"	Globe Vehicles Ltd. A/c.	Dr.	2,00,000	
	To Bank A/c.			2,00,000
	(Being I instaiment paid)			
"	Depreciation A/c.	Dr.	74,500	
	To Trucks A/c.			74,500
	(Being depreciation @ 10%)			
"	Profit & Loss A/c.	Dr.	1,01,750	
	To Depreciation A/c.			74,500
	To Interest A/c.			27,250
	(Being Depreciation and Interest transferred)			

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1983					
Dec. 31	Trucks A/c.	Dr.		1,81,387	
	Interest A/c.	Dr.		18,613	
	To Globe Vehicle Ltd. A/c.				2,00,000
	(Being II Instalment due)				
"	Globe Vehicles Ltd. A/c.	Dr.		2,00,000	
	To Bank A/c.				2,00,000
	(Being II instalment paid)				
"	Depreciation A/c.	Dr.		67,050	
	To Trucks A/c.				67,050
	(Being depreciation @ 10%)				
"	Profit & Loss A/c.	Dr.		85,663	
	To Depreciation A/c.				67,050
	To Interest A/c.				18,613
	(Being Depreciation and Interest transferred)				
1984					
Dec. 31	Trucks A/c.	Dr.		1,90,863	
	Interest A/c.	Dr.		9,137	
	To Globe Vehicle Ltd. A/c.				2,00,000
	(Being III Instalment due)				
"	Globe Vehicles Ltd. A/c.	Dr.		2,00,000	
	To Bank A/c.				2,00,000
	(Being II instalment paid)				
"	Depreciation A/c.	Dr.		60,345	
	To Trucks A/c.				67,05
	(Being depreciation @ 10%)				
1984					
Dec. 31	Profit & Loss A/c.	Dr.		69,482	
	To Depreciation A/c.				60,3
	To Interest A/c.				9,1
	(Being Depreciation and Interest transferred)				

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In the Books of Globe Vehicles Ltd.
(Hire-Vendors)

Journal

1982			Rs.	Rs.
Jan. 1	Castle Cement Co. Ltd. A/c. Dr.		7,45,000	
	To Sales A/c.			7,45,000
	(Being sale of 3 trucks on hire-purchase)			
"	Bank A/c.		2,00,000	
	To Castle Cement Co. Ltd. A/c.			2,00,000
	(Being amount received as down payment)			
"	Castle Cement Co. Ltd. A/c. Dr.		27,250	
	To Interest A/c.			27,250
	(Being interest receivable for the year)			
"	Bank A/c.		2,00,000	
	To Castle Cement Co. Ltd. A/c.			2,00,000
	(Being I instalment received)			
"	Interest A/c. Dr.		27,250	
	To Profit and Loss A/c.			27,250
	(Being interest transferred)			
1983				
Dec. 31	Castle Cement Co. Ltd. A/c. Dr.		18,613	
	To Interest A/c.			18,613
	(Being interest received for the year)			
"	Bank A/c.		2,00,000	
	To Castle Cement Co. Ltd. A/c.			2,00,000
	(Being II instalment received)			
"	Interest A/c. Dr.		18,613	
	To Profit and Loss A/c.			18,613
	(Being interest transferred)			
1984				
Dec. 31	Castle Cement Co. Ltd. A/c. Dr.		9,137	
	To Interest A/c.			9,137
	(Being interest received for the year)			
"	Bank A/c. Dr.		2,00,000	
	To Castle Cement Co. Ltd. A/c.			2,00,000
	(Being final instalment received)			
"	Interest A/c. Dr.		9,137	
	To Profit and Loss A/c.			9,137
	(Being interest transferred)			

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Dr. **Castle Cement Co. Ltd. A/c.** Cr.

		Rs.			Rs.
1982			1982		
Jan. 1	To Sales A/c.	7,45,000	Jan. 1	By Bank A/c.	2,00,000
Dec. 31	To Interest A/c.	27,250	Dec. 31	By Bank A/c.	2,00,000
			"	By Balance c/d.	3,72,250
		7,72,250			7,72,250
1983			1983		
Jan. 1	To Balance b/d.	3,72,250	Dec. 31	By Bank A/c.	2,00,000
Dec. 31	To Interest A/c.	18,613	"	By Bank c/d.	1,90,863
		3,90,863			3,90,863
1984			1984		
Jan. 1	To Balance b/d.	1,90,863	Dec. 31	By Bank A/c.	2,00,000
Dec. 31	To Interest A/c.	9,137			
		2,00,000			2,00,000

Note:

1. Sales A/c. in the Vendor's books will be transferred to trading A/c. along with other sales at the end of the year.

   Sales A/c. Dr.
   To Trading A/c.

2. The question does not specify or indicate the method to be followed either in the case of hire-purchase or the hire-vendor. Here, the first method is followed in both the cases.

Illustration - 5

On 1st April, 1980 Gangadhar Manufacturing Company purchased a machine from Modern Machineries Ltd. Rs. 20,000 was paid immediately and further three instalments of Rs. 25,000 each was paid by Gangadhar Manufacturing Co. on 31st March 1981, 1982 and 1983 respectively. The rate of interest was 6% p.a. Cash price of the machine was Rs. 86,830.

Write up the journal of Gangadhar Manufacturing Co. assuming that it provides depreciation 10% on Straight Line Method.

Also write the journal entries as they appear in the books of Modern Machineries Ltd. and prepare the following ledger accounts: (i) Gangadhar Mfg. Co. A/c. (ii) Interest Suspense A/c. (iii) Interest A/c. and (iv) Profit and Loss A/c. Show further how the relevant items appear in the Balance Sheet.

Solution

As Interest Suspense A/c. is indicated in the problem both books will be prepared following the Interest Suspense Method.

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Analytical Table

Date	Down Payment or instalment paid	Principal amount	Interest @ 5%	Cash Price still due after this instalment
	Rs.	Rs.	Rs.	Rs.
1	2	3	4	5
1-4-1980	20,000	20,000	—	66,830 (86,830–20,000)
31-3-1981	25,000	20,990	4,010	45,840 (66,830–20,990)
31-3-1982	25,000	22,250	2,750	23,590 (45,840–22,250)
31-3-1983	25,000	23,590	1,410	— (23,590–23,590)
Total	95,000	86,830	8,170	

In the Books of Gangadhar Mfg. Co.

Journal

1980			Rs.	Rs.
Apr. 1	Machinery A/c.	Dr.	86,830	
	Interest Suspense A/c.	Dr.	8,170	
	To Modern Machineries Ltd. A/c.			95,000
	(Being the amount payable on machinery including interest)			
"	Modern Machineries Ltd. A/c.	Dr.	20,000	
	To Bank A/c.			20,000
	(Being amount paid as down payment)			
1981				
Mar. 31	Interest A/c.	Dr.	4,010	
	To Interest Suspense A/c.			4,010
	(Being interest for the year transferred from Interest Suspense A/c.)			
"	Modern Machineries Ltd. A/c.	Dr.	25,000	
	To Bank A/c.			25,000
	(Being I instalment paid)			
"	Depreciation A/c.	Dr.	8,683	
	To Machinery A/c.			8,683
	(Being Depreciation @ 10%)			
"	Profit & Loss A/c.	Dr.	12,693	
	To Depreciation A/c.			8,683
	To Interest A/c.			4,010
	(Being Depreciation and interest transferred)			

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1982 Mar. 31	Interest A/c. To Interest Suspense A/c. (Being interest for the year transferred)	Dr.		2,750	2,750
"	Modern Machineries Ltd. A/c. To Bank A/c. (Being II instalment paid)	Dr.		25,000	25,000
"	Depreciation A/c. To Machinery A/c. (Being Depreciation @ 10%)	Dr.		8,683	8,683
"	Profit & Loss A/c. To Depreciation A/c. To Interest A/c. (Being Depreciation and interest transferred)	Dr.		11,433	8,683 2,750
1983 Mar. 31	Interest A/c. To Interest Suspense A/c. (Being interest for the year transferred)	Dr.		1,410	1,410
"	Modern Machineries Ltd. A/c. To Bank A/c. (Being III instalment paid)	Dr.		25,000	25,000
"	Depreciation A/c. To Machinery A/c. (Being Depreciation @ 10% p.a.)	Dr.		8,683	8,683
"	Profit & Loss A/c. To Depreciation A/c. To Interest A/c. (Being Depreciation and interest for the year transferred)	Dr.		10,093	8,683 1,410

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In the Books of Modern Machineries Ltd.

Journal

1980				Rs.	Rs.
Apr. 1	Gangadhar Mfg. Co. A/c.	Dr.		95,000	
	To Sales A/c.				86,830
	To Interest Suspense A/c.				8,170
	(Being the amount receivable on machinery sold on hire-purchase)				
"	Bank A/c.	Dr.			20,000
	To Gangadhar Mfg. Co. Ltd. A/c.				20,000
	(Being down payment received)				
1981					
Mar. 31	Interest Suspense A/c.	Dr.		4,010	
	To Interest A/c.				4,010
	(Being interest for the year)				
"	Bank A/c.	Dr.		25,000	
	To Gangadhar Mfg. Co. A/c.				25,000
	(Being I instalment received)				
"	Interest A/c.	Dr.		4,010	
	To Profit & Loss A/c.				4,010
	(Being interest transferred)				
1982					
Mar. 31	Interest Suspense A/c.	Dr.		2,750	
	To Interest A/c.				2,750
	(Being interest for the year)				
"	Bank A/c.	Dr.		25,000	
	To Gangadhar Mfg. Co. A/c.				25,000
	(Being II instalment received)				
"	Interest A/c.	Dr.		2,750	
	To Profit & Loss A/c.				2,750
	(Being interest transferred)				
1983					
Mar. 31	Interest Suspense A/c.	Dr.		1,410	
	To Interest A/c.				1,410
	(Being interest for the year)				
	Bank A/c.	Dr.		25,000	
	To Gangadhar Mfg. Co. A/c.				25,000
	(Being III & final instalment received)				
"	Interest A/c.	Dr.		1,410	
	To Profit & Loss A/c.				1,410
	(Being interest transferred)				

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Ledger Accounts

Gangadhar Mfg. Co. A/c.

Dr. Cr.

		Rs.			Rs.
1980			1980		
Apr. 1	To Sales A/c.	86,830	Apr. 1	By Bank A/c.	200,000
"	To Int. Sus. A/c.	8,170			
			1981		
			Mar. 31	By Bank A/c.	25,000
			"	By Balance c/d	50,000
		95,000			95,000
1981			1982		
Apr. 1	To Balance b/d.	50,000	Mar. 31	By Bank A/c.	25,000
			"	By Balance c/d.	25,000
		50,000			50,000
1982			1983		
Apr. 1	To Balance b/d.	25,000	Mar. 31	By Bank A/c.	25,000
		25,000			25,000

Interest Suspense A/c.

Dr. Cr.

		Rs.			Rs.
1981			1980		
Mar. 1	To Interest A/c.	4,010	Apr. 1	By Gangadhar	
"	To Balance c/d.	4,160		Mfg. Co. A/c.	8,170
		8,170			8,170
1982			1981		
Mar. 31	To Interest A/c.	2,750	Apr. 1	By Balance b/d.	4,160
"	To Balance c/d.	1,410			
		4,160			4,160
1983			1982		
Mar. 31	To Interest A/c.	1,410	Apr. 1	By Balance b/d.	1,410
		1,410			1,410

Interest A/c.

Dr. Cr.

		Rs.			Rs.
1981			1981		
Mar. 31	To P & L A/c.	4,010	Mar. 31	By Int. Sus. A/c.	4,010
			1982		R s.
1982					
Mar. 31	To P & L A/c.	2,750	Mar. 31	By Int. Sus. A/c.	2,750
			1983		Rs.
1983					
Mar. 31	To P & L A/c.	1,410	Mar. 31	By Int. Sus. A/c.	1,410

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Profit & Loss A/c.
for the year ending 31-3-1981

	By Interest A/c.	4,010

Profit & Loss A/c.
for the year ending 31-3-1982

	By Interest A/c.	2,750

Profit & Loss A/c.
for the year ending 31-3-1983

	By Interest A/c.	1,410

Modern Machineries Limited
Balance Sheet as on 31st March, 1981

Liabilities	Rs.	Assets	Rs.
Interest Suspense A/c.	4,160	Gangadhar Mfg. Co.	50,000

Balance Sheet as on 31st March, 1982

Interest Suspense A/c.	1,410	Gangadhar Mfg. Co.	25,000

Balance Sheet as on 31st March, 1983

Interest Suspense A/c.	Nil	Gangadhar Mfg. Co.	Nil

We have, so far, worked out problems where rate of interest, total cash price and instalments are given. In problems on hire-purchase, some times, information on one of these items is not given, we will have to calculate this missing information on the basis of information provided in the problem.

9.6 PROCEDURE FOR WORKING OUT THE PROBLEM WHEN CASH PRICE IS NOT GIVEN

Illustration - 6

On 1st Jan. 1979 Ronald Enterprises purchased a machinery from Wahab Industries Ltd. on hire-purchase and immediately paid Rs. 10,000. The balance was paid in four annual instalments of Rs. 10,000 each 31st Dec. every year. Interest was charged @ 10% on the balance of cash price.

Ronald Enterprise depreciates machinery @ 15% on reducing balance method.

Prepare Ledger Accounts in the books of both parties.

Explanation : Cash price is not given in the problem. Hence, this must be ascertained first.

Cash price can be ascertained from the procedure given below:

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(a) Take up the last instalment first (4th year). The instalment amount is inclusive of the interest. Therefore, find out the interest component by the formula.

$$\text{Instalment Amount} \times \frac{\text{Rate (of interest)}}{100 + \text{Rate}}$$

For ex. when instalment is Rs. 10,000 and rate of interest is 10%, $10,000 \times \frac{10}{100 + 10}$

(b) The same formula must be applied to find out the interest for the third year, then the second year and finally, for the first year. This is known as 'Work Back' method.

(c) The cash price paid for the fourth year should be added to the amount of instalment of the third year before applying the formula to find out the interest component for the third year. The reason is that at that time 3rd instalment is due. The cash price of the 4th instalment is also due.

Similarly for the second year cash prices paid in third and fourth years should be included and for the first year, cash prices of II, III and IV years.

Now, let us attempt the solutions of the problem, accordingly.

Solution

Table for ascertainment of Cash Price

Year	Instalment Rs.	Interest paid	Rs.	Cash price paid Rs.
31-12-'82 (4th year)	10,000	$10,000 \times \frac{10}{100 + 10}$	= 909	9,091 (10,000–909)
31-12-'81	10,000	$10,000 + 9,091 \times \frac{10}{100 + 10}$ (19,091)	= 1,736	8,264 (10,000–1,736)
31-12-'80	10,000	10,000 + 8264 + (27355) $9,091 \times \frac{10}{110}$	= 2,487	7,513(10,000-2487)
31-12-'79	10,000	$10,000 + 7,513 + 8,264 + 9,091 \times \frac{10}{110}$ $= 34,868 \times \frac{10}{110}$	= 3,170	6,830 (10,000–3,170)
1-1-'79	10,000	Down Payment - No Interest		10,000
	Total	50,000	INT 8,302	C.P. 41,698

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In the Books of Ronald Enterprises
(Hire Purchasers)

Ledger Accounts

Dr. **Machinery A/c.** Cr.

		Rs.			Rs.
1979 Jan. 1	To Wahab Indts. Ltd. A/c.	41,698	1979 Dec. 31	By Depreciation A/c.	6,255
				By Balance c/d.	35,443
		41,698			41,698
1980 Jan. 1	To Balance b/d.	35,443	1980 Dec. 31	By Depreciation A/c.	5,316
				By Balance c/d.	30,127
		35,443			35,443
1983 Jan. 1	To Balance b/d.	30,127	1981 Dec. 31	By Depreciation A/c.	4,519
				By Balance c/d.	25.608
		30,127			30,127
1982 Jan. 1	To Balance b/d.	25,608	1982 Dec. 31	By Depreciation A/c	3,841
				By Balance c/d.	21,761
		25,608			25,608

Dr. **Wahab Industries Ltd. A/c.** Cr.

		Rs.			Rs.
1979 Jan. 1	To Bank A/c.	10,000	1979 Jan. 1	By Machinery A/c.	41,698
Dec. 31	To Bank A/c.	10,000	Dec. 31	By Interest A/c.	3,170
"	To Balance c/d.	24,868			
		44,868			44,868
1980 Dec. 31	To Bank A/c.	10,000	1980 Jan. 31	By Balance b/d.	24,868
"	To Balance c/d.	17,355	Dec. 31	By Interest A/c.	2,487
		27,355			27,355
1981 Dec. 31	To Bank A/c.	10,000	1981 Jan. 31	By Balance b/d.	17,355
"	To Balance c/d.	9,091	Dec. 31	By Interest A/c.	1,736
		19,091			19,091
1982 Dec. 31	To Bank A/c.	10,000	1982 Jan. 31	By Balance b/d.	9,091
			Dec. 31	By Interest A/c.	909
		10,000			10,000

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Interest A/c.

Dr.		Rs.			Rs.	Cr.
1979 Dec. 31	To Wahab Indts.	3,170	1979 Dec. 31	By P & L A/c.	3,170	
1980 Dec. 31	To Wahab Indts.	2,487	1980 Dec. 31	By P & L A/c.	2,487	
1981 Dec. 31	To Wahab Indts.	1,736	1981 Dec. 31	By P & L A/c.	1,736	
1982 Dec. 31	To Wahab Indts.	909	1982 Dec. 31	By P & L A/c.	909	

Depreciation A/c.

Dr.		Rs.			Rs.	Cr.
1979 Dec. 31	To Machinery A/c.	6,255	1979 Dec. 31	By P & L A/c.	6,255	
1980 Dec. 31	To Machinery A/c.	5,316	1980 Dec. 31	By P & L A/c.	5,316	
1981 Dec. 31	To Machinery A/c.	4,519	1981 Dec. 31	By P & L A/c.	4,519	
1982 Dec. 31	To Machinery A/c.	3,841	1982 Dec. 31	By P & L A/c.	3,841	

Profit & Loss A/c.
for the year ending 31st December 1979

Dr.		Rs.	Cr.
	To Interest	3,710	
	To Depreciation	6,255	

Profit & Loss A/c.
for the year ending 31st December 1980

		Rs.	
	To Interest	2,487	
	To Depreciation	5,316	

Profit & Loss A/c.
for the year ending 31st December 1981

		Rs.	
	To Interest	1,736	
	To Depreciation	4,519	

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Profit & Loss A/c.
for the year ending 31st December 1982

		Rs.	
	To Interest	909	
	To Depreciation	3,841	

In the Books of Wahab Indts. Ltd.
(Hire Vendors)
Ledger Accounts
Ronald Enterprises A/c.

Dr. Cr.

		Rs.			Rs.
1979			1979		
Jan. 1	To Sales A/c.	41,698	Jan. 1	By Bank A/c.	10,000
Dec. 31	To Interest A/c.	3,170	Dec. 31	By Bank A/c.	10,000
				By Balance c/d.	24,868
		44,868			44,868
1980					
Jan. 1	To Balance b/d.	24,868	1980		
Dec. 31	To Interest A/c.	2,487	Dec. 31	By Bank A/c.	10,000
				By Balance c/d.	17,355
		27,355			27,355
1981					
Jan. 1	To Balance b/d.	17,355	1981		
Dec. 31	To Interest A/c.	1,736	Dec. 31	By Bank A/c.	10,000
				By Balance c/d.	9,091
		19,091			19,091
1982					
Jan. 1	To Balance b/d.	9,091	1982		
Dec. 31	To Interest A/c.	909	Dec. 31	By Bank A/c.	10,000
		10,000			10,000

Dr. **Interest A/c.** Cr.

		Rs.			Rs.
1979			1979		
Dec. 31	To P & L A/c.	3,170	Dec. 31	By Ronald Enterprises A/c.	3,170
1980			1980		
Dec. 31	To P & L A/c.	2,487	Dec. 31	By Ronald Enterprises A/c.	2,487
1981			1981		
dec. 31	To P & L A/c.	1,736	Dec. 31	By Ronald Enterprises A/c.	1,736
1982			1982		
Dec. 31	To P & L A/c	909	Dec. 31	By Ronald Enterprises A/c.	909

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Profit & Loss A/c.
for the year ending 31st December, 1979

Dr. Cr.

		Rs.
	By Interest A/c.	3,170

Profit & Loss A/c.
for the year ending 31st December, 1980

		Rs.
	By Interest A/c.	2,487

Profit & Loss A/c.
for the year ending 31st December, 1981

		Rs.
	By Interest A/c.	1,736

Profit & Loss A/c.
for the year ending 31st December, 1982

		Rs.
	By Interest A/c.	909

Notes :

1. Calculations are made to the nearest rupee.
2. 31st December was assumed as the date of closing of accounts for tboth the parties.
3. Full cash price method in the case of hire-purchasers and the method without interest suspense A/c. in the case of hire-vendor are followed since no specific method is contained in the question.

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9.7 PROCEDURE FOR WORKING OUT THE PROBLEM WHEN RATE OF INTEREST IS NOT GIVEN

When the cash price and instalments are given, interest for each year can be foun out even though the rate of interest is not given. The total interest can be obtained by decucting the cash price from the hire-purchase price. The total interest should then be distributed in the ratio of reverse serial order of the instalments. For example, if there are four instalments 1,2,3 and 4, the total interest is distributted in the ratio of 4:3:2:1 respectively. In other words, the division is made on the basis of the amount still due towards instalments at the beginning of each year. This technique is followed when the instalment amounts payable are uniform.

Illustration - 7

Devaki General Stores Ltd. purchased a three-wheeler delivery van from Mini Motors Ltd. on hire-purchase basis. ~~On 1st basis.~~ On 1st Jan. 1981, the date of signing the agreement they paid Rs. 8,600. The balance is paid @ Rs. 5,000 on 31st Dec. every year for three years.

The cash price of the van is Rs. 20,000 and the hire-purchasers provide depreciation at a uniform rate of 10% p.a., on the original cost.

Enter these transactions in the journals of both the parties assuming that they adjust interest through interest suspense a/c. and that they close their books on 31st December.

Solution

As the rate of interest is not given, first the total interest will have to be distributed as follows:

	Rs.
Hire Purchase price (8,600 + 5,000 + 5,000 + 5,000)	= 23,600
Cash price, as given	= 20,000
Total interest	3,600

The number of instalments being three, the interest will be distributed in the ratio of 3:2:1.

I year $3,600 \times \frac{3}{6}$ = Rs. 1,800

II year $3,600 \times \frac{2}{6}$ = Rs. 1,200

III year $3,600 \times \frac{1}{6}$ = Rs. 600

Total = Rs. 3,600

Analytical Table

Date	Down Payment or instalment paid	Principal amount	Interest	Cash Price still due after this instalment
	Rs.	Rs.	Rs.	Rs.
1	2	3	4	5
1-1-1981	8,600	8,600	--	11,000 (20,000–8,600)
31-12-1981	5,000	3,200	1,800	8,200 (11,400–3,200)
31-12-1982	5,000	3,800	1,200	4,400 (8,200–3,800)
31-12-1983	5,000	4,400	600	-- (4,400–4,400)

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In the Books of Devaki General Stores Ltd.
(Hire Purchasers)
Journal

			Rs.	Rs.
1981				
Jan. 1	Van A/c.	Dr.	20,000	
	Interest suspense A/c.	Dr.	3,600	
	To Mini Motors Ltd. A/c.			23,600
	(Being hire-purchase of dely. Van)			
"	Mini Motors A/c.	Dr.	8,600	
	To Bank A/c.			8,600
	(Being down paymen made)			
Dec.31	Interest A/c.	Dr.	3,600	
	To Interest Suspense A/c.			3,600
	(Being interest for the year)			
"	Mini Motors Ltd. A/c.	Dr.	5,000	
	To Bank A/c.			5,000
	(Being I Instalment paid)			
"	Depreciation A/c.	Dr.	2,000	
	To Van A/c.			2,000
	(Being Depreciation @ 10% p.a.)			
"	Profit & Loss A/c.	Dr.	5,600	
	To Interest A/c.			3,600
	To Depreciation A/c.			2,000
	(Being Depreciation and interest transferred)			
1982				
Dec.31	Interest A/c.	Dr.	1,200	
	To Interest Suspense A/c.			1,200
	(Being interest for the year)			
"	Mini Motors Ltd. A/c.	Dr.	5,000	
	To Bank A/c.			5,000
	(Being II Instalment paid)			
"	Depreciation A/c.	Dr.	2,000	
	To Van A/c.			2,000
	(Being Depreciation @ 10% p.a.)			
"	Profit & Loss A/c.	Dr.	3,200	
	To Interest A/c.			1,200
	To Depreciation A/c.			2,000
	(Being Depreciation and interest transferred)			

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1983 Dec.31	Interest A/c. Dr.		600	
	To Interest Suspense A/c.			600
	(Being interest for the year)			
"	Mini Motors Ltd. A/c. Dr.		5,000	
	To Bank A/c.			5,000
	(Being III & Final Instalment paid)			
"	Depreciation A/c. Dr.		2,000	
	To Van A/c.			2,000
	(Being Depreciation @ 10% p.a.)			
"	Profit & Loss A/c. Dr.		2,600	
	To Interest A/c.			600
	To Depreciation A/c.			2,000
	(Being Depreciation and interest transferred)			

In the Books of Mini Motors Ltd.
(Hire Vendors)
Journal

			Rs.	Rs.
1981 Jan. 1	Devaki General Store Ltd. A/c. Dr.		23,600	
	To Sales A/c.			20,000
	To Mini Interest Suspense A/c.			3,600
	(Being Sale of van on hire-purchase)			
"	Bank A/c. Dr.		8,600	
	To Devaki General Stores Ltd. A/c.			8,600
	(Being down payment received)			
Dec. 31	Interest Suspense A/c. Dr.		3,600	
	To interest A/c.			3,600
	(Being interest for the year)			
"	Bank A/c. Dr.		5,000	
	To Devaki General Stores Ltd. A/c.			5,000
	(Being I instalment received)			
"	Interest A/c. Dr.		3,600	
	To profit & Loss A/c.			3,600
	(Being interest transferred)			
1982 Dec. 31	Interest Suspense A/c. Dr.		1,200	
	To interest A/c.			1,200
	(Being interest for the year)			

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"	Bank A/c. To Devaki General Stores Ltd. A/c. (Being II instalment received)	Dr.		5,000	5,000
"	Interest A/c. To profit & Loss A/c. (Being interest transferred)	Dr.		1,200	1,200
1983 Dec. 31	Interest Suspense A/c. To interest A/c. (Being interest for the year)	Dr.		600	600
"	Bank A/c. To Devaki General Stores Ltd. A/c. (Being III instalment received)	Dr.		5,000	5,000
"	Interest A/c. To profit & Loss A/c. (Being interest transferred)	Dr.		600	600

Check Your Progress - 3

1. Explain the procedure where information like cash price or rate of interest is not given.

.....

.....

.....

9.8 DEFAULT AND REPOSSESSION OF GOODS

When the hire-purchaser commits default in the payment of instalments, the hire-vendor has a right to take back the goods, treating the payment made till date as hire charges. The loss suffered by the hire-purchaser as a result of the repossession will have to be written off to Profit & Loss A/c. The vendor sells these goods usually after spending some amount towards repairs and reconditioning. This may result in profit or loss which he transfers to his own profit and loss account.

However, when the hire-purchaser has already paid substantial portion of the price for the goods taken, the vendor may not take back the entire goods but only a part of the goods, leaving the remaining with the hire-purchaser. For example, when the hire-purchaser buys 5 trucks and pays 6 out of the ten instalments, then only 2 trucks may be taken back by the hire-vendor, on default.

The accounting to be followed in the event of default and re-possession will be different for complete re-possession and partial re-possession.

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I. **When the Vendor takes complete re-possession of the goods :**

The procedure is as follows :

a) **In the books of the purchaser :**

(i) Entries will be passed as usual upto the date of default including entries for depreciation and interest, for the year in which he commits the default. Of course, the entry for the payment of the instalment will not be made in respect of the instalment defaulted.

(ii) The balance in the vendor's a/c. will be transferred to the asset account by debiting vendor's a/c. and crediting the asset a/c.

(iii) The balance left in the asset account now represents loss and will be closed by transfer to profit and loss a/c.

b) **In the books of the Vendor :**

(i) Entries will be passed as usual upto the date of default including entry for interest for the year for which the buyer failed to pay the instalment.

(ii) The vendor closes the account of the hire-purchaser by crediting his account and debiting a newly opened Repossessed Stock Account (or Returned Goods a/c.)

Repossessed Stock Account will be further debited with expenses incurred in repairing etc., when these goods are sold, this account is credited (and the bank a/c. debited). Any balance now remaining in this account will be transferred to profit and loss account.

Illustration - 8

Hyderabad Transport Ltd. purchased three mini trucks from Efficient Motors Ltd. on hire-purchase basis. Each truck costs Rs. 40,000 - The other details are as follows:

Down payment	...	Rs. 30,000 (for all trucks)
Instalments - three equal	...	Rs. 30,000 each year together with interest 5% p.a.
Depreciation written off by Hyderabad Transport Ltd.	...	20% on W.D.V. (written down value)

The buyers paid the instalment due, at the end of the first year but could not pay the next. The hire vendor took re-possession of all the three trucks. He spent Rs. 5,350 on repairing the trucks and sold them for Rs. 70,000.

Give the journal entries in the books of the buyers and important ledger accounts in the books of both parties.

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Solution

Journal of Hyderabad Transport Ltd.

			Rs.	Rs.
1st year	Mini Trucks A/c. Dr.		1,20,000	
	To Efficient Motors Ltd. A/c.			1,20,000
	(Being cash price of 3 trucks purchased on hire-purchase system)			
	Efficient Motors Ltd. A/c. Dr.		30,000	
	To Bank A/c.			30,000
	(Being down payment made)			
	Interest A/c. Dr.		4,500	
	To Efficient Motors Ltd. A/c.			4,500
	(Being interest due for the year on Rs. 90,000 @ 5%)			
	Efficient Motors Ltd. A/c. Dr.		34,500	
	To Bank A/c.			34,500
	(Being I instalment paid) (Rs. 30,000 + interest)			
	Depreciation A/c. Dr.		24,000	
	To Mini Trucks A/c.			24,000
	(Being depreciation @ 20%)			
	Profit & Loss A/c. Dr.		24,000	
	To Interest A/c.			4,500
	To Depreciation A/c.			24,000
	(Being Depreciation transferred)			
2nd year	Interest A/c. Dr.		3,000	
	To Efficient Motors Ltd. A/c.			3,000
	(Being interest due for the year on Rs. 60,000 @ 5%)			
	Depreciation A/c.		19,200	
	To Mini Trucks A/c.			19,200
	(Being depreciation for the year)			
	Efficient Motors Ltd. A/c. Dr.		63,000	
	To Mini Trucks A/c.			63,000
	(Being the balance in Vendor's A/c. transferred on default)			

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	Profit & Loss A/c.	Dr.		36,000	
	To Mini Trucks A/c. (Loss)				*13,800
	To Depreciation A/c.				19,200
	To Interest A/c.				3,000
	(Being loss on repossession, depreciation & interest transferred)				

* See Mini Truck ledger A/c.

Important Ledger Accounts

Dr. **Mini A/c.** Cr.

		Rs.			Rs.
1st year	To Efficient Motors Ltd. A/c.	1,20,000	1st year	By Depreciation A/c.	24,000
				By Balance c/d.	96,000
		1,20,000			1,20,000
2nd year	To Balance b/d.	96,000	2nd year	By Depreciation A/c.	19,200
				By Efficient Motors transferred	63,000
				By P & L A/c. (Loss)	13,800
		96,000			96,000

Dr. **Efficient Motors Ltd. A/c.** Cr.

		Rs.			Rs.
1st year	To Bank A/c.	30,000	1st year	By Mini Truck A/c.	1,20,000
	To Bank A/c.	34,500		By Interest A/c.	4,500
	To Balance c/d.	60,000			
		1,24,500			1,24,500
2nd year	To Mini Trucks (A/c. transfer)	60,000	2nd year	By Balance b/d	60,000
				By Interest A/c.	3,000
		63,000			63,000

Note :

1. In this problem, the amount payable for the cash price is uniform (Rs. 30,000). Each instalment comprises this thirty thousand plus interest for the year.
2. It is assumed that the buyers followed the full cash price method.
3. If, on the other hand, asset is recorded at the part-cash-price no entry will be passed for showing the amount due to vendors in the second year because of default.

Under this method, as the student is aware, each year the Hire-Vendor's A/c will not show any balance. As such the question of transferring the balance of hire vendor's a/c to asset a/c does not arise. The asset a/c will appear under this method as follow:

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Mini A/c.

Dr.		Rs.			Rs.	Cr.
1st year	To Efficient Motors Ltd. A/c.	30,000	1st year	By Depreciation A/c.	24,000	
	To Efficient Motors Ltd. A/c.	30,000		By Balance c/d.	36,000	
		60,000			60,000	
2nd year	To Balance b/d.	36,000	2nd year	By Depreciation A/c.	19,200	
				By P & L A/c. (Loss)	**16,800	
		36,000			36,000	

** This amount represents total loss which was split in the earlier working, as follows:

Loss Rs. 13,800 + Interest. for 2nd year Rs. 3,000 = 16,800.

Books of Efficient Motors Limited

Important Ledger Accounts

Hyderabad Transport Ltd.

Dr.		Rs.			Rs.	Cr.
1st year	To Sales A/c.	4,500	1st year	By Bank A/c.	30,000	
	To Interest A/c.	4,500		By Bank A/c.	34,500	
				By Balance c/d.	60,000	
		1,24,500			1,24,500	
2 yr.	To balance b/d.	60,000	2 yr.	By Transfer to Repossessed Stock A/c.	63,000	
	To Interest	3,000				
		63,000			63,000	

Repossessed Stock A/c.

Dr.				Cr.
	To Hyd. Transport Ltd.	63.000	By Bank (sales)	70,000
	To Cash A/c. repairs etc.	5,350		
	To P & L A/c. (Profit)	1,650		
		70,000		70,000

II. When the Vendor takes re-possession of a part of the goods :

As in the first case, entries will be passed up to the date of default, including the entries for depreciation and interest in the books of the buyer and entry for interest in the vendor's books in the year of default.

However, in case of partial re-possession, neither the Vendor's A/c. nor the buyers a/c. will be closed in their respective books. This is because of the fact that the entire asset is not taken back. At the close the asset a/c in the buyer's books will have a balance equal to the value of the (part) asset allowed to remain with the buyer. The value of the asset taken away by the vendor is fixed as per mutual agreement and is debited to vendor's account and credited to the asset

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account. After adjusting these items, any difference between the debit and credit sides of the asset a/c in the books of the buyer will be transferred to profit and loss a/c.

The re-possessed stock account in the vendor's books will be dealt with, in the same manner as described in the case of complete-repossession.

Illustration - 9

North India Transporters Ltd. purchased two trucks costing Rs. 80,000 each from Southern India Motors Ltd. on hire purchase system, on 1st Jan. 1982. On the same day an amount of Rs. 20,000 per truck was paid. The balance was to be paid in three equal instalments together with interest @ 10% on 31st Dec. each year. The hire-purchasers could not pay the final instalments.

After negotiations, the vendors took back one truck valuing it at 30% depreciation on the diminishing value method and adjusting this value against amount due.

The repossessed truck was sold by vendors for Rs. 40,000 after spending Rs. 7,248 for its repairs and overhauling.

Write up the ledger accounts in the books of both the parties assuming that the buyers charge depreciation at 25% on the written down value.

Solution

Dr. **Books of North India Transporters Ltd.** Cr.

Trucks A/c

1982 Jan. 1	To S.I. Motors Ltd.	1,60,000	1982 Dec. 31	By Depreciation (25%)	40,000
				By Balance c/d.	1,20,000
		1,60,000			1,60,000
1983 Jan. 1	To Balance b/d.	1,20,000	1983 Dec. 31	By Depreciation	30,000
				By Balance c/d.	90,000
		1,20,000			1,20,000
1984 Jan. 1	To Balance b/d.	90,000	1984 Dec. 31	By Depreciation	22,500
				By Vendors (1)	27,440
				By P & L A/c. (3) Loss	6,310
				By Balance c/d. (2)	33,750
		90,000			90,000

1) **Value of one truck re-possessed at 30% Depreciation on W.D.V.**

		Rs.
I Year	Cost of 1 truck	80,000
	Less Depreciation 30% $\left(80,000 \times \frac{30}{100}\right)$	24,000
		56,000

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II Year	Less Depreciation 30% $\left(56,000 \times \frac{30}{100}\right)$	16,800
		39,200
III Year	Less Depreciation 30% $\left(39,200 \times \frac{30}{100}\right)$	11,760
		27,440

2) **Value of one truck left with buyers :**

I Year	Cost of one truck	80,000
	Less Depreciation 25% $\left(80,000 \times \frac{25}{100}\right)$	20,000
		60,000
II Year	Less Depreciation 25% $\left(60,000 \times \frac{25}{100}\right)$	15,000
		45,000
III Year	Less Depreciation 25% $\left(45,000 \times \frac{25}{100}\right)$	11,250
		33,750

Hence, Rs. 33,750 should be the closing balance of the asset a/c.

3. After adjusting the value of the truck taken over and the closing balance of Rs. 33,750, the difference is transferred to Profit & Loss A/c. (Loss).

Southern India Motors Ltd. A/c.

Dr.		Rs.			Cr. Rs.
1982			1982		
Jan. 1	To Bank A/c.	40,000	Jan. 1	By Truck A/c.	1,60,000
Dec. 31	To Bank A/c.	52,000	Dec. 31	By Interest A/c.	12,000
"	To Balance c/d.	80,000			
		1,72,000			1,72,000
1983			1983		
Dec. 31	To Bank A/c.	48,000	Jan. 1	By Balance b/d.	80,000
"	To Balance c/d.	40,000	Dec. 31	By Interest A/c.	8,000
		88,000			88,000
1984			1984		
Dec. 31	To Truck A/c. (Repossessed)	27,440	Jan. 1	By Balance b/d.	40,000
			Dec. 31	By Interest A/c.	4,000
"	To Balance c/d.	16,560			
		44,000			44,000

Interest A/c.

Dr.					Cr.
1982	To S.I. Motors Ltd.	12,000	1982	By P & L A/c.	12,000
1983	To S.I. Motors Ltd.	8,000	1983	By P & L A/c.	8,000
1984	To S.I. Motors Ltd.	4,000	1984	By P & L A/c.	4,000

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Dr. **P & L A/c.** Cr.

		Rs.
	1982	
	To Interest	12,000
	To Depreciation	40,000
	1983	
	To Interest	8,000
	To Depreciation	30,000
	1984	
	To Interest	4,000
	To Depreciation	22,500

Books of Southern India Motors Ltd.

Dr. **Northern India Transporters Ltd. A/c.** Cr.

		Rs.			Rs.
1982			1982		
Jan. 1	To Sales A/c.	1,60,000	Jan. 1	By Bank A/c.	40,000
Dec. 31	To Interest A/c.	12,000	Dec. 31	By Bank A/c.	52,000
				By Balance c/d.	80,000
		1,72,000			1,72,000
1983					
Jan. 1	To Balance b/d.	80,000	1983		
Dec. 31	To Interest A/c.	8,000	Dec. 31	By Bank A/c.	48,000
			"	By Balance c/d.	40,000
		88,000			88,000
1984					
Jan. 1	To Balance b/d.	40,000	1984		
Dec. 31	To Interest A/c.	4,000	Dec. 31	By Repossessed stock A/c.	27,440
			"	By Balance c/d.	16,560
		44,000			44,000

Dr. **Repossessed Stock A/c.** Cr.

		Rs.			Rs.
1984			1984		
Dec. 31	To Northern India Transporters Ltd.	27,440	Dec. 31	By Cash A/c. (Sale)	40,000
	To Cash Account	7,248			
	To P & L A/c. (Profit)	5,312			
		40,000			40,000

Note : The student may himself prepare the Interest A/c. and Profit & Loss A/c.

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9.9 HIRE-PURCHASE TRADING ACCOUNT

When the goods, sold under the hire-purchase system, are of small value such as electric fans, radios, cycles, etc., the vendor may find it very inconvenient to open a separate account for each of the numerous customers. He maintains a separate subsidiary book for this purpose. Details such as date of contract, customer, article cost and selling prices, down payment, number of instalments allowed, date of payment of each instalment etc., will be entered in this book in various columns. From these details, the following summarised information can be obtained :

a) Stock with the customers at the beginning and end of the year.

b) Instalments due and unpaid at the beginning and end (i.e., debtors)

c) Cost price of the goods sent to customers during the year.

d) Cash received from customers.

e) Any return of goods.

With the help of the above information, the trader will prepare a Hire-Purchase Trading Account to ascertain the net profit made on the hire-purchase sales. As the preparation of hire-purchase trading account is considered as an advanced topic involving entries and calculations of a complex nature, it is excluded from the purview of the present discussion.

9.10 SUMMING UP

When goods are sold on hire-purchase system, the cash price along with interest, which together constitute the hire-purchase price, is paid in instalments.

In the books of the purchaser, one of the three methods may be followed in recording the transactions;

a) The asset account is debited with cash price included in each instalment when the payment falls due (Asset Accrual Method).

b) The asset is debited with full cash price on signing the contract.

c) In addition to debiting the asset with full cash price, total interest is debited to Interest Suspense Account on signing the contract (Interest Suspense Method).

In the books of the vendor full cash price is credited to sales account. Interest is credited and purchases account debited when each instalment falls due. when interest suspense method is followed interest suspense account is debited. In the problems, if cash price is not given, it has to be ascertained by 'Back Work' method. And where rate of interest is not given, it has to be distributed in the ratio of the total instalment amount due at the beginning of each, or, in other words, in reverse serial order.

While recording the hire-purchase transactions in the books of hire-purchaser, depreciation may be charged on 'Straight Line Method' or 'Diminishing Balance Method'.

In the case of default in the payment of instalments under hire-purchase system, goods are repossessed either wholly or a part of them. Depending upon the valuation of goods repossessed and remaining, the accounts must be adjusted. When the goods, sold under hire-purchase system are of small value, the vendor maintains a separate subsidiary book to enter such transactions.

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With the help of this information, he prepares an account known as 'Hire Purchase Trading Account'.

9.11 CHECK YOUR PROGRESS : MODEL ANSWERS

1. (a) There are three methods of recording the transactions in the books of Hire-purchaser. They are: (a) Asset Accrual Method, (b) Full Cash Price Method and (c) Interest Suspense Method.

   (b) Asset A/c. Dr.
   To Hire Vendor's A/c.

2. In the case of straight-line method the amount of depreciation to be charged every year, will be same over the life of the asset. Contrary to this, the amount of depreciation to be charged decreases progressively from year to year under Reducing Balance Method.

3. Where cash price is not given, it is ascertained by 'Work Back Method'. When rate of interest is not given, it is calculated in the following manner.

   (i) Ascertain the total interest by deducting the cash price from the Hire-purchase price.

   (ii) The amount thus ascertained in step (i) to be distributed in the ratio of reverse serial order of the instalments.

9.12 MODEL EXAMINATION QUESTIONS

I. Answer the following in 30 lines each.

1. Give the model entries without figures in first year of the Hire-purchase agreement in the books of Purchaser and Vendor.
2. Define a Hire-purchase contract and discuss its salient features.
3. What are the legal consequences of a buyer of goods under Hire-purchase system committing default in the payment of instalment? What changes occur from the accounting point of view?

II. Answer the following in 15 lines each.

1. How do you distribute the total interest in the hire-purchase transactions where rate of interest is not given?
2. Explain the procedure for ascertaining cash price when it is not given under, hire-purchase.
3. Write short notes on the following.
   a) Assert Accrual Method.
   b) Interest Suspense Account
4. Write short notes on the following:
   a) Re-possessed stock
   b) Hire Purchase Trading Account.

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Problems :

1. On 1st Jan. 1981, Mehra Mini Wool (P) Ltd. purchased a machine from Automatic Machines Ltd. The same day a sum of Rs. 2,200 was paid as down payment. The remaining was paid in three annual instalments of Rs. 2,200 each at the end of 1981, 1982 and 1983. The cash price of the machine was Rs. 7,700. No depreciation was provided by the newly incorporated purchasing company. The vendors charge interest @ 10% p.a.

   Journalise these transactions in the books of Mehra Wool (P) Ltd. and write up the Vendor's A/c.

   (Interest 1 year Rs. 550; 2nd year Rs. 385 and 3rd year Rs. 165).

2. The X Transport Company purchased a Motor car from India Motors Ltd. on 1st January paying Rs. 10,000 cash immediately and agreeing to pay further three instalments of Rs. 10,000 each on 31st December each year for 3 years. The cash price of the car was Rs. 37,251 and the motor company charges interest @ 5% p.a. The Transport Company depreciates the car @ 20% on reducing balance system.

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

   (Interest Rs. 1,363; Rs. 931; Rs. 455)

3. The Hyderabad Industries Ltd. purchased on 1st Jan. 1982 a lathe machine from HMT Ltd at a cost of Rs. 26,000 and paid Rs. 8,300 as down payment under hire-purchase system. They further paid on 31st Dec. of 1982, 1983 and 1984 Rs. 8,000 each towards the instalments. The machine was depreciated @ 10% p.a. on fixed instalment (Straight line) System.

   Prepare the ledger accounts in the books of both the parties. (The total interest Rs. 6,300 must be distributed in the ratio of 3:2:1 - Rs. 3,150; 2,100; 1,050).

4. Rao & Company purchased a 3500 CC Motor Cycle for their office use for Rs. 8,600 on hire purchase system and immediately paid Rs. 1,600. Again Rs. 2,400, Rs. 4,400 and Rs. 1,600 were paid at the end of the 1st year, 2nd year and 3rd year respectively, which sums are inclusive of interest @ 10% p.a. The asset was depreciated @ 20% p.a. on written down value. The vendors were Exe Ltd.

   Journalise these transactions in the books of Rao & Co. and prepare Rao & Co's A/c. and Interest Suspense A/c. in Vendor's books.

   (Interset Rs. 700; 530; 170)

5. On 1-1-1981 India Trucks Ltd. sold a truck on Hire Purchase basis to Kashmir Transport Company who made an immediate payment of Rs. 45,000. Identical sums were paid at the end of 1981, 1982 and 1983. The vendors charge interest @ 10% p.a. Kashmir Transport Co. provides depreciation @ 25% on written down value.

   Write up the ledger accounts in the books of transport company including interest suspense a/c and profit and loss a/c and also show how the relevant accounts appear in their Balance Sheets.

   Make calculations to the nearest rupee.

   Hint : First ascertain the cash price. Interest Rs. 11,191; Rs. 7,810 and Rs. 4,091 Cash price Rs. 1,56,908).

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6. *A* sold a machine to B on hire-purchase system on 1st Jan. 1983. The cash price of the machine was Rs. 57, 130 against which he paid Rs. 15,000 on 1-1-1983. *B* was to pay three more instalments of Rs. 20,000 each on 31st December every year for three years beginning from 31-12-1983. *A*, charges 20% interest per annum.

B paid the first instalment on 31-12-1983 but failed to pay the second and *A* seized the machine. *A* spent Rs. 3,500 and sold it for Rs. 45,000.

Write Journal entries in the books of both the parties, assuming that *B* provides annual deprecsiation @ 15% on written down value. Also show the repossessed stock a/c. in the vendor's books. (Loss to *B* Rs. 4,609; Profit to *A* Rs. 4,833).

7. On 1st January 1981, Exe Ltd. purchased 3 trucks from Wye Ltd. on hire-purchase basis. The cash price of each truck was Rs. 1,20,000. Down payment was Rs. 60,000. Further three instalments of Rs. 1,28,000 each at the end of each year were to be paid. These include interest @ 13% p.a. Exe Ltd. charges depreciation @ 10% on straight line method.

During 1983, Exe Ltd. was caught up in a very difficult financial position and could not pay the third instalment. Wye Ltd. took repossession of one truck adjusting its value against the amount due. The truck was valued by Wye Ltd. on the basis of 13% depreciation annually, on written down value basis. After spending Rs. 8,580 on repairs Wye Ltd. sold the truck for Rs. 98,000.

Prepare the Truck A/c. and Hire-vendor's A/c. in the books of Exe Ltd. and the Hire-purchaser's A/c. as also Repossessed stock A/c. in Wye's books.

(Re-possessed value of 1 truck Rs. 79,020; closing balance of truck a/c. Rs. 1,68,000; Loss to Exe Ltd. Rs. 4,980; Profit to Wye Ltd. on sale of repossessed stock Rs. 10,400)

9.13 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy. M : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C. & Grewal, T.S : Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

9.14 GLOSSARY

Asset Accrual : Treating the asset as property by the buyer only to the extent of cash price included in instalments as they fall due.

Default : Failure on the part of the buyer to pay one or more instalments.

Re-possession : The seller taking back the goods on default under hire-purchase system.

Interest Suspense : The total interest payable (H.P Price – Cash Price)

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Hire Purchase Trading A/c.	:	An account prepared to find out the net profit on hire-purchase or instalment-purchase sales by vendor in the case of goods of small value.
Straight Line Method	:	A method of depreciation wherein the asset is depreciated at a certain percentage on original cost uniformly over the period of life of the asset.
Diminishing Balance Method	:	A method of depreciation where every year, a certain percentage of depreciation is written off on the balance after previous year's depreciation.

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UNIT-10 : INSTALMENT PURCHASE SYSTEM

Contents

10.0 Aims and Objectives
10.1 Introduction
10.2 Distinction between the Hire-Purchase and Instalment Purchase Systems
10.3 Accounting aspect of the Instalment Purchase Transactions
10.4 Summing Up
10.5 Check Your Progress : Model Answers
10.6 Model Examination Questions
10.7 Recommended Books

10.0 AIMS AND OBJECTIVES

The aim of this unit is to learn the accounting entries to be passed in the books of Hire-Purchaser and Hire-Vendor, under Instalment Purchase System.

After reading this unit, you should be able to:

- draw the distinction between Hire-Purchase and Instalment Purchase Systems
- pass journal entries in the books of Hire-Purchaser
- pass journal entries in the books of Hire-Vendor.

10.1 INTRODUCTION

In unit-9 we have seen the recording of transactions in the books of Hire-Purchaser and Hire-Vendor. The Instalment Purchase System is different in certain matters from Hire-Purchase System, particularly in respect of legal aspects. We cannot follow all the three methods, which we discussed under Hire-Purchase System, to record the transactions under Instalment Purchase System. Let us understand how entries are passed both in the books of Hire-purchaser and Hire-vendor.

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10.2 DISTINCTION BETWEEN THE HIRE PURCHASE AND INSTALMENT PURCHASE SYSTEMS

The Instalment Purchase System is similar to the Hire-Purchase System in many respects. The legal position, however, is different. When goods are sold on Instalment Purchase System, it is like a credit sale, with the price being payable in instalments along with interest. The following points of distinction between the two systems may be noted:

1. **Contract :** While the agreement under the hire-purchase system is for hiring the asset; in the case of instalment system it is an agreement of sale.
2. **Ownership :** The ownership in the asset passes immediately on signing the agreement under instalment system, whereas it passes only after the payment of last instalment in the hire-purchase system. The vendor remains the owner till that date.
3. **Default :** Default in the payment of instalments by the purchaser will entitle the vendor to take back the asset under hire-purchase system. No such right exists in the

instalment system. He can only sue the recovery of the amount but cannot repossess the asset.

4. **Return of the goods :** The hire-purchaser can terminate the contract and return the asset or goods to the vendor under hire-purchase system. This is not possible in instalment purchase system.

5. **Dealing with the asset :** The hire-purchaser cannot damage, destroy or dispose of the goods. The instalment purchaser can deal with them in the manner, he chooses.

Check Your Progress - 1

1. In what respects the Hire-Purchase System is different from Instalment Purchase System?

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10.3 ACCOUNTING ASPECT OF THE INSTALMENT PURCHASE TRANSACTIONS

In so far as the recording of the transactions in the books of the Instalment purchaser and the Instalment vendor is concerned it is the same as under the hire-purchase system learnt earlier in Unit 9. The same entries recorded in the books of both the parties under hire-purchase will be followed here too.

However, the asset accrual method cannot be followed here as the buyer acquires ownership as soon as he enters into agreement. As the buyer becomes liable to pay for the cash price of the asset as well as the interest as per the agreement the *Interest Suspense Method* is followed in recording the transactions in the books of the purchaser as well as the vendor under the Instalment Purchase System. The other aspects such as the ascertainment of cash price or distribution of interest when they are not given are common. The question of repossession of stock does not arise in the instalment purchase system, as the vendor has no right to take back the property even though the purchaser fails to pay the instalment. The other method, viz., debiting interest and crediting vendor's a/c, when an instalment falls due may also be adopted, but this is seldom followed in solving problems on instalment purchase system.

Illustration - 1

On 1st January 1979, X purchased a machine from Y Ltd. at a cost of Rs. 66,850 on instalment system and paid Rs. 15,000. Further, he paid Rs. 20,000 each on 31st Dec. 1979, 1980 and 1981 which includes interest @ 8% p.a. on the unpaid balance of the cash price. Machinery was depreciated at 20% on reducing balance method by X.

Record the transactions in the books of X. Prepare ledger accounts in the books of Y Ltd.

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Solution :

Analytical Table

Date	Down Payment or instalment Rs.	Principal amount (Cash Price) Rs.	Interest 8% Rs.	Cash price still due after this instalment Rs.
1	2	3	4	5
1-1-1979	15,000	15,000	–	51,850 (66,850–15,000)
31-12-79	20,000	15,852	4,148	35,998 (51,850–15,852)
31-12-80	20,000	17,120	2,880	18,878 (35,998–17,120)
31-12-81	20,000	18,878	1,122	Nil (18,878–18,878)
Total	75,000	66,850	8,150	—

Books of X

Journal

1979 Jan.1	Machinery A/c. Dr.		Rs. 66,850	Rs.
	Interest Suspense A/c. Dr.		8,150	
	To Y Ltd. A/c.			75,000
	(Being machinery purchased on instalment basis)			
"	Y Ltd. A/c. Dr.		15,000	
	To Bank A/c.			15,000
	(Being down payment made)			
1979 Dec. 31	Interest A/c. Dr.		4,148	
	To Interest Suspense A/c.			4,148
	(Being interest due for the year transferred)			
"	Y Ltd. A/c. Dr.		20,000	
	To Bank A/c.			20,000
	(Being I instalment paid)			
"	Depreciation A/c. Dr.		13,370	
	To Machinery A/c.			13,370
	(Being Depreciation for the year - $66,850 \times \frac{20}{100}$)			
"	Profit and Loss A/c. Dr.		17,518	
	To Depreciation A/c.			13,370
	To Interest A/c.			4,148
	(Being depreciation and interest transferred)			

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1980 Dec. 31	Interest A/c. Dr. To Interest Suspense A/c. (Being interest due for the year transferred)		2,880	2,880
"	Y Ltd. A/c. Dr. To Bank A/c. (Being II instalment paid)		20,000	20,000
"	Depreciation A/c. Dr. To Machinery A/c. (Being Depreciation for the year - $53,480 \times \frac{20}{100}$)		10,696	10,696
"	Profit and Loss A/c. Dr. To Depreciation A/c. To Interest A/c. (Being depreciation and interest transferred)		13,576	10,696 2,880
1981 Dec. 31	Interest A/c. Dr. To Interest Suspense A/c. (Being interest due for the year transferred)		1,122	1,122
"	Y Ltd. A/c. Dr. To Bank A/c. (Being III instalment paid)		20,000	20,000
"	Depreciation A/c. To Machinery A/c. (Being Depreciation for the year - $42,784 \times \frac{20}{100}$)		8,557	8,557
"	Profit and Loss A/c. Dr. To Depreciation A/c. To Interest A/c. (Being depreciation and interest transferred)		9,679	8,557 1,122

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Books of Y Ltd.

Ledger Account

Dr. **X's A/c.** Cr.

		Rs.			Rs.
1979			1979		
Jan. 1	To Sales A/c.	66,850	Jan. 1	By Bank A/c.	15,000
"	To Interest Suspense A/c.	8,150	Dec. 31	By Bank A/c.	20,000
		75,000		By Balance c/d.	40,000
					75,000
1980					
Jan. 1	To Balance b/d.	40,000	1980		
			Dec. 31	By Bank A/c.	20,000
				By Balance c/d.	20,000
		40,000			40,000
1981					
Jan. 1	To Balance b/d.	20,000	1981		
			Jan. 1	By Bank A/c.	20,000
		20,000			20,000

Dr. **Interest Suspense A/c.** Cr.

		Rs.			Rs.
1979			1979		
Dec. 31	To Interest A/c.	4,148	Jan. 1	By X A/c.	8,150
	To Balance c/d.	4,002			
		8,150			8,150
1980					
Dec. 31	To Interest A/c.	2,880	1980		
	To Balance c/d.	4,002	Jan. 1	By Balance b/d.	4.002
		4,002			4,002
1981					
Dec. 31	To Interest A/c.	1,122	1981		
			Jan. 1	By Balance b/d.	1,122
		1,122			1,122

Dr. **Interest A/c.** Cr.

		Rs.			Rs.
1979			1979		
Dec. 31	To P & L A/c.	4,148	Dec. 31	By Int. Sus. A/c.	4,148
1980			1980		
Dec. 31	To P & L A/c.	2,280	Dec. 31	By Int. Sus. A/c.	2,880
1981			1981		
Dec. 31	To P & L A/c.	1,122	Dec. 31	By Int. Sus. A/c.	1,122

Dr. **Profit & Loss A/c.**
for the year ending 31-12-1979 Cr.

			By Interest A/c.	4,148

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Profit & Loss A/c.
for the year ending 31-12-1980

	By Interest A/c.	2,880

Profit & Loss A/c.
for the year ending 31-12-1981

	By Interest A/c.	1,122

Illustration - 2

Alfa Trading Co. Ltd. sold a machine to Kamalakar & Bros on instalment purchase system charging interest @ 10% p.a. on Jan. 1, 1980. The following sums were paid on the dates mentioned in full discharge of the obligation towards the cost as well as interest.

	Rs.
01-01-1980	2,00,000
31-12-1980	1,21,000
31-12-1981	1,33,100
31-12-1982	1,46,410

Assuming that the buyers provide depreciation @ 20% p.a. on diminishing balance method and that they close their books on 31st Dec. every year, prepare Machinery A/c., Vendors A/c. and Interest Suspense A/c. in their books.

Solution

Before attempting the ledger accounts, we have to ascertain the cash price it is not given. The procedure to find out the cash price is already explained in detail earlier under the hire-purchase system.

Date	Instalment Rs.	Interest Rs.		Cash price Rs.
31-12-1982	1,46,410	$\frac{10}{110} \times 1,46,410$	= 13,310	1,33,100
31-12-1981	1,33,100	$\frac{10}{110} \times 1,33,100 + 1,33,100$	= 24,200	1,08,900
31-12-1980	1,21,000	$\frac{10}{110} \times 1,21,000 + 1,08,900 + 1,33,100$	= 33,000	88,000
1-1-1980	2,00,000	Down Payment - Nil		2,00,000
Total	6,00,510		70,510	5,30,000

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Books of Kamalakar & Brothers

Dr. **Machinery A/c.** Cr.

1980		Rs.	1980		Rs.
Jan. 1	To Alfa Trading Co. Ltd.	5,30,000	Dec. 31	By Depreciation A/c.	1,06,000
				By Balance c/d.	4,24,000
		5,30,000			5,30,000
1981					
Jan. 1	To Balance b/d.	4,24,000	1981		
			Dec. 31	By Depreciation A/c.	84,800
				By Balance c/d.	3,39,200
		4,24,000			4,24,000
1981					
Jan. 1	To Balance b/d.	3,39,200	1981		
			Dec. 31	By Depreciation A/c.	67,840
				By Balance c/d.	2,71,360
		3,39,000			3,39,200

Dr. **Alfa Trading Co. Ltd. (Vendor) A/c.** Cr.

1980		Rs.	1980		Rs.
Jan. 1	To Bank A/c.	2,00,000	Jan. 1	By Machinery A/c.	5,30,000
Dec. 31	To Bank A/c.	1,21,000		By Interest sus. A/c.	70,510
	To Balance c/d.	2,79,510			
		6,00,510			6,00,510
1981			1981		
Dec. 31	To Bank A/c.	1,33,100	Dec. 31	By Balance b/d.	2,79,510
	To Balance c/d.	1,46,410			
		2,79,510			2,79,510
1982			1982		
Dec. 31	To Bank A/c.	1,46,410	Jan. 1	By Balance b/d.	1,46,410
		1,46,410			1,46,410

Dr. **Interest A/c.** Cr.

1980		Rs.	1980		Rs.
Jan. 1	To Alfa Trading Co	70,510	Dec. 31	By Interest A/c.	33,000
				By Balance c/d.	37,510
		70,510			70,510
1981					
Jan. 1	To Balance b/d.	37,510	1981		
			Dec. 31	By Interest A/c.	24,200
				By Balance c/d.	13,310
		37,510			37,510
1982					
Jan. 1	To Balance b/d.	13,310	1982		
			Dec. 31	By Interest A/c.	13,310
		13,310			13,310

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Illustration - 3

On 1st July 1982, X purchased a machine for his printing press from ABC Enterprises (P) Ltd. on instalment purchase system at a cash price of Rs. 46,580 of which he immediately paid Rs. 7.580. The remaining is to be paid in six half-yearly instalments of Rs. 6,500 each plus interest @ 12% per annum. The instalments are to be paid on 30th June and 31st December, every year. X who closes his books at the end of December, decided to depreciate the machinery at 10% p.a. on straight line basis.

You are requested to write up the Journal entries in the books of X up to 31st December 1983.

Solution :

Books of X

Journal

				Rs.	Rs.
1982					
July 1	Machinery A/c.	Dr.		46,580	
	Interest Suspense A/c.	Dr.		8,190	
	To ABC Enterprises (P) Ltd. A/c.				54,770
	(Being machinery purchased on instalment basis)				
"	ABC Enterprises (P) Ltd. A/c.	Dr.		7,580	
	To Bank A/c.				7,580
	(Being down payment made)				
Dec. 31	Interest A/c.	Dr.		2,340	
	To Interest Suspense A/c.				2,340
	(Being interest for half year) $39,000 \times \frac{12}{100} \times \frac{6}{12}$				
"	ABC Enterprises (P) Ltd. A/c.	Dr.		8,840	
	To Bank A/c.				8,840
	(Being I instalment paid 6,500 + 2,340)				
"	Depreciation A/c.	Dr.		2,329	
	To Machinery A/c.				2,329
	(Being Depreciation from the date of purchase $46580 \times \frac{10}{100} \times \frac{6}{12}$				
"	Profit and Loss A/c.	Dr.		4,669	
	To Interest A/c.				2,340
	To Depreciation A/c.				2,329
	(Being interest, depreciation transferred)				

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1983				
June 30	Interest A/c.	Dr.	1,950	
	To Interest Suspense A/c.			1,950
	(Being interest for half year $= 32,500 \times \frac{12}{100} \times \frac{6}{12}$)			
"	ABC Enterprises (P) Ltd. A/c.	Dr.	8,450	
	To Bank A/c.			8,450
	(Being II instalment paid 6,500 + 1,950)			
Dec. 31	Interest A/c.	Dr.	1,560	
	To Interest Suspense A/c.			1,560
	(Being interest for half year $= 26,000 \times \frac{12}{100} \times \frac{6}{12}$)			
Dec. 31	ABC Enterprises (P) Ltd. A/c.	Dr.	8,060	
	To Bank A/c.			8,060
	(Being III instalment paid 6,500 + 1,560)			
"	Depreciation A/c.		4,658	
	To Machinery A/c.			4,658
	(Being Depreciation for full year)			
"	Profit and Loss A/c.	Dr.	8,168	
	To Interest A/c.			4,658
	To Depreciation A/c.			2,329
	(Being Depreciation & interest transferred at the end of the year - interest 1,950 + 1,560)			

Notes :

1. Total interest debited to Interest Suspense A/c. Rs. 8,190 is arrived at, as follows:

			Rs.
31-12-1982	on Rs. 39,000 (46,480–7,580) $39,000 \times \frac{12}{100} \times \frac{6}{12}$	=	2,340
30-6-1983	on Rs. 32,500 (39,000–6,500) $32,500 \times \frac{12}{100} \times \frac{6}{12}$	=	1,950
31-12-1983	on 26,000 (32,500–6,500)	=	1,560
30-6-1984	19,500 (26,000–6,500)	=	1,170
31-12-1984	13,000 (19,500–6,500)	=	780
30-6-1985	6,500 (13,000–6,500)	=	390
	Total	=	8,190

2. Each year, the instalment amount paid is Rs. 6,500 plus interest for the period.

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3. Entries for depreciation and the transfer of interest and depreciation to profit and loss will be made only on the date on which the accounting year has ended. It is 31st Dec. here. For the first year, 1982 depreciation is calculated for half-year, from the date of purchase 1-7-1982 to 31-12-1982.

4. In problems involving half-yearly instalments when tranfer to profit and loss a/c is made, at the end of the accounting year, care must be taken to transfer interest paid in the middle of the year as well as at the end, along with depreciation.

10.4 SUMMING UP

When goods are sold on Instalment Purchase System, the accounting Procedure is the same as that of Hire Purchase System, except that the method usually followed under instalment system is "Interest Suspense Method". Asset Accrual Method cannot be followed.

10.5 CHECK YOUR PROGRESS : MODEL ANSWERS

	HIRE-PURCHASE		INSTALMENT PURCHASE
1.	Title in the goods transfers only after the last instalment is paid	1.	Title in the goods passes to te purchaser immediately after the agreement.
2.	The instalment paid before the last instalment would be treated as hire charges.	2.	Each instalment is treated as payment towards principal and interest.
3.	The agreement can be cancelled any time before the last instalment being paid.	3.	There is no such right to the purchaser.
4.	The seller has the right to repossess the goods, in case the purchaser is in default of instalment.	4.	The seller has not such right but he can file a suit for damages.
5.	The Hire Purchaser cannot sell the goods, as he has no title.	5.	The purchaser can sell the goods as he has title of the goods.

10.6 MODEL EXAMINATION QUESTIONS

I. Answer the following in 30 lines each.

1. What do you understand by instalment purchase system? In what ways is it different from the Hire-purchase system?
2. Explain the advantages of Hire-purchase or Instalment purchase agreements that may accrue to the purchaser and vendor? How are these transactions different from credit sales?

II. Answer the following in 15 lines each.

1. Write short notes on the following:

   a) Instalment purchase system.
   b) Interest Suspense Method.

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Problems

1. Vasakha Vans Ltd. sold a mini delivery van to Raju & Sons on instalment purchase system accepting an immediate payment of Rs. 10,000 against the cash price of Rs. 32,215. Raju & sons further paid Rs. 10,000 each at the end of 1st year, 2nd year and 3rd year for three years. Interest was charged at $16\frac{2}{3}$ per cent per annum.

   Raju & Sons provide depreciation on the reducing balance method @ 20% p.a.

   Prepare Vasakha Vans Ltd. interest suspense a/c for three years in the books of Raju & Sons. Also prepare Raju & Sons account and Interest Suspense A/c in the books of Vendors. (Interest Rs. 3,703; 2,653; 1,429).

2. Velbeing Enterprises Ltd. purchased three scooters for official use from New Auto Product Ltd. on instalment purchase system and make a cash down payment of Rs. 5,000. The balance amount is to be paid in five instalments of Rs. 5,000 each at the end of each year for 5 years. The cash price of the scooters is Rs. 23,000. Interest is chargeable @ 12% p.a. Velbeing Enterprises Ltd. write off depreciation @ 10% on straight line method.

   Journalise these transactions in the books of both the parties for the first two years.

   (Total interest Rs. 7,000; 1st year Rs. 2,160; 2nd Year Rs. 1,819).

Maruti Transports purchased a truck on instalment purchase system from Safe speeds Ltd. on 1-1-1980. The cash price was Rs. 1,21,850 and down payment Rs. 21,850. The balance was payable in 4 instalments of Rs. 25,000 each plus an annual interest @ 12% p.a. at the end of 1980, 1981, 1982 and 1983. Maruti Transports provide depreciation @ 20% on W.D.V.

Prepare ledger accounts.

(I instalment Rs. 37,000; II 34,000; III 31,000 and IV 28,000 Total interest Rs. 30,000; H.P. Price Rs. 1,51,850).

RECOMMENDED BOOKS

Gupta, R.L : Advanced Accountancy, Sultan Chand & Sons, New Delhi.

Shukla, M.C. & Grewal, T.S : Advanced Accounts, S. Chand & Co. Ltd., New Delhi.

Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

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ADVANCED ACCOUNTS

BLOCKS : V - VIII

BRAOU

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Hyderabad
1993.

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Dr. B.R. Ambedkar Open University
Hyderabad.

First Publsihed 1986
Revised in 1991
Re-print in 1993
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Printed at Chary & Company, 9-4-9, Charles Street, Secunderabad – 500 025.

PREFACE

This book deals with the topics in 'Advanced Accounts' included in the syllabus for the Third Year of B.Com., course offered by the Andhra Pradesh Open University. These topics generally cover the core area of the subject to be studied in the third year of the three year degree course in commerce. The syllabus for the sake of convenience is divided into blocks, each of which comprises a number of units. Each block generally covers a specific area of the subject. The Units are prepared by specialists in accordance with a format so designed as to enable the student to read and understand them without much difficulty. Each unit begins with a statement of its objectives followed by synopsis. And at the end of each unit assignment intended to test the student's comprehension of its subject matter is given. Technical terms with which the student may not be familiar are given at the end of each unit under the head 'Glossary'.

The purpose of introducing this course is to ensure that the student on graduating from the University will have acquired adequate knowledge in Accounting matters of the Business and Non-Business concerns. This book covers units from 11 to 26.

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BLOCK-V : PARTNERSHIP ACCOUNTS

UNIT-11 : PARTNERSHIP ACCOUNTS-AN INTRODUCTION

Contents

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11.0 AIMS AND OBJECTIVES

Preparation of partnership accounts involves the observance of certain rules, legal provisions and adjustments. This unit is designed to familiarise you with such rules, provisions, etc.

After going through this unit, you should be able to :

- define the term partnership
- list out the features and characteristics of partnership
- explain the contents of partnership deed
- recognise the rules applicable in the absence of agreement among the partners
- distinguish between partnership and co-ownership.

11.1 INTRODUCTION

It is the common experience of businessmen that the combination of more than one person in business, brings out better and more efficient results. In addition, a person who has the ability and experience but does not have the required money can join with person(s) who can bring in the necessary money. Thus, when two or more persons combine their skill and property in a venture and agree to share the results, it is referred to as Partnership. While in a sole trading concern, one person is the owner in a partnership concern two or more persons share the ownership. The limitations of sole trader to a large extent, are overcome in partnership type of business.

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11.2 DEFINITION - ESSENTIAL FEATURES - CHARACTERISTICS

Partnership in India is governed by the Indian Partnership Act, 1932. Section 4 of the Act defines a partnership as 'the relation between persons who have agreed to share the profits of the business carried on by all or any of them acting for all'. Individually they are called 'Partners' and collectively it is called a 'Firm'.

According to the above definition the following are the essential features of a partnership.

a. Number of Persons : In order to constitute a partnership firm there should be atleast two persons. (The maximum number is twenty and if the business is that of banking it must not exceed ten. If the number exceeds this limit the partnership becomes illegal).

b. Agreement : It is necessary that there should be an agreement between the partners.

c. Activity : The partners have to join to carry on some business.

d. Profits : They must agree to share the profits (or losses, as the case may be). It cannot be called as partnership, if the profits are not shared.

e. Management : The firm can be managed by all the partners or any of them on behalf of all.

The characteristics of partnership are as follows :

i. The law treats the partners and the firm as one. They are not legally separate. If a partner dies, the firm gets dissolved. Each partner can enter into contracts on behalf of the firm and each of them can be sued for the debts of the firm.

ii. The liability of the partners is both joint and several and unlimited. If the firm's assets are not sufficient enough to pay of its debts, the remaining amount can be recovered from any or all of the partners. (There is provision for partners with limited liability, but there should be atleast one partner with unlimited liability).

iii. No partner can retire from the firm without the consent of the remaining partners.

11.3 PARTNERSHIP DEED

A partnership is the outcome of an agreement between the partners. Such an agreement may be made simply by word of mouth (oral); or implied by the conduct of the persons; or in writing. Though verbal or implied agreement may be quite sufficient to evidence the existence it is always advisable to have a written agreement, so that, in case of any dispute, it may readily be referred to.

The document which contains the terms and conditions of the agreement for the conduct of the business is called 'Partnership Deed'. The terms and conditions are inserted in the Deed in the form of clauses. As the accounts of the partnership are to be prepared strictly in accordance with the agreement, the usual accounting clauses which should find a place in the Deed are as follows :

a. The capital of the firm and the proportion in which it is to be contributed by the partners.

b. The ratio of sharing profits and losses.

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c. Whether the capital accounts are 'FIXED' or 'FLUCTUATING'?

d. Whether interest is to be allowed on capital and charged on drawings and if so, at what rate?

e. The amount each partner can be allowed to draw, in anticipation of profits.

f. Amount of salaries, if any, payable to partnmers.

g. Preparation and authenticating the annual accounts.

h. The method of ascertaining the partner's share in the event of death/retirement.

i. The method of ascertaining the value of goodwill of the firm

j. Whether any interest is to be paid to the partner, if amount is advanced in addition to capital; and if so, at what rate?

k. How the accounts are to be settled in case of insolvency of a partner?

l. Provision for arbitration clause in case of dispute between partners.

In addition to the above, the deed can contain provisions for smooth conduct of the business. In most respects, the partners may make whatever arrangements they like for the conduct of the business, and also in respect of the adjustment of their mutual rights and interests. However, where there is no agreement, the whole of the Indian Partnership Act applies, but only certain provisions thereof apply to a firm having an ageement.

11.4 RULES APPLICABLE IN THE ABSENCE OF AGREEMENT

Where there is no specific agreement between the partners-written, verbal, express or implied - the relations of partners are determined by the following rules, as per the Partnership Act:

i. Partners share profits/losses equally;

ii. Interst on capital is not allowed and similarly no interest is charged on drawings;

iii. Partners are not entitled for any salary or remunerations;

iv. Partners giving loans to the firm are entitled to interest at 6 per cent per annum;

v. The partnership books are to be kept at the place of business and every partner will have access besides the right to inspect and copy any of them.

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Illustration - 1

Balram and Krishna commenced partnership business on 1st Jan. 1985. There is no partnership agreement between them. Balram contributed Rs.80,000 and Krishna Rs.20,000 as capital. Balram also advanced the firm Rs.40,000 on 1st July, 1985.Balram was hospitalized for 3 months and could not attend to the business during this period. For the year ended December 31, 1985, the firm's profits amounted to Rs.51,200. Balram claimed that the profits should be distributed in proportiont to the capital contributed; and he should be paid 12% interest on loan. Krishna claimed that the profits should be distributed equally and he should be paid special remuneration of Rs.5,000 for looking after the business entirely, when Balram was hospitalized.

You are required to distribute the profits as per law, giving reasons to the claims of partners.

Solution

In the absence of any specific agreement between the partners, as per the Partnership Act, 1932 :

a. the profits are to be shared by Balram and Krishna equally;

b. Balram is entitled to 6% interest on the loan;

c. Krishna is not entitled for any remuneration :

The profits are distributed as follows :

	Rs.
Profits as ascertained	51,200
Less : Interest on Balram's loan of Rs. 40,000 at the rate of 6% for 6 months.	1,200
Net Profit	50,000
Balram's share	25,000
Krishna's share	25,000

Check Your Progress - I

1. What are the rules applicable in the absence of agreement among the partners?

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11.5 PARTNERSHIP AND CO-OWNERSHIP

It was stated earlier that in the case of a partnership firm, there will be two or more owners. But partners are different from Co-owners as follows:

i. Partnership is necessary the result of an agreement while co-ownership may not. They may be legal co-heirs.

ii. Partners share profits of a business. The co-owners share the income, if any, from the asset owned.

iii. A co-owner can demand partition in the property but a partner cannot demand partition of the firm's property.

iv. A co-owner can transfer his interest in the property without the consent of others but in a partnership firm, partners cannot transfer their interests freely.

v. Each partner acts as agent of other partners but a co-owner does not.

11.6 REGISTRATION OF FIRMS

According to the Partnership Act, it is not compulsory for the partnership firms to get registered, though the Act contains a provision for registration. But if the firm is not registed :-

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a. the firm cannot file a suit against third parties: and

b. no partner can file a suit against the firm or other partners of the firm. Hence, it is desirable to get the firm registered under Partnership Act.

11.7 USUAL ADJUSTMENTS IN PARTNERSHIP ACCOUNTS

Interest on Capital : Where there is agreement between the partners, interest on capital at the agreed rate can be paid, but only, out of profits of the firm. Interest on partners' capitals is paid with a view to maintain equity inter-se. It is possible the partners may contribute unequal amounts towards capital but have agreed to share profits equally. It is also possible that partners may share profits unequally, but contribute equally to the capital of the firm. In such cases in order to protect the interest of the partners, so that do not stand to lose, interest on capital can be allowed.

Interest on Drawings : Drawings are made by the partners in anticipation of profits, which accrue throughout the period. If the partnership agreement permits, interest can be charged on their drawings. This is also done in order to adjust their rights inter-se. For example, the partners may contribute the capital equally and share profits equally, but may draw unequal amounts from the firm. Those who draw smaller amounts stand to lose compared to those who draw larger sums.

Remuneration to Partners : According to Section 12(b) of the Partnership Act every partner is bound to attend diligently to his duites in the conduct of the business. As per Section 13(a), no partner is entitled to receive remuneration for taking part in the business. However, it may become necessary to pay remuneration to those partners who devote their full attention to the business, while others do not. Hence, if the partners agree mutually, some of them can be be paid salary.

In view of the above, the net profit, as may be arrived at, cannot straight away be transferred to capital accounts of the partners. It requires further adjustment towards interest on Capitals, Partners' salaries and Interest on Drawings. Such an adjustment can be made in the P & L Account itself. Alternatively, the net profit in the P & L Account can be transferred to P & L Appropriation Account, necessary adjustments can be made there at and then the profit divided among the members.

The following illustrations will explain the adjustments.

Illustration - 2

Kamal and Vimal entered into partnership on 1st January 1985 contributing Rs.60,000 and Rs.45,000 respectively. They agreed to share profits and losses in 3:2 ratio. Vimal is entitled to a salary of Rs.2,000 p.m. Partners are entitled to interest on capital at 6% per annum.

During the year Kamal and Vimal withdraw Rs.5,000 and Rs.4,000 respectively and the interest on the same amounted to Rs.250 and Rs.200 respectively. For the year 1985, the profits before the above adjustments amounted to Rs.13,000 Show the distribution of profits among the partners.

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Solution

Profit and Loss Appropriation Account
for the year ended 31st December, 1985.

Dr. Cr.

		Rs.			Rs.
To Interest on capital:			By P & L A/c. (N.P)		13,000
			By Interest on Drawings:		
Kamal	3,600		Kamal	250	
Vimal	2,700		Vimal	200	
		6,300			450
To Partners' Salaries:					
Vimal		2,000			
To Capital A/c.:					
Kamal N/P 3/5	3,090				
Vimal N/P 2/5	2,060				
		5,150			
		13,450			13,450

Illustration - 3

Raja, Rama and Ravi are in partnership and on 1.10.1984, their capital stood at Rs.50,000, Rs.40,000, and Rs.45,000 respectively. Raja and Ravi are entitled to draw for the year a salary of Rs.5,000 and Rs.4,500 respectively. All the partners ar entitled for interest on Capital at 8% p.a. No interest is charged on drawings. Their drawings amounted to Rs.4,000 each. Of the net profits, Rs.9,000 is shared by the partners in the ratio of 40:30:20 respectively and the remaining net profits are shared equally.

For the year ended 30th Sept. 1985, the profits after charging interest on capital but before debiting partner's salaries amounted to Rs.30,500. Show the distribution of net profits among the partners.

Solution

Profit and Loss Appropriation Account
for the year ended 31st December, 1985.

		Rs.		Rs.
To Partner's Salaries:			By Profit b/f.	30,500
Raja	5,000			
Ravi	4,500			
		9,500		
To Capital A/c. (NP trd):				
Raja	8,000			
Rama	7,000			
Ravi	6,000			
		21,000		
		30,500		30,500

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Amount of profits to be distributed equally, is arrived at as follows :

Rs. 21,000–Rs. 9,000 = Rs. 12,000		
Raja's profit 40/90 × 9,000 =	4,000 + 1/3 of Rs. 12,000 =	Rs. 4,000
Rama's profit 30/90 × 9,000 =	3,000 + 1/3 of Rs. 12,000 =	Rs. 4,000
Ravi's profit 20/90 × 9,000 =	2,000 + 1/3 of Rs. 12,000 =	Rs. 4,000
	9,000	Rs. 12,000

Interest on Drawings : The interest on drawings has to be charged according to the time that elapses between the date of drawing and the end of the year. If the dates on which amounts are drawn are not available, interest can be charged on the whole amount for half of the accounting period (i.e., if the accounts are drawn up of an year, interest is charged for 6 months) on the assumption that the money was drawn evenly throughout the year.

Illustration - 4

Rakesh, a partner has drawn the following sums of money :

	Rs.
28th Feb. 1980	500
31st March 1985	400
30th June 1985	600
31st Oct. 1985	800

Accounts are drawn up on 31st December every year. Interest on drawings is to be charged at 6% p.a. Ascertain the interest.

Solution

On Rs. 500, interest is to be charged for 10 months i.e. 500 × 10/12 × 6/100 =	25
On Rs. 400, interest is to be charged for 9 months i.e. 400 × 9/12 × 6/100 =	18
On Rs. 600, interest is to be charged for 6 months i.e. 600 × 6/12 × 6/100 =	18
On Rs. 800, interest is to be charged for 2 months i.e. 800 × 2/12 × 6/100 =	8
Total interest on Drawings	69

Alternatively, it can also be calculated on product method as follows :

Amount	*Months*	*Product*
Rs.		
500	10	5,000
400	9	3,600
600	6	3,600
800	2	1,600
		13,800

Interest on the product of 13,800 for one month $= 13{,}000 \times \frac{1}{12} \times \frac{6}{100}$

$= \text{Rs. } 69$

It can also be calculated by finding out an average drawing date.

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Check Your Progress - 2

1. What is the logic behind the calculation of interest on capital and drawings?

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Adjustments for the past : Sometimes the partners may be paid their salaries, interest on capital etc., wrongly. Such errors may be discovered at a later date i.e., after the net profits have been distributed. That requires rectification. It is necessary to find out what is the excess amount credited or debited so that it can be adjusted now.

The following illustration makes the things clear :

Illustration - 5

The accounts of the partnership firm of Satyam, Shivam and Sundaram for the calendar year 1984 and 1985 were already drawn up and closed. It is now dscovered that there is no provision for payment of interest on capital as per the partnership agreement, but the partners have been allowed interest on capital at 5% for 1984, and 1985 which amounted to as follows :

	1984	*1985*
	Rs.	*Rs.*
Satyam	700	720
Shivam	400	420
Ssundaram	220	220

The partners shared profits and losses in 2:2:1 ratio. Ascertain the amount to be adjusted to rectify the error.

Solution

Statement showing the adjustment

Year	Partner	Interest allowed	Interest allowed amount, now distributed as profit	adjustment required for the year	Tot amount to b adjuste
		Rs.	Rs.	Rs.	R
1984	Satyam	700	528	–172	
	Shivam	400	528	+128	
	Sundaram	220	264	+ 44	
		1,320	1,320		
1985	Satyam	720	544	–176	-3
	Shivam	420	544	+124	-3
	Sundaram	220	272	+52	
		1,360	1,360		

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The journal entries required to be passed for partners' salaries, interest on capital, interest on drawings, etc., are given in the next unit.

Partnership Accounts

There is no fundamental difference betwee the accounts of a Sole Trader and that of a partnership. The transactions are recorded in the usual manner. However, it becomes necessary to maintain personal accounts of the partners seperately for each.

At the end of the period the final accounts of the firm are drawn up in the same manner as they are drawn up for a sole trader concern. However, profits & losses have to be distributed among all the partners.

This is explained in the following unit.

11.8 SUMMING UP

When two or more persons combine their skill and property in a venture and agree to share the results, it is referred to as partnership. Individually they are called 'Partners' and collectively called a 'Firm'. The agreement between the partners may be oral, implied or written. It is always advisable to have a written agreement, known as 'partnership Deed', so that in case of any dispute, it may readily be referred to. The accounts of the partnership are to be prepared in accordance with the agreement.

Partnership in India is governed by partnership Act, 1932. Where there is no specific agreement between the partners, the relations of partners are determined by the provisions of the partnership Act. It is desirabel to get the firm registered under the partnership Act.

There is no fundamental difference between the accounts of a Sole Trader and that of a partnership. The transactions are recorded in the usual manner. However, it becomes necessary to maintain personal accounts of the partners separately. Certain adjustments may also have to be made in regard to interest on capital, interest on drawings, remuneration to partners, etc.

11.9 CHECK YOUR PROGRESS : MODEL ANSWERS

1. i) All the partners should share profits and losses equally.

   ii) Interest on capital is not allowed and in the same manner interest on drawings is not charged.

   iii) No partner is entitled for salary or commission.

   iv) Partners who advance loans to the firm are entitled to receive interest at 6% p.a.

   v) All the partners are entitled for examining the books of accounts and take a copy of them.

2. Sometimes, partners may bring in unequal capitals but agree to share profits and losses equally. In such a case, the partners who contribute more capital will gain nothing for the excess capital contributed over and above their respective share. Therefore, in order to maintain equity among the partners, interest on capital is allowed.

Likewise, interest on drawings is charged so as to bring about an equity between the partners drawing more amounts and the partners drawing less amounts.

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11.10 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines each.

1. What is Partnership? What are the usual adjustiments in partnership accounts ?
2. State the provisions of partnership Act to be followed when the partnership agreement is silent.

B. Answer the following in 15 lines each.

1. What are the contents of Partnership deed ?
2. Define partnership and explain its main features.
3. Distingush between Partnership and Co-ownership.

11.11 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C & Grewal, T.S : Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

11.12 GLOSSARY

Firm : Partnership Comprising of some Partners.

Partner : A person sharing the profits and losses of the Partnership firm.

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

Partnership Deed : Document containing the terms and conditions of the agreement between partners to carry on the partnership business.

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UNIT-12 : METHODS OF MAINTAINING CAPITAL ACCOUNTS

Contents

12.0 Aims and Objectives
12.1 Introduction
12.2 Partner's Capital Accounts
12.3 Fluctuating Capital
12.4 Fixed Capital
12.5 Summing Up
12.6 Check Your Progress : Model Ansers
12.7 Model Examination Questions
12.8 Recommended Books
12.9 Glossary

12.0 AIMS AND OBJECTIVES

The aims of this unit are to explain the methods of preparing capital accounts of partners.

After reading this unit, you should be able to:

- Prepare the capital accounts of partners under fluctuating capital method,
- Prepare the capital accounts of partners under fixed capital method.

12.1 INTRODUCTION

We all know that, in partnership, there will be more than two partners. These partners, generally, contribute capital and withdraw, now and then, amounts for their personal requirements in anticipation of profits to be made in near future. The capitals of partners are subject to adjustments, when there are items like profit or loss, interest on capital, interest on drawings, etc. If all these adjustments are shown separately for each partner in the Balance Sheet itself, the Balance Sheet may run into several pages. To avoid this inconvenience, capital accounts are prepared separately for each partner. Let us learn, in this unit, how the capital accounts are to be prepared.

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12.2 PARTNER'S CAPITAL ACCOUNTS

In the case of a sole trading concern, the required capital is brought in by the Sole Trader. In the case of partnership firm, the capital is brought in by the partners. However, it is not necessary that every partner must bring in the capital. It is also not necessary that they must bring in equal amounts. Capital can be contributed by the partners either in the form of cash or in the shape of assets. The total capital of the firm can be increased by further contributions or reduced by withdrawals, later, by mutual consent. There will be as many capital accounts as there are partners. In addition, separate drawings accounts can be maintained for each partner. In certain cases, in addition to a captial account and a drawing account, a current account is also maintained for each partner. This current account will be credited with all incomes of the partner and debited with all expenses incurred on behalf of the partner. At the time of closing the books and preparing the final accounts, we must ascertain the method of maintaining the Capital Accounts, so that the drawing account is closed by transfer and balances arrived at.

There are two methods of maintaining the Capital Accounts. They are: (1) *Floating or Fluctuating Capital Method* and (2) *Fixed Capital Method.*

12.3 FLOATING OR FLUCTUATING CAPITAL

Under this method a Capital Account is kept for each partner, in which are recorded all the transactions relating to the amount of capital contributed, interest on capital, drawings, interest on drawings, salary of the partner and share of profit or loss; and the balance of which appears in the Balance Sheet. Since all these entries are passed through Capital Account, the capital at the end of the period will not be the same what it was at the beginning of the period. Thus, under this method the capital will be fluctuating from one period to the other.

12.4 FIXED CAPITAL

Some firms, however, prefer to continue to show in the Capital Accounts, only the capital amount contributed by the partner. In such a case, entries are passed in the Capital Account only when capital is brought in or withdrawn. All other items like Drawings, Interest on drawings, Interest on capital, Salary of the partner etc., are recorded in the Current Account or "Drawings Account". Balances of both Capital Account and Current Account are shown in the Balance Sheet. Since the Capital Account shows a constant figure (unless additional capital is introduced or existing capital is withdrawn), this method is known as Fixed Capital Method.

JOURNAL ENTRIES

The following are the journal entries passed under both the above methods for recording various transactions:

Transaction	*Fluctuation capital method*	*Fixed capital method*
1. Capital contributed: a) in cash	Bank A/c. Dr. To Partner's Capital A/c.	Bank A/c. Dr. To Partner's Capital A/c.
b) in kind	Concerned property A/c. Dr. To Partner's Capital A/c.	Concerned property A/c. Dr. To Partner's Capital A/c.
2. Interest on Capital :	Interest on Capital A/c. Dr. To Partner's Capital A/c.	Interest on Capital A/c. Dr. To Partner's Current A/c.
3. Salary or Commision payable to Partner	Partner's Salaries A/c. Dr. or Partner's Commision A/c. Dr. To Partner's Capital A/c.	Partner's Salaries A/c. Dr. or Partner's Commission A/c. Dr. To Partner's Current A/c.
4. For Drawings: i) in cash	Partner's Drawings A/c. Dr. To Bank A/c.	*Partner's Drawings A/c. Dr. or Partner's Current A/c. Dr. To Bank A/c.

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ii) in goods	Partner's Drawings A/c. Dr. To Purchases A/c.	*Partner's Drawings A/c. Dr. or Partner's Current A/c. Dr. To Purchases A/c.

* Where partner's drawings A/c. is debited it later transferred to Partner's Current Account.

5. For Interest on Drawings	Partner's Capital A/c. Dr. To Interest on Drawings A/c.	Partner's Current A/c. Dr. To Interest on Drawings A/c.
6. For distributing Profit	P & L A/c. Dr. or P & L Appro. A/c. Dr. To Partner's Capital A/c.	P & L A/c. Dr. or P & L Appro. A/c. Dr. To Partner's Current A/c.
7. For sharing the loss	Partner's Capital A/c. Dr. To P & L A/c. or To P & L Appro. A/c.	Partner's Current A/c. Dr. To P & L A/c. or To P & L Appro. A/c.

Both the methods of maintaining the capital accounts are explained in the following illustration:

Illustration - 1

Sham and Madhu entered into a partnership. On 1st Jan. 85 their capitals were Rs. 1,52,000 and Rs. 32,000 respectively. For the six months ended 30th June 85, they made a profit of Rs. 42,800 before allowing 5% p.a. interest on capitals and Rs. 6,000 as salary to Madhu. Sham drew Rs. 24,800 and Madhu Rs. 14,000 as Drawings.

The profits were shared by Sham and Madhu in 4:1 ratio. Prepare the Profit and Loss Appropriation Account and the accounts of the partners as on 30th June 85, both under (a) Fluctuating Capital Method and (b) Fixed Capital Method.

Solution

a) Fluctuating Capital Method

Dr. **Profit & Loss Appropriation Account for the half year ended 30th June 1985** Cr.

		Rs.		Rs.
To Interest on Capital:			By P & L A/c. (N.P. b/f)	42,800
Sham	3,800			
Madhu	800			
		4,600		
To Partner's Salary:				
Madhu		6,000		
" Sham's Capital A/c. 4/5 N.P.	25,760			
" Madhu's Capital A/c. 1/5 N.P.	6,400			
		32,200		
		42,800		42,800

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Sham's Capital A/c.

Dr.	Rs.		Rs.	Cr.
To Drawings	24,800	By Balance b/f.	1,52,000	
To Balance c/d.	1,56,760	By Interest on capital	3,800	
		By P & L Appropriation A/c. 4/5 N.P.	25,760	
	1,81,560		1,81,560	
		By Balance b/d.	1,56,760	

Madhu's Capital A/c.

Dr.	Rs.		Rs.	Cr.
To Drawings	14,000	By Balance b/f.	32,000	
To Balance c/d.	31,240	By Interest on capital	800	
		By Partner's Salary	6,000	
		By P & L Appropriation A/c. 1/5 N.P.	6,440	
	45,240		45,240	
		By Balance b/d.	31,240	

b) Fixed Capital Method

Profit & Loss Appropriation Account

for the half year ended 30th June 1985

Dr.		Rs.		Rs.	Cr.
To Interest on Capital:			By P & L A/c. (N.P. b/f)	42,800	
Sham	3,800				
Madhu	800				
		4,600			
To Partner's Salary:					
Madhu		6,000			
Sham's current A/c. 4/5 N.P.	25,760				
Madhu's Current A/c. 1/5 N.P.	6,400				
		32,200			
		42,800		42,800	

Sham's Capital A/c.

Dr.	Rs.		Rs.	Cr.
To Balance c/d.	1,52,000	By Balance b/f.	1,52,000	
	1,52,000		1,52,000	
		By Balance b/d.	1,52,000	

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Dr. **Madhu's Capital A/c.** Cr.

	Rs.		Rs.
To Balance c/d.	32,000	By Balance b/f.	32,000
	32,000		32,000
		By Balance b/d.	32,000

Dr. **Sham's Current A/c.** Cr.

	Rs.		Rs.
To Drawings	24,800	By Interest on capital	3,800
To Balance c/d.	4,760	By P & L Appropriation A/c. 4/5 N.P.	25,760
	29,560		29,560
		By Balance b/d.	4,760

Dr. **Madhu's Current A/c.** Cr

	Rs.		Rs.
To Drawings	14,000	By Interest on capital	800
		By Partner's salary a/c.	6,000
		By P & L Appropriation A/c. 1/5 N.P.	6,440
		By Balance c/d.	760
	14,000		14,000

Check Your Progress - I

(a) Distinguish between Fluctuating Capital Method and Fixed Capital Method.

.....

.....

.....

.....

(b) What is the journal entry under fixed capital method, when a partner draws cash from the business?

.....

.....

.....

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Illustration - 2

On 1st Jan. 1985 Ajay and Bhaskar entered into partnership to share profits and losses in the ratio of 3:2. They have contributed Rs. 50,000 and Rs. 40,000 respectively, towards the capital of the firm. As per the partnership deed, interest is to be allowed on Capitals at 6% per annum and 5% interest is to be charged on drawings. Ajay is entitled to a salary of Rs. 6,000 p.a. The partner's drawings during 1985 were as follows:

	Ajay	Bhaskar
March 31, 1985	Rs. 2,000	Rs. 1,200
June 30, 1985	Rs. 3,000	Rs. 2,000
Sept. 30, 1985	Rs. 2,000	Rs. 1,600
Dec. 31, 1985	Rs. 2,400	Rs. 1,800

During the year 1985, the firm made a profit of Rs. 61,110/- before making the above adjustments. Show the P & L Appropriation A/c. and partner's accounts both under Fluctuating Capital and Fixed Capital Methods. Show also how the relevant items appear in the Balance Sheet as on 31st December, 1985.

Solution

Calculation of Interest on Drawings of Ajay

Date	Amount	Months to Dec. 31	Product (Amount × Months)
	Rs.		
March 31, 1985	2,000	9	18,000
June 30, 1985	3,000	6	18,000
Sept. 30, 1985	2,000	3	6,000
Dec. 31, 1985	2,400	0	0
		Total	42,000

$$\text{Interest} = 42{,}000 \times \frac{1}{12} \times \frac{5}{100} = \text{Rs. } 175/-.$$

Calculation of Interest on Drawings of Bhaskar

Date	Amount	Months upto Dec. 31	Product (Amount × Months)
	Rs.		
March 31, 1985	1,200	9	10,800
June 30, 1985	2,000	6	12,000
Sept. 30, 1985	1,600	3	4,800
Dec. 31, 1985	1,800	0	0
		Total	27,600

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Interest = $27,600 \times \frac{1}{12} \times \frac{5}{100}$ = Rs.115/-.

a) Fluctuating Capital Method

Profit & Loss Appropriation Account
for the year ended 31st December 1985

Dr. Cr.

		Rs.			Rs.
To Interest on Capital:			By P & L A/c. (N.P. b/f)		61,110
Ajay	3,000		By Interest on Drawings		
Bhaskar	2,400		Ajay	175	
		5,400	Bhaskar	115	
					290
To Partner's Salary:					
Ajay		6,000			
" Ajay capital A/c.					
3/5 N.P.	30,000				
" Bhaskar capital A/c.					
2/5 N.P.	20,000				
		50,000			
		61,400			61,400

Dr. **Ajay's Capital A/c.** Cr.

	Rs.		Rs.
To Drawings	9,400	By Bank	50,000
To Interest on Drawings	175	By Partner's salary	6,000
To Balance c/d.	79,425	By Interest on capital A/c.	3,000
		To P & L Appropriation A/c. 3/5 N.P.	30,000
	89,000		89,000
		By Balance b/d.	79,425

Dr. **Bhaskar's Capital A/c.** Cr.

	Rs.		Rs.
To Drawings	6,600	By Bank	40,000
To Interest on Drawings	115	By Interest on capital	2,400
To Balance c/d.	55,685	By P & L Appropriation A/c. 2/5 N.P.	20,000
	62,400		62,400
		By Balance b/d.	55,685

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Balance Sheet as on Dec. 31, 1985

Liabilities		Rs.	Rs.	Assets
Ajay's Capital A/c.:				
Amount introduced		50,000		
Add: Salary		6,000		
Interest on capital		3,000		
3/5 N.P.		30,000		
		89,000		
Less: Drawings	9,400			
Interest on drawings	175	9,575	79,425	
Bhaskar's Capital A/c.:				
Amount introduced		40,000		
Add: Interest on capital		2,400		
2/5 Net Profit		20,000		
		62,400		
Less: Drawings	6,600			
Interest on drawings	115	6,715	55,685	

b) Fixed Capital Method

Profit & Loss Appropriation Account
for the year ended 31st December 1985

Dr. Cr.

		Rs.		Rs.
To Interest on Capital:			By P & L A/c. (N.P. b/f)	61,110
			By Interest on Drawings	
Ajay	3,000		Ajay 175	
Bhaskar	2,400		Bhaskar 115	
		5,400		290
To Partner's Salary:				
Ajay		6,000		
" Ajay's current A/c.				
3/5 N.P.	30,000			
" Bhaskar's current A/c.				
2/5 N.P.	20,000			
		50,000		
		61,400		61,400

Ajay's Capital A/c.

Dr. Cr.

	Rs.		Rs.
1985		1985	
Dec. 31 To Balance c/d.	50,000	Jan. 1 By Bank	50,000
	50,000		50,000
		1986	
		Jan. 1 By Balance b/d.	50,000

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Dr. Bhaskar's Capital A/c. Cr.

	Rs.		Rs.
1985		1985	
Dec. 31 To Balance c/d.	40,000	Jan. 1 By Bank	40,000
	40,000		40,000
		1986	
		Jan. 1 By Balance b/d.	40,000

Dr. Ajay's Current A/c. Cr.

	Rs.		Rs.
To Drawings	9,400	By Parnter's Salary	6,000
To Interest on Drawings	175	By Interest on capital	3,000
To Balance c/d.	29,425	By P & L Appropriation A/c. 3/5 N.P.	30,000
	39,000		39,000
		By Balance b/d.	29,425

Dr. Bhaskar's Current A/c. Cr.

	Rs.		Rs.
To Drawings	6,600	By Interest on capital	2,400
To Interest on Drawings	115	By P & L Appropriation A/c. 2/5 N.P.	20,000
To Balance c/d.	15,565		
	22,400		22,400
		By Balance b/d.	15,685

Balance Sheet as on Dec. 31, 1985

Liabilities		Rs.	Rs.	Assets
Capital Accounts:				
Ajay		50,000		
Bhaskar		40,000		
			90,000	
Ajay's Current A/c.:				
Salary		6,000		
Interest on capital		3,000		
3/5 N.P.		30,000		
		39,000		
Less: Drawings	9,400			
Interest on drawings	175	9,575	29,425	
Bhaskar's Capital A/c.:				
Interest on capital		2,400		
2/5 N.P.		20,000		
		22,400		
Less: Drawings	6,600			
Interest on drawings	115	6,715	15,685	

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Note: We have given the details of Capital Accounts of partners in the Balance Sheet. However, it is not necessary to give details when Capital Accounts are prepared.

12.5 SUMMING UP

There are two methods of maintaining the capital accounts viz., Floating or Fluctuating Capital Method and Fixed Capital Method. Under the floating capital method a Capital Account is kept for each partner and the capital will be fluctuating from one period to the other. Under the Fixed Capital Method Capital Account as well as Current Accounts of the partners are maintained. Capital Accounts show the amount of the capital contributed by the partners. Current Accounts show other items like drawings, interest on capital, etc. The balances of both the accounts are shown in the Balance Sheet.

12.6 CHECK YOUR PROGRESS : MODEL ANSWERS

1. (a) Under fluctuating capital method, a capital account is kept for each partner and in that all the transactions relating to the concerned partner are recorded. Under fixed capital method, there will be two accounts for each partner viz., capital account and current account. The capital account contains only the entries relating to capital brought in and capital withdrawn. All other items are entered in current account.

   (b) Concerned Partner's Drawings account Dr.
   To Bank A/c.

Note: The total drawings account is transferred to current account subsequently. If there is only one transaction of drawings, it can be straight away debited to current account.

12.7 MODEL EXAMINATION QUESTIONS

A . Answer the following in 30 lines.

1. Explain how the accounts are maintained under Fixed Capital Method and Fluctuating Capital Method.

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Problems

1. On 31st December 1985, the capital accounts of Amal & Bimal stood at Rs. 80,000 and Rs. 60,000 respectively, after necessary adjustments in respect of drawings and net profits for 1985. It was subsequently ascertained that interest on capitals and drawings at 5% p.a. was not taken into account. During the year Amal withdrew Rs. 2,400 at the end of each quarter and Bimal withdrew Rs. 3,600 at the end of each half year. Amal and Bimal share profits in 3:2 ratio and the profits for 1985 as adjusted amounted to Rs. 40,000. Show the adjustments required in the capital accounts.

   (Answers Interest on capital - Amal: Rs. 3,280, Bimal: Rs. 2,560.
   Interest on drawings - Amal: Rs. 180, Bimal: Rs. 90.
   Balance in Capital A/c. - Amal: Rs. 79,758, Bimal: Rs. 60,242)

2. Charan and Bharan were sharing profits in the ratio of 3:1 in their partnership business. They were having an office manager, Mr. Karan, drawing a salary of Rs. 18,000 per annum. With effect from 1st July 1984, they decided to admit Mr. Karan into partership for a fifth share in the profits. Any excess of Karan's share over and above his salary and commission

(at 5% net profits after charging such commission) which he used to get previously is to be borne by Charan. For the year ended June 30, 1985 the profits of the firm (before charging Karan's salary and commission) amounted to Rs. 2,62,440. Show the final distribution of profits.

(Answer: Charan: Rs. 1,51,752, Bharan: Rs. 52,200, Karan: Rs. 52,488)

12.8 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C. & Grewal, T.S : Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

12.9 GLOSSARY

Fixed Capital : Balance in the capital account, which does not change unless additional capital is introduced or existing capital is withdrawn.

Final Accounts : Trading, Profit & Loss, Profit & Loss Appropriation Accounts, Balance Sheet of a bussiness concern.

Floating Capital or Fluctuating Capital : Balance in the capital account which fluctuates from one period to another, because of posting of all transactions like Interest on Capital, Drawings etc.

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UNIT-13 : FINAL ACCOUNTS OF THE PARTNERSHIP FIRM

Contents

13.0 Aims and Objectives
13.1 Introduction
13.2 Final Accounts of the Partnership Firm
13.3 Illustrations on Final Accounts
13.4 Summing Up
13.5 Model Examination Questions
13.6 Recommended Books

13.0 AIMS AND OBJECTIVES

The aim of this unit is to present the final accounts of partnership with various adjustments.

Having gone through this unit, you should be able to:

- identity the differences between the final accounts of sole trade and that of partnership.
- prepare the final accounts of partnership firm.

13.1 INTRODUCTION

In unit 12 we have seen how capital accounts of partners are prepared. In this unit we shall learn the preparation of final accounts of partnership firm with comprehensive illustrations. The final accounts of partnership firm include Trading and Profit and Loss Account, Profit and Loss Appriation Account and Balance Sheet. We shall see how these accounts are to be prepared.

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13.2 FINAL ACCOUNTS OF THE PARTNERSHIP FIRM

As already stated earlier, there is not much difference between the preparation of final accounts of a Sole Trading Concern and the Partnership Firm. Since there will be more than one owner in the firm, there will be as many capital accounts, drawings accounts, current accounts maintained separately. At the end of the year the drawings are adjusted to Capital account of the partner under the fluctuating capital method and to the current account of the partner under the fixed capital method.

Usually, the partnership deed may contain provisions for payment of salary, interest on capital, commission etc., to the Partners. These are credited to Capital Account or Current Account of the partner as the case may be, at the end of the year. In the same manner, interest on drawings may have to be charged to partner. This is debited to Capital Account or Current Account of the partner, at the end of the year.

The trading account and Profit and Loss Account of the firm are prepared on lines similar to the sole trading concern. The Profit arrived at is transferred to Profit & Loss Appropriation A/c, for taking into account the interest on capital, partners' salaries, Interest on drawings etc., and thereafter the net profit or net loss, distributed among the partners in the profit/loss sharing ratio. The net profit is credited to Partner's Capital Account (or Partner's Current A/c. as the case may be) and the net loss debited to Partner's Capital A/c. or Partner's Current A/c. as

the case may be. These adjustments are shown in the Balance Sheet, in the respective partner's capital or current accounts. We have already seen these aspects in the previous lesson.

We shall now see how these are drawn up under the Fluctuating Capital Method and Fixed Capital Method.

Illustration - 1

Ram agreed to take the Manager, Raghu into the Partership on 1st January 1985 on the following conditions:

a) Raghu, as manager of business, is to be credited with 10% of the net profits after charging interest on capital (at 5% to both the partners).

b) Each partner draws Rs. 120 per week on account of anticipated profits.

c) Profits & Loss are to be shared by Ram and Raghu in 2:1 ratio.

d) Excess of profits of Raghu are to be credited to his capital account.

On 31st December 1985 the following balances appeared in the firm's books:

	Rs.		Rs.
Ram's capital	1,20,000	Sales Returns	1,070
Ram's drawings	6,240	Sundry Creditors	85,440
Raghu's drawings	6,240	Sundry Debtors	93,600
Manufacturing charges	20,000	Cash at Bank	27,900
Trade Expenses	20,280	Carriage outwards	2,090
Wages	40,060	Sales	3,16,040
Bad debts	550	Purchases	1,86,030
Discount received	420	Building	31,000
Plant & Machinery	31,050	Salaries	12,500
Stock 1-1-85	26,200	Rent, Taxes and Insurance	3,900
Purchase Returns	2,810	Goodwill	10,000

You are required to prepare the Trading and Profit & Loss Account for the year ended 1985 and a balance sheet as on December 31, 1985, after taking into consideration the following:

a) Provide Rs. 570 for wages outstanding.
b) Provide 2.5% for doubtful debts.
c) Plant & Machinery is worth Rs. 29,000.
d) Unexpired Insurance amounted to Rs. 250.
e) Stock on hand at the end amounted to Rs. 49,120.

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Solution

Trading and Profit & Loss A/c.
for the year ended Dec. 31, 1985.

Dr. Cr.

		Rs.			Rs.
To Opening Stock		26,200	Rs. Sales	3,16,040	
To Purchases	1,86,030		Less: returns	1,070	
Less: returns	2,810				3,14,970
		1,83,220	By Closing stock		49,120
To Wages	46,060				
Add: Outstanding	570				
		46,630			
To Manufacturing expenses		20,000			
To Gross profit c/d.		88,040			
		3,64,090			3,64,090
To Trade expenses		20,280	By Gross Profit b/d		88,040
To Rent, Taxes &			By Discount received		420
Insurance	3,900				
Less: Prepaid	250				
		3,650			
To Salaries		12,500			
To Carriage outwards		2,090			
To Bad debts		550			
To Provision for doubtful debts		2,340			
To Depreciation on P & M.		2,050			
To Net Profit		45,000			
		88,460			88,460

Profit and Loss Appropriation Account
for the year ended Dec. 31, 1985.

	Rs.		Rs.
To Interest on Capital:		By P & L A/c. (N.P. b/d)	45,000
Ram	6,000		
To Raghu's commission*	3,900		
To Ram's capital A/c. 2/3 N.P.	23,400		
To Raghu's capital A/c. 1/3 N.P.	11,700		
	45,000		45,000

* Raghu's commission is calculated as follows:

Net Profit as per P & L A/c.	Rs. 45,000
Less: Interest on capital	6,000
Net Profit after charging interest on capital	39,000

10% of Rs. 39,000 = Rs. 3,900.

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Balance Sheet as on December 31, 1985

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Ram's capital	1,20,000		Goodwill		10,000
Add: Interest	6,000		Building		31,000
2/3 N.P.	23,400		Plant & Machinery	31,050	
	1,49,400		Less: Depreciation	2,050	
Less: Drawings	6,240				29,000
		1,43,160	Stock		49,120
Raghu's capital :			Sundry Debtors:	93,600	
1/3 N.P.	11,700		Less. Prov. for DD	2,340	
Add: Commission	3,900				91,260
	15,600		Unexpired insurance		250
Less: Drawings	6,240		Cash at Bank		27,900
		9,360			
Sundry creditors		85,440			
Outstanding wages		570			
		2,38,530			2,38,530

Illustration - 2

The following balances were extracted from the books of Ram Mohan & Co., as on 31st December 1985:

	Rs.		Rs.
Ram's capital	45,000	Sundry debtors	15,000
Mohan's capital	35,000	Purchases	1,30,000
Ram's current A/c.	5,000	Carriage outward	2,800
Mohan's current A/c.	5,000	Salesmen's commission	20,000
Furniture	8,000	Rent received	8,000
Free hold Building	1,20,000	Sales	1,60,000
Bad debts	800	Discount allowed	1,000
Creditors	10,000	Loan taken from Ram on 1.7.1985	40,000
Cash in hand	10,400	General expenses	7,050
Ram's drawings	5,000	Provision for doubtful debts	1,000
Mohan's drawings	4,000		
Bank Overdraft	15,050		

Prepare the Final Accounts and the Balance Sheet after taking into consideration the following:

1. Mohan is entitled for a salary of Rs. 6,000 p.a.
2. Partner's are entitled for interest in capital:
   Ram Rs. 3,000 Mohan Rs. 2,400
3. Interest on drawings is to be charged at 6% per annum.
4. Rent accrued due Rs. 1,000.
5. Closing stock Rs. 35,000.
6. Depreciation is to be written off from furniture at 10%.
7. Provision is to be made for doubtful debts at 3% on Debtors.

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Solution

Trading and Profit & Loss Account
for the year ended Dec. 31, 1985.

		Rs.			Rs.
To Purchases		1,30,000	By Sales		1,60,000
To Gross Profit c/d.		65,000	By Closing stock		35,000
		1,95,000			1,95,000
To General Expenses		7,050	By Gross Profit b/d.		65,000
To Salesman's Commission		20,000	By Rent received	8,000	
To Discount allowed		1,000	Add: Accrued due	1,000	
					9,000
To Carriage outward		2,800			
To Bad debts	800				
Add: Prov. for DD reqd.	450				
	1,250				
Less: existing provision for DD.	1,000				
		250			
To Depreciation of furniture at the rate of 10% on Rs. 8000		800			
To Interest on loan from at the rate of 6% on 40,000, half year		1,200			
Net profit c/d.		40,900			
		74,000			74,000

Profit and Loss Appropriation Account
for the year ended December 31, 1985

		Rs.			Rs.
To Partner's salary:			By Net Profit b/d.		40,900
Mohan		6,000	By Interest on Drawings:		
To interest on capital					
Ram	3,000		Ram	150	
Mohan	2,400		Mohan	120	
		5,400			270
To Ram's current a/c. 1/2 N.P.	14,885				
To Mohan's current a/c. 1/2 N.P.	14,885				
		29,770			
		41,170			41,170

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Balance Sheet as on Dec. 31, 1985

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Ram's Capital	45,000		Freehold Building		1,20,000
Mohan's Capital	35,000	80,000			
Ram's current a/c.			Furniture	8,000	
Balance 1.1.85	5,000		Less: Depreciation		
Add: Interest on capital	3,000		at the rate of 10%	800	7,200
1/2 N.P.	14,885		Stock on hand		35,000
	22,885		Sundry Debtors	15,000	
Less: Drawings 5,000			Less: Prov. for doubtful debts	450	14,550
Interest on drawings 150	5,150	7,735	Rent accrued due		1,000
Mohan's current a/c.			Cash in hand		10,400
Balance 1.1.85	5,000				
Add: Salary	6,000				
Interest on capital	2,400				
1/2 N.P.	14,885				
	28,285				
Less: Drawings 4,000					
Interest on Drawings 120	4,120	24,165			
Ram's loan	40,000				
Add: Interest accrued	1,200				
		41,200			
Bank overdraft		15,050			
Sundry creditors		10,000			
		1,88,150			1,80,150

13.3 ILLUSTRATIONS ON FINAL ACCOUNTS

So far, we have seen how final accounts of the Parternship firm are prepared both under Fixed Capital Method and Fluctuating Capital Method. The following illustrations will provide further guidance in attending to various adjustments.

Illustration - 3

Rajeswar and Venkateswar are in partnership as architects, sharing profits and losses equally. The partnership deed provides:

a) that interest at 5% per annum is to be allowed on capital and current account balances at the commencement of the year.

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b) Capitals to remain fixed.

c) Rajeswar and Venkateswar are entitled to a salary of Rs. 1,000 and 1,200 respectively p.a.

The following balances were extracted from the books of the firm as on 30th Sept. 1985:

	Rs.		Rs.
Capitals : (1.10.84)		Office Furniture	21,000
Rajeswar	31,000	Drawings Equipment	8,600
Venkateswar	27,000	Motor Cars	23,000
Current A/c. : (1.10.84)		National Savings Certificates	4,000
Rajeswar	1,200	Sundry Debtors	21,400
Venkateswar	1,800	Sundry Creditors	3,250
Drawings:		Loan from Andhra Bank	10,000
Rajeswar	21,150	Printing & Stationery	1,540
Venkateswar	17,100	Salaries	82,400
Motor Car expenses	2,130	Rent & Rates	6,120
Interest on loan	300	Insurance	630
Prov. for Depreciation:		Postage & Telephones	1,980
Office furniture	4,500	Bank charges	3,360
Motor cars	4,600	Interest on NSCs	330
Drawing equipment	2,650	Professional fees received	1,42,130
Cash in hand	150		
Cash at bank	1,3600		

Prepare the Profit and Loss account for the year ended 30th Sept. 1985 and Balance Sheet as on that date after taking into account the following:

1. The Bank Loan is at 6%.
2. Venkateswar paid Rs. 310 to one of the firm's creditors, which has not been recorded in the books at all.
3. Rs. 190 paid towards in the insurance premium on the personal policy of Rajeswar is included in the Insurance amount.
4. Uncompleted work was valued at Rs. 8,200 as on 30.9.1985.
5. Stock of stationery at 30th Sept. 1985 is Rs. 250.
6. Rent and electricity charges unpaid are Rs. 300 and Rs. 230 respectively.
7. Rates and Insurance unexpired are Rs. 420 and Rs. 190 respectively.
8. For the current year depreciation is as follows:
   Drawing Equipment Rs. 1,290; Motor Cars Rs. 4,600;
   Office Furniture Rs. 2,100.

B.R.A.O.U

Solution

Dr. **Profit and Loss Account for the year ended September 30, 1985** Cr.

		Rs.		Rs.
To Salaries		82,400	By Professional fees received	1,42,130
To Printing & Stationery	1,540		By Work in progress	8,200
Less: Stock at end	250		By Interest on Investments	330
		1,290		
To Rent and Rates	6,120			
Add: Rent outstanding	300			
	6,420			
Less: Rates unexpired	420			
		6,000		
To Insurance	630			
Less: Personal Premium	190			
	440			
Less: unexpired	190			
		250		
To Electricity Charges		230		
To Postage & Telephones		1,980		
To Bank Charges		3,360		
To Motor car expenses		2,130		
To Interest on bank loan	300			
Add: Outstanding	300			
		600		
To Depreciation:				
Drawing equipment	1,290			
Motor cars	4,600			
Office Furniture	2,100			
		7,990		
To Net profit c/f.		44,430		
		1,50,660		1,50,660

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Profit and Loss Appropriation Account
for the year ended 30th September 1985

		Rs.		Rs.
To Partner's salary:			By P & L. A/c.	
Rajeswar	1,000		(N.P. b/f.)	44,430
Venkateswar	1,200			
		2,200		
To interest on capital & current a/cs:				
Rajeswar	1,610			
Venkateswar	1,410			
		3,050		
To Rajeswar's current a/c. 1/2 N.P.	19,090			
To Venkateswar's current a/c. 1/2 N.P.	19,090			
		39,180		
		44,430		44,430

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Balance Sheet as on September 30, 1985

Liabilities	Rs.	Rs.	Assets		Rs.	Rs.
Capital:			Office furniture		21,000	
Rajeswar	31,000		Less: Prov. for Depn.			
Venkateswar	27,000		1.10.84	4,500		
		58,000	Current year depreciation	2,100	6,600	
Current a/c.: Rajeswar:						14,400
Op. Balance	1,200		Drawing equipment		8,600	
Add: Salary	1,000		Less: Prov. for deprn.			
Int. on capital and current a/c.	1,610		1.10.84	2,650		
Net Profit 1/2	19,090		Current year Depreciation	1,290	3,940	4,660
	22,900					
Less: Drawings 21,150			Motor cars		23,000	
Insurance 190	21,340	1,560	Less: Prov. for Depn.			
			1.10.84	4,600		
Current a/c:			Current year Depn.			
Venkateswar:				4,600	9,200	12,800
Op. Balance	1,800					
Add: salary	1,200		National Saving certificates			4,000
Int. on capital and currrent a/c.	1,440		Sundry debtors			21,400
Net Profit 1/2	19,090		Work in progress			8,200
paid to creditors	310		Stock of stationery			250
			Unexpired Insurance			190
	23,840		Unexpired rates			420
Less: Drawings	17,100		Cash at bank			13,600
		6,740	Cash in hand			150
Loan from						
Andhra Bank	10,000					
Add: Interest due	300					
		10,300				
Sundry creditors	3,250					
Less: Paid by Partner	310					
		2,940				
Outstanding expenses:						
Rent	300					
Electricity charges	230					
		530				
		80,070				80,070

Illustration - 4

Vishnu, who was carrying on business as a Sole Trader took his Office Manager, Madhav on 1.7.84 as his partner on the following terms:

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a) Vishnu and Madhav were to draw Rs. 750 and Rs. 500 p.m. on which no interest is to be charged.

b) Interest at 6% was to be allowed on capitals.

c) Madhav was to be paid a salary of Rs. 250 p.m.

d) Profits were to be shared by Vishnu and Madhav in 3:1 ratio.

e) Out of Madhav's share of profits, Rs. 5,000 (or so much available) shall be transferred to his capital a/c. till his capital is equal to half of that of Vishnu.

On 30th June 1985, the following balances were extracted from the books of the firm:

	Rs.		Rs.
Capital:		Madhav's salary	3,000
Vishnu	85,000	Stock on 30th June 85	39,240
Madhav (cash brought in on 1.7.84)	5,000	Bad debts	3,810
Drawings:		Provision for Bad Debts	2,500
Vishnu	9,000	Office salaries	14,890
Madhav	3,000	Office expenses	2,630
Goodwill	40,000	Travelling expenses	19,730
Plant & Machinery	38,000	Rent & Insurance	2,760
Overdraft at S.B.I.	2,460	Discount received	230
Sundry Debtors	87,320	Office furniture	2,000
Carriage on sales	15,420	Sundry creditors	66,340
		Gross profit	1,19,270

Prepare the final accounts of the firm, after taking into account the following:

a) Plant and Machinery, and Office Furniture are to be depreciated at 10% and 5% respectively.

b) Provision for Bad Debts should be maintained at Rs. 4,500.

c) Travelling expenses bill of Rs. 1,960 is pending to be paid.

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Solution

Profit and Loss Account
for the year ended June 30, 1985

	Rs.	Rs.		Rs.
To Office salaries		14,890	By Gross profit b/f.	1,19,270
To Office expenses		2,630	By Discount received	230
To Travelling expenses:	19,730			
Add: Outstanding	1,960			
		21,690		
To Rent & Insurance		2,760		
To Depreciation on:				
P & M at the				
rate of 10%	3,800			
Office Furniture 5%	100			
		3,900		
To Carriage on sales		15,420		
To Prov. for B.D.				
required	4,500			
Bad debts	3,810			
	8,310			
Less: Prov. for B.D.				
opening	2,500			
		5,810		
To Net Profit c/f.		52,400		
		1,19,500		1,19,500

Profit and Loss Appropriation Account
for the year ended June 1985

		Rs.		Rs.
To Partner's salary:			By Net Profit b/f.	52,400
Madhav		3,000		
To interest on capital				
Vishnu	5,100			
Madhav	300			
		5,400		
To Vishnu current a/c.	33,000			
To Madhav				
current a/c. 6,000				
To Madhav				
capital a/c. 5,000	11,000	44,000		
		52,400		52,400

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Balance Sheet as on June 30, 1985

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital:			Good-will		40,000
Vishnu	85,000		Plant & Machinery	38,000	
Madhav 5,000			Less: Depreciation	3,800	
Transferred from current year profit 5,000					34,200
	10,000	95,000	Office Furniture	2,000	
Current Accounts:			Less: Depreciation	100	
Vishnu					1,900
Interest on capital	5,100		Stock		39,240
3/4 Net Profit	33,000		Sundry Debtors	87,320	
	38,100		Less: P.D.D.	4,500	
Less: Drawings	9,000			82,820	
		29,100			
Madhav					
Interest on Capital	300				
Net Profit transferred	6,000				
	6,300				
Less: Drawings	3,000	3,300			
Creditors		66,340			
Overdraft at S.B.I.		2,460			
Outstanding Travelling expenses		1,960			
		1,98,160			1,98,160

Illustration - 5

Arun & Pavan who were carrying on business, decided to admit their Sales Manager, Kiran, into business with effect from 1st January 1985 and share profits and losses in the ratio of 3:2:1. It was also decided that Kiran should transfer half of his profits every year to his Capital Account, till it amounts to Rs. 30,000. The following trial balance was extracted from the books of the firm on 31st Dec. 1985:

	Rs.	Rs.
Debtors and Creditors	1,76,800	84,280
Bad debts	4,940	
Cash on hand	1,100	
Purchases and Sales	7,41,300	9,11,000
Stock at beginning	1,25,000	
Provision for doubtful debts		6,500
Rent and Taxes	8,700	
Salaries and wages	36,000	
Arun's capital		1,20,000
Pavan's capital		60,000
Arun's current account		12,000
Pavan's current account	2,180	

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Indian Overseas Bank overdrawn		11,440
Advertising	10,340	
Motor vehicles	36,000	
Furniture	16,000	
Trade expenses	12,860	
Arun's drawings in 1985	18,000	
Pavan's drawings in 1985	12,000	
Kiran's drawings in 1985	4,000	
	12,05,220	12,05,220

Prepare the final accounts of the firm taking into account the following:

a) Stock at end amounted to Rs. 1,15,340

b) Provision for doubtful Debts should be at 5% on debtors.

c) Rs. 3,000 of the Advertising is to be carried forward.

d) Furniture and Motor vehicles are to be depreciated at 10% and 20% respectively.

e) Partners are entitled interest on capital at 9%.

Trading and Profit & Loss A/c.
for the year ended Dec. 31, 1985.

		Rs.		Rs.
To Opening Stock		1,25,000	By Sales	9,11,000
To Purchases		7,41,300	By Closing Stock	1,15,340
To Gross Profit c/d.		1,60,040		
		10,26,340		10,26,340
To Salaries & Wages		36,000	By Gross Profit b/d.	1,60,040
To Rent & Taxes		8,700		
To Trade expenses		12,860		
To Advertising	10,340			
Less: c/f	3,000			
		7,340		
To Provision for BD required at the rate of 5% on 1,76,800	8,840			
Add: Bad debts	4,940			
	13,780			
Less: existing provision for BD	6,500			
		7,280		
To Depreciation:				
On furniture	1,600			
On Motor vehicle	7,200			
		8,800		
To Net Profit c/f.		79,060		
		1,60,040		1,60,040

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Profit and Loss Appropriation Account
for the year ended 31st December, 1985

		Rs.		Rs.
To Interest on Capital:			By Net Profit b/d.	79,060
Arun	10,800			
Pavan	5,400			
		16,200		
To Arun's current a/c. (3/6)	31,430			
To Pavan's current a/c. (2/6)	20,953			
To Kiran's current a/c. (1/12)	5,238			
To Kiran's capital a/c. (1/12)	5,239			
		62,860		
		79,060		79,060

Balance sheet as on 31st December, 1985

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital:					
Arun	1,20,000				
Pavan	60,000		Motor Vehicles	36,000	
Kiran	5,329		Less: Depreciation	7,200	
		1,85,239			28,800
Current Accounts:					
Arun: Op. Balance	12,000		Furniture	16,000	
Add. N.P.	31,430		Less: Depreciation	1,600	
Int. on capital	10,800				14,400
	54,230		Stock at end		1,15,340
Less: Drawings	18,000				
		36,230			
Pavan: N.P.	20,953		Sundry Debtors	1,76,800	
Interest on capital	5,400		Less: Prov. for B/D.	8,840	
	26,353				1,67,960
Less: Drawings 12,000			Advertising prepaid		3,000
Op. Balance 2,180			Cash on hand		1,100
	14,180	12,173			
Kiran: N.P.	5,238				
Less: Drawings.	4,000				
		1,238			
Creditors		84,280			
I.O.B. Overdraft		11,440			
		3,30,600			3,30,600

Illustration - 6

Two brothers Rama and Krishna are carrying on partnership business in the name of Ramakrishna Traders, sharing Profits & Losses in 3:2 ratio. The following balances were extracted from their books as on December 31, 1985:

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Bills payable	6,000	Buildings	43,800
Creditors	10,000	Motor vehicles	12,000
Provision for D. Debts	2,000	Patents	6,000
Sales	1,20,000	Plant & Machinery	44,000
Purchase returns	4,000	Drawings:	
Discount received	800	Rama	10,000
Interest received	400	Krishna	6,000
Loan from Rama at 5%	8,000	Interest paid	600
Rama's capital	48,000	Discount allowed	184
Krishna's capital	40,800	Rent, Rates, Insurance	900
Trade Expenses	2,000	Royalties paid	800
Salaries & Wages	12,000	General expenses	2,400
Sales returns	8,000	Purchases	50,000
Sundry debtors	12,000	Opening stock	20,000
Bills receivable	4,600	Bad debts	600
		Cash at bank	3,116

Prepare Trading, Profit & Loss Account and Balance Sheet taking into consideration the following additional information:

a) Expenses outstanding: Salaries: Rs. 1,600, Rent Rs. 200, interest to Rama on loan Rs. 200 (to be credited to his capital account).

b) Expenses prepaid Rates Rs. 100.

c) Interest to be received Rs. 200.

d) Provision for doubtful debts is to be raised to Rs. 2,400. One of the debtors for Rs. 1,600 has become insolvent and only Rs. 800 have been received.

e) Provide for Discount on Debtors & Creditors at 2%.

f) Closing stock Rs. 36,000.

g) Depreciate plant and machinery 5%. Motor vehicles 10%, Patents 15% and building 2.5%.

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Solution

Trading and Profit & Loss Account for the year ended December 31, 1985

	Rs.	Rs.		Rs.	Rs.
To opening stock		20,000	By Sales	1,20,000	
To Purchases	50,000		Less: Ret.	8,000	
Less: Returns	4,000				1,12,000
		46,000	By Closing stock		36,000
To Trading expenses		2,000			
To Royalties paid		2,000			
To G/P c/d.		79,200			
		1,48,000			1,48,000
To Salaries & Wages	12,000		By G.P. c/d.		79,200
Add: Outstanding	1,600		By Discount received		800
		13,600	By Int. received	400	
To General expenses:			Add: to be recd.	200	
Rent, Rates,					600
Insurance	1,900				
Add: Rent o/s	200		By Prov. for discount		
			on Crs. at 2%	10,000	200
	2,100				
Less: Rates prepaid	100				
		2,000			
To Interest paid		600			
To Interest on loan					
Rama		200			
To Bad detbs	600				
Add: New B.D.	800				
Prov. for DD					
reqd.	2,400				
	3,800				
Less: existing Prov.	2,000				
		1,800			
To Discount allowed		184			
To Prov. for Dis. on Drs.					
2% on (12,000-800-					
2400=8800		176			
To Depn: On P & M at					
the rate of 5%	2,200				
On Motor vehicle at					
the rate of 15%	1,200				
On patents at the					
rate of 15%	900				
On buildings at					
the rate of 2.5%	1,095				
To Net Profit:					
Rama (3/5)	32,667				
Krishna (2/5)	21,778				
		54,445			
		80,800			80,800

BRAOU

Balance Sheet as on December 31, 1985

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Capital:					
RAMA: Op. balance	48,000				
Add: N.P. 3/5	32,667		Buildings	43,800	
" Int. on loan	200		Less: Depreciation	1,095	
	80,867				42,705
Less: Drawings	10,000		Patents	6,000	
		70,867	Less Depreciation	900	
					5,100
KRISHNA: Op. balance	40,800		Plant & Machinery	44,000	
Add: 2/5 N.P.	21,778		Less: Depreciation	2,200	
	62,578				41,800
Less: Drawings	6,000		Motor Vehicles	12,000	
		56,578	Less: Depreciation	1,200	
					10,800
Loan from Rama at the rate of 5%		8,000	Closing Stock		36,000
Creditors	10,000		Sundry Debtors	12,000	
Less: Prov. for Dis.	200		Less: Further B.D.	800	
		9,800		11,200	
Bills payable		6,000	Less: Prov. for DD	2,400	
Expenses outstanding:				8,800	
Salaries	1,600		Less: prov. for		
Rent	200		Dis. on Drs.	176	
		1,800			8,624
			Bills Receivable		4,600
			Interest to be received		200
			Prepaid rates		100
			Cash at Bank		3,116
		1,53,045			1,53,045

13.4 SUMMING UP

There is not much difference between the preparation of final accounts of Sole Trading concern and that of a partnership firm. The profit arrived at in the Profit & Loss Account is transferred to Profit and Loss Appropriation Account for taking into account the interest on capital, partners' salaries, interest on drawings, etc., and thereafter the net profit or loss will be distributed among the partners in their profit/loss sharing ratio. These adjustments are also shown in the Balance Sheet in the respective partner's capital or current accounts.

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13.5 MODEL EXAMINATION QUESTIONS

Problems

1. Rani and Radha are partners sharing profits and losses in 3:1 ratio. As per the terms of their agreement, Rani can draw Rs. 750 p.m., and Radha can draw Rs. 7,200 p.a., on which no interest is to be charged. Both are entitled for interest on capitals at 6% p.a. Radha is entitled to a salary of Rs. 3,000 p.a.

   On 31st December, 1985, their ledger disclosed following:

	Rs.		Rs.
Purchases	2,10,000	Sales	3,29,270
Stock 31.12.85	39,240	Office salaries	14,890
Rent, Rates	22,490	Office expenses	2,630
Discount (credit)	230	Bank O.D.	2,460
Carriage on sales	15,420	Debtors	87,320
Provision for bad debts	2,500	Creditors	66,340
Bad debts	3,810	Furniture	2,000
Plant & Machinery	38,000	Radha's salary	3,000
Good will	40,000	Radha's drawings	3,000
Radha's capital	10,000	Rani's drawings	9,000
Rani's capital	80,000		

Prepare the final accounts of the firm (taking into consideration the following) under Fixed Capital Method:

a) An amount of Rs. 5,000 (or so much as is available) out of Radha's share of profits, has to be transferred to her capital account, till her capital account is equal to 1/4th of Rani's capital.

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

c) Raise the Provision for Doubtful Account to Rs. 4,500.

d) Rent outstanding RS. 1,960.

(Answer: Net profit: Rani - 33,000, Radha - Rs. 11,000.
Balance Sheet total : Rs. 1,98,160).

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2. Aruna and Bimala were in partnership sharing profits and losses in the ratio 2:1. They admitted on 1st July 1985 Karuna and Dharani into partnership giving them 2/12 and 1/12 share of future profits. Aruna has guaranteed Dharani a minimum profit of Rs. 2,400. Dharani was also to get Rs. 100 p.m., as salary. All are entitled to 5% interest on capital. The following balances were extracted from their books as on 30th September, 1985:

	Rs.		Rs.
Purchases	55,400	Sales	96,870
Wages	8,000	Office overheads	9,440
Machinery	12,000	Depreciation on machinery 1.10.84	4,000
Sundry debtors	7,600	Provision for bad debts	280
Sundry creditors	5,520	Aruna's capital	12,000
Cash	12,150	Bimala's capital	6,400
Aruna's drawings	8,000	Karuna's capital	4,800
Bimala's drawings	5,000	Dharani's capital	3,600
Karuna's drawings	400	Stock 1.10.84	15,000
Dharani's drawings	480		

Sales upto 30th June 85 amounted to Rs. 72,000. Stock on 30th September 85 amounted to Rs. 13,820. Office overheads accrued amounted to Rs. 240. Machinery is to be depreciated by Rs. 1,600. Provision for doubtful debts is to be raised to Rs. 1,000. Goods costing Rs. 800 were sold on sale or return basis at Rs. 1,200. The purchasers still had time to decide as on 30th September, 85.

Prepare the Trading, P & L Account and Balance Sheet.
(Answer: Gross Profit Rs. 31,890, N.P. Rs. 18,565, B.S. Total: 38,570)

13.6 RECOMMENDED BOOKS

1. Gupta, R.L : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C. & Grewal, T.S. : Advanced Accounts, S. Chand S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

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UNIT-14 : ADMISSION OF PARTNER

Contents

14.0 Aims and Objectives
14.1 Introduction
14.2 Revaluation of Assets and Liabilities
14.3 Adjustment of Accumulated Profits and Losses
14.4 Adjustment of the Goodwill of the Firm
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14.0 AIMS AND OBJECTIVES

The objective of this unit is to explain the adjustment of assets, liabilities, accumulated profits and goodwill of the firm when a new partner is admitted into partnership. It also explains the adjustments to be made in the capital and profits of the firm on the admission of a partner.

After completing this unit, you will be able to :

- explain the accounting treatment involved in the adjustment of assets and liabilities
- distribute the accumulated profits and losses to the existing partners
- ascertain the value of goodwill and explain its accounting ratio
- calculate new profit sharing ratio and sacrificing ratio
- adjust the capitals of the partners on some basis
- work out the problems relating to the adjustment of assets and liabilities and guarantee of minimum profit to the incoming partner
- describe the accounting treatment when a part of the profit is reserved for the old partners.

14.1 INTRODUCTION

Sometimes, the Sole Trader or an already existing partnership concern may decide to take a new partner (or more partners) into the business, to meet the need to additional capital, special skills or influence. Such a new partner gets entitled to a share in the future profits of the firm (whether he brings in capital or not). Hence, certain adjustments are required in regard to the assets and liabilities, undistributed profits and losses, goodwill of the firm and calculation of new profit sharing ratio among the partners. Some times, the capitals of the old partners may have

to be adjusted on the basis of the capital brought in by the new partner. At some occasions the amount of capital to be brought in by the new partner shall be determined in accordance with the total capital contributed by the old partners. Often, the incomming partner may be given assurance regarding the value of assets and liabilities and also for a fixed amount of profit. Likewise, the old partners may be reserved a portion of the profit at the time of adjustments which are effected on the basis of partnership deed. Let us now learn the theoretical and practical aspects at the time of admission of a new partner.

14.2 REVALUATION OF ASSETS AND LIABILITIES

It normally happens that the assets and liabilities of the business are allowed to appear in the books as a going concern and not at realisable values. 'Fluctuations in the Fixed Assets are not taken into account in the case of a going concern. When a new partner is admitted, he gets a right in the properties as well. Hence in order to be fair to the existing partners and as well as the incomming partner, all the assets and liabilities are scrutinised and revalued. It is possible the Provisions made for depreciation, doubtful debts etc., are inadequate. Hence, suitable adjustments may be necessary to the capital accounts of the existing partners.

Adjustment in the book values of assets & liabilities is made by opening a 'Revaluation Account' (or 'Profit & Losss Adjustment Account') which will be debited with losses and credited with profits, consequent upon revaluation. The balance in the Revaluation Account represents net loss or net gain, which will be transferred to the existing owners (in their old profit sharing ratio), and the Revaluation Account closed. The following journal entries are passed :

a. For increasing the value of the assets or decreasing the value of the liabilities:

Concerned asset account	Dr.	
Concerned liability account	Dr.	
To Revaluation A/c.		

b. For decreasing the value of the assets or increasing the value of the liabilities:

Revaluation A/c	Dr.	
To Concerned Assets A/c		
To Concerned Liability a/c.		

c. For transfering the debit balance of Revaluation Account (loss):

Existing partners' capital a/c's	Dr.	(in their old ratio)
To Revaluation a/c.		

d. For transferring the credit balance of Revaluation Account (Profit):

Revaluation a/c	Dr.	
To Existing Partner's capital a/c (in their old ratio)		

The assets and liabilities will now appear at their revised figures. It maay be noted here that if the Revaluation A/c is not opened, the loss or gain from each asset/liability account is to be transferred to capital accounts(s). This will be a tedious process and the net loss or gain on account of revaluation of various assets and liabilities cannot be known. This is avoided by opening Revaluation Account to which loss/gain from each Asset/Liability account is transferred, and finally , the net loss/gain transferred to capital accounts(s). Thus, if there are only one or two items to be adjusted, the loss/gain can be directly transferred to capital account(s).

This is explained in the following illustration.

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Illustration - 1

Victor and Samuel are partners and their balanace sheet stood as below on Dec..31, 1985 on which date they desired to admit Luther.

Liabilites	Rs.	Assets	Rs.
Victor's capital	32,000	Buildings	36,000
Samuel's capital	16,000	Machinery	6,000
Sundry Creditors	1,500	Stock	4,000
		Sundry debtors	3,000
		Cash	500
	49,500		49,500

They share profits and losses in proportion to their capital.. Prior to admitting luther, they desire that (a) Provision for doubtful debts be created to the extent of 10% of debtors; (b) Stock and buildings be depreciated by 15% ; (c) value of machinery be stepped up by 20%; and (d) Provision for liability on bill discounted Rs.300.

Give journal entries and show the revised balance sheet as it appears before Luther is admitted. Show also Revaluation a/c.

Solution

Journal

1.	Revaluation a/c.	Dr.	6,600	
	To Provision for doubtful debts a/c.			300
	" Provision for Liability on bill discounted a/c.			300
	" Stock a/c			600
	" Buildings a/c			5,400
	(Being the entry for loss on revaluation of assets and liabilities)			
2.	Machinery a/c.	Dr.	1,200	
	To Revaluation a/c.			1,200
	(Being the entry for raising the value of Machinery,on revaluation).			
3.	Victors' capital a/c.	Dr.	3,600	
	Samuel capital a/c	Dr.	1,800	
	To Revaluation a/c.			5,400
	(Being the entry for transferring the net loss on revaluation)			

Revaluation Account

Dr.	Rs.			Cr. Rs.
To Provision for doubtful debts a/c	300	By Machinery a/c		1,200
To Prov. for laibility on bill discounted	300	" Victor's capital a/c	3,600	
To Stock a/c	600	" Samuel's capita l a/c	1,800	5,400
To Buildings a/c	5,400			
	6,600			6,600

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Revised Balance Sheet as on December 31, 1985

Liabilities	Rs.	Assets		Rs.
Victor's capital	28,400	Buildings(36,000–5,400)		30,600
Samuel's capital	14,200	Machinery(6,000+1,200)		7,200
Sundry Creditors	1,500	Stock(4,000–600)		3,400
Prov.for liability		Sundry debtors	3,000	
on bills discounted	300	Less:Prov.for DD	300	2,700
		Cash		500
	44,400			44,400

Memorandum Revaluation Account:

Sometimes, the partners including the new partner, may resolve to keep the assets and liabilities revalued, at their pre- revaluation figures. In such cases, the Revaluation Account is called a Memorandum Revaluation Account and this is divided into two sections. In the first section, the entries for loss/gain in the assets/liabilities are posted, (vide journal entries (a) and (b) given under Adjustment of Assets & Liabilities'). However, while posting the journal entries, the asset/liabilities accounts are not given the postings. It is only the 'Memorandum Revaluation Account' that is posted. In other words, only one effect of the transaction is posted. Then, the net gain/loss (vide journal entry (c) or (d) referred above) is posted to existing owners (prior to admission of new partner) capital accounts and as well as Memorandum Revaluation Account. At this stage, the Memorandum Revaluation Account gets closed. After the admission of the new partner, the jounral entries (a) and (b) are reversed and posted (again, only) to Memorandum Revaluation Account (and not to the concerned asset/liability accounts). The part where this is done is known as second section. The difference in the Memorandum Revaluation Account is now transferred to all the partner's capital accounts (including new partner) in their profit sharing ratio, from the Memorandum Revaluation Account. This entry is posted both to capital accounts and Memorandum Revaluation Account.

(i) When there is profit on revaluation:

Memorandum Revaluation A/c. Dr.
To old partners' capital accounts.

(ii) After the admission of new parter:

Individual partners' accounts Dr. (Including New partner)
To Memorandum Revaluation A/c.

This method is explained in the following Memorandum Revaluation Account.

Illustration - 2

Assuming that the three partners in Illustration - 1; share profits and losses in 2:1:1 ratio, the Memorandum Revaluation Account when prepared, appears as follows:

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Dr. **Memorandum Revaluation A/c.** Cr.

	Rs.		Rs.
To Prov. for doubtful debts	300	By Increase in Machinery	1,200
To Prov. for liability on Bill discounted	300	By Victor's capital a/c.	3,600
To Stock a/c.	600	By Samuel's capital a/c.	1,800
To Building a/c.	5,400		
	6,600		6,600
To Decrease in Machinery	1,200	By Prov. for doubtful debts a/c.	300
To Victor's capital a/c.	2,700	By Prov. for liability on bill discounted	300
To Luther's capital a/c.	1,350	By Stock a/c.	600
		By Building a/c.	5,400
	6,600		6.600

14.3 ADJUSTMENT OF ACCUMULATED PROFITS & LOSSES

It is necessary, before a new partner is admitted into the business, to distribute all accumulated profits (and also losses) of the concern to the existing partners in the old profit sharing ratio. This is so because, it is these partners who have earned the profits (or have incurred the losses) and hence those profits belong to them only. After the admission of the new partner, he also gets a share in the profits. Therefore, the following entries are passed for the accumulated profits/losses, before the new partner is admitted.

a) For accumulated profits:

General Reserve A/c.	Dr.	
P & L A/c. (for credit balance)	Dr.	
..... etc.		
To Existing Partners' capital accounts.		
(Being the entry for transferring the accumulated profits)		

b) For accumulated losses:

Existing partners' capital a/cs.	Dr.	
To profit & Loss a/c. (for debit balance)		
(Being the entry for transfer of accumulated losses)		

Check Your Progress - I

A and *B* are in partnership, sharing profits and losses in 3:2 ratio. The Balance Sheet of the firm as on 31st December 1990 was as follows:

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Balance Sheet

Liabilities		Rs.	Assets	Rs.
Sundry Creditors		10,000	Bank	5,000
Bills payable		4,000	Sundry Debtors	8,000
General Reserve		6,000	Stock	6,000
Capitals:			Bills Receivable	2,000
A	12,000		Machinery	8,000
B	8,000		Land and Buildings	11,000
		20,000		
		40,000		40,000

On 1-1-1991 *C* is admitted into partnership for 1/5th share, for which he has to bring in Rs. 5,000 towards capital. The assets and liabilities of the firm are revalued on his admission as follows:

i) Machinery is to be reduced by 5%.
ii) Land and Buildings are to be appreciated by Rs. 4,000.
iii) Provide Rs. 500 towards bad and doubtful debts.

Pass journal entries and show the Revaluation Account.

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14.4 ADJUSTMENT OF GOODWILL OF THE FIRM

The businessmen make efforts to establish good reputation for their business and bring it to a stage of profit-making. He must have faced several risks. When a new person is admitted into the business, he also gets entitled to share the profits which are due to the efforts put in by the previous partners. Hence, the previous partners should be rewarded, suitably, by the new partner, as they surrender a part of their future profit rights in the business, in favour of the new comer. Hence it is necessary to value the goodwill of the business concern. The following factors usually influence the value of the goodwill:

a) Location of the business
b) Nature of the business/product/service
c) Efficiency of the Management
d) Competition
e) Capital required
f) Tenure of the business
g) Technical know how required
h) Customer satisfaction.

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Goodwill is an intangible asset. In the case of a partnership firm, goodwill may have to be valued:

a) When the new partner is admitted;
b) When the existing partners change their profit ratio;
c) When one of the existing partners retires or dies;
d) When the business is sold;
e) When the business is amalgamated with another one; and
f) When the partners decide to close down the business.

Methods of Valuation

Goodwill is valued generally by (a) Average method; (b) Super profits method; and (c) Capitalisation method. However, before a particular method is selected, it is necessary to refer to the Partnership Deed of the firm.

a) Average Profits Method : In this case it is valued as 'a few years' purchase of average past profits of 'some years'. For example, if it is given as 'Three years' purchase of four years' average profits, we have to calculate first, the average of the preceding four years profits and then multiply the resultant figure with three. This is explained below:

Illustration - 3

A firm values its goodwill on the basis of 4 years purchase of average profits of previous 3 years. Previous three years profits were Rs. 9,000, Rs. 12,000, and Rs. 15,000. What is the goodwill of the firm?

Solution

Total profits of previous three years = 9,000 + 12,000 + 15,000 = 36,000
Average of previous 3 years profits = 36,000/3 = Rs. 12,000.
4 years purchase of average profits = 4 × 12,000 = Rs. 48,000.
Goodwill of the firm is Rs. 48,000.

b) Super Profits Method : Goodwill is also termed as the expected future profits of the business, over and above normal profits, known as 'Super profits'. Goodwill can be valued on the basis of super profits of the business. There are two ways of doing the same.

i) In this case goodwill can be taken as equal to some 3 or 4 or 5 times of the super profits. For example, if the capital of the business is Rs. 1,00,000 and the normal return were to be 10%, then the normal profits should be Rs. 10,000. Suppose, the profits of the firm are Rs. 20,000, then Rs. 10,000 (i.e. Rs. 20,000 minus Rs. 10,000) are the profits. If the goodwill is to be taken as 3 years purchase of super profits, it will be 3 × Rs. 10,000 = Rs. 30,000.

ii) In this case, the capital value of an annuity equal to super profits, for a given number of years and at a given rate of interest is found out. This capital value is treated as the Goodwill of the business.

c) Capitalisation Method : When a business is established, one expects some normal return, on the capital. Under this method the value of the business is estimated on the basis of the expected return and the average profits. The formula for this is:

$$\frac{\text{Profit}}{\text{Normal return}} \times 100$$

From the value of the business thus arrived at, the net assets are deducted and the resultant figure is treated as the Goodwill. For example, for a business the normal return on capital is 10% per annum and the average profits are Rs. 17,500. The value of the business = 17,500/10 × 100 = Rs. 1,75,000. If the net assets are Rs. 1,25,000, then the goodwill is Rs. 1.75,000 – Rs. 1,25,000 = Rs. 50,000.

In addition to the above three methods, goodwill can also be calculated on the basis of the share of the incoming partner. Suppose, the incoming partner, for a 1/4th share in profits, brings in Rs. 5,000 as his share of goodwill. Then the firm's full value of the goodwill can be taken as 4 × Rs. 5,000 = Rs. 20,000.

Treatment of Goodwill

We have seen that the new partner, when he joins the firm, gets the benefit of super profit earning capacity of the firm. Therefore, he has to compensate the existing partners, but for whose efforts, the firm would not have reached that stage. Thus when a new person joins, he has to compensate, separately, towards goodwill of the firm, in addition to bringing in money, if any, towards the capital of the firm. There are different ways of treating the goodwill. They are:

i) Premimum Method.
ii) Revaluation Method.
iii) Memorandum Revaluation Method.

i) Premium Method : This method is followed when the incoming partner brings in cash towards his share of goodwill of the firm. This, in turn, can take the following forms:

1. **The Premium is paid privately :** In this case the new partner pays his share of goodwill amount to the existing partners privately. Nothing is recorded in the books of the firm. This method is not desirable. No entry is passed in the firm's books, as the matter is treated as outside the business.

2. **Amount of premium is retained in business :** In this case, the new partner brings the cash towards goodwill, into the business, it is credited to the existing partners' capital accounts and retained in the business. Existing partners' capital accounts have to be credited in proportion to the profit sacrificed by them in favour of the incoming partner. For this purpose, sacrificing ratio is to be ascertained.

Sacrificing ratio : Suppose, X & Y are partners in a firm sharing profits and losses in 3:2 ratio i.e. 3/5 and 2/5 respectively. Now, they decided to admit Z and give him 1/5th share in future profits, and that the new profit sharing ratio shall be 2:2:1 i.e. 2/5, 2/5, 1/5.

It is seen from the above that Y continues to share 2/5 profits. It is X who has sacrificed his 1/5 share (out of 3/5ths) towards Z. Hence, sacrificing ratio of X & Y is 1 : 0. Therefore, entire goodwill that may be brought in by Z, shall go to X only.

The following journal entries are required:

a) When cash is brought in towards goodwill:

Bank A/c.	Dr.	
To Goodwill A/c.		
(Being the amount brought in by the new partner towards Goodwill)		

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b) For giving the goodwill to existing partners:

Goodwill A/c.	Dr.	
To Existing partners' capital A/cs. (in sacrificing ratio)		
(Being the entry for transferring the goodwill to existing partners)		

3. **Amount of premium is withdrawn by previous partners :** In this case, the amount of premium brought in by the new partner is withdrawn by the previous partners. Hence, one more journal entry is required for withdrawing the amount in addition to (a) and (b) under 2 above. It is :

c) When the goodwill amount is withdrawn by the previous partners, after it is credited:

Existing partners' capital A/cs. (same amount that is credited)	Dr.	
To Bank A/c.		
(Being the entry for recording the withdrawal of goodwill amount)		

The premium method is explained in the following illustration:

Illustration - 4

Ramesh and Satish are partners in a partnership firm sharing Profits & Losses in 3:2 ratio. They decided to admit Prakash for a 1/5th share in the business. The new profit sharing ratio shall be 2:2:1 between Ramesh, Satish and Prakash. Prakash brings in Rs. 5,000 as his share of goodwill, which is later withdrawn. Pass necessary journal entries in the books of the firm.

Solution

Journal

			Rs.	Rs.
a) Bank A/c.	Dr.		5,000	
To Goodwill A/c.				5,000
(Being the entry for the cash broughtin by Prakash towards goodwill)				
b) Goodwill A/c.	Dr.		5,000	
To Ramesh capital A/c.				5,000
(Being goodwill amount credited to Ramesh, having sacrificed the same)				
c) Ramesh's capital A/c.	Dr.		5,000	
To Bank A/c.				5,000
(Being the goodwill amount withdrawn by previous partners)				

Note : Sacrificing ratio is calculated as follows :

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Previous partners	According to previous ratio (pr)	According to new ratio (nr)	Sacrifice (pr minus nr)
Ramesh	3/5	2/5	1/5
Satish	2/5	2/5	nil.

In case goodwill account already exists, such goodwill account is written off in the old profit sharing ratio to the old partners' capital accounts.

ii) **Revaluation Method :** This method is followed when the new partner does not bring in cash towards goodwill. Goodwill account is then raised to its full value, before the new partner is admitted, in the books of the firm. It is possible sometimes, the goodwill account may exist in the books and its amount may be less than the full value or more than the full value. Hence, the following steps are followed :

Step :

1. Ascertain the full value of the goodwill;
2. Find out the difference between the full value of the goodwill and the amount appearing in the books already (if there is no such account in the books, it can be taken as Zero).
3. Pass the journal entry for the difference so that the goodwill account now appears in the books at its full value.

The following are the journal entries required under this method:

a) Where there is no goodwill account in the books now or where the full value of the goodwill is more than the existing goodwill amount:

Goodwill A/c.	Dr. (for the difference as as per step 2 above)
To previous partners' capital A/cs.	(in their old profit) sharing ratio)
(Being the entry for raising the Goodwill account).	

b) Where the existing goodwill amount is more than full value of the goodwill:

Previous partners's capital A/cs.	Dr. (in their old profit sharing ratio)
To Goodwill A/c.	(for the difference amount as per step 2 above)
(Being the entry for bringing down the goodwill to its full value.)	

This is expalined in the following illustration :

Illustration - 5

Amal, Bimal and Kamal share profits and losses in 3:2:1 ratio. They admit Suman into partnership giving him 1/4 share in future profits. The goodwill of the firm is valued by agreement

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b) **New Partner acquires the share from existing partners in a particular proportion :** Sometimes new partner may acquire his share of profit in future profits of the firm, from the existing partners in a particular proportion. For example: A and B are sharing profits in 3:2 ratio. They decided to admit C into partnership for a 6th share, which he acquires $\frac{1}{8}$ from A and $\frac{1}{24}$ from B. The ratio is calculated as follows :

C acquires $\frac{1}{6}$th share of profit by taking $\frac{1}{8}$ from A, $\frac{1}{24}$ from B.

A's remaining share $= \frac{3}{5} - \frac{1}{8} = \frac{24-5}{40} = \frac{19}{40}$

B's remaining share $= \frac{2}{5} - \frac{1}{24} = \frac{48-5}{120} = \frac{43}{120}$

Thus A:B:C $= \frac{19}{40} : \frac{43}{120} : \frac{20}{120}$

$= \frac{57}{120} : \frac{43}{120} : \frac{20}{120}$

= 57:43:20

Check Your Progress - II

(a) What do you mean by 'Sacrificing Ratio'?

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(b) A, B and C are partners sharing profits and losses in the ratio of 6:5:3. 'D' is admitted as a partner and is given $\frac{1}{8}$ th share of future profits. What is the new profit sharing ratio of the partners?

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(c) A and B are partners sharing profits and lossess in the proportion of $\frac{3}{5}$ and $\frac{2}{5}$ respectively. They agreed to admit 'C' as a partner. Their future profit sharing ratio shall be 8:7:5. Find out 'Sacrificing Ratio'?

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14.6 ADJUSTMENT REGARDING CAPITALS

When a new partner is admitted into the firm, the partners may agree to adjust their capital accounts in proportion to the new profit sharing ratio. This can be done in two ways:

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a) Adjusting the capital accounts of the old partners on the basis of the capital of the new partner;

b) Calculating the capital of the partners on the basis of the total capital of the new firm and accordingly, adjusting the old partners' capitals and asking the new partner to bring in the necessary amount as capital.

a) **Adjusting the capital accounts on the basis of the new partner's capital :** On the basis of the profit ratio and capital brought in by the new partner, the amount of capital to be maintained by each old partner (depending upon the new profit sharing ratio) is calcualted. This amount is compared with balance in the capital account (after making the necessary adjustments regarding, goodwill, accumulated profits/losses and revaluing assets/liabilities). If the balance in the capital account is less:

i) the old partner brings in the necessary amount; or

ii) the old partner's current account is debited and capital account credited.

If the balance in the capital account is more:

iii) the old partner withdraws the excess amount; or

iv) the old partner's capital account is debited and current account credited.

b) **Calculating the capital of the partners on the basis of the total capital of the firm :** When the total capital of the newly constituted firm is given, each partner's capital is calculated on the basis of the total capital and the respective share of each partner (in the new profit sharing ratio). The new partner is asked to bring in his share of capital and old partners' capital accounts are adjusted depending upon the balance whether excess or less, as explained against points (i) to (iv) under 1 (a).

c) **Determining the new partner's capital if it is not given :** Sometimes the new firm's total capital may not be given and the student may be required to calculate the amount which the new partner may have to bring in as capital. In such a case, the old partners' total capital (after making adjustments regarding goodwill, accumulated profits/losses, revaluation) and the proportion of their total profit in the newly constituted firm are ascertained. For example, the new partner's share of profit in the new firm is $\frac{1}{6}$th. It means that the total proportion of the old partners' profits is $\frac{5}{6}$th (which should be shared in the previous profit sharing ratio). Let us assume that the total capital of all the old partners (after making adjustments) is Rs. 50,000. The $\frac{5}{6}$th share of their capital is Rs. 50,000, for $\frac{1}{6}$th share the new partner has to bring in:

$$\frac{1}{6} \times 50,000 \times \frac{6}{5} = \text{Rs. } 10,000$$

The old partner's capital, if required can also be calculated and excess or deficit balance can be adjusted as explained earlier.

This is made clear through the following illustrations

Illustration - 7

Bhima and Krishna are partners in a firm sharing profits and losses in the ratio of 4:3. Their capitals are Rs. 60,000 and Rs. 50,000 respectively. They decide to admit Balaram with Rs. 16,000 as capital by giving him a $\frac{1}{8}$th share in future profits. They also decide to adjust their capitals according to the new profit sharing ratio by bringing in additional amount or withdrawing

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additional amount. Make the necessary adjustments in the capital accounts:

Solution

Calculation of new profit sharing ratio:

Balaram gets $\frac{1}{8}$th share in the new firm.

Remaining profits are $1 - \frac{1}{8} = \frac{7}{8}$.

Bhima will get $\frac{7}{8} \times \frac{4}{7} = \frac{4}{8}$ (or $\frac{1}{2}$)

Krishna will get $\frac{7}{8} \times \frac{3}{7} = \frac{3}{8}$

The ratio of Bhima, Krishna, Balram $= \frac{4}{8} : \frac{3}{8} : \frac{1}{8}$

$= 4 : 3 : 1$

Calculation of the capital to be maintained:

Bhima: For $\frac{1}{8}$th share Balaram brings Rs. 16,000

For $\frac{4}{8}$th share Bhima should have

$\frac{4}{8} \times 16,000 \times \frac{8}{1} =$ Rs. 64,000.

Krishna : For $\frac{1}{8}$th share Balaram brings Rs. 16,000

For $\frac{3}{8}$th share Krishna should have

$\frac{3}{8} \times 16,000 \times \frac{8}{1} =$ Rs. 48,000.

Thus Bhima has to bring in Rs. 4,000 (64,000 – 60,000) and Krishna can withdraw Rs. 2,000 (48,000-50,000). The following entries are passed:

Journal

			Rs.	Rs.
Bank A/c.	Dr.		4,000	
To Bhima's capital A/c.				4,000
(Being the additional amount brought in by Bhima as per the agreement)				
Krishna's capital A/c.	Dr.		2,000	
To Bank A/c.				2,000
(Being the excess amount as per the agreement, withdrawn by Krishna)				

Illustration - 8

Akbar and Pasha were carrying on a partnership business. On the 31st of December, 1985, their capitals stood at Rs. 40,000 and Rs. 34,500 respectively. On that date they decided to admit Basheer for a $\frac{1}{5}$th share in future profits. Basheer was to bring in capital in proportion to the new profit sharing ratio. The old partners' capital accounts also are to be adjusted to the new profit sharing ratio. For this purpose they bring in the additional capital required. Pass necessary journal entries on the admission of the new partner and adjustment of old partners' capital accounts.

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Solution

Calculation of the new profit sharing ratio:

Basheer gets $\frac{1}{5}$th share in the new firm;

Remaining profits are: $1 - \frac{1}{5} = \frac{4}{5}$.

The $\frac{4}{5}$th of the profits will be shared by Akbar and Pasha equally (in the absence of any ratio, it is to be presumed that they are sharing profits equally).

Akbar will get $\frac{4}{5} \times \frac{1}{2} = \frac{4}{10}$

Pasha will get $\frac{4}{5} \times \frac{1}{2} = \frac{4}{10}$

Basheer's share is : $\frac{1}{5} = \frac{2}{10}$

Thus the share of Akbar, Pasha, Basheer : $\frac{4}{10} : \frac{4}{10} : \frac{2}{10}$

$= 4 : 4 : 2$

Calculation of capital:

For $\frac{4}{5}$th remaining profits, the combined capitals of Akbar & Pasha are Rs. 74,500.

Thus for $\frac{1}{5}$th share Basheer should get $\frac{1}{5} \times 74,500 \times \frac{5}{4}$ = Rs. 18,625.

The total capital of the firm should be: $74,500 \times \frac{5}{4}$ = Rs. 93,125

Akbar's capital should be Rs. 93,125 $\times \frac{4}{10}$	= 37,250
Pasha's capital should be Rs. 93,125 $\times \frac{4}{10}$	= 37,250
Basheer's capital	= 18,625
	= 93,125

Thus Akbar has to withdraw Rs. 2,750 and Pasha and Basheer have to bring in Rs. 2,750 and Rs. 18,625 respectively. The following journal entries are passed.

Journal

				Rs.	Rs.
1985 Dec. 31	Bank A/c.	Dr.		21,375	
	To Basheer's capital A/c.				18,625
	To Pasha's capital A/c.				2,750
	(Being the additional amount brought in by Basheer and Pasha)				
	Akbar's Capital A/c.	Dr.		2,750	
	To Bank A/c.				2,750
	(Being the excess amount in the capital a/c withdrawn)				

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14.7 GUARANTEE OF ASSETS AND LIABILITIES

As we have seen earlier, the assets and liabilities are usually revalued before the new partner is admitted into the firm. However, the new partner may, sometimes, ask the old partners to guarantee the values of assets and liabilities shown in the Balance Sheet (prepared just before admission). If this guarantee is given by the old partner(s), the loss that may arise later, if any, has to be borne by the old partner(s) as per their old profit sharing ratio. It is sometimes possible that the provision made for doubtful debts may not be sufficient to meet the bad debts, the latter exceeding the former. The excess loss in such a case is to be borne by the old partners.

The adjustment required to be made is explained through the following illustration :

Illustration - 9

Raghav and Bhairav were sharing profits and losses in the ratio of 3:2. They decided to admit madhav for a 1/4th share in future profit(s) and the latter was to bring in Rs. 10,000 as his capital. The old partners guaranteed the assets and liabilities shown in the Balance Sheet.

It was later noticed that the bad debts actually exceed the provision made, i.e., Rs. 500 and the outstanding expenses of Rs. 500 were not taken into account in the final accounts prior to his admission.

Pass the necessary journal entries.

Solution

Journal

			Rs.	Rs.
Bank A/c.	Dr.		10,000	
To Madhav's capital a/c.				10,000
(Being the capital brought in by Madhav)				
Raghav's capital a/c	Dr.		600	
Bhairav's capital a/c	Dr.		400	
To provision for doubtful debts a/c				500
To outstanding expenses a/c				500
(Being the entry for short provision for Doubtful debts and bringing into a/c outstanding expenses)				

14.8 GUARANTEE OF MINIMUM PROFIT

Sometimes a share in the partnership is offered to an employee of the firm. In that case the new partner may request the old partners to guarantee a minimum amount of remuneration which he was getting as profit after admission. This guarantee can be given by all the existing partners or some of them

As long as the share of profit of the new partner is more than the guaranteed profit (the remuneration which he was getting), the profit of the period is distributed in the new profit sharing ratio.

If the share of profit is less than the guaranteed profit, the new partner is credited with the guaranteed profit and the short-fall (i.e. guaranteed profit – his share of profit as per profit sharing ratio) is debited to the other partner(s) in their profit sharing ratio. Alternatively, if all the other partners have given the guarantee, the new partner is given the guaranteed profit out of the profits of the firm and the remaining profits are shared by the remaining partners.

The adjustments are explained in the following illustration.

Illustration - 10

Rakesh and Satish, who were in partnership sharing profits and losses in 3:2 ratio, decided to admit into the partnership Mukesh the office manager who was getting Rs. 6,000 per annum as salary and 5% of the net profits (before charging such commission) as commission. Mukesh is entitled to 1/6th share in future profits. The old partners guaranteed Mukesh the amount which he was getting by way of salary and commission as his share of profits. Short fall, if any, is to be met by the old partners in their profit sharing ratio.

For the following 12 months' period the profits of the firm (without charging Mukesh's salary and commision) amounted to Rs. 42,000. Explain how the profits are distributed.

Solution

Amount that Mukesh would have got, had he continued as Manager :

	Rs.	Rs.
Profit prior to Salary & Commission		42,000
Salary	6,000	
Commission at the rate of 5% on 36,000	1,800	
		7,800
Net Profit		34,200

Amount which Mukesh would get, if Profits are distributed :

1/6 share of Rs. 42,000 = 7,000.

Thus, if profits are distributed, Mukesh gets Rs. 800 (7,800 – 7,000) less than what he was getting as office Manager. The short fall of Rs. 800 is to be met by Rakesh and Satish in 3:2 ratio, i.e., Rs. 480 and Rs. 320 respectively. This is adjusted as follows:

Dr. **P & L Appropriation Account** Cr.

	Rs.		Rs.
To Mukesh capital a/c	7,800	By Profit b/f	42,000
To Rakesh capital a/c	20,520		
To Satish capital a/c	13,680		
	42,000		42,000

Alternatively, the distribution can also be presented as follows:

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P & L Appropriation Account

Dr.	Rs.		Rs.	Cr.
To Mukesh capital a/c 1/6 N.P.	7,800	By Profit b/d	42,000	
To Rakesh capital a/c 3/6 N.P.	21,000	By Rakesh's capital a/c	480	
To Satish capital a/c 2/6 N.P.	14,000	By Satish's capital a/c	320	
	42,800		42,800	

14.9 RESERVATION OF PROFIT TO OLD PARTNERS

Sometimes just before the new partner was admitted into the firm, the old partners might have obtained a big order which was almost executed. The old partners might wish that the profit on such order be distributed among them. The new partner might agree to such a request. In suh a case out of the profits of the following period, first the profit expected on such pending order would be distributed among the previous partners in their old profit sharing ratio and the remaining profits would then be shared by all the partners in their new profit sharing ratio.

This is explained in the following illustration:

Illustration - 11

Harsha and Varsha are partners in a firm. They admitted Karsha into the firm for 1/3 share of future profits. The old partners got a profitable contract which was almost completed and the new partner agreed to the old partners' taking an estimated profit of Rs. 5,000 from the following period's profits. For the following period, the P & L A/c. disclosed a profit of Rs. 23,000. Give journal entries for distribution of profit and show the P & L Appropriation A/c.

Solution

Journal

			Rs.	Rs.
P & L Appropriation a/c	Dr.		5,000	
To Harsha capital a/c				2,500
To Varsha capital a/c				2,500
(Being the entry for the distribution of profit on the contract of previous year)				
P & L Appropriation a/c	Dr.		18,000	
To Harsha capital a/c				6,000
To Varsha capital a/c				6,000
To Karsha capital a/c				6,000
(Being the entry for distribution of profits in new profit sharing ratio)				

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Dr. P & L Appropriation Account Cr.

	Rs.		Rs.
To Harsha capital a/c	2,500	By P & L a/c (N.P. b/f)	23,000
To Varsha capital a/c	2,500		
To Harsha capital a/c 1/3 N.P.	6,000		
To Varsha capital a/c 1/3 N.P.	6,000		
To Karsha capital a/c 1/3 N.P.	6,000		
	23,000		23,000

Check Your Progress - 3

Anand and Mukesh are in partnership sharing profits and losses equally. They admitted Mukund giving him 1/5th share in future profits after guaranteeing an amount of Rs. 10,000 of profits every year to the old partners. The profit for the year 1990 amounted to Rs. 40,000. Pass journal entries.

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14.10 ADMISSION OF A PARTNER DURING THE ACCOUNTING YEAR

Normally, new partners are admitted into the firm at the beginning of the accounting year so that there is no dispute with regard to profits earned from the commencement of the accounting year to the date of admission. This simplifies the distribution of profits earned from the date of admission to the end of the accounting period. However, it is not necessary that one should be admitted at the beginning of the accounting period only.

Sometimes, a partner can be admitted during the course of the accounting year. But the profit and loss account cannot be prepared upto that date, as it would involve stock taking among other things. Hence, the profit and loss account is prepared at the end of the accounting period only. However, it is the old partners who are entitled to the profits earned upto the date of admission of the new partner, while all the partners are entitled to the profits earned after the admission of the new partner. Hence, it is necessary to estimate the profits for the pre-admission period and post-admission period. The profits of the entire accounting period are apportioned between the pre-admission period and post-admission period on the basis of sales or time (days or months) during those two periods.

It is explained in the following illustration :

Illustration - 12

Akhil and Nikhil are partners sharing profits and losses in the ratio of 2:1. They prepare their annual accounts at the end of each calendar year. On 1.5.1985 they decided to admit Sunil for 1 1/4th share in future profits of Rs. 48,000. Distribute the profits among the partners for the year ending on December 31, 1985.

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Solution

The profits for the entire year are Rs. 48,000/-
In the pre-admission period there are 4 months.
In the post-admission period there are 8 months.
Hence, the pre-admission and post-admission profits will be in 4:8 ratio or 1:2 ratio.
Therefore,

pre-admission profits are : 48,000 × 1/3 = 16,000.
post-admission profits are : 48,000 × 2/3 = 32,000.

Distribution of Profits

Profits of	Ratio	Akhil	Nikhil	Sunil	Total
		Rs.	Rs.	Rs.	Rs.
Pre-admission	2:1	10,667	5,333	–	16,000
Post-admission	2:1:1	16,000	8,000	8,000	32,000
		26,667	13,333	8,000	48,000

The following are some comprehensive illustrations involving admission of partner among other things:

Illustration - 13

Sudhakar and Karunakar are in partnership sharing profits and losses in the ratio of 3:2. Their Balance Sheet is as follows:

Balance Sheet as on 31st Dec., 1985

Liabilities	Rs.	Assets		Rs.
Creditors	4,000	Bank		6,500
Sudhakar capital	20,000	Debtors	10,000	
Karunakar capital	10,000	Less: Prov. BD.	4,000	
				6,000
		Stock		15,000
		Plant & Machinery		6,500
	34,000			34,000

On the 1st of January, 1986, they decided to admit Palekar into partnership and give him 1/2 share in future profits. Palekar was to bring into the business a building worth Rs. 10,000 as goodwill of the firm and sufficient capital to give him a half share in the total capital of the firm. It was further agreed to reduce the provision for bad debts to Rs. 1,000. The stock is to be taken at Rs. 20,000. The Plant is to be reduced to Rs. 5,000. Give journal entries for these and prepare the Balance Sheet of the newly constituted firm.

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Solution

Journal

			Rs.	Rs.
P & L Adjustment a/c	Dr.		1,500	
To Plant & Machinery a/c				1,500
(Being the entry for reducing the value of P & M)				
Provision for Bad debts a/c	Dr.		3,000	
Stock a/c	Dr.		5,000	
To P & L Adjustment a/c				8,000
(Being entry for gain on revaluation)				
P & L Adjustment a/c	Dr.		6,500	
To Sudhakar's capital a/c				3,900
To Karunakar's capital a/c				2,600
(Being the distribution of net gain on revaluation)				
Building a/c	Dr.		10,000	
To Goodwill a/c				10,000
(Being the entry for bringing building towards goodwill)				
Goodwill a/c	Dr.		10,000	
To Sudhakar's capital a/c				6,000
To Karunakar's capital a/c				4,000
(Being the entry for distributing goodwill among old partners)				
Bank a/c	Dr.		46,500	
To Palekar's capital a/c				46,500
(Being the amount brought in by a new partner)				

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

		Rs.		Rs.
To Plant and Machinery		1,500	By Provision for bad debts a/c	3,000
To Sudhakar's capital a/c	3,900		By Stock a/c	5,000
To Karunakar's capital a/c	2,600			
		6,500		
		8,000		8,000

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The capital to be brought in by the new partner is calculated as follows:

	Rs.
Sudhakar's capital-previously	20,000
Karunakar's capital-previously	10,000
Profit on revaluation	6,500
Goodwill	10,000
Total capital of Sudhakar & Karunakar :	46,500
Total Share of Sudhakar & Karunakar is	1/2
Their combined capital	46,500
Share of the new partner	1/2
Amount to be brought in by the new partner	46,500

Bank Account

Dr.	Rs.		Rs.	Cr.
To Balance b/d	6,500	By Balance c/d	53,000	
To Palekar's Capital a/c	46,500			
	53,000		53,000	
To Balance b/d	53,000			

Balance Sheet as on January 1, 1986

Liabilities	Rs.	Assets		Rs.
Sudhakar's capital	29,900	Building		10,000
Karunakar's capital	16,600	Plant & Machinery		5,000
Palekar's capital	46,500	Stock		20,000
Creditors	4,000	Debtors	10,000	
		Less: Prov. B.D.	1,000	9,000
		Bank balance		53,000
	97,000			97,000

Illustration - 14

Anand and Bhargava are partners sharing profits & Losses in 2:1 ratio. Their Balance Sheet was as follows on 31-12-1985:

	Rs.		Rs.
Anand's capital	1,50,000	Plant & Machinery	40,000
Bhargava's capital	1,00,000	Stock	2,20,000
Creditors	20,000	Debtors	1,50,000
Bank O.D.	1,50,000	Cash	10,000
	4,20,000		4,20,000

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On January 1st, 1986 they decided to admit Chaturvedi into partnership and give him 1/4 share in the future profits. The new partner had to bring in Rs. 30,000 for his share of goodwill and Rs. 1,00,000 towards capital. It was agreed that the Plant & Machinery was to be reduced by Rs. 4,000 and stock to be raised to Rs. 2,49,400. Provision was to be made for doubtful debts Rs. 5,000. It was also agreed that capitals should also be in proportion to that of Chaturvedi, either by bringing in additional cash or withdrawing.

Give the necessary journal entries, capital accounts and the Balance Sheet of the newly constituted firm.

Solution

Journal

		Rs.	Rs.
P & L Adjustment a/c Dr.		9,000	
To Plant & Machinery a/c			4,000
To Provision for doubtful debts			5,000
(Being the entry for loss on revaluation)			
Stock a/c Dr.		29,400	
To P & L Adjustment a/c			29,400
(Being the entry for raising the value of stock)			
P & L Adjustment a/c Dr.		20,400	
To Anand's capital a/c			13,600
To Bhargav's capital a/c			6,800
(Being the entry for distribution of profit on revaluation)			
Bank a/c Dr.		30,000	
To Goodwill a/c			30,000
(Being the entry for cash brought in by the new partner towards goodwill)			
Goodwill a/c Dr.		30,000	
To Anand's capital a/c			20,000
To Bhargav's capital a/c			10,000
(Being the entry for distribution of goodwill)			
Bank a/c Dr.		1,00,000	
To Chaturvedi capital a/c			1,00,000
(Being the cash brought in by new partner)			
Bank a/c Dr.		16,400	
To Anand's capital a/c			16,400
(Being the additional cash brought in)			
Bhargav's capital a/c Dr.		16,800	
To Bank a/c			16,800
(Being the excess capital withdrawn)			

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Anand's Capital A/c

Dr.			Cr.
	Rs.		Rs.
To Balance c/d	2,00,000	By Balance b/f	1,50,000
		By P & L Adjustment a/c	13,600
		By Goodwill a/c	20,000
		By Bank	16,400
	2,00,000		2,00,000
		By Balance b/d	2,00,000

Bhargav's Capital A/c

Dr.			Cr.
	Rs.		Rs.
To Bank	16,800	By Balance b/f	1,00,000
To Balance c/d	1,00,000	By P & L Adjustment a/c	6,800
		By Goodwill a/c	10,000
	1,16,800		1,16,800
		By Balance b/d	1,00,000

Chaturvedi's Capital A/c

Dr.			Cr.
	Rs.		Rs.
To Balance c/d	1,00,000	By Bank	1,00,000
	1,00,000		1,00,000
		By Balance b/d	1,00,000

Balance Sheet (of the new firm) as on the 1st January, 1986

Liabilities	Rs.	Assets		Rs.
Anand's capital	2,00,000	Plant & Machinery		36,000
Bhargav's capital	1,00,000	Stock		2,49,400
Chaturvedi's capital	1,00,000	Debtors	1,50,000	
Creditors	20,000	Less: Prov. for BD	5,000	
Bank Overdraft	20,400			1,45,000
		Cash		10,000
	4,40,400			4,40,400

Note : Chaturvedi's capital for 1/4th share is Rs. 1,00,000.

Capital adjustment working:

Remaining capital i.e., 1 – 1/4 = 3/4 must be equal to Rs. 3,00,000.

This amount must be contributed by Anand and Bhargav in 2:1 ratio.

Anand's share = Rs. 2,00,000

Bhargav's share = Rs. 1,00,000

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14.11 SUMMING UP

When a new partner is admitted into partnership, he is entitled to a share in the future profits of the firm. Hence, certain adjustments may have to be made in regard to assets and liabilities, undistributed profits/losses and goodwill. Goodwill is generally valued by Average Profits Method, Super Profits Method and Capitalisation Method.

When a new partner joins the partnership, generally, he may have to contribute capital and also compensate the old partners by way of goodwill. Goodwill is treated in the books in different ways. Whenever there is a change in the partnership deed, there is a need to calculate the new profit sharing ratio.

The old partners, on admission of a new partner, sometimes, adjust their capital accounts in proportion to their new profit sharing ratio. Sometimes, the partner may be guaranteed a minimum amount of profit by one or more old partners. Often, a new partner may be admitted during the accounting year. In such a case, profit for the pre-admission and post-admission are calculated separately. The pre-admission profit is distributed among the old partners and the profit for the period of post-admission is distributed among all the partners in the new profit sharing ratio.

14.12 CHECK YOUR PROGRESS : MODEL ANSWERS

Journal Entries

				Rs.	Rs.
1.	(i)	Revaluation a/c	Dr.	900	
		To Machinery a/c			400
		To Provision for bad and doubtful debts			500
		(Being the reduction in the value of Machinery and Debtors)			
	(ii)	Land and Buildings a/c	Dr.	4,000	
		To Revaluation a/c			4,000
		(Being the value of land and Buildings appreciated)			
	(iii)	Revaluation a/c	Dr.	3,100	
		To A's capital a/c			1,860
		To B's capital a/c			1,240
		(Being the profit on revaluation distributed)			
	(iv)	Bank a/c	Dr.	5,000	
		To C's capital a/c			5,000
		(Being the capital brought in by 'C')			

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Dr. **Revaluation A/c** Cr.

	Rs.		Rs.
To Machinery a/c	400	By Land and Buildings a/c	4,000
To Provision for Bad and Doubtful debts a/c	500		
To A's Capital a/c	1,860		
To B's Capital a/c	1,240		
	4,000		4,000

2. (a) Difference between old ratio and new ratio.

(b) A : B : C = 6 : 5 : 3

D's share = $\frac{1}{8}$

∴Remaining share : $1 - \frac{1}{8} = \frac{7}{8}$

Now,

A's share = $\frac{7}{8} \times \frac{6}{14} = \frac{6}{16}$

B's share = $\frac{7}{8} \times \frac{5}{14} = \frac{6}{16}$

C's share = $\frac{7}{8} \times \frac{3}{14} = \frac{3}{16}$

D's share = $\frac{1}{8}$ or $\frac{2}{16}$

Thus, new profit sharing ratio = 6 : 5 : 3 : 2

(c) Sacrificing Ratio : Old Ratio – New Ratio

Old Ratio of A and B = 3 : 2

New Ratio of A, B and C = 8 : 7 : 5

A's Sacrificing share = $\frac{3}{5} - \frac{8}{20} = \frac{4}{20}$

B's Sacrificing share = $\frac{2}{5} - \frac{7}{20} = \frac{1}{20}$

∴Sacrificing Ratio = 4 : 1

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			Rs.	R
3.	(i)	P & L Appropriation a/c. Dr.	10,000	
		To Anand's capital a/c		5,0
		To Mukhesh's capital a/c		5,0
		(Being the distribution of guaranteed profit)		
	(ii)	P & L Appropriation a/c Dr.	30,000	
		To Anand's capital a/c		12,0
		To Mukhesh's capital a/c		12,0
		To Mukund's capital a/c		6,0
		(Being the remaining profit distributed among all the partners in the ratio of 2:2:1 (i.e., new ratio)		

14.13 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines each.

1. Explain the various methods of valuaing goodwill.
2. Explain the various methods of treatment of goodwill.

B. Answer the following in 15 lines each.

1. Why should assets and liabilities be revalued before the admission of a new partner?
2. How do you treat the goodwill under 'Premium Method'?
3. How do you treat the goodwill under 'Premium Method'?
4. How capital accounts of the partners are adjusted when a new partner is admitted?

Problems

1. Anita, Binata, Mamata were sharing profits in the ratio of 4:3:2. They decided to admit Sarita into partnership for 1/3 share in future profits. Calculate the new profit sharing ratio and the ratio in which the old partners have sacrificed.

   (Answer : New ratio – 8:6:4:9; sacrificing ratio – 4:3:2)

2. Vani and Rani were in partnership sharing profits in 4:3 ratio. They admitted Subhashini into the firm by offering her 3/7th share in future profits (which she takes 2/7th from Vani and 1/7th from Rani). Ascertain the new profit sharing ratio and the sacrificing ratio.

   (Answer : New ratio – 2:2:3; sacrificing ratio – 2:1)

3. Ashwani and Bharani were in partnership sharing profits and losses 3/5 and 2/5 respectively. Their capital balances were Rs. 1,00,000 and Rs. 75,000 respectively. They agreed to admit Kartik into Partnership for a third share in future profits. Kartik brought in Rs. 1,00,000. As he is unable to bring in anything more towards Goodwill, it is agreed to raise the Goodwill account in the books which was valued at Rs. 75,000.

   Give journal entries, capital accounts of the partners. Calculate the ratio in which they have to share future profits.

   (Answer : Capitals : Aswani Rs. 1,45,000; Bharani Rs. 1,05,000, Kartik Rs. 1,00,000; Ratio: 6:4:5)

4. Radha and Ramani are partners in a firm. Their Balance Sheet was as under on 31st December, 1985:

Liabilities	Rs.	Assets	Rs.
Radha's capital	30,000	Cash at bank	10,000
Ramani's capital	20,000	Sundry debtors	32,000
Reserve fund	8,000	Stock	25,000
Creditors	35,000	Furniture	11,000
Expenses payable	5,000	Machinery and Plant	20,000
	98,000		98,000

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They decided to admit Rajani into partnership with the following adjustments:

a) Provision for doubtful debts has to be created at Rs. 6,000.

b) Investments not appearing in the books amounted to Rs. 8,000.

c) Furniture is to be depreciated to Rs. 8,000.

d) Rajani has to bring in Rs. 20,000 towards capital and Rs. 20,000 towards goodwill (which is withdrawn by old partners).

Give journal entries, necessary ledger accounts and balance sheet after admission.

(Answer : Loss Rs. 1,000; Balance Sheet total Rs. 1,17,000)

5. Atmaram and Rajaram are partners sharing profits and losses in 3:2 ratio. They decided to admit Dharaniram who has to bring in Rs. 80,000 towards capital and Rs. 20,000 towards goodwill. Their new profit sharing ratio shall be 2:2:1. Their balance sheet before admission was as under:

Liabilities	Rs.	Assets	Rs.
Capital: Atmaram	80,000	Goodwill	25,000
Rajaram	80,000	Plant & Machinery	1,55,000
General Reserve	40,000	Debtors	20,000
Sundry creditors	20,000	Cash at bank	20,000
	2,20,000		2,20,000

They decided that Goodwill account should appear in the books at Rs. 60,000.

Give journal entries and necessary ledger accounts and prepare the Balance Sheet after admission of Dharaniram.

(Answer : Balance Sheet Total Rs. 3,55,000)

6. Amar and Akbar were in partnership sharing profits in 2:1 ratio. They decided to admit Anthony on 1st January 85 for 1/6th share in future profits. Anthony was to bring Rs. 1,00,000 towards capital and Rs. 8,000 towards goodwill. Amar and Akbar agreed to share profits equally after Anthony's admission. Their balance sheet stood as under on 31st December 1984:

Liabilities	Rs.	Assets	Rs.
Capital: Amar	1,25,000	Cash	10,000
Akbar	75,000	Stock	1,00,000
Creditors	80,000	Debtors	64,000
Bills payable	20,000	Machinery	50,000
		Furniture	76,000
	3,00,000		3,00,000

The following adjustments were agreed, on admission:

a) Stock, Machinery and Furniture are to be taken at Rs. 1,10,000 Rs. 40,000, and Rs 70,000 respectively.

b) Provision for doubtful debts to be created at Rs. 3,000. Amar has agreed to share the entire loss on these adjustments.

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For the year ended 31st December, 1985 the firm earned a profit of Rs. 2,40,000 and their drawings amounted to Rs. 80,000, Rs. 80,000 and Rs. 20,000 respectively.

Journalise the adjustments on 1st January 1985. Give the capital accounts of the partners. Assuming that the entire profit is in the form of cash prepare the balance sheet of the firm as on 31st December, 1985.

(Answer : Capital : Amar Rs. 1,48,000, Akbar Rs. 91,000.
Anthony Rs. 1,20,000, Balance Sheet Total Rs. 4,59,000)

7. The balance sheet of Aruna and daughters stood as under as on 31st December, 1985:

Liabilities	Rs.	Assets	Rs.
Capital: Aruna	21,700	Goodwill	11,900
Karuna	16,600	Buildings	19,500
Varuna	9,000	Furniture	2,400
Creditors	9,300	Stock	11,000
		Debtors	11,800
	56,600		56,600

They decided to admit Taruna into partnership on the following terms:

1. Taruna should bring 15,000 (towards capital and Rs. 5,000 towards goodwill).
2. Goodwill account should not appear in the books.
3. Stock and Debtors were to be taken at Rs. 1,140, Rs. 540 less respectively. Building to be raised by Rs. 7,500.
4. The total capital of the firm shall be Rs. 40,000. Capitals are to be adjusted transferring excess amount to current accounts and assuming that deficit is made good in cash.

Prepare necessary ledger accounts and the balance sheet of the newly constituted firm.

(Answer : Balance Sheet Total Rs. 66,880.)

8. Siva and Vishnu are in partnership sharing profits and losses in the proportion of 3/4 and 1/4 respectively. The balance sheet of the firm on 31st December 1989 was as follows:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	33,200	Cash at bank	18,000
Capital: Siva	24,000	Bills receivable	2,400
Vishnu	12,800	Book debts	12,800
		Stock	16,000
		Furniture	800
		Building	20,000
	70,000		70,000

On 1st January 1990 Brahma was admitted into partnership on the following terms :

(i) Brahma pays Rs. 8,000 as capital for 1/5th share in the firm.

(ii) Stock and furniture be reduced by 10% and 5% provision for doubtful debts be created on Book debts and bills receivable.

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(iii) Value of Building be increased by 20%.

(iv) A liability to the extent of Rs. 800 be created in respect of a claim for damages against the firm.

(v) An item of Rs. 400 included in sundry creditors need not be paid and hence can be excluded.

Prepare Revaluation Account, Partners' Capital Accounts and the Initial Balance Sheet of the firm.

(Ans: Revaluation profit Rs. 1,280, Initial Balance Sheet Rs. 79,560)

9. The Balance Sheet of A and B who share profits and losses in the ratio of 3:2 as on 31-12-1986 was as follows:

Liabilities		Rs.	Assets		Rs.
Capitals:			Building		20,000
A :	30,000		Machinery		16,000
B :	20,000		Furniture		6,000
		50,000	Debtors	21,200	
General Reserve		10,000	L. RDD	1,200	
Creditors		12,000			20,000
Bills payable		6,000	Stock		10,000
Profit and Loss a/c		2,000	Cash at bank		8,000
		80,000			80,000

On 1st January 1987 partners agreed to admit C for one third share of profits on the following terms:

i) Building is to be revalued at Rs. 40,000

ii) Machinery is to be depreciated by 10%

iii) Reserve for doubtful debts is estimated at Rs. 1,600

iv) Goodwill of the firm is to be valued at Rs. 30,000.

v) 'C' brings sufficient cash for his share of goodwill.

vi) The capitals of old partners are adjusted to new ratio on the basis of the capital of 'C'.

vii) A and B also become equal partners on his admission.

viii) 'C' brings cash Rs. 16,000, machinery worth Rs. 6,000, building worth Rs. 8,000; as capital.

Prepare capital accounts and balance sheet and also pass the journal entries.

Note : Goodwill should be distributed in the sacrificing ratio i.e., in 4:1 ratio.

(Ans: Revaluation profit Rs. 20,000; Balance Sheet Rs. 1,08,000)

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14.14 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy, M. : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Jain, S.P & Narang, K.L. : Advanced Accountancy, Kalyani Publishers, New Delhi & Ludhiana.
3. Maheswari, S.N : Advanced Accountancy, Vikas Publishing House, New Delhi.

14.15 GLOSSARY

Accumulated Profit/Loss : Profit/Losses not distributed, but allowed to accumulate.

Adjustment of Assets and Liabilities : Adjusting the balances of assets and liabilities to their true values.

Good will : Present value of anticipated excess earnings (OR) extra saleable value attached to prosperous business, beyond the intrinsic value of Net Assets.

Gaining Ratio : Difference between new and old ratio.

New Partner : Person to be admitted into the existing partnership.

Old Partners : The, then existing partners in the firm before a new partner is admitted.

Revaluation Account : An account prepared to show the increase and decrease in the value of assets and liabilities on the admission of a new partner.

Sacrificing Ratio : Ratio in which the partners have agreed to sacrifice their share.

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UNIT - 15 : RETIREMENT OR DEATH OF A PARTNER

Contents

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15.2 Revaluation of Assets and Liabilities
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15.0 AIMS AND OBJECTIVES

The aims of this unit are to acquaint you with the accounting process involved at the time of retirement or death of a partner.

Having gone through this unit, you should be able to :

- adjust the assets and liabilities as per the agreement of partnership
- calculate the gaining ratio of partners remaining after the retirement/death of a partner
- find out the amount due to retiring / deceased partner
- adjust the capitals of continuing partners.

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15.1 INTRODUCTION

Sometimes, the partner of the firm may decide to retire for personal or business reasons. According to the Partnership Act, a partner can retire as per the following three methods :

a) One can retire from the firm if all the other partners agree to the same.
b) If there is an express agreement among the partners, the partner can retire accordingly.
c) If the partnership is at will, one can retire from the firm by giving a notice of his desire to retire from the firm.

When retirement of a partner is at his free will, a partner's exit may become inevitable when he dies while in partnership.

In both the above cases i.e. when a partner retires or dies, it is necessary to find out what is the amount due to the retiring/deceased partner and how it is to be paid out. We have seen in unit 14, that certain adjustiments, are necessary before a new partner is admitted. Similarly, adjustments in regard to accumulated profits, goodwill, assets and liabilities may be necessary to ascertain the amount due to retiring/deceased partner. We shall now see what adjustiments are required.

15.2 REVALUATION OF ASSETS & LIABILITIES

The assets and liabilities are revalued either in the case of death or retirement, as is done in the case of admission of a partner. However, the net loss or gain on account of revaluation is distributed to all the partners including the retiring/deceased partner.

15.3 ACCUMULATED PROFITS & LOSSES

The undistributed profits/losses belong to all the partners of the firm including the retiring/deceased partner. Hence, to ascertain the amount due to them, it is necessary to distribute such accumulated profits/losses to all the partners. The procedure to be followed is similar to that of admission of a partner explained earlier. However, when the remaining partners decide to continue the business without any charge in the profit sharing ratio between them the accumulated profits/losses can be distributed only to the retiring/ deceased partner, instead of all the partners.

15.4 ADJUSTMENT OF GOODWILL

Goodwill is valued in a similar manner as explained in unit 14 i.e. average profits method, super profits method and capitalisation method.

The retiring/deceased partner is also entitled to share in the goodwill of the firm. It is to be credited to him as follows :

a) When there is no goodwill account in the books and it is to be raised to its full value the following journal entry is passed :

Goodwill a/c.	Dr. (for its full value)
To All the partners' capital a/cs.	(in their profits sharing ratio)

b) When there is goodwill account already in the books, but it is less than the full value :

When the good will account in the books is appearing at an amount less than its full value, the difference is ascertained and the entry at (a) above is passed for such difference amount.

c) When there is goodwill account already in the books and its value is more than the full value :

In such cases, the difference is ascertained and the following entry is passed for the difference of amount.

All the Partners' capital accounts	Dr. (in their profit ratio)
To Goodwill a/c.	(for difference amount)

d) When the goodwill account is to be raised and then written off :

In the circumstances (a) (b) & (c) explained above, goodwill account is brought to its full value. However, the continuing partners may decide to write off the account and not to show in the Balance Sheet. The following additional entry is necessary to write off the account:

Continuing partners' capital accounts.	Dr. (in their revised ratio)
To Goodwill a/c.	

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e) When the goodwill account is raised only to the share of retiring /deceased partner :

Some times goodwill account may be raised only to the extent of the share of the retiring/deceased partner instead of its full value. The following entry is necessary:

Goodwill a/c.	Dr. (to the extent of retiring/ deceased partners share)
To The retiring/deceased partners' capital a/c.	

Later if it is decided to write off the goodwill account the following journal entry is necessary:

Continuing partners' capital a/cs.	Dr. (in gaining ratio)
To Goodwill account.	

The above treatment is valid when there is no change in the profit sharing ratio of old partners.

15.5 CALCULATION OF GAINING RATIO OF THE REMAINING PARTNERS

Usually, when a partner dies/retires from the firm, the other partners continue to stay in the business and share the profits and losses in the ratio in between them. In other words, they gain (the retiring/deceased partner's share of profit/loss) in their previous ratio. However, sometimes the new ratio of the continuing partners may be given. In such cases it is necessary to calculate the gain, by deducting the new proportion from the previous proportion. This gaining ratio is necessary as the compensation to the retiring/ deceased partner is to be paid by the continuing partners in the gaining ratio. This is the reverse of the sacrificing ratio we have learnt in the case of Admission of a partner in Unit 14.

15.6 ASCERTAINING THE AMOUNT DUE TO THE RETIRING/DECEASED PARTNER

The total amount payable to the retiring/deceased partner comprises the following:

i) Capital account balance
ii) Interest on capital and salary, if any, upto the date of retirement/death.
iii) Share of accumulated profits/losses.
iv) Share of profit/loss on revaluation.
v) Share of goodwill.
vi) Share of profit/loss for the current period, from the date of last preparation of final accounts to the date of retirement/death.

This can be ascertained proportionately on the basis of previous year profits. However, it is necessary to refer to the agreement, before selecting a particular basis.

From the aggregate of the above amount, the withdrawals made by the partner, the interest, if any, due on the same should be deducted. The resulting figure is the amount due to the retiring/deceased partner.

BRAOU

Check your Progress - 1

(a) What is gaining ratio?

.....

.....

(b) How do you ascertain the amount due to Retiring/Deceased Partner?

.....

.....

.....

.....

15.7 ADJUSTING THE CAPITALS OF THE CONTINUING PARTNERS

Sometimes, the continuing partners may decide to adjust their capital amount balances to their new profit sharing ratio. The total capital of all the partners is taken as the firm's capital and the amount each individual partner is required to maintain is ascertained on the basis of the new profit sharing ratio. If the amount so arrived at is less than the existing balance, the difference amount is refunded to him or cerdited to his current account. If the amount so arrived at is more than the existing balance the partner would be asked to bring the difference amount or his capital account is credited by debiting his current account.

15.8 MODE OF PAYMENT TO RETIRING/DECEASED PARTNER

The amount due to the retiring partner or deceased partner is paid out in the following ways :

a) **Lumpsum payment :** The entire amount due, is paid to the retiring partner or the executors of the deceased partner in lumpsum. The required funds can be borrowed from Bank or can be found from a joint life policy (in the case of death of one of the partners). However, it is difficult to pay heavy amount suddenly. Hence, this method is not usually adopted.

b) **Instalment method :** The entire amount due is transferred to his Loan account (Executors of Deceased Partner's Loan account - in the case of deceased partner) and the amount is paid out together with agreed interest in certain fixed instalments.

Before selecting a particular method, it is necessary to refer the Partnership Agreement, whether there is any provision in this regard.

The following illustrations will make the above adjustments clear.

Illustration - 1

Ajit, Biswas and Chatterjee are partners in a firm sharing profits and losses equally. On 31st December, 1985, their Balance Sheet was as follows :

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Liabilities	Rs.	Assets		Rs.
Sundry Creditors	16,900	Cash at Bank		3,000
Investment Reserve	1,200	Debtors	12,000	
		Less: Prov. DD	800	
				11,200
Ajit's capital	30,000			
Biswas's capital	20,000	Stock		10,000
Chatterjee's capital	20,000	Investment (Cost)		5,000
		Property		20,000
		Goodwill		38,900
	88,100			88,100

On January 31st, 1986 Chatterjee was allowed to retire. As per the Partnership Agreement (i) Goodwill is to be valued as two years purchase of average profits of last 3 years and (ii) profit to the date of retirement of partner has to be calculated on the basis of average profits of previous three years.

It was agreed to by the partners that property is to be taken at Rs.30,000, Investments at Rs.4,700 and there is no necessity for Provision for doubtful debts as all the debtors are good.

Profits for preceding three years are :
1985 : 12,000 1984 : 10,500 1983 : 9,000

Pass journal entries and show the retiring partner's account and the Balance Sheet after retirement of Chatterjee.

Solution

Journal

			Rs.	Rs.
Ajit's capital a/c.	Dr.		5,967	
Biswas's capital a/c.	Dr.		5,967	
Chatterjee's capital a/c.	Dr.		5,966	
To Goodwill a/c.				17,900
(Being the entry for bringing down the goodwill to its value)				
Profit & Loss a/c.	Dr.		292	
To Chatterjee's capital a/c.				292
(Being Chatterjee's profit for 1 month)				
Property a/c.	Dr.		10,000	
Provision for Doubtful debts a/c.	Dr.		800	
Investment Reserve a/c	Dr.		900	
To P & L Adj. a/c.				11,700
(Being the entry for revaluing the items)				

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P & L Adjustment a/c.	Dr.		11,700	
To Ajit's capital a/c.				3,900
To Biswas's capital a/c.				3,900
To Chatterjee's capital a/c.				3,900
(Being the entry for transferring the profit on revaluation)				
Chatterjee's capital a/c.	Dr.		18,226	
To Chatterjee's loan a/c.				18,226
(Being the entry for transferring the amount due to his loan a/c.)				

Dr. **Chatterjee's Capital A/c.** Cr.

	Rs.		Rs.
To Goodwill a/c.	5,966	By Balance	20,000
To Chatterjee's loan a/c.	18,226	By P & Ajustment a/c.	3,900
		By P & L a/c.	292
	24,192		24,192

Balance Sheet as on 31st January, 1986

Liabilities	Rs.	Assets		Rs.
Ajit's capital	27,933	Goodwill		21,000
Biswas's capital	17,933	Property		30,000
Chatterjee's loan	18,226	Investments	5,000	
Sundry Creditors	16,900	Less: Inv. Reserve	300	
				4,700
Sundry Creditors	16,900	Stock		10,000
		Sundry Debtors		12,000
		Cash at Bank		3,000
		P & L A/c.		292
	80,992			80,992

Calculation: Average Profit $= \frac{12,000 + 10,500 + 9,000}{3} = \frac{31,500}{3}$ = Rs. 10,500

Goodwill = 2 × 10,500 = Rs. 21,000

Profit for 1 month $= \frac{10,500}{12}$ = Rs. 875

Share of profit of Chatterjee $= \frac{875}{3}$ = Rs. 292

Illustration - 2

P, Q and R were in partnership sharing profits and losses equally. On 1-1-86 P retired when the firm's Balance Sheet was as under:

BRAOU

Liabilities		Rs.	Assets	Rs.
Capital Accounts:			Land & Buildings	8,400
P	16,000		Plant & Machinery	13,960
Q	13,600		Debtors	17,830
R	15,600	45,200	Investments	16,000
Reserve Fund		12,000	Cash	14,860
Creditors		13,850		
		71,050		71,050

The partners agreed to revalue the assets on P's retirement as follows:

Land and Buildings	Rs. 11,600;
Plant and Machinery	Rs. 13,128;
Investments	Rs. 16,800.

Besides, goodwill was valued at Rs. 19,200. P's amount was settled by giving investments valued at Rs. 16,800 and the remaining in cash. For this purpose, Q brought in Rs. 8,000 as additional capital.

Prepare Revaluation a/c, partners' capital accounts and the revised balance sheet assuming that Goodwill Account is not raised in the books.

Solution

Revaluation Account

		Rs.		Rs.
To Plant Machinery		832	By Land and Buildings	3,200
To Profit on Revaluation:			By Investments	800
P	1,056			
Q	1,056			
R	1,056			
		3,168		
		4,000		4,000

Capital Accounts

	P	Q	R		P	R	R
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To P's Capital	–	3,200	2,300	By Balance b/d	16,000	13,600	15,600
To Investments	16,800	–	–	By Revaluation Profit	1,056	1,056	1,056
To Bank	10,656	–	–	By Q's capital	3,200	–	–
To Balance c/d	–	23,456	17,456	By R's capital	3,200	–	–
				By Reserve Fund	4,000	4,000	4,000
				By Bank	–	8,000	–
	27,456	26,656	20,656		27,456	26,656	20,656

BRAOU

Cash Account

	Rs.		Rs.
To Balance b/d	14,860	By P's capital a/c	10,656
To Q's capital a/c	8,000	By Balance c/d	12,204
	22,860		22,860

Balance Sheet

Liabilities		Rs.	Assets	Rs.
Creditors		13,850	Land and Buildings	11,600
Capitals:			Plant & Machinery	13,128
Q	23,456		Debtors	17,830
R	17,456		Cash at Bank	12,204
		40,912		
		54,762		54,762

Illustration - 3

Lakshmayya, Obayya and Nandayya are in partnership sharing profits and losses in 2:2:1 ratio. They are entitled to interest on capitals at 5% p.a. and salary of Rs. 600, Rs. 500, and Rs. 400 p.m. respectively. Their balance sheet on December 31st, 1984 was as follows:

	Rs.		Rs.
Lakshmayya's capital	70,000	Sundry assets	80,000
Obayya's capital	60,000	Sundry Debtors	50,000
Nandayya's capital	30,000	Cash at Bank	30,000
Obayya's current a/c.	7,000	Lakshmayya's current a/c.	20,000
Nandayya's current a/c.	3,000		
Sundry creditors	10,000		
	1,80,000		1,80,000

Lakshmayya died on 30th June 1985. According to Partnership Deed the deceased partner is entitled to share of profit upto the date of death on the basis of average profits of preceding two years and share of goodwill on the basis of one year's purchase of average profits of preceding three years, in addition to balance in the capital account interest on capital at 5% and salary.

The profits were as follows:
1984 - 60,000; 1983 - 50,000 1982 - 40,000.

The other partners decided to continue the business and pay off the executors of Lakshmayya, by raising a Bank loan of Rs. 80,000.

Give journal entries Lakshmayya's capital account and the Balance Sheet of Continuing Partners.

BRAOU

Solution

Journal

		Rs.	Rs.
Profit & Loss a/c.	Dr.	11,000	
Interest on capital a/c.	Dr.	1,750	
Partner's salary a/c.	Dr.	3,600	
To Lakshmayya's capital a/c.			16,350
(Being the estimated profit upto date of death, Interest on capital & salary entitled)			
Goodwill a/c.	Dr.	50,000	
To Lakshmayya's capital a/c.			20,000
To Obayya's capital a/c.			20,000
To Nandayya's capital a/c.			10,000
(Being Goodwill a/c. raised)			
Lakshmayya's capital a/c.	Dr.	20,000	
To Lakshmayya's current a/c.			20,000
(Being his current a/c. balance transferred)			
Lakshmayya's capital a/c.	Dr.	86,350	
To Executors of Lakshmayya's loan a/c.			86,350
(Being the amount due, transferred to Executors' Loan a/c.)			
Bank a/c.	Dr.	80,000	
To Bank Loan a/c.			80,000
(Being Bank loan raised)			
Executors of Lakshmayya's Loan a/c.	Dr.	86,350	
To Bank a/c.			86,350
(Being the amount paid)			

Ledger

Lakshmayya's Capital A/c.

Dr.	Rs.		Cr. Rs.
		By Balance	70,000
To Lakshmayya's current a/c.	20,000	By Interest on capital a/c.	1,750
To Executors of Lakshmayya's Loan a/c.	86,350	By Partner's salary a/c.	3,600
		By P & L a/c.	11,000
		By Goodwill a/c.	20,000
	1,06,350		1,06,350

BRAOU

Dr. **Cash Account** Cr.

	Rs.		Rs.
To Balance b/d	30,000	By Executors of Laxmaiah a/c.	86,350
To Bank Loan a/c.	80.000	By Balance c/d	23,650
	1,10,000		1,10,000

Dr. **Executors of Lakshmayya's Loan a/c.** Cr.

	Rs.		Rs.
To Bank	86,350	By Lakshmayya's capital a/c.	86,350

Calculations : $\frac{\text{Profit upto date of death}}{\text{Average profit of last 2 years}} = \frac{60,000 + 50,000}{2}$

= Rs. 55,000

Lakshmayya's share $= 55,000 \times \frac{6}{12} \times \frac{2}{5}$ = Rs. 11,000

Goodwill of the firm :

Average profit of last 3 years $= \frac{60,000 + 50,000 + 40,000}{3}$

$= \frac{1,50,000}{3} = 50,000$

One year's purchase = 1 × 50,000 = Rs. 50,000.

Balance Sheet as on July 1, 1985

Liabilities	Rs.	Assets		Rs.
Obayya's capital	80,000	Goodwill		50,000
Nandayya's capital	40,000	Sundry assets		80,000
Bank Loan	80,000	Sundry Debtors		50,000
Obayya's current a/c.	7,000	P & L a/c.	11,000	
Nandayya's current a/c.	3,000	Int. on capital	1,750	
Sundry creditors	10,000	Partners salary	3,600	
		Cash		16,350
				23,650
	2,20,000			2,20,000

Illustration - 4

Basu, Sen and Gupta are partners sharing profits and losses equally. On 1st January 1983, Basu retires from the firm, on which date their balance sheet stood as under:

Liabilities	Rs.	Assets	Rs.
Basu capital	20,000	Property	40,000
Sen capital	20,000	Sundry debtors	20,000
Gupta capital	20,000	Bills Receivable	10,000
Reserve	15,000	Cash at Bank	5,000
	75,000		75,000

BRAOU

Goodwill of the firm is valued at Rs. 15,000. Sen and Gupta decided to continue the business. It was agreed to between the continuing partners and Basu that the amount due to Basu should be paid in three equal yearly instalments of Rs. 11,016 each including 5% interest on the balances. Show Basu's account.

Solution

Basu's Capital A/c.

Dr.			Cr.	
		Rs.		Rs.
To Basu's loan a/c.		30,000	By Balance	20,000
			By Goodwill	5,000
			Reserve	5,000
		30,000		30,000

Basu's Loan account

Dr.			Cr.		
		Rs.			Rs.
1983			1983		
Dec.31	To Bank	11,016	Jan. 1	By Basu's capital account	30,000
" 31	To Balance c/d.	20,484	Dec.31	By Interest at rate of 5%	1,500
		31,500			31,500
1984			1984		
Dec.31	To Bank	11,016	Jan. 1	By Balance b/d.	20,484
" 31	To Balance c/d.	10,492	Dec.31	By Interest at the rate of 5%	1,024
		21,508			21,508
1985			1985		
Dec.31	To Bank	11,016	Jan. 1	By Balance b/d.	10,492
			Dec.31	By Interest at the rate of 5%	524
		11,016			11,016

Note : Interest is rounded off to the nearest rupee.

Illustration - 5

Chand, Balu and Suraj are in partnership sharing profits and losses in 4:3:2 ratio. Their balance sheet on 31st December 1984 was as under:

BRAOU

	Rs.		Rs.
Creditors	40,000	Cash in hand	20,000
Mortgage loan	50,000	Cash at Bank	10,000
Chand's capital	2,00,000	Sundry debtors	1,30,000
Balu's capital	1,50,000	Stock	1,80,000
Suraj's capital	1,00,000	Plant & Machinery	2,00,000
	5,40,000		5,40,000

Chand decided to retire the firm on 31st March 1985. As per the partnership agreement, when a partner retires, he is entitled to goodwill calculated at 2 years' purchase of average profits of previous 5 years; and profit upto the date of retirement on the basis of previous year's profits. Profits for the previous year amounted to Rs. 1,44,000. Profits for the previous 5 years amounted to Rs. 4,50,000.

Show Chand's capital account and the balance sheet of continuing partners, assuming that the continuing partners decided to write off the Goodwill account.

Solution

Dr. **Chand's Capital A/c.** Cr.

	Rs.		Rs.
To Chand Loan a/c.	2,96,000	By Balance b/f	2,00,000
		By Goodwill	80,000
		By Profit & Loss a/c.	16,000
	2,96,000		2,96,000

Calculation:

Goodwill: Total profits for previous 5 years = 4,50,000
Average profit per annum = 90,000
Two years purchase = 2 × 90,000 = 1,80,000.
Chand's share = 1,80,000 × 4/9 = Rs. 80,000.

Profit: Previous year's profit = 1,44,000.
Profit for 3 months = 1,44,000 × 3/12
Chand's share = 1,44,000 × 3/12 × 4/9 = Rs. 16,000.

Balance Sheet as on April 1, 1985

Liabilities	Rs.	Assets	Rs.
Creditors	40,000	Cash on hand	20,000
Mortgage loan	50,000	Cash at bank	10,000
Chand loan a/c.	2,96,000	Sundry debtors	1,30,000
Balu's capital	1,02,000	Stock	1,80,000
Suraj's capital	68,000	Plant & Machinery	2,00,000
		P & L a/c.	16,000
	5,56,000		5,56,000

EGAOU

Check Your Progress - 2

(a) What is the journal entry to be passed for transferring the amount due to retiring partner?

.....

.....

.....

(b) What is the journal entry to be passed for transferring the amount due to the deceased partner?

.....

.....

.....

15.9 SUMMING UP

When a partner retires or dies, adjustments (as are made on admission of a partner) in regard to accumulated profits, goodwill, assets and liabilities and profit upto the date of retirement/death, may be required to be made to ascertain the amount due to retiring or deceased partner. He is paid out the amount in lumpsum or the amount is transferred to a Loan Account and paid out together with agreed interest in certain instalments.

15.10 CHECK YOUR PROGRESS : MODEL ANSWERS

1. (a) Difference between New Ratio and Old Ratio, or excess of New Ratio over Old Ratio.

   (b) (i) Balance of Capital account.

   (ii) Interest on capital, salary if any, upto the date of retirement / death.

   (iii) Share of accumulated Profits / losses.

   (iv) Share of revaluation profit and goodwill.

   (v) Share of profit from the date of last final accounts to the date of retirement / death.

   The sum of all the above would be the amount payable to the retiring / deceased partner.

2 (a) Retiring partner's capital a/c. Dr.
To Retiring partner's loan a/c.
(Being the amount due to the retiring partner transferred to his loan account).

(b) Deceased partner's capital a/c. Dr.
To Deceased partner's Executors's a/c.
(Being the amount due to the deceased partner transferred to his executors' account).

BRAOU

15.11 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines.

1. How is the account of a retiring partner/deceased partner settled?

B. Answer the following in 15 lines.

1. What are the usual adjustments that are required in the case of retirement or death of a partner.
2. How is the account of retiring/deceased partner settled?
3. How are the profits upto the date of retirement/death ascertained?

Problems

1. The balance sheet of Alkesh, Dinesh, Mody sharing profits and losses in 4:3:2 ratio was as under, as on 31st December, 1985:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	8,280	Cash	6,600
Capitals:		Debtors	5,880
Alkesh	24,000	Stock	9,600
Dinesh	18,000	Machinery	10,200
Mody	12,000	Building	30,000
	62,280		62,280

Dinesh desired to retire from the firm and the partners agreed to the following :

a) Building to be taken at Rs. 33,000.

b) A debtors account for Rs. 210 is not included in the above.

c) Stock to be raised by Rs. 1,920.

d) Dinesh has to pay to Alkesh and Mody Rs. 840 and Rs. 780 respectively. Adjustment is to be made in accounts.

e) Dinesh's share of goodwill out of the firm's goodwill of Rs. 10,818, is to be debited to Alkesh & Mody (who are going to share profits in future in 2:1 ratio) and credited to Dinesh.

f) The entire capital of the firm after Dinesh's retirement is to be readjusted in the future profit sharing ratio of continuing partners, by bringing in or withdrawing necessary cash.

Pass journal entries and prepare the balance sheet of the continuing partners.

(Answer : Profit Rs. 5,310. Balance Sheet Total Rs. 67,410)

BRAOU

2. **Ajay, Biswas and Kamalesh were in partnership sharing profits and losses as to 1/2, 1/3 and 1/6 respectively. Their balance sheet stood as under as on 31st December, 1985:**

Liabilities	Rs.	Assets	Rs.
Creditors	20,000	Goodwill	1,00,000
Bills payable	10,000	Fixed Assets	1,00,000
Capitals:		Current assets	1,30,000
Ajay	1,40,000		
Biswas	1,00,000		
Kamalesh	60,000		
	3,30,000		3,30,000

On 1st January 1986 Kamalesh retired and his interest in the firm was fixed at Rs. 80,000. Ajay and Biswas brought the amount in their profit sharing proportion and paid to Kamalesh. Ramesh was admitted into partnership on the same date for a 1/6th share of future profits. Ramesh agreed for Goodwill of Rs. 60,000 being credited to Ajay and Biswas. Ramesh agreed to bring in 20% of the combined capitals of Ajay and Biswas (after all adjustments).

Prepare partner's capital accounts and give the balance sheet of the firm after admission of Ramesh.

(Answer : Balance Sheet Total Rs. 3,42,000)

3. Amir, Basheer, and Khan were partners sharing profits and losses in 3:2:1 ratio. Basheer died on 31st August 1985. As per the partnership deed the executors of the deceased partner, are entitled to:

   1. Capital balance as on the date of death.
   2. Interest on capital upto the date of death, at 6% p.a.
   3. Share of profit upto the date of death during that year, based upon the profits of the previous year;
   4. Goodwill, taking the firm's goodwill at 2 years purchase of average profits of previous three years.

The firm's accounts were last drawn upto 30th June 1985, and on that date Basheer's capital stood at Rs. 6,000. The profits for the preceding 3 years ended on 30th June 83, 84, 85 were Rs. 7,800, 9,000, and Rs. 9,600 respectively. The remaining partners who continued the business, borrowed the sum required from the Bank and paid off the executors.

Pass necessary journal entries and show Basheer's account.

(Answer : Rs. 12,460)

BRAOU

4. Ajay, Bose and Chartterjee were in partnership and Chatterjee died on 31st March 1985. The Balance Sheet of the firm stood as under as on 31st December, 1984:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	31,200	Cash at Bank	8,000
Reserve	12,000	Sundry debtors	36,000
Investments Reserve	4,200	Stock	56,000
Provision for		Investments	16,000
doubtful debts	3,600	Freehold property	60,000
Capital :		Goodwill	27,000
Ajay	60,000		
Bose	50,000		
Chatterjee	42,000		
	2,03,000		2,03,000

As per the agreement, deceased partner was entitled for goodwill, calculating firm's goodwill at one year's purchase of average profits of preceding years; and profit upto the date of death based upon preceding five year's profits. The assets and liabilities were also to be got revalued as on the date of death.

The profits from 1980 to 1984 amounted to Rs. 23,000, 25,000, 16,000, 20,000 and 24,000 respectively. Valuation as on 31st March 85 was as follows :

a) Freehold property Rs. 1,14,000

b) Sundry Debtors all good

c) Stock Rs. 50,000

d) Investments Rs. 15,000

e) Liability for workmen's compensation Rs. 6,000

Show Chatterjee's account and Balance Sheet of the continuing partners.

(Answer : amount due to Chartterjee's executors Rs. 62,467, Balance Sheet total Rs. 2,46,600)

BRAOU

15.12 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C & Grewal, T.S : Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

15.13 GLOSSARY

Deceased Partner : The partner in the firm who died.

Retiring Partner : Partner who decides to retire from the business.

UNIT-16 : DISSOLUTION OF FIRM

Contents

16.0 Aims and Objectives
16.1 Introduction
16.2 Modes of Dissolution
16.3 Settlement of Accounts
16.4 Firm Debts vs. Private Debts
16.5 Accounting Procedure on Dissolution
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16.7 Check Your Progress : Model Answers
16.8 Model Examination Questions
16.9 Recommended Books

16.0 AIMS AND OBJECTIVES

The aim of this unit is to explain you the circumustances in which the firm gets closed and the accounting procedure to be followed.

After going through this unit, you should be able to :

- explain the various ways in which the firm can be closed
- explain how firm debts and private debts are settled on dissolution
- work out the problems on dissolution.

16.1 INTRODUCTION

We have seen in the previous unit how accounts are settled when a partner decides to retire from the firm or dies. In such cases it was taken that the remaining partners decided to carry on the business. In other words the firm's existence continued. But where the remaining partners decide not to continue the business, the firm's existence comes to an end, and a different accounting treatment is required to close the firm's books. Such a closure is known as DISSOLUTION of the firm.

16.2 MODES OF DISSOLUTION

Section 39 to 55 of the Partnership Act, 1932 contains the provisions of dissolution of the partnership firm. According to the Act, a firm may get dissolved in any one of the following ways :

a) **Dissolution by agreement (Section 40) :** A partnership comes into existence by way of an agreement between two or more Persons. Similarly, it comes to an end when all the partners agree that it should be closed.

b) **Compulsory dissolution (Section 41) :** When all the partners become insolvent, the firm gets dissolved. The firm also gets dissolved when all but one become insolvent, as only one person cannot carry on the business (this is known as sole trader form of business). Sometimes, the business carried on by a firm, may be declared - illegal and hence the firm may have to compulsorily get dissolved.

c) **On the happening of a certain event (Section 42) :** The firm may also get dissolved in the following cases, unless there is an agreement to the contrary :

i) after the expiry of the duration of the firm, if any;

ii) after the completion of the adventure for which the firm was specifically formed;

iii) on the death of one of the partners.

d) **By serving a notice (Section 43) :** In the case of a partnership at will, the firm gets dissolved when a partner serves notice on the other partners of his intention to dissolve the firm;

e) **By order of the court (Section 44) :** The court on an application may order dissolution of the firm in the following circumstances;

i) When one of the partners has become of unsound mind ;

ii) When a partner has become incapable of performing his duties as a partner;

iii) When a partner is found to be guilty of misconduct which affects the business of the firm;

iv) When a partner wilfully and persistently commits breach of agreement (between the partners) in the conduct of the business;

v) When a partner has transferred his interest in the firm;

vi) When the business cannot be carried on except at loss;

vii) When the court is satisfied on the basis of the grounds which make it just and equitable to dissolve the firm.

Sometimes the partners may resolve to convert the firm into a company or sell to a joint stock company. In such cases also, the firm would get dissolved.

16.3 SETTLEMENT OF ACCOUNTS

Where there is no specific agreement between the partners as to how the accounts on dissolution are to be settled, provisions of Section 48 to 50, which are as follows, shall have to be follwed:

Losses : Losses, including deficiencies of capital shall be paid first out of profits, next out of capital and finally, if necessary, by the partners contributing in the ratio in which they share profits and losses.

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) paying the debts of the firm to a third party.

ii) paying each partner proportionately, the amount due to him from the firm towards advances, other than the capital;

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iii) paying each partner proportionately, the amount due to him from the firm towards capital;

iv) dividing the remaining amount, among the partners, in their profit sharing ratio.

16.4 FIRM'S DEBTS Vs. PRIVATE DEBTS

When the firm is dissolved there may be firm's debts, as well as individual partner's debts (in their individual capacities). When both the debts exist, the debts should be settled in the following manner :

a) Firm's debts should be paid first, out of the property of the firm and the remaining amount should be distributed among the partners in the manner explained under the para, 'Settlement of Accounts'.

b) Private debts for the partners would be paid first out of the private estates of the partners. If any surplus is left in private estate, after paying the debts, the amount will be utilised in paying off firm's liabilities (when the amount realised on the properties of the firm is not sufficient)

16.5 ACCOUNTING PROCEDURE ON DISSOLUTION

When a firm is dissolved, all its accounts should get closed. On the date of dissolution there will be certain assets and liabilities. The assets have to be disposed off and the liabilities paid out. The following accounts are usually opened :

Realisation Account : When individual assets are disposed off and liabilities paid out, some balances (representing loss or profit) may be left in such individual accounts. Unless all are added, the net loss or net gain on account of dissolution (which has to be transferred to partners) cannot be known. Hence all assets and outside liabilities are transferred to an account, known as 'Realisation Account', the proceeds of the assets credited to it and the liabilities are paid from that account. This account, ultimately, reveals the loss or gain on account of dissolution.

Capital accounts : After paying the outside liabilities and partners' advances, if any, partners are to be paid. Sometimes the partners may have to bring in some amount. Hence, to know their position, the capital accounts of all the partners are opened.

Cash/Bank Account : Since cash is to be received and paid, this account is not, normally, transferred to Realisation Account. All entries of receipt and payment of money are recorded in this account.

The following are the entries that are usually passed on dissolution of the firm.

1. For transferring the asset accounts (except cash) to Realisation a/c.:

Realisation account	Dr.
To Asset accounts (individually)	(at book values)

2. For transferring the outside liabilities and provisions against assets to Realisation a/c. :

Liabilities a/c. (individually)	Dr.
Provision or Fund a/c.	Dr. (at book values)
To Realisation account.	

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3. The Capital accounts, Partners' loan a/c. and cash/bank a/c. (if both cash and bank are given one is closed by transfer to another and only the other one is operated till the end) are opened at this stage. (They already exist in the books but in the examination such accounts are opened with opening balances as on the date of dissolution).

4. For transferring accumulated profits:

Reserve account	Dr.
P & L a/c. (for credit balance)	Dr.
To Partners' capital a/cs.	(in their profit sharing ratio)

5. For transferring the accumulated losses:

Partners' capital accounts	Dr. (in their profit sharing ratio)
To Profit & Loss a/c.	
(for debit balance)	

6. When cash is realised on assets :

Bank account	Dr. (for actual amount realised)
To Realisation a/c.	

7. When the assets are taken over by partners :

Partners' capital accounts	Dr. (at the values agreed upon)
To Realisation a/c.	

8. When outside liabilities are paid off :

Realisation account	Dr. (for actual amount paid)
To Bank a/c.	

9. When liabilities are taken over by partners:

Realisation a/c.	Dr. (for agreed amount)
To Partners' capital a/cs.	

10. When some expenses are incurred by the firm for dissolution:

Realisation account	Dr.
To Bank a/c.	

11. When dissolution expenses are met by the partners:

Dissolution account	Dr.
To Partners' capital a/c.	

12. The Realisation account may now show some balance representing loss or gain on dissolution. This is transferred to partners' capital accounts in their profit sharing ratio. Where there is gain (i.e. credit side is more)

Realisation a/c.	Dr.
To Partners's capital a/cs.	

Where there is loss (i.e. debit side is more)

Partners' capital a/cs.	Dr.
To Realisation a/c.	

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13. For paying partners' advances:

Partners' Loan a/c. Dr.
To Bank a/c.

14. The above entries are given assuming that the capital accounts are maintained under Fluctuating capital method. If Fixed Capital Method is followed, all entries made hither to (to the Partner's capital accounts) are made to partners' current accounts instead of capital accounts. The balances on current accounts are now transferred to respective capital accounts.

Entry when current a/c Credit side is more:

Partners' current a/c. Dr.
To Partners' capital a/c

Entry when current a/c debit side is more :

Partner's capital a/c. Dr.
To Partners' current a/c.

15. At this stage, only the partners are to be paid. Sometimes a partner's capital account may show debit balance, representing the amount due from him to the firm. Such partners bring in the necessary amount and the remaining partners (whose accounts show credit balance) are paid the amount due to them.

Entry for receipt of cash when a partner's capital a/c shows debit balance:

Bank a/c. Dr.
To Respective Partner's capital a/c.

Entry for payment of cash when a partner's capital a/c shows credit balance:

Respective partner's capital a/c. Dr.
To Bank a/c.

AT THIS STAGE ALL ACCOUNTS WOULD GET CLOSED

Sometimes it may be given in the problem that some amount is realised on an asset, for example Goodwill, though such an item does not appear in the Balance Sheet just before dissolution. Similarly, it may also be given that some amount is paid towards a liability, though such an item does not appear in the Balance Sheet (before dissolution). In such cases, we can assume that such assets & liabilities did exist in the balance sheet (before dissolution) at zero values and got transeferred to Realisation A/c. The accounting treatment suggested above will, therefore, hold good and no further adjustment is required.

No specific treatment is required for Goodwill, as is done in the case of admission, retirement or death of a partner. It is treated just like any other asset and transferred to Realisation Account (if it exists) along with other assets.

The procedure is explained in the following illustrations:

Illustration - 1

Sham and Sunder are in partnership sharing profits and losses in 3:2 ratio. The following was their balance sheet as on 31st December, 1985:

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Liabilities	Rs.	Assets	Rs.
Creditors	10,560	Cash at Bank	7,260
Reserve for contingencies	10,000	Investments	41,600
Bank overdraft	20,000	Debtors	39,200
Sham's capital	1,20,000	Stock	17,500
Sunder's capital	40,000	Furniture	5,000
		Building	90,000
	2,00,560		2,00,560

They decided to dissolve the partnership on the above date. The assets except cash and investments are sold on January 15, 1986 for Rs. 1,38,000. The investments, were taken over by Sunder at Rs. 44,000, who agreed to discharge the Bank overdraft. The expenses of dissolution amounted to Rs. 2,200. The creditors were paid Rs. 10,060 in full settlement.

Give journal entries and Ledger accounts relating to the dissolution which was completed on 20th January, 1986.

Solution

Journal

			Rs.	Rs.
1985				
Dec. 31	Realisation a/c.	Dr.	1,93,300	
	To Building a/c.			90,000
	To Furniture a/c.			5,000
	To Stock a/c.			17,500
	To Debtors a/c.			39,200
	To Investments a/c.			41,600
	(Being the entry for transfer of assets to Realisation a/c.)			
" 31	Creditors account	Dr.	10,500	
	Bank overdraft a/c.	Dr.	20,000	
	To Realisation a/c.			30,560
	(Being the entry for transfer of liabilities to Realisation a/c.)			
1986				
Jan. 15	Bank account	Dr.	1,38,000	
	To Realisation a/c.			1,38,000
	(Being the entry for cash realised on assets)			
" 20	Sunder's capital a/c.	Dr.	44,000	
	To Realisation a/c.			44,000
	(Being the investments taken over by Sunder)			

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20	Realisation account To Sunder's capital a/c. (Being the Bank overdraft taken over by Sunder)	Dr.		20,000	20,000
" 20	Realisation account To Bank a/c. (Being the realisation expenses incurred)	Dr.		2,200	2,200
" 20	Realisation account To Bank a/c. (Being the Creditors Paid in full settlement).	Dr.		10,060	10,060
Jan. 20	Reserve for contingencies a/c. To Sham's capital a/c. To Sunder's capital a/c. (Being the reserve distributed between the partners)	Dr.		10,000	6,000 4,000
" 20	Sham's capital a/c. Sunder's capital a/c. To Realisation a/c. (Being the loss on dissolution transferred)	Dr. Dr.		7,800 5,200	13,000
" 20	Sham's capital account Sunder's capital a/c. To Bank a/c. (Being the amount due to partners paid)	Dr. Dr.		1,18,200 14,800	1,33,000

LEDGER

Realisation A/c.

Dr.		Rs.			Cr. Rs.
1985 Dec.31	To Sundry Assets	1,93,300	1985 Dec.31	By Sundry Liabilities	30,560
1986 Jan.20	To Bank a/c. (exp.)	2,200	1986 Jan.15	By Bank (sale of assets)	1,38,000
" 20	Bank a/c. (Crs.)	10,060	" 20	By Sunder's capital a/c. (Investments)	44,000
" 20	" Sunder capital a/c. (Bank OD)	20,000		" Sham's capital a/c. (3/5 loss)	7,800
			" 20	By Sunder's capital a/c. (2/5 loss)	5,200
		2,25,560			2,25,560

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Dr. **Bank A/c.** Cr.

1985		Rs.	1986		Rs.
Dec. 31	To Balance b/f	7,260	Jan. 20	By Realisation a/c. (Exp.)	2,200
1986			" 20	By Realisation a/c. (Crs.)	10,060
Jan.15	To Realisation A/c.	1,38,000	" 20	By Sham's capital a/c.	1,18,200
			" 20	By Sunder's capital a/c.	14,800
		1,45,260			1,45,260

Dr. **Sham's Capital A/c.** Cr.

1986		Rs.	1985		Rs.
Jan.20	To Realisation a/c. (loss)	7,800	Dec.31	By Balance b/f.	1,20,000
			1986		
" 20	To Bank a/c.	1,18,200	Jan.20	By Reserve for contingencies	6,000
		1,26,000			1,26,000

Dr. **Sunder's Capital A/c.** Cr.

1986		Rs.	1985		Rs.
Jan.20	To Realisation a/c. (Investments)	44,000	Dec.31	By Balance b/f.	40,000
			1986		
" 20	To Realisation a/c. (Loss)	5,200	Jan.20	By Reserve for contingencies a/c.	4,000
"	To Bank a/c.	14,800	"	By Bank OD a/c.	20,000
		64,000			64,000

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Check Your Progress - 1

(a) Why Realisation Account is prepared?

.....

.....

(b) When cash realised on assets is transferred to Realisation Account; what is the entry?

.....

.....

.....

(c) What is the entry when liabilities are taken over by partner?

.....

.....

.....

Illustration - 2

The following is the Balance Sheet of Arjun and Bhim as on 31st December, 1985, on which date they decided to dissolve the firm.

Liabilities	Rs.	Assets		Rs.
Sundry creditors	60,000	Cash at Bank		17,000
Bills payable	16,000	Stock		10,000
Mrs. Arjun's loan	10,000	Investments		20,000
Mrs. Bhim's loan	20,000	Debors	40,000	
Reserve fund	20,000	Less: R.B.D.	4,000	
				36,000
Investment fluctuation fund	2,000	Building		70,000
Arjun's capital	30,000	Goodwill		8,000
Bhim's capital	10,000	P & L A/c.		7,000
	1,68,000			1,68,000

a) Bhim took, half of the investments 10% less and the remaining realised Rs. 9,000.
b) Arjun promised to pay Mrs. Arjun's loan and took the stock for Rs. 8,000.
c) Debtors, Building and goodwill realised Rs. 1,80,000.
d) Creditors and Bills payable were settled in full at Rs. 75,620.
e) The old typewriter lying in the office was taken over by Bhim at Rs. 600.
f) Realisation expenses amounted to Rs. 2,000.

Give journal entries and ledger accounts necessary to record the dissolution.

Solution

Journal

		Rs.	Rs.
Realisation a/c.	Dr.	1,48,000	
To Stock a/c.			10,500
To Investments a/c.			20,000
To Debtors a/c.			40,000
To Building a/c.			90,000
To Goodwill a/c.			8,000
(Being the assets transferred to Realisation a/c.)			

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Sundry Creditors a/c.	Dr.	60,000		
Bills payable a/c.	Dr.	16,000		
R.B.D. a/c.	Dr.	4,000		
Investment Fluctuation Fund a/c.	Dr.	2,000		
To Realisation a/c.			82,000	
(Being the entry for transfer of the liabilities).				
Mrs. Arjun Loan a/c.	Dr.	10,000		
To Arjun's capital a/c.			10,000	
(Being Mrs. Arjun's loan transferred)				
Arjun's capital a/c.	Dr.	8,000		
To Realisation a/c.			8,000	
(Being stock taken over)				
Bhim's capital a/c.	Dr.	9,600		
To Realisation a/c.			9,600	
(Being half of the investments at the rate of 9,000/- and typewriter at Rs. 600 taken over)				
Bank account	Dr.	1,89,000		
To Realisation a/c.			1,89,000	
(Being the investment Rs. 9,000 and other assets Rs. 1,80,000 realised)				
Realisation account	Dr.	75,620		
To Bank a/c.			75,620	
(Being creditors and B/P paid in full)				
Realisation account	Dr.	2,000		
To Bank a/c.			2,000	
(Being the dissolution expenses paid)				
Realisation account	Dr.	62,980		
To Arjun's capital a/c.			31,490	
To Bhim's capital a/c.			31,490	
(Being the profit on dissolution transferred)				
Reserve fund a/c.	Dr.	20,000		
To Arjun's capital a/c.			10,000	
To Bhim's capital a/c.			10,000	
(Being the general reserve distributed)				
Arjun's capital a/c.	Dr.	3,500		
Bhim's capital a/c.	Dr.	3,500		
To P & L a/c.			7,000	
(Being the P & L a/c. debit Balance distributed)				

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Mrs. Bhim's laon a/c.	Dr.		10,000	
To Bank a/c.				10,000
(Being Mrs. Bhim's loan paid)				
Arjun's capital account	Dr.		69,990	
Bhim's capital a/c.	Dr.		38,390	
To Bank a/c.				1,08,380
(Being the amount due paid)				

LEDGER

Dr. **Realisation A/c.** Cr.

1985		Rs.	1985		Rs.
Dec.31	To Sundry Assets	1,48,000	Dec.31	Sundry Liabilities	82,000
"	To Bank (liabilities)	75,620	"	By Arjun's capital a/c. (stock)	8,000
"	To Bank (Exp.)	2,000	"	By Bank (Sale of assets)	1,89,000
"	To Arjun's capital a/c.	31,490	"	By Bhim's capital a/c. (investment)	9,600
"	To Bhim's capital a/c.	31,490			
		2,88,600			2,88,600

Dr. **Bank A/c.** Cr.

1985		Rs.	1985		Rs.
Dec.31	To Balance b/f	17,000	Dec.31	By Realisation a/c. (Liabilities)	75,620
	To Realisation a/c. (sale of assets)	1,89,000		By Realisation a/c. (exp.)	2,000
				By Mrs. Bhim's loan	20,000
				By Arjun's capital a/c.	69,990
				By Bhim's capital a/c.	38,390
		2,06,000			2,06,000

Dr. **Arjun's Capital A/c.** Cr.

1985		Rs.	1985		Rs.
Dec.31	To P & L. A/c.	3,500	Dec.31	By Balance b/f.	30,000
	To Realisation a/c. (stock)	8,000		By Reserve fund a/c.	10,000
				By Mrs. Arjun Loan a/c.	10,000
	To Bank a/c.	69,990		By Realisation a/c. (Profit)	31,490
		81,490			81,490

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Dr. **Bhim's Capital A/c.** Cr.

1985		Rs.	1985		Rs.
Dec.31	To P & L a/c.	3,500	Dec.31	By Balance b/f.	10,000
	To Realisation a/c. (Invest. & TW)	9,600		By Reserve fund a/c.	10,000
	To Bank a/c.	38,390		By Realisation a/c. (Profit)	31,490
		51,490			51,490

Illustration - 3

Amar, Bharat and Chand are partners in a firm sharing profits and losses in 5:3:2 ratio. They had business at two places Hyderabad and Madras. Their Balance Sheet was as follows as on 30th September 1985.

Liabilities	Rs.	Assets	Rs.
Creditors	9,830	Cash at Bank	11,400
Amar's capital	30,000	Cash on hand	1,150
Bharat's capital	24,000	Goodwill	10,000
Chand's capital	12,000	Sundry Debtors:	
Amar's current a/c.	15,100	Hyderabad	41,250
		Madras	19,750
		Bharat's current a/c.	5,150
		Chand's current a/c.	2,230
	90,930		90,930

They decided to dissolve the firm. Bharat agreed to take over Hyderabad business and Chand agreed to take over Madras Business together with respective assets and liabilities. Bharat and Chand have to pay Rs. 30,000 to Amar towards goodwill of the business taken over by them (Rs. 18,000 towards Hyderabad business and Rs. 12,000 towards Madras business). Rent for Madras office is outstanding for 2 months at the rate of Rs. 500 p.m. This is included in the Creditors. The remaining creditors belong to Hyderabad business. Debtors should be taken at 2% discount.

Show the necessary Ledger accounts.

Solution

Dr. **Bank A/c.** Cr.

	Rs.		Rs.
To Balance b/f.	11,400	By Amar's capital a/c.	69,490
To Cash account	1,150		
To Bharat's capital a/c.	34,111		
To Chand's capital a/c.	22,829		
	69,490		69,490

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Sometimes, on dissolution, the capital accounts of some of the partners may show a debit balance. Such partners are required to bring in necessary cash, so that other partners' accounts can be settled.

16.7 CHECK YOUR PROGRESS : MODEL ANSWERS

1. (a) To know the profit or loss made at the time of dissolving the firm.

   (b) Bank a/c. Dr.
   To Realisation a/c.
   (Being the amount realised on assets).

   (c) Realisation a/c. Dr.
   To Partner's Capital a/c.
   (Being the liabilities taken over)

16.8 MODEL EXAMINATION QUESTIONS

A. Answers the following in 15 lines each.

1. What are the circumstances under which a firm gets dissolved?
2. How do you deal with unrecorded assets and liabilities at the time of dissolution of a firm?
3. What is the order in which the assets are applied when a firm is dissolved?
4. What is meant by Loss on Realisation and how it is distributed?

PROBLEMS

1. The balance sheet of Krishna and Balram stood as under as on 31st December, 1985 on which date they decided to dissolve the firm.

Liabilities	Rs.	Assets	Rs.
Capital:		Cash at Bank	7,000
Krishna	30,000	Stock	35,600
Balram	40,000	Debtors	24,800
Sundry creditors	26,000	Furniture	5,600
Krishna's loan	10,000	Machinery	45,000
Reserve	12,000		
	1,18,000		1,18,000

The assets other than cash realised Rs. 99,200. Creditors allowed a discount of Rs. 448. Realisation expenses amounted to Rs. 1,088.

Answer: Loss on realisation Rs. 12,440. Krishna and Balram will be paid Rs. 29,780 and Rs. 39,780 respectively).

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2. Dharma, Sarma and Karma were partners sharing profits and losses in 3:2:1 ratio. They decided to dissolve the firm on 31st December, 1985 and Sarma took over the business. On that date their Balance Sheet was as under:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	28,000	Goodwill	12,000
Capital:		Sundry debtors	57,200
Dharma	68,000	Investments	25,200
Sarma	80,000	Machinery	30,000
Karma	38,400	Motor Van	26,000
		Stock	49,200
		Cash	14,800
	2,14,400		2,14,400

Dharma took the investments at Rs. 22,000 and Motor Van at Rs. 28,000. Sarma took over other assets and liabilities at book values, except Machinery at Rs. 32,800 and Stock at Rs. 42,000.

Show the ledger accounts of the partners assuming that any amount required is made good by the partners.

(Answer: Profit on realisation: Rs. 2,400, Sarma brings in Rs. 43,200; Dharma and Karma were paid Rs. 19,200, Rs. 38,800).

16.9 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy, M. : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C. & Grewal, T.S : Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

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UNIT-17 : INSOLVENCY OF A PARTNER

Contents

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17.3 Loss arising out of Insolvency
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17.0 AIMS AND OBJECTIVES

When a partner or some of the partners of partnership become insolvent, there is a need to write the same in the books of accounts of the firm. In this unit, an attempt is made to explain you the accounting procedure when a partner becomes insolvent.

On completition of this unit, you should be able to :

- explain the consequences of insolvency of a partner
- distribute the loss arising out of the onsolvency of a partner among the solvent partners
- calculate the capital ratio of solvent partners as per the decision given in Garner vs. Murray case.

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17.1 INTRODUCTION

We have seen in the previous unit how the partners' capital accounts are settled when the firm is dissolved. The procedure indicated suits where the firm is solvent and its partners are also solvent. Sometimes, some of the partners' capital accounts may show debit balance. If they are solvent they would bring in necessary cash and hence there will be no difficulty in settling the accounts of other partner(s).

Suppose the account of a partner shows debit balance and being insolvent, he is not in a position to pay the amount due to the firm. Such an amount becomes loss to the firm.

So far we have come across trading losses and loss on dissolution, which are shared by all the partners in their profit sharing ratio. Now the question that arises is, how the loss on account of insolvency of a partner is to be shared by other partners. We shall deal with the same in the following paras.

17.2 CONSEQUENCES OF INSOLVENCY

When a partner is adjudicated by the court as insolvent, he ceases to be partner of the firm from the date on which the order of adjudication is made. The partnership firm also gets dissolved on the date of order of adjudication, unless there is some provision in the Partnership agreement to the contrary. From that date onwards, the estate of the insolvent partner is not liable for the acts of the firm. Similarly the firm also cannot be held liable for the acts of the insolvent partner from the date of the order of adjudication.

17.3 LOSS ARISING OUT OF INSOLVENCY

The debit balance of the insolvent partner's capital account, to the extent not paid to the firm, is known as **Loss arising out of insolvency**. Such loss is to be borne by the other solvent partners in accordance with the decision in GARNER Vs. MURRAY case, which is as follows :

17.4 DECISION IN GARNER Vs. MURRAY CASE

The question as to how the loss on account of insolvency of a partner was to be shared by other solvent partners arose in a leading case Garner Vs. Murray. The learned Judge held that there should be a distinction between ordinary loss arising out of the realisation of assets and the abnormal loss arising on account of capital deficiency of an insolvent partner. He ruled that in the absence of an agreement between the partners to the contrary, the dficiency on insolvent Partner's capital account should be borne by others who are solvent in proportion to their capitals which stood before the dissolution of the firm.

So for there has been no court decision in India questioning this ruling. However, according to Section 48 of the Partnership Act, the assets of the firm, including any sums contributed by the partners to make up losses or deficiencies of capital must be applied (after paying creditors and partners' loans) in paying each partner what is rateably due to him on capital. This is similar to the ruling in Garner Vs. Murray according to which the solvent partners had to contribute to the losses on realisation in cash and share the deficiency in the capital account of the insolvent partner according to their capital ratio. Hence, this rule is applicable in India also.

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17.5 CAPITAL RATIO

As per Garner Vs. Murray ruling the loss on insolvent partner's capital account is to be borne by other solvent partners in their capital ratio, before dissolution. Hence, it is necessary to calculate the capital ratio.

We have seen earlier that partners can maintain their capital accounts either under Fixed Capital Method or Fluctuating Capital Method.

Capital Ratio under Fixed Capital Method : Under this method, since all adjustments towards trading profits/losses, drawings, interest on drawings, interest on capital, salary etc., are made in the current account, the balance in the Capital Account represents the capital before the dissolution. Hence the loss on insolvent partner's capital acount (after transferring his current a/c balance to the capital a/c), is distributed in the ratio of the balances in Capital accounts of other solvent partners.

Capital Ratio under Fluctuating Capital Method : Under this method all adjustments towards profits, drawings, etc., are made in the capital accounts only. Hence, to know the capital on the date of dissolution, all undistributed profits/losses, interest on capital, drawings, interest on drawings, etc., (upto the date of dissolution), but not loss on realisation, are posted to the capital accounts including that of the insolvent partner, and the capital balance thus arrived at should be the basis of the ratio according to which the loss on insolvency partner's capital account is to be borne.

The loss or profit on realisation is not taken into consideration for arriving at the capital, as according to the rule, the capital before dissolution only is to be taken into account.

As per the ruling in Garner Vs. Murray, solvent partners have to bring in cash to the extent of loss on realisation. This is intended to bring the capital accounts of the solvent partners to the level they stood before the dissolution. In practice, though cash is not brought in by the solvent partners, notional entries are passed as if they have brought in cash. Therefore, all postings to the solvent partners' capital accounts from the Realisation Account, are reversed either by debiting or crediting the Cash Account, balances of the solve nt partners' capital accounts struck and resultant figures taken as the basis for the ratio.

Check Your Progress - 1

How does the solvent partners share the loss arising due to insolvency of a partner?

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17.6 PROCEDURE WHEN SOME OF THE PARTNERS ARE INSOLVENT

The adjustments required when some of the partners are adjudicated insolvent are explained in the following two illustrations, both when fixed capital method and fluctuating capital methods are in operation:

Illustration - 1

Amal, Bimal and Kamal are partners sharing profits and losses in the ratio of 2:2:1. Their balance sheet as on 31st December, 1985 stood as follows, on which date they decided to dissolve the firm.

Liabilities	Rs.	Assets	Rs.
Creditors	50,000	Goodwill	40,000
Reserve	10,000	Building	40,000
Amal's capital	35,000	Plant and Machinery	25,000
Bimal's capital	15,000	Sundry debtors	10,000
Kamal's capital	5,000	Kamal's current a/c	15,000
Amal's current a/c	10,000		
Bimal's current a/c	5,000		
	1,30,000		1,30,000

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The assets realised Rs. 42,500. On the date of dissolution it was found that there was a liability on bill discounted to the extent of Rs. 3,000. Dissolution expenses amounted to Rs. 500. Kamal became insolvent and is unable to bring any amount.

Give journal entries and ledger accounts.

Solution

Journal

1985 Dec.31	Realisation Account Dr.		1,15,000	
	To Goodwill a/c.			40,000
	To Building a/c.			40,000
	To Plant & Machinery a/c.			25,000
	To Sundry Debtors a/c.			10,000
	(Being the entry for transfer of assets)			
"	Creditors a/c. Dr.		50,000	
	To Realisation a/c.			50,000
	(Being the entry for transfer of creditors)			
"	Reserve a/c. Dr.		10,000	
	To Amal's current a/c			4,000
	To Bimal's current a/c			4,000
	To Kamal's current a/c.			2,000
	(Being the entry transfer of Reserve to partners)			
"	Bank a/c. Dr.		42,500	
	To Realisation a/c.			42,500
	(Being the sale proceeds realised on assets)			
"	Realisation A/c. Dr.		500	
	To Bank A/c.			500
	(Being the realisation expenses paid)			
"	Realisation a/c. Dr.		53,000	
	To Bank a/c.			53,000
	(Being the creditors and liability on on bills discounted paid)			
"	Amal's current a/c Dr.		30,400	
	Bimal's current a/c. Dr.		30,400	
	Kamal's current a/c. Dr.		15,200	
	To Realisation a/c.			76,000
	(Being the loss on realisation transfered)			
"	Kamal's capital a/c. Dr		28,200	
	To Kamal's current a/c.			28,200
	(Being the entry for closing Kamal's current a/c. by transfer to capital a/c.)			

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"	Amal's current a/c.	Dr.		16,240	
	Bimal's current a/c.	Dr.		6,960	
	To Kamal's capital a/c.				23,200
	(Being the loss on insolvency of Kamal transferrred to Amal and Bimal in capital ratio)				
"	Bimal's capital a/c.	Dr.		28,360	
	To Bimal's current a/c.				28,360
	(Being Bimal's current a/c. transfered to capital a/c.)				
"	Amal's capital a/c.	Dr.		32,640	
	To Amal's current a/c.				32,640
	(Being Amal's current a/c. balance transferred to his capital a/c.)				
"	Bank a/c.	Dr.		13,360	
	To Bimal's capital a/c.				13,360
	(Being the amount due received)				
"	Amal's capital a/c.	Dr.		2,360	
	To Bank a/c.				2,360
	(Being the amount due paid)				

Ledger

Realisation A/c.

Dr.	Rs.		Rs.	Cr.
To Sundry Assets	1,15,000	By Creditors a/c	50,000	
To Bank a/c. (exp.)	500	By Bank a/c. (assets realised)	42,500	
To Bank a/c. (creditors & Lia.on Bills)	53,000	By Amal's current a/c. 2/5 loss	30,400	
		By Bimal's current a/c 2/5 lss	30,400	
		By Kamal's current a/c 1/5 loss	15,200	
	1,68,500		1,68,500	

Amal's Capital A/c.

Dr.	Rs.		Rs.	Cr.
To Amal's current a/c.	32,640	By Balance b/f	35,000	
To Bank a/c.	2,360			
	35,000		35,000	

Bimal's Capital A/c.

Dr.	Rs.		Rs.	Cr.
To Bimal's current a/c.	28,360	By Balance b/f	15,000	
		By Bank a/c.	13,360	
	28,360		28,360	

BRAOU

Dr. **Kamal's Capital A/c.** Cr.

	Rs.		Rs.
To Kamal's current a/c.	28,200	By Balance b/f	5,000
		By Amal's current a/c.7/10 loss	16,240
		By Bimals current a/c. 3/10 loss	6,960
	28,200		28,200

Dr. **Amal's Current A/c.** Cr.

	Rs.		Rs.
To Realisation a/c 2/5 loss	30,400	By Balance b/f	10,000
To Kamal's capital a/c 7/10 loss	16,240	By Reserve a/c.	4,000
		Amal's capital a/c.	32,640
	46,640		46,640

Dr. **Bimal's Current A/c.** Cr.

	Rs.		Rs.
To Realisation a/c. 2/5 loss	30,400	By Balance b/f	5,000
To Kamal's capital a/c. 3/10 loss	6,960	By Reserve a/c.	4,000
		Bhimal's capital a/c	28,360
	37,360		37,360

Dr. **Kamal's Current A/c.** Cr.

	Rs.		Rs.
To Balance b/f.	15,000	By Reserve a/c.	2,000
To Realisation a/c. 1/5 loss	15,200	By Kamal's capital a/c.	28,200
	30,200		30,200

Dr. **Bank A/c.** Cr.

	Rs.		Rs.
To Realisation a/c.(assets realised)	42,500	By Realisation a/c.(exp.)	500
To Bimal's capital a/c.	13,360	By Realisation a/c. (creditors and Liabilities on bills)	53,000
		By Amal's capital a/c.	2,360
	55,860		55,860

Illustration - 2

Abhiram, Balaram, Kushalram and Daulatram were partners in a firm sharing profits and losses in 4:3:2:1 ratio. On 30th September, 1985 their balance sheet stood as under:

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Liabilities	Rs.	Assets	Rs.
Sundry Creditors	60,000	Cash at Bank	3,000
Abhiram's capital	1,80,000	Stock	69,000
Balaram's capital	1,20,000	Plant & Machinery	2,40,000
Kushalram's capital	18,000	Goodwill	60,000
		Daulatram's capital	6,000
	3,78,000		3,78,000

Kushalram and Daulatram became insolvent. Rs. 3,000 was realised from Kushalram while nothing was realised from Daulatram's private estate. The partners decided to dissolve the firm. Stock, Plant & Machinery realised Rs.1,89,000. Nothing was realised towards, goodwill. The actual liability on creditors amounted to Rs.72,000. Rs.18,000 were spent towards realisation.

Give journal entries and ledger accounts to show the dissolution.

Solution

Journal

1)	Realisation a/c. Dr.		3,69,000	
	To Stock a/c.			69,0000
	To Plant & Machinery a/c.			2,40,000
	To Goodwill			60,000
	(Assets trasnferred to realisation a/c.)			
2)	Sundry Creditors a/c. Dr.		60,000	
	To Realisation a/c.			60,000
	(Being creditors transferred)			
3)	Bank a/c. Dr.		1,89,000	
	To Realisation A/c.			1,89,000
	(Amount realised on assets)			
4)	Realisation a/c. Dr.		18,000	
	To Bank a/c.			18,000
	(Realisation expenses spent)			
5)	Realisation a/c. Dr.		72,000	
	To Bank a/c.			72,000
	(Amount paid to creditors)			
6)	Abhiram's capital a/c. Dr.		84,000	
	Balram's capital a/c. Dr.			63,000
	Kushalram's capital a/c. Dr.		42,000	
	Daulatram's capital a/c. Dr.		21,000	
	To Realisation a/c.			2,10,000
	(Loss on realisation distributed)			
7)	Bank a/c. Dr.		3,000	
	To Kushalram's capital a/c.			3,000
	(amount realised from Kushalram)			

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8)	Bank a/c.	Dr.		1,47,000	
	To Abhiram's capital a/c.				84,000
	To Balaram's capital a/c.				63,000
	(Being cash brought in towards loss on realisation - Notional entry)				
9)	Abhiram's capital a/c.	Dr.		12,600	
	Balaram's capital a/c.	Dr.		8,400	
	To Kushalram's capital a/c.				21,000
	(Loss on insolvency transferred to solvent partners in their capital ratio i.e., 3:2)				
10)	Abhiram's capital a/c.	Dr.		16,200	
	Balram's capital a/c.	Dr.		10,800	
	To Daulatram's capital a/c.				27,000
	(Loss on insolvency transferred to solvent partners in their capital ratio i.e., 3:2)				
11)	Abhiram's capital a/c.	Dr.		1,51,200	
	Balram's capital a/c.	Dr.		1,00,800	
	To Bank a/c.				2,52,000
	(Being the amount payable paid off)				

Ledger

Dr. **Realisation A/c.** Cr.

	Rs.		Rs.
To Sundry assets	3,69,000	By Sundry Creditors a/c	60,000
To Bank a/c. (exp.)	18,000	By Bank (sale of assets)	1,89,000
To Bank a/c. (creditors)	72,000	By Abhiram's capital a/c. 4/10 loss	84,000
		By Balram's capital a/c. 3/10 loss	63,000
		By Kushalram's capital a/c. 2/10 loss	42,000
		By Daulatram's capital a/c. 1/10 loss	21,000
	4,59,000		4,59,000

Dr. **Abhiram's Capital A/c.** Cr.

	Rs.		Rs.
To Realisation a/c.(loss)	84,000	By Balance b/f	1,80,000
To Balance c/d.	1,80,000	By Bank a/c.	84,000
	2,64,000		2,64,000
To Kushalram's capital a/c. 3/5 loss	12,600	By Balance b/d	1,80,000
To Daulatram's capital a/c. 3/5 loss	16,200		
To Bank a/c.	1,51,200		
	1,80,000		1,80,000

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Balaram's Capital A/c.

Dr.	Rs.		Cr. Rs.
To Realisation a/c.(loss)	63,000	By Balance b/f	1,20,000
To Balance b/d.	1,20,000	By Bank a/c.	63,000
	1,83,000		1,83,000
To Kushalram's capital a/c. 2/5 loss	8,400	By Balance b/f	1,20,000
To Daulatram's capital a/c. 2/5 loss	10,800		
To Bank a/c.	1,00,800		
	1,20,000		1,20,000

Kushalram's Capital A/c.

Dr.	Rs.		Cr. Rs.
To Realisation a/c.(loss)	42,000	By Balance b/f	18,000
		By Bank a/c.	3,000
		By Abhiram's capital a/c. 3/5 loss	12,600
		By Balaram's capital a/c. 2/5 loss	8,400
	42,000		42,000

Daulatram's Capital A/c.

Dr.	Rs.		Cr. Rs.
To Balance b/f	6,000	By Ahbiram's capital a/c. 3/5 loss	16,200
To Realisation a/c.	21,000	By Balaram's capital a/c. 2/5 loss	10,800
	27,000		27,000

Bank A/c.

Dr.	Rs.		Cr. Rs.
To Balanace b/f	3,000	By Realisation a/c.(exp.)	18,000
To Realisation a/c. (sale of assets)	1,89,000	By Realisation a/c (Creditors)	72,000
To Kushalram's capital a/c.	3,000	By Abhiram's capital a/c.	1,51,200
To Abhiram's capital a/c.	84,000	By Balram's capital a/c.	1,00,800
To Balram's capital a/c.	63,000		
	3,42,000		3,42,000

Note:

1. Journal entry No.8 is passed as a notional one, so that when the partners capital a/cs. are balanced, it gives the basis of the ratio in which the loss on insolvency is to be borne.
2. If the amount mentioned in entry No. 8 is not brought in by Abhiram and Balram, the amount they would be paid at the end comes to :

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Abhiram: Rs. 1,51,200 – 84,000 = Rs.67,200
Balram: Rs. 1,00,800 – 63,000 = Rs.37,800

17.7 PROCEDURE WHEN ALL THE PARTNERS ARE INSOLVENT

When the firm's liabilities cannot be paid in fully by disposing off the firm's assets and the partners are not in a position to bring the amount due from them, all the partners are said to be insolvent. In such circumstances, the creditors of the firm will not be paid in full but only partly. They have to be paid whatever cash is available in the firm (after meeting dissolution expenses) together with cash brought in if any, by the partners. Since they are not paid in full the following procedure can be followed instead of the procedure followed above (when only some of the partners are insolvent).

The creditors are not transferred to Realisation account. They are paid to the extent cash is available (including cash contributed if any, by the insolvent partners), by opening a separate account. The unsatisfied (unpaid) portion of creditors account is transferred to an account called Deficiency Account'. The capital account balances of the partners are also transferred to this Deficiency Account. The Deficiency Account will then automatically get closed and thus all accounts get closed.

This is explained in the following illustration.

Illustration - 3

Madhu, Suman and Rao are partners in a firm sharing profits and losses equally. Their Balance Sheet on 31st Dec,'85 was as follows:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	1,80,000	Fixed assets	1,65,000
Madhu capital	66,000	Profit & Loss a/c.	36,000
Rao's capital	30,000	Suman's capital a/c.	75,000
	2,76,000		2,76,000

All the three partners have become insolvent. The private estates of Madhu and Suman were not sufficient enough to pay to off the private liabilities. There was a surplus of Rs.6,000 from Rao's private estate, after paying off the private liabilities. The fixed assets of the firm realised Rs.1,20,000, while the expenses connected there with amounted to Rs.3,000.

The firm is dissolved. Give journal entries and ledger accounts.

Solution

Journal

1)	Realisation a/c.	Dr.		1,65,000	
	To Fixed Assets a/c.				1,65,000
	(For transfer of fixed assets)				
2)	Bank a/c.	Dr.		1,20,000	
	To Realisation A/c.				1,20,000
	(For cash realised on assets)				

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3)	Realisation a/c. Dr.		3,000	
	To Bank a/c.			3,000
	(For paying the expenses)			
4)	Madhu's capital a/c. Dr.		16,000	
	Suman's capital a/c. Dr.		16,000	
	Rao's capital a/c. Dr.		16,000	
	To Realisation a/c.			48,000
	(For transferring loss on realisation)			
5)	Madhu's capital a/c. Dr.		12,000	
	Suman's capital a/c. Dr.		12,000	
	Rao's capital a/c. Dr.		12,000	
	To Realisation a/c.			36,000
	(Being debit balance on P & L a/c. transferred.)			
6)	Bank a/c. Dr.		6,000	
	To Rao's capital a/c.			6,000
	(Being the surplus received from Rao's private estate)			
7)	Sundry Creditors a/c. Dr.		1,23,000	
	To Bank a/c.			1,23,000
	(Being cash available paid)			
8)	Madhu's capital a/c. Dr.		38,000	
	Rao's capital a/c. Dr.		8,000	
	To Deficiency a/c.			46,000
	(Balances transferred to Deficiency account.)			
9)	Sundry Creditors a/c. Dr.		57,000	
	To Deficiency a/c.			57,000
	(Being the balance transferred to deficiency a/c.)			
10)	Deficiency a/c. Dr.		1,03,000	
	To Suman's capital a/c.			1,03,000
	(Balances on his capital a/c. transferred to deficiency a/c.)			

Realisation A/c.

Dr.	Rs.		Cr. Rs.
To fixed assets a/c.	1,65,000	By Bank a/c. (sale of assets)	1,20,000
To Bank a/c.(exp.)	3,000	By Madhu's capital a/c. 1/3 loss	16,000
		By Suman's capital a/c. 1/3 loss	16,000
		By Rao's capital a/c. 1/3 loss	16,000
	1,68,000		1,68,000

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Dr. **Bank A/c.** Cr.

	Rs.		Rs.
To Realisation a/c. (sale of assets)	1,20,000	By Realisation a/c.(exp.)	3,000
To Rao's capital a/c.	6,000	By Sundry creditors a/c.	1,23,000
	1,26,000		1,26,000

Dr. **Sundry Creditors A/c.** Cr.

	Rs.		Rs.
To Bank a/c.	1,23,000	By Balance b/f	1,80,000
To Deficiency a/c.	57,000		
	1,80,000		1,80,000

Dr. **Madhu's Capital A/c.** Cr.

	Rs.		Rs.
To Realisation a/c.(loss)	16,000	By Balance b/f	66,000
To P&L a/c.	12,000		
To Deficiency a/c.	38,000		
	66,000		66,000

Dr. **Suman's Capital A/c.** Cr.

	Rs.		Rs.
To Balance b/f	75,000	By Deficiency a/c.	1,03,000
To Realisation a/c.(Loss)	16,000		
To Deficiency a/c.	12,000		
	1,03,000		1,03,000

Dr. **Rao's Capital A/c.** Cr.

	Rs.		Rs.
To Realisation a/c. (loss)	16,000	By Balance b/f	30,000
To P&L a/c.	12,000	By Bank a/c.	6,000
To Deficiency a/c.	8,000		
	36,000		36,000

Dr. **Deficiency A/c.** Cr.

	Rs.		Rs.
To Suman's capital a/c.	1,03,000	By Sundry creditors a/c.	57,000
		By Madhu's capital a/c.	38,000
		By Rao's capital a/c.	8,000
	1,03,000		1,03,000

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17.8 SUMMING UP

When a partner's capital account shows debit balance he is not in a position to pay the amount due to the firm, being insolvent, such an amount becomes loss (to the firm).

Loss arising from capital deficiency of an insolvent partner is different from other trading losses and loss on dissolution. As per the decision in Garner vs. Murray case, where the partnership agreement is not contrary, the deficiency on insolvent partner's capital account should be borne by the other solvent partners in proportion to their capitals which stood before dissolution of the firm.

Under Fixed Capital Method, the balance in the capital accounts of the partners, represents the capitals before dissolution. Under Flucuating Capital Method, undistributed profits/losses, interest on capital, drawings, interests on drawings (upto the date of dissolution), but not loss on realisation, are posted to the capital accounts. The capital balances thus arrived at should be the basis of the ratio of capitals before dissolution.

Sometimes, all the partners may be insolvent and firm's assets may not be sufficient to pay off its liabilities. The creditors will be paid only partly to the extent cash is available.

17.9 CHECK YOUR PROGRESS : MODEL ANSWERS

1. The loss arising on account of insolvency of a partner is distributed depending on the method of maintaing the capital accounts of partners.

   a) When the capitals are fixed, the solvent partners share the loss in their fixed capital ratio.

   b) When the capitals are fluctuating, the loss is distributed in the ratio of capital balances standing in the accounts of solvent partners, after transferring accumulated profits/losses, if any, but before adjusting the profit or loss on realisation.

17.10 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines each:

1. Discuss the Garner vs. Murray case and explain how the judgement can be implemented?
2. Expain how the accounts are settled when the firm is insolvent?
3. Explain the circumstances under which a firm becomes insolvent.

B. Answer the following in 10 lines each:

1. What is meant by insolvency of a partner and the firm?
2. What is the decision in Garner vs. Murray case?
3. How do you calculate the Capital Ratio for transferring loss arising due to insolvency of a parter?

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PROBLEMS

1. Naveen Nischal and Nirmal were partners sharing profits and losses in 3:2:1 ratio. On 31st December, 1985 their Balance Sheet was as under:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	3,500	Stock	4,750
Naveen's Loan	600	Cash	950
Reserve	1,200	Furniture	500
P&L a/c	600	Machinery	2,100
Capital: Naveen	2,000	Nirmal's capital	600
Nischal	1,500	Drawings: Naveen	400
		Nischal	100
	9,400		9,400

They decided to dissolve the firm. Stock and furniture realised Rs.4,650. Naveen took over the machinery at Rs.1,800. There was another liability, on a bill discounted, for Rs.60. Expenses of dissolution amounted to Rs.60. Nirmal became insolvent and Rs.190 could be recovered from his estate.

Give journal entries and show the ledger accounts necessary when (a) capitals are fixed; and (b) capitals are fluctuating.

(Answers: Loss on realisation Rs.1,020. Payment to Naveen & Nischal when fixed:Rs.540, 1,880; When fluctuating:Rs.544, 1,876)

2. Pavan, Poor and Raju were partners. Their balance sheet was as under as on 30th September 85.

Liabilities	Rs.	Assets	Rs.
Capital: Pavan	5,000	Building	2,000
Raju	3,000	Furniture	1,000
Cur. A/c. Pavan	200	Stock & Debtors	10,620
Raju	100	Cash	500
Creditors	6,000	Cur.A/c(Poor)	980
Loan on mortagage of Bldg.	800		
	15,100		15,100

They share profits and losses in 6:3:5 ratio. They decided to close down the firm. Buildings, Furniture and Stock & Debtors realised Rs.1,200; Rs.400; and Rs.7,000 respectively. Expenses amounted to Rs.400. Creditors were paid Rs.4,500 in full satisfaction. Poor has become insolvent and a final dividend of 50 paise in a rupee was paid from his estate.

Give necessary ledger accounts to record dissolution.

(Answer: Loss on realisation Rs.3,920; Pavan & Raju are paid Rs.4,361 and Rs.2,759 respectively).

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17.11 RECOMMENDED BOOKS

1. Gupta, R.L. & Radhaswamy, M. : Advanced Accountancy Sultan Chand & Sons, New Delhi.
2. Shukla, M.C & Grewel, T.S. : Advanced Accounts, : S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P. & Narang, K.L. : Advanced Accountancy, : Kalyani Publishing House, New Delhi.

17.12 GLOSSARY

Insolvent Firm : A firm which is not able to pay its liabilities and declared as insolvent.

Insolvent Partner : A partner who is not able to pay his liabilities and declared as insolvent.

Solvent Partner : Partner who is in a position to pay off his liabilities.

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UNIT - 18 : SALE TO A COMPANY

Contents

18.0 Aims and Objectives
18.1 Introduction
18.2 Special Points in the case of Sale to a Company
18.3 Steps involved in closing the Books of the Firm
18.4 Summing up
18.5 Check Your Progress : Model Answers
18.6 Model Examination Questions
18.7 Recommended Books
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18.0 AIMS AND OBJECTIVES

This unit has been introduced with a view to acquainting you with the accounting procedure in the books of the partnership firm, when it is converted into a company or when it is sold to a company.

At the end of this unit, you should be able to;

- explain the steps involved in closing the books of the firm
- work out the problems on conversion of firm into a company
- work out the problems on sale of firm to a company.

18.1 INTRODUCTION

Sometimes a partnership firm may decide to convert itself into a joint stock company. This may be necessary when huge finances are required or more number of persons than the required under Partnership Act, are to be taken into the Business. It may also be converted into a company when the partners like to take advantage of priciple of limited liability.

Sometimes the partnership business may be sold to a company form of organisation.

Whether it is conversion into a company or sale to a company there are two aspects to be considered from the accounting point of view. They are:

i. the books of the firm are to be closed.

ii. the books of the company are to be opened or entries for purchase of business by the company are to be passed.

The second aspect is dealt with in company accounts. We shall now see the procedure to be followed in the books of partnership concern. Basically, there is no difference in the accounting procedure to be followed in the case of dissolution of a firm and conversion into or sale to a company. However, there are some special points to be considered in the case of conversion or sale to a company.

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18.2 SPECIAL POINTS IN THE CASE OF SALE TO A COMPANY

1. The purchasing company generally pays the purchase consideration in the form of cash, debentures or shares. These items are distributed among the partners. However, debentures and shares, cannot be distributed in fractions. They are distributed to the nearest whole number. In addition, when there is no clear agreement among the partners, the balance of purchase consideration left i.e., cash, shares and debentures are to be distributed among the partners in the ratio of their final claims (final balances in their capital accounts).

2. Normally, the purchasing company takes over all the assets. Hence, it is assumed that cash/bank balance is also taken over by the purchasing company. However, where it is given specially that cash/bank balance is not taken over, (it is not transferred to Realisation account) but that account is opened along with capital account, etc., with the opening balance given.

18.3 STEPS INVOLVED IN CLOSING THE BOOKS OF THE FIRM

As mentioned earlier the accounting procedure is similar to that of dissolution of a firm. The following are the steps involved:

1. Transfer all the assets to Realisation Account.

Realisation Account	Dr.	
To Individual assets a/c.		

2. Transfer all outside laibilities to Realisation a/c.

Individual Liability accounts	Dr.	
To Realisation a/c.		

3. Record the purchase consideration agreed to be paid by the company:

Company Account	Dr.	
To Realisation a/c.		

4. Receive the purchase consideration:

Bank a/c.	Dr.	
Debentures in the company a/c.	Dr.	
Shares in the company a/c.	Dr.	
To the company a/c.		

5. Dispose off the assets which are not taken over by the company.

Bank a/c .	Dr. (for cash received)	
Partner's capital or current a/c.	Dr. (if any partner has taken over)	
To Realisation a/c.		

6. Pay off the liabilities not taken over by the company.

Realisation a/c.	Dr.	
To Partners' Capital or current a/c.		(for the amount taken over by the partner)
To Bank a/c		(for cash paid)

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7. Transfer the loss or gain from the Realisation a/c to Partners'accounts in their profit sharing rat

For gain: (when credit side is more)

Realisation a/c. Dr.
To Partners' capital or current a/c.

For loss: (when debit side is more)

Partners' capital or Current a/c. Dr.
To Realisation a/c.

No separate entry is required for loss or gain on any asset/liability, not taken over by the company. It gets automatically incorporated in the loss or gain on realisation (in the realisation account).

8. Transfer the undistributed profits or losses to partners

For profits:

Reserve account Dr.
P&L a/c (credit balance) Dr.
To Partner's capital or current a/c. (in their profit sharing ratio)

For Losses:

Partners' capital or Current a/c. Dr. (in their profit sharing ratio)
To P&L a/c (debit balance)

9. Close the current accounts of the partners, if any, by transfer to thier respective capital accounts.

For debit balance in current account:

Partners' capital a/c. Dr.
To Partners' current a/c.

For credit balance in current account:

Partner's Current a/c. Dr.
To partner's capital a/c.

10. Distribute the balance of Cash, Debentures, Shares, etc., received from the purchasing company, to the partners in the ratio of their final balances,

Partners' capital a/cs. Dr.
To Debentures in the company
To Shares in the company
To Bank

ote:1. Current accounts of the partners need be opened only when fixed capital method is followed.

2. At this stage all accounts in the firm's books would get closed.

The accounting procedure is explained in the following illustrations.

Illustration - 1

Ramayya and Sommayya are partners in the firm sharing profits and losses in 2:1 ratio. On 31st December '985, they decided to convert their firm into a Limited Company, on which date their position was as follows:

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Liabilities	Rs.	Assets	Rs.
Sundry Creditors	4,200	Cash at Bank	9,000
Bills payable	8,100	Stock	36,600
Ramayya's capital	60,000	Debtors	11,700
Sommayya's capital	30,000	Buildings	45,000
	1,02,300		1,02,300

The company took over the business except cash and bills payable. Equity shares of Rs.10 each for Rs.1,35,000 were allotted by the company. The expenses of realisation amounted to Rs.900. Pass Journal entries to close the books of the firm and also show the important ledger accounts.

Solution

1.	Realisation Account Dr. To Stock a/c. To Debtors a/c. To Buildings a/c. (For transfer of assets)		93,300	 36,600 11,700 45,000
2.	Sundry Creditors a/c. Dr. Bills payable a/c. Dr. To Realisation a/c. (For transferring the liabilities)		4,200 81,00	 12,300
3.	Limited company a/c Dr. To Realisation a/c. (For purchase consideration agreed to)		1,35,000	 1,35,000
4.	Equity shares in Limited company a/c Dr. To Limited Company a/c. (Being purchase consideration received.)		1,35,000	 1,35,000
5.	Realisation a/c Dr. To Bank a/c. (Being bills payable Rs.8,100 and realisation expenses Rs.900 paid)		9,000	 9,000
6.	Realisation a/c Dr. To Ramayya's capital a/c. To Somayya's capital a/c. (Profit on Realisation transferred)		45,000	 30,000 15,000
7.	Ramayya's capital a/c Dr. Somayya's capital a/c Dr. To Equity shares in Limited company a/c. (For distributing the equity shares among the partners)		90,000 45,000	 1,35,000

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Ledger

Dr **Realisation** **Cr.**

	Rs.		Rs.
To Sundry Assets a/c.	93,300	By Sundry Liabilities a/c	12,300
To Bank (B/P 8,100; Exp.900)	9,000	By Limited company a/c.	1,35,000
To Ramayya's capital a/c 2/3 P.	30,000		
To Somayya's Capital a/c 1/3 P.	15,000		
	1,47,300		1,47,300

Dr. **Limited Company A/c.** Cr.

	Rs.		Rs.
To Realisation a/c.	1,35,000	By Equity shares in Limited company a/c.	1,35,000
	1,35,000		1,35,000

Dr. **Equity Shares in Limited Company A/c.** Cr.

	Rs.		Rs.
To Limited company a/c.	1,35,000	By Ramayya's capital a/c	90,000
		By Somayya's capital a/c.	45,000
	1,35,000		1,35,000

Dr. **Ramayya's Capital A/c.** Cr.

	Rs.		Rs.
To Equity shares in Limited Company a/c.	90,000	By Balance b/f	60,000
		By Realisation a/c. 2/3 profit	30,000
	90,000		90,000

Dr. **Somayya's Capital A/c.** Cr.

	Rs.		Rs.
To Equity shares in Limited Company a/c.	45,000	By Balance b/f	30,000
		By Realisation a/c.2/3 Profit	15,000
	45,000		45,000

BRAOU

Check Your Progress - 1

a. What is the entry when the partners receive purchase consideration in the form of shares and debentures from the company.

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.....

.....

b. How do you close the current account debit balances of partners? (write Jounral entry).

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Illustration - 2

Anand and Bhaskar are partners sharing profits and losses in 2:1 ratio. On 31st December, 1985 their balance sheet stood as follows:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	1,10,000	Plant & Machinery	1,40,000
Bills payable	60,000	Stock	70,000
Anand's current a/c	40,000	Debtors	1,30,000
Anand's capital a/c	1,00,000	Cash at Bank	30,000
Bhaskar's capital a/c.	80,000	Bhaskar current a/c	20,000
	3,90,000		3,90,000

They decided to sell their firm to Vijay Engineering Co. Ltd., which has agreed to take Plant and Machinery, Stock for Rs.3,48,000 and pay Rs.1,40,000 in cash and the remaining in 2,600 equity shares of Rs.100 each at an agreed value of Rs.80 each. The debtors realised Rs.1,22,000 and the creditors were paid Rs.1,02,000 in full settlement. B.P. were paid in full. They agreed to take the shares in proportion to their fixed capital ratio.

Pass journal entries and show ledger accounts in the books of the firm.

Solution

Journal

1.	Realisation a/c. Dr.		3,40,000	
	To Plant & Machinery a/c.			1,40,000
	To Stock a/c.			70,000
	To Debtors a/c.			1,30,000
	(For transfer of assets)			
2.	Sundry Creditors a/c. Dr.		1,10,000	
	Bills payable a/c Dr.		60,000	
	To Realisation a/c.			1,70,000
	(For transfer of liabilities)			
3.	Vijay Engineering Co.Ltd., a/c. Dr.		3,48,000	
	To Realisation a/c.			3,48,000
	(For purchase consideration agreed)			

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4.	Bank a/c.	Dr.		1,40,000	
	Equity Shares in Vijaya Engineering Co.Ltd.a/c.	Dr		2,08,000	
	To Vijay Engg.Co.Ltd., a/c.				3,48,000
	(For purchase consideration received)				
5.	Bank a/c.	Dr.		1,22,000	
	To Realisation a/c.				1,22,000
	(For amount realised on Debtors)				
6.	Realisation a/c.	Dr.		1,62,000	
	To Bank a/c.				1,62,000
	(For paying creditors & B.P)				
7.	Realisation a/c.	Dr.		1,38,000	
	To Anand's current a/c.				92,000
	To Bhaskar's current a/c				46,000
	(Profit on realisation distributed)				
8.	Anand's current a/c.	Dr.		1,32,000	
	Bhaskar's current a/c	Dr		26,000	
	To Anand's capital a/c.				1,32,000
	To Bhaskar's capital a/c.				26,000
	(For closing the current a/c. by transfer)				
9.	Anand's capital a/c.	Dr.		1,15,520	
	Bhaskar's capital a/c.	Dr.		92,480	
	To Equity shares in Vjay Engg.Co..Ltd., a/c.				2,08,000
	(Equity shares distributed in Fixed Capital ratio i.e., 5:4)				
10.	Anand's capital a/c.	Dr.		1,16,480	
	Bhaskar's capital a/c.	Dr.		13,520	
	To Bank a/c.				1,30,000
	(Remaining cash paid to partners to settle their accounts)				

Ledger

Dr. **Realisation A/c.** Cr.

	Rs.		Rs.
To Sundry Assets a/c.	3,40,000	By Sundry Liabilities a/c	1,70,000
To Bank a/c. (crs.B/P)	1,62,000	By Vijay Engg.Co.Ltd., account	3,48,000
To Anand's current a/c 2/3 p.	92,000		
To Bhaskar's current a/c. 1/3 P.	46,000	By Bank a/c. (Drs.)	1,22,000
	6,40,000		6,40,000

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Bank A/c.

Dr.	Rs.		Cr. Rs.
To Balance b/f	30,000	By Realisation a/c. (Crs.&BP)	1,62,000
To Vijaya Engg.Co. Ltd., a/c	1,40,000	By Anand's Capital a/c.	1,16,480
To Realisation a/c. (Drs.)	1,22,000	By Bhaskar's capital a/c	13,520
	2,92,000		2,92,000

Vijay Engineering Company Limited A/c.

Dr.	Rs.		Cr. Rs.
To Realisation a/c	3,48,000	By Bank account	1,40,000
		By Equity shares in Vijaya Engg.co..Ltd., a/c.	2,08,000
	3,48,000		3,48,000

Equity Shares in Vijay Engineering Co.Ltd., A/c.

Dr.	Rs.		Cr. Rs.
To Vijaya Engg.Co.Ltd.,a/c	2,08,000	By Anand's capital a/c 5/9	1,15,520
		By Bhaskar's capital account 4/9	92,480
	2,08,000		2,08,000

Anand's Capital A/c.

Dr.	Rs.		Cr. Rs.
To Equity shares in Vijaya Engg.Co.Ltd.,a/c.	1,15,520	By Balance b/f	1,00,000
To Bank a/c.	1,16,480	By Anand's current a/c.	1,32,000
	2,32,000		2,32,000

Anand's Current A/c.

Dr.	Rs.		Cr. Rs.
To Anand's capital a/c.	1,32,000	By Balance b/f	40,000
		By Realisation a/c. 2/4 P.	92,000
	1,32,000		1,32,000

Bhaskar's Capital A/c.

Dr.	Rs.		Cr. Rs.
To Equity shares in Vijaya Engg.Co. Ltd., a/c.	92,480	By Balanace b/f	80,000
To Bank a/c.	13,520	By Bhaskar's current a/c.	26,000
	1,06,000		1,06,000

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Dr. **Bhaskar's Current A/c.** Cr.

	Rs.		Rs.
To Balance b/f	20,000	By Realisation a/c 1/3 P.	46,000
To Bhaskar's capital a/c.	26,000		
	46,000		46,000

18.4 SUMMING UP

Sometimes a partnership firm may be converted into a company form of organisation or it may be sold to a company. Basically, there is no difference in the accounting procedure to be followed in the case of dissolution of a firm and conversion into or sale to a company.

The purchasing company, generally, pays the consideration in the form of cash, debentures or shares. These are distributed among the partners.

18.5 CHECK YOUR PROGRESS : ANSWERS

(a) Partner's capital A/cs. Dr.
To Equity Shares in Limited Company A/c.
To Debentures in Limited company A/c.

(b) The following entry is passed:

Partners' capital Accounts Dr.
To partner's current Accounts

(Being the debit balances of current accounts closed)

18.6 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines each:

1. What are the important points to be noted in the sale of a firm to a limited company?
2. What is the differences in the accounting treatment between dissolution and conversion of the firm into a company?

B. Answer the the following in 15 lines each:

1. What is meant by purchase consideration? How is it distributed among the partners?
2. What do you understand by conversion of a firm into a company?
3. Explain the accounting procedure that you follow when a firm is sold to a company.

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PROBLEMS

1. Ram and Shyam were partners sharing profits and losses in 2:1 ratio. They decided to convert their firm into a Company, on 31st December, 1985 on which date their balance sheet was as under:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	6,000	Cash	1,400
Bank loan	2,000	Debtors	5,200
Capital: Ram	4,000	Stock	3,200
Shyam	2,000	Machinery	1,000
		Buildings	3,200
	14,000		14,000

All assets and liabilities except Bank loan were transferred to the company. The purchase price of the firm fixed at Rs.12,000 and which settled the transaction by paying cash Rs.2,400, Debentures Rs.4,800 and the balance in equity shares of the company. Bank loan was paid by the firm. Debentures and Shares were shared by partners in 2:1 ratio. Show the dissolution.

(Answer: Profit on realisation Rs.4,000).

2. Amar and Banerjee were in partnership sharing profits and losses in 2:1 ratio. On 31st December, 1985 their Balance Sheet was as under:

Liabilities	Rs.	Assets		Rs.
Sundry Creditors	2,500	Cash		65
Amar's loan	1,000	Bills receivable		200
General Reserve	300	Debtors	3,000	
Capital:Amar	1,500	Less:.R.B.D	150	2,850
Banerjee	1,000	Stock		1,185
		Machinery		2,000
	6,300			6,300

They decided to sell their business to a Limited Company, which took over the assets and liabilities as follows:

Machinery Rs.800, Stock Rs.1,750, Debtors Rs.2,535, Bills Receivable Rs.200 and Goodwill Rs.300, Creditors Rs.1,950 (in full settlement), Dissolution expenses amounted to Rs.15. The company paid Rs.2,000 in fully paid equity shares and Rs.1,685 in cash.

(Answer: Loss on realisation Rs.615 Amar gets Rs.109 cash and Rs.1,181 shares, Banerjee Rs.76 cash and Rs.819 shares).

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18.7 RECOMMENDED BOOKS

1. Gupta, R.L. & Radhaswamy, M : Advanced Accountancy, Sultan chand & sons, New Delhi.
2. Shukla, M.c & Grewal, T.S. : Advanced Accounts, S.Chand & Co.Ltd., New Delhi
3. Jain, S.P & Narang, K.L. : Advanced Accountancy, Kalyani Publishing House, New Delhi

18.8 GLOSSARY

1 Conversion into a company : Changing the existing form of organisation into that of a company

2. Purchase consideration : The amount agreed to be paid by the purchasing company for acquiring the business of the partnership firm.

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BLOCK - VI : DEPARTMENTAL ACCOUNTS

UNIT - 19 : DEPARTMENTAL ACCOUNTS - I

Contents

19.0 Aims and Objectives
19.1 Introduction
19.2 Meaning of Departmental Accounts
19.3 Advantages of Departmental Accounts
19.4 Methods of maintaining Departmental Accounts
19.5 Allocation of Expenses
19.6 Inter-departmental Transfers - at cost and at profit
19.7 Summing up
19.8 Check Your Progress : Model Answers
19.9 Model Examination Questions
19.10 Recommended Books
19.11 Glossary

19.0 AIMS AND OBJECTIVES

The aims of this unit are to explain the meaning of departmental accounts and the methods of maintaining such accounts.

At the end of this unit, you should be able to:

- explain the meaning of departmental accounts
- list out the advantages of maintaining departmental accounts
- identify the basis for the allocation of expenses among various departments
- identify how transfer of goods takes place among various departments.

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19.1 INTRODUCTION

In a big business there will be several departments, each dealing with a particular kind of goods or services. In this unit, an attempts is made to expose you to the meaning, advantages and methods of maintaining departmental accounts. This unit provides the theoretical frame work of departmental accounts.

19.2 MEANING OF DEPARTMENTAL ACCOUNTS

A businessman may deal in different types of goods and services. If the business is carried on a small scale, he may sell the goods or provide the services in one shop itself. But, if the business is carried on relatively bigger scale, he may divide his business into some broad divisions known as departments. Each department may deal in certain class of goods and services. For example, one department may deal in cloth, another in medicines and still another may be dealing in shoes etc. All the departments will be generally under one roof. Each department is separately managed by a departmental manager. Activities of all departments are coordinated and controlled by a general manager. The general manager lays down the general policy and

guide lines for the conduct of the departments. The departmental managers may carry on their activities in the best interest of the departments, subject to the guidelines given by the general manager. This type of departmental organisations quite common in case of big retail stores.

When a business is split up in a number of departments, the accounts have to be kept in such a manner as to throw light not only on the trading result of the business as a whole, but also on the trading result of each department individually. Accounts maintained to serve this purpose are known as Departmental accounts. Departmental trading and profit and loss account are prepared on columnar basis which will reveal the profit (or loss) of each department separately and also the combined result.

19.3 ADVANTAGES OF DEPARTMENTAL ACCOUNTS

1. It enables the management to compare the performance of one department with that of another and, of the same department over a period.

2. It helps the management in formulating proper policies relating to expansion of business. Some departments may be earning profits, while others may be incurring losses. Necessary investigation may be conducted to know why some departments are running in loss. Causes of inefficiency may be known, and if possible, corrective steps may be taken to put them on proper lines. If it is not possible to reduce the losses over all profits can be increased by closing down such departments. The departments showing profits may be given more attention, and if possible, expanded to maximise profits. New profitable lines, which can be added successfully along with the existing ones, can be throught of.

3. Departmental accounts can be used for rewarding departmental staff showing good results. This will create a healthy spirit of competition among the departments, and each department will try to maximise its profits.

19.4 METHODS OF MAINTAINING DEPARTMENTAL ACCOUNTS

There are two methods of keeping departmental accounts:

1. Each department is regarded as a separate unit and independent records are kept for each department and at the end of the year the trading and profit and loss account is prepared for each department separately. The trading results of the departments are combined to know the result of the business establishment as a whole. This method is very expensive and time consuming. Because of its limitations, this method is rarely used.

2. Under the second method, accounts are maintained on columnar basis. Purchases book, Sales book, Returns inwards book and Returns outwards book etc. are provided with extra columns so as to give information separately for each department. For example, purchase book will be ruled as follows:

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Purchases Book

Date	Particulars	L.F.	Total Rs.	Dept. A	Dept. B	Dept. C
				Rs.	Rs.	Rs.

The same ruling can be given for Sales Book, Returns Inwards Book and Returns Outwards Book. If cash purchases and cash sales are more in volume, then cash book can also be provided with extra columns for each department.

19.5 ALLOCATION OF EXPENSES

Departmental trading account in columnar form can be easily prepared as information regarding purchases, sales, opening and closing stocks, and direct expenses can be easily ascertained when the accounts are maintained in columnar form. Difficulty arises only in case of indirect expenses which are common for the concern as a whole. These expenses have to be distributed or allocated to different departments on an equitable or reasonable basis. If that is not done properly, departmental results may be misleading. The following guidelines may be followed in allocation of expenses.

1. Expenses incurred specially for a particular department should be charged directly to that department. For example, salary paid to the employees working in a department should be charged to that department.

2. Expenses relating to building such as rent and rates, repairs to building, insurance on building, should be allocated in the ratio of space occupied by the different departments.

3. Amount spent on lighting may be conveniently allocated according to meter reading, if separate meters for each department are kept. They can also be apportioned on the basis of number of points in each department. If the above information is not available, allocation may be made on the basis of floor area occupied by each department.

4. Expenses having a bearing on sales such as carriage outwards, selling commission, bad debts, discount on sales etc., should be apportioned on the basis of turnover of each department.

There appears to be some disagreement among accountants regarding the term turnover.

Some accountants feel that turnover should include transfers to other departments, while others feel that inter-departmental transfers should be ignored for this purpose. Whatever method followed, it is better to give an explanatory note.

5. Advertising may be allocated on the basis of space devoted to each department, or if this information is not available it may be allocated on the basis of turnover.

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6. Insurance on stock should be charged on the basis of average stock lying in each department.

7. Labour welfare expenses should be allocated among the different departments on the basis of number of employees in each department.

8. Depreciation for each machine should be calculated and charged to the departments using them. If the information regarding the value of machine used by each department is not available, then it may be charged in the ratio of sales.

9. Income-tax should be charged to the various departments on the basis of net profit (before tax) of each department.

10. There are certain expenses which cannot be allocated to various departments, in an equitable or reasonable manner such as debenture interest, Director's fees, Auditor's fees, General Manager's salary, Share transfer fees, office expenses etc. No useful purpose will be served by arbitrary allocation. Profits earned by all departments may be brought down in one account, termed as general profit and loss account and expenses which cannot be allocated reasonably to the various departments should be debited to that account. Similarly, non-departmental incomes or profits such as interest on investments, profits on sale of an asset may be credited to that account and net profit (or loss) for the business as a whole ascertained.

Check Your Progress - 1

What are the boses for the allocation of the following expenses:

(a) Rent, rates, taxes and repairs to building.

.....

(b) Selling expenses, Advertisment, discount allowed and bad debts.

.....

(c) Canteen expenses, medical expenses and welfare expenses.

.....

(d) Interest on capital and interest on debentures.

.....

19.6 INTER-DEPARTMENTAL TRANSFERS

Generally transfer of goods and services may take place from one department to another department. While preparing the departmental trading and profit and loss account, the department receiving the goods or services should be debited and the department providing such goods or services should be credited with the value of goods or services supplied.

Transfer of goods and services from one department to another is usually at cost. However, if such transfer is at a profit, the profit or loss of each department should be ascertained on the basis of transfer price itself. If the goods supplied by one department to another at profit are

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completely sold out by the transferee department, there is no unrealised profit because goods purchased are sold to third party and the profit charged by the transferor department is realised. However, if part of the goods transferred by one department to other at profit remain unsold then there is 'unrealised profit' from the business concerns point of view. In this case, the closing stock of the transferee department includes the profit charged by the selling department which is not realised as it is not yet sold to third party. In such a case, a reserve is created to the extent of loading or profit included in the closing stock by passing the following journal entry.

		Dr.
General Profit and Loss account		
To Stock Reserve account		
(Being the profit charged by the transferor dept. included in the closing stock of the transferee department adjusted).		

In case, the opening stock of the transferee department includes profit charged by the transferor department, then stock reserve would have been created in the last year. This have to be transferred to general profit and loss account in the current year by means of the following entry:

		Dr.
Stock Reserve account		
To General Profit and loss account		
(Being the adjustment of profit charged by the transferor department in cluded in the opening stock of the transferree department).		

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

Check Your Progress - 2

What is the adjustment entry to be passed when a part of the goods transferred from one department to another department remained unsold at the end of the year?

.....

.....

.....

19.7 SUMMING UP

A business may be divided into a number of divisions known as 'Departments'. Accounts maintained in such a manner which will disclose not only the profits made by the business as a whole, but also the trading results of each department separately are known as 'Departmental Accounts'.

A departmental trading and profit and loss account in columns form is prepared showing the expenses incurred and income earned and net profit or loss made by each department separately.

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Expenses may be direct or indirect. Direct expenses are those expenses which are specifically incurred for a particular department and hence allocated or charged to the concerned department. Indirect expenses are those expenses which are incurred for the benefit of all the departments and cannot be allocated precisely. Such expenses have to be apportioned or charged to the various departments on an equiatable or reasonable manner. For example, expenses connected with building may be allocated on the basis of the area of occupied by each department. Similarly, expenses having a bearing on sales can be allocated in the ratio of turnover. Expenses which cannot be apportioned on an equitable basis will be charged to General Profit & Loss Account.

Goods may be transferred or services may be rendered by one department to another. It may be recorded at cost or at profit. Departments receiving goods or services should be debited and the department providing such goods or services should be credited. If the goods sold by one department to another at profit and a part of such goods remain unsold with the transferee department, then a reserve has to be created for unrealised profit included in stock.

19.8 CHECK YOUR PROGRESS : MODEL ANSWERS

1. (a) On the basis of floor area occupied.

   (b) on the basis of turnover

   (c) on the basis of number employees

   (d) There is no basis for the allocation of these expenses and as such they have to be charged to General Profit and Loss Account.

2. General profit and Loss Account Dr.
   To Stock Reserve A/c.

19.9 MODEL EXAMINATION QUESTIONS

A. Answer the following in 30 lines each:

1. What do you mean by Departmental Accounts? Point out their Advantages.
2. Explain clearly the basis of allocation of expenses among the various departments.

B. Answer the following in 15 lines each:

1. What is the accounting treatment of interdepartmental transfers at (a) cost price (b) profit.
2. How are the following items apportioned between different deparments:(a) Rent; (b) Advertising, (c) Discount received.
3. Write short notes on:
   (a) Departmental Trading A/c.
   (b) Direct & Indirect Expenses.
4. What is the basis of apportinment of the following items:
   a) Depreciation b) lighting c) Income-Tax.
5. How do you treat the following items in Departmental accounts? a) Interest on investments; b) Interest on bank loan; c) Audit fees; d) General Manager's salary.

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19.10 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy, M : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C & Grewel, T.S : Advanced Accounts, S.Chand & Co.Ltd, New Delhi.
3. Jain, S.P. & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

19.11 GLOSSARY

Departmental Accounts : The accounts prepared in columnar form to show the trading results of each department individually and the net result of the business as a whole are called departmental accounts.

Direct Expenses : The expenses which can be allocated to different departments precisely are called direct expenses .

Indirect expenses : The expenses which are incurred for the common benefit of the business and cannot be conveniently allocated to a particular department are called indirect expenses.

Inter-departmental transfers : The goods transferred from one Department to another department are known as inter-departmental transfers.

Stock Reserve : When goods are transferred from one department to other at profit, the closing stock of transferee may include unrealised profit. Reserve created to provide for such unrealised profit is called 'Stock Reserve'.

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UNIT - 20 : DEPARTMENTAL ACCOUNTS - II

Contents

20.0 Aims and Objectives
20.1 Introduction
20.2 Illustrations
20.3 Summing up
20.4 Check Your Progress
20.5 Model Examination Questions
20.6 Recommended Books

20.0 AIMS AND OBJECTIVES

The unit provides a practical perspective of the departmental accounts.

Having studied this unit, you should be able to:

- prepare departmental Trading and Profit and Loss Account
- prepare departmental General Profit and Loss Account and Balance Sheet.

20.1 INTRODUCTION

In unit-19 we have discussed the complete theoretical frame work of departmental accounts. In this unit, we will be learning the actual preparation of departmental accounts with appropriate illustrations.

The expenses that can be identified with departments on some basis are allocated and others are debited to General Profit and Loss Account. Let us get into details.

20.2 ILLUSTRATIONS

Illustration - 1

A firm has two departments, A and B. From the following particulars prepare Departmental Trading and Profit and Loss Account and General Profit and Loss Account for the year ended 31st December, 1985.

	Rs.
Stock on 1-1-1985:	
'A' Department	25,000
'B' Department	30,000
Purchases:	
'A' Department	1,00,000
'B' Department	1,50,000
Sales:	
'A' Department	2,00,000
'B' Department	3,00,000
Carriage inwards	2,500
Salaries	20,000
Rent and Rates	9,000

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	8,000
Advertising	2,000
Insurance	6,000
General expenses	4,000
Discount Allowed	5,000
Carriage outwards	1,250
Discount received	600
Audit fees	7,000
Interest on loan taken	800
Interest on Investments	

The following further information is provided:

(1) Stock on 31st December, 1985:
'A' Department Rs.10,000
'B' Department Rs.20,000

(2) Goods were transferred from Department A to Department B at cost Rs.6,000.

(3) Salaries and general expenses are to be allocated equally between the two departments.

(4) Area occupied by the two departments is in the ratio of 1 : 2

(5) Insurance premium is for a comprehensive policy, allocation being inconvienient.

Solution

Departmental Trading and Profit and Loss Account

For the year ended 31st December, 1985

Dr. Cr.

	Dept.A	Dept. B	Total		Dept.A	Dept.B	Total
To opening Stock	25,000	30,000	55,000	By Sales	2,00,000	3,00,000	500,000
To Purchases	1,00,000	1,50,000	2,50,000	By Goods transferred to B Deartment	6,000	–	6,000
To Goods transferred from A Department	–	6,000	6,000	By Closing Stock	10,000	20,000	30,000
To Carriage Inwards	1,000	1,500	2,500				
To Gross Profit c/d	90,000	1,32,500	2,22,500				
	2,16,000	3,20,000	5,36,000		2,16,000	3,20,000	5,36,000
To Salaries	10,000	10,000	20,000	By Gross Profit b/d	90,000	1,32,500	2,22,500
To Rent and Rates	3,000	6,000	9,000	By Discount received	500	750	1,250
To Advertising	3,200	4,800	8,000				
To General expenses	3,000	3,000	6,000				
To Discount allowed	1,600	2,400	4,000				
To Carriage outwards	2,000	3,000	5,000				
To Net Profit (transferreds to general profit and loss account)	67,700	1,04,050	1,71,750				
	90,500	1,33,250	2,23,750		90,500	1,33,250	2,23,750

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General Profit and Loss Account

Dr. for the year ended 31st December, 1985 Cr.

	Rs.		Rs.
To Insurance	2,000	By Net Profit (Transferred from Departmental Profit and loss account)	1,71,750
To Audit fees	600		
To Interest on loan	7,000		
To Net Profit (Transferred to Capital Account)	1,62,950	By Interest on Investments	800
	1,72,550		1,72,550

Explanatory Notes

1. Carriage inwards and discount received have been allocated in the ratio of purchases.
2. Carriage outwards, Advertising and discount allowed have been allocated in the ratio of sales.
3. Rent and Rates are allocated in the ratio of area occupied.
4. It is stated in the problem that insurance premium is for comprehensive policy and allocation between the departments is inconvenient, hence it is charged to general profit and loss account. Audit fees and interest on loan taken cannot be reasonably allocated between the departments, hence charged to general profit and loss account.
5. Interest is investments is non-departmental income, hence credited to general profit and loss account.

Illustration - 2

From the undermentioned information and instructions prepare departmental trading and profit and loss account in columnar form of the three departments.

	Dept. A Rs.	Dept. B Rs.	Dept. C Rs.
Stock, January, 1984	40,000	30,000	90,000
Stock, December 31,1984	45,000	40,200	82,400
Purchases	2,05,300	2,40,600	3,40,000
Returns outwards	2,100	3,200	3,300
Sales	3,08,600	4,03,400	5,09,800
Returns inwards	8,600	3,400	9,800
Carriage inwards	3,400	3,800	4,300
Wages	14,000	13,000	16,000

Goods were transferred from one department to another at cost price as follows:

1. From Department A to Department B Rs .8,000 and to Department C Rs. 5,000
2. From Department B to Department A Rs. 3,000 and to Department C Rs. 4,000
3. From Department C to Department B Rs. 3,000 and to Department B Rs. 2,000

Allocate equally printing and stationery Rs. 2,100; general charges Rs. 1,800; insurance Rs. 600; postage Rs. 300; and depreciation Rs. 3,000.

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Apportion the following further expenditure as you think best:

Establishment Rs. 18,000; Bad debts Rs. 2,400, advertising Rs. 6,000 and income tax Rs. 67,000, rentandrates Rs. 6,000 is to be split up in proportion to space occupied i.e., Department A-3, Department B-2; Department C-3, other space-2.

Solution

Departmental Trading and Profit & Loss Account

Dr. for the year ending 31st December, 1984 Cr.

	Dept. 'A'	Dept. 'B'	Dept. 'C'	Total		Dept. 'A'	Dept. 'B'	Dept. 'C'	Total
	Rs.	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.	Rs.
To Opening Stock	40,000	30,000	90,000	1,60,000	By Sales (less returns)	3,00,000	4,00,000	5,00,000	12,00,000
To Purchase (less returns)	2,03,200	2,37,400	3,37,300	7,77,900	By Goods supplied to other departments	13,000	7,000	5,000	25,000
To Goods Received from other					By Closing stock	45,000	40,200	82,400	1,67,600
To Carriage inwards	3,400	3,800	4,300	11,500					
To Wages	14,000	13,000	16,000	43,000					
To Gross profit c/d	91,400	1,53,000	1,30,800	3,75,200					
	3,58,000	4,47,200	5,87,400	13,92,600		3,58,000	4,47,200	5,87,400	3,92,600
To Establishment	4,500	6,000	7,500	18,000	By Gross Profit b/d	91,400	1,53,000	1,30,800	3,75,200
To Printing and stationery	700	700	700	2,100					
To General charges	600	600	600	1,800					
To Insurance	200	200	200	600					
To Postage	100	100	100	300					
To Rent and Rates	2,200	1,600	2,200	6,000					
To Bad debts	600	800	1,000	2,400					
To Advertising	1,500	2,000	2,500	6,000					
To Depreciation	1,000	1,000	1,000	3,000					
To Net Profit (before tax)	80,000	1,40,000	1,15,000	3,35,000					
	91,400	1,53,000	1,30,800	3,75,200		91,400	1,53,000	1,30,800	3,75,200
To Income Tax	16,000	28,000	23,000	67,000	By Net Profit (before tax)	80,000	1,40,000	1,15,000	3,35,000
To Net Profit	64,000	1,12,000	92,000	2,68,000					
	80,000	1,40,000	1,15,000	3,35,000		80,000	1,40,000	1,15,000	3,35,000

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Working Notes

Goods received from and transferred to departments have been ascertained as follows:

Deaprtment - A

	Rs.
Goods received from other departments	
From Department B	3,000
From Department C	3,000
	6,000
Goods transferred to other departments	
To Department B	8,000
To Department C	5,000
	13,000
Department - B	
Goods received from other departments	
From Department A	8,000
From Department C	2,000
	10,000
Goods transferred to other departments	
To Department A	3,000
To Department C	4,000
	7,000
Department - C	
Goods received from other departments	
From Department A	5,000
From Department B	4,000
	9,000
Goods transferred to other departments	
To Department A	3,000
To Department B	2,000
	5,000

(2) Establishment, Bad Debts and Advertising have been divided in the ratio of net sales i.e., 3:4:5.

(3) Rent and Rates have been divided in the ratio of space occupied. Rent and Rates of other space have been divided equally.

(4) Income tax has been divided in the ratio of Net Profit before tax.

Illustration - 3

From the following trial balance, prepare departmental trading and profit and loss account, general profit and loss account for the year ended 31st December, 1984 and Balance Sheet as on that date.

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Trial Balance

Debit balances	Rs.	Credit balances	Rs.
Opening Stock:		Capital	50,000
Dept. A	30,000	Sundry Creditors	33,500
Dept. B	20,000	Loan from Bank	10,000
Carriage Inwards:		Sales:	
Dept. A	2,000	Dept. A	1,50,000
Dept. B	4,000	Dept. B	3,00,000
Purchases:		Interest on Investments	500
Dept. A	1,00,000		
Dept. B	2,00,000		
Salaries:			
Dept. A	15,000		
Dept. B	12,000		
General Salaries	4,000		
Advertising	2,000		
Rent, Rates and taxes	3,000		
Carriage outwards	9,000		
Furniture & Fittings	6,000		
Plant and Machinery	1,00,000		
Sundry Debtors	19,000		
Drawings	5,000		
Investments	10,000		
Cash at Bank	2,00		
Interest on Bank Loan	1,000		
	5,44,000		5,44,000

The following information is also provided:

(1) Closing stock - Dept. A Rs. 25,000; Dept.B Rs. 40,000.
(2) Area occupied by two departments in the ratio of 1 : 2
(3) General salaries are to be divided in the ratio of 5 : 3
(4) Interest outstanding on Bank Loan Rs.200.
(5) Depreciate Plant and Machinery and Furniture at 10%. Depreciation of plant and Machinery should be allocated in the ratio of 3 : 1 and of furniture in the ratio of space occupied.

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Departmental Trading and Profit and Loss Account

Dr. for the year ended 31st December, 1985 Cr.

	Dept.A	Dept. B	Total		Dept.A	Dept.B	Total
To opening Stock	30,000	20,000	50,000	By Sales	1,50,000	3,00,000	4,50,000
To Purchases	1,00,000	2,00,000	3,00,000	By Closing Stock	25,000	40,000	65,000
To Gross Profit c/d	43,000	1,16,000	1,59,000				
	1,75,000	3,40,000	5,15,000		1,75,000	3,40,000	5,15,000
To Salaries	15,000	12,000	27,000	By Gross Profit b/d	43,000	1,16,000	1,59,000
To General Salaries	2,500	1,500	4,000				
To Rent and Rates	1,000	2,000	3,000				
To Advertising	667	1,333	2,000				
To Carriage outwards	3,000	6,000	9,000				
To Depreciation:							
Furniture & Fittings	200	400	600				
Plant & Machinery	7,500	2,500	10,000				
To Net Profit (transferred to general profit and loss account)	13,133	90,267	1,03,400				
	43,000	1,16,000	1,59,000		43,000	1,16,000	1,59,000

General Profit and Loss Account

for the year ending 31st December, 1984.

		Rs.		Rs.
To Interest on Loan	1,000		By Net profit b/d (from departmental profit and loss account	1,03,400
To Add. oustanding	200			
		1,200	By Interest on Investments	500
To Net profit (transferred to Capital account)		1,02,700		
		1,03,900		1,03,900

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Balance Sheet

as at 31st December, 1984

Liabilities		Rs.	Assets		Rs.
Capital			Plant & Machinery	1,00,000	
Opening Balance	50,000		Less: Depn. at 10%	10,000	
Add Net Profit	1,02,700				90,000
	1,52,700		Furniture and Fittings	6,000	
Less: Drawings	5,000		Less: Depn. at 10%	600	
		1,47,000			5,400
Loan from Bank	10,000		Investments		10,000
Add: outstanding interest	200		Closing Stock		65,000
		10,200	Sundry Debtors		19,000
Sundry Creditors		33,500	Cash at Bank		2,000
		1,91,400			1,91,400

Illustration - 4

Messrs. A, B and C carried on business as cloth merchants at Hyderabad. The partners A, B and C were incharge of the Departments I, II and III respectively. The partners are entitled to remuneration equal to 50% of profits (before charging their remuneration) of the respective departments of which they are incharge and the balance of profits are to be divided among them in the ratio of 1 : 2 : 2 respectively. On the basis of the following information prepare Departmental trading and profit and loss account and General Profit and Loss account of the business.

Opening Stock:	Rs.	Sales:	Rs.
Department - I	10,000	Department - I	1,00,000
Department - II	20,000	Department - II	1,50,000
Department - III	30,000	Department - III	2,00,000
Purchases:		Closing Stock:	
Department - I	60,000	Department - I	15,000
Department - II	70,000	Department - II	12,000
Department - III	90,000	Department - III	10,000
Salaries	10,000	Advertising	9,000
Rent	6,000	Discount Allowed	1,800
Discount Received	6,000	Sundry Expenses	3,600
Depreciation	6,000		

Goods having a transfer price of Rs. 2,400 and Rs. 6,000 were transferred from Department I and II respectively to department III. The inter-departmental transfers are made at 120% of the cost.

The opening stock of department III does not include any goods transferred from other departments, but closing stock includes Rs. 2,400 valued at the inter-departmental transfer price.

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The various items are to be apportioned amongst the three departments in the following proportion.

	Dept. I	Dept. II	Dept. III
Salaries	2	1	2
Rent	3	2	1
Depreciation	1	1	1
Discount received	2	2	1

All other expenses: on the basis of sales (excluding inter-department transfers) of each department.

Solution

Departmental Trading and Profit & Loss Account
for the year ended .....

	Dept. I	Dept. II	Dept. III	Total		Dept. I	Dept. II	Dept. III	Total
	Rs.	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.	Rs.
To Opening Stock	10,000	20,000	30,000	60,000	By Sales	1,00,000	1,50,000	2,00,000	4,50,000
To Purchases	60,000	70,000	90,000	2,20,000					
To Goods transferred from other departments	—	—	8,400	8,400	By Goods transferred to Dept.III	2,400	6,000	—	8,400
To Gross profit c/d	47,400	78,000	81,600	2,07,000	By Closing Stock	15,000	12,000	10,000	37,000
	1,17,400	1,68,000	2,10,000	4,95,400		1,17,400	1,68,000	2,10,000	4,95,400
To Salaries	4,000	2,000	4,000	10,000	By Gross Profit b/d	47,400	78,000	81,600	2,07,000
To Rent	3,000	2,000	4,000	10,000	By Discount Received	400	400	200	1,000
To Depreciation	2,000	2,000	2,000	6,000					
To Advertising	2,000	3,000	4,000	9,000					
To Discount	400	600	800	1,800					
To Sundry Expenses	800	1,200	1,600	3,600					
To Net profit (transferred to General profit and loss account)									
To Depreciation	35,600	67,600	68,400	1,71,600					
	47,800	78,400	81,800	2,08,000		47,800	78,400	81,800	2,08,000

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General Profit and Loss Account

Dr. for the year ended ..... Cr.

		Rs.		Rs.
To Stock Reserve $\left(\frac{20}{120} \times 2,400\right)$		400	By Net Profit b/d (Transferred from Departmental profit loss a/c)	1,71,600
To Remuneration to partners (being 50% of profit of the department of which they are incharge)				
A	17,800			
B	33,800			
c	34,200			
		85,800		
To Net profit transferred to capital Accounts:				
A - 1/5	17,080			
B - 2/5	34,160			
C - 3/5	34,160			
		85,400		
		1,71,600		1,71,600

Check Your Progress - 1

A firm has three departments viz., A, B, and C and it wanted to prepare Departmental Trading and Profit and Loss Account for the year ending 31st December, 1990. The normal rate of Gross Profit is 30%, 25%, 20% respectively for departments A, B and C on sales.

Indirect Expenses are charged on the basis of Sales.

The following are the figures relating to the period ending with 31st Dec., 1990.

Stock 1-1-1990	10,000	15,000	20,000
Purchases	25,000	30,000	40,000
Sales	40,000	50,000	60,000
Direct Expenses	7,000	8,000	10,000

The total indirect expenses are Rs. 15,000.

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20.3 SUMMING UP

In this unit illustrations are given on the preparation of Departmental Trading & Profit and Loss Account, General Profit and Loss Account and Balance Sheet.

20.4 CHECK YOUR PROGRESS : MODEL ANSWERS

Departmental Trading and Profit & Loss Account
for the year ended 31.12.1990

	Dept. A	Dept. B	Dept. C	Total		Dept. A	Dept. B	Dept. C	Total
	Rs.	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.	Rs.
To Stock	10,000	15,000	20,000	45,000	By Sales	40,000	50,000	60,000	1,50,000
To Purchases	25,000	30,000	40,000	95,000	By Closing stock	14,000	15,500	22,000	51,500
To Direct Expenses	7,000	8,000	10,000	25,000	(Bal. fig.)				
To G.P. c/d	12,000	12,500	12,000	36,500					
	54,000	65,500	82,000	2,01,500		54,000	65,500	82,000	2,01,500
To Indirect Expenses	4,000	5,000	6,000	15,000	By G.P. b/d	12,000	12,500	12,000	36,500
To Net Profit	8,000	7,500	6,000						
	12,000	12,500	12,000	36,500		12,000	12,500	12,000	36,500

20.5 MODEL EXAMINATION QUESTIONS

Problems

1. On the basis of the following information ascertain the value of goods received by and supplied to each department. Goods were transferred from:

   Department X to Department Y Rs. 379; to Department Z Rs. 6,543
   Department Y to Department X Rs. 7,654; to Department Z Rs. 2,345
   Department Z to Department X Rs. 4,567; to Department Y Rs. 5,678

2. How do you apportion the following between Departments A, B and C.

	Rs.		Rs.
Rent and rates	4,000;	Discount received	500
Discount allowed	800;	Advertising	1,200
Lighting	140;	Bad debts	900

Following further information is furnished:

	Dept. A	Dept. B	Dept. C
Sales	50,000	30,000	20,000
Purchases	30,000	15,000	5,000
No. of light points	4	2	1
Area occupied by each Department	5	3	2
Other space	2		

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3. Goods having a transfer price of Rs. 40,000 were transferred from department X to Department Y. The inter-departmental transfers are made at 125% of cost. The opening stock of department X does not include any goods transferred from other departments, but closing stock includes Rs. 5,000 valued at the inter-departmental price. How do you treat this in the books of business?

4. From the following Trial Balance and adjoined information prepare Departmental Trading and Profit and Loss Account for the year ended 31st December, 1985 and a Balance Sheet as on that date.

Trial Balance as on 31st December, 1985

	Debit Rs.	Credit Rs.
Stock on 1-1-1985:		
Department A	30,000	
Department B	25,000	
Purchases:		
Department A	70,000	
Department B	40,000	
Wages:		
Department A	18,000	
Department B	12,000	
Sales:		
Department A		1,50,000
Department B		1,00,000
Capital		50,000
Carriage inwards:		
Department A	1,000	
Department B	2,000	
Salaries	20,000	
Travelling expenses	2,000	
Rent and Taxes	8,000	
Insurance	2,400	
Advertisement	6,000	
General Expenses	600	
Cash at Bank	5,000	
Bills receivable		4,000
Bills payable		8,000
Sundry Creditors		30,000
General Reserve		20,000
Plant and Machinery	50,000	
Furniture and Fittings	10,000	
Sundry Debtors	20,300	
Buildings	30,000	
Printing and stationery	500	
Discount allowed	1,200	
	3,58,000	3,58,000

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Additional information:

(a) Stock on 31st December, 1985: Department A Rs. 15,000; Department B Rs. 10,000.
(b) Wages outstanding: Department A Rs. 800: Department B Rs. 500.
(c) Salaries outstanding Rs. 3,000.
(d) Taxes prepaid Rs. 500.
(e) Write off Bad debts Rs. 300 and make a provision for doubtful debts at 5% on sundry debtors.
(f) Depreciate Plant and Machinery at 10% and Buildings at 5%.

All unallocated expenses are to be apportioned on the basis of turnover.

Ans:

	Dept. A Rs.	Dept. B Rs.
Gross Profit	45,200	30,500
Net Profit	14,600	10,100

Balance sheet total Rs. 1,37,000

5. From the following trial balance prepare departmental Trading and Profit and Loss Account for the year ended 31st March, 1985 and Balance Sheet as at the date:

Trial Balance

	Debit Rs.	Credit Rs.
Stock on 1-4-1984:		
Department A	35,000	
Department B	30,000	
Purchases:		
Department A	80,000	
Department B	60,000	
Sales:		
Department A		1,30,000
Department B		90,000
Wages:		
Department A	15,000	
Department B	6,000	
Rent, taxes, and insurance	12,000	
Sundry expenses	3,000	
Salaries	6,000	
Lighting	2,100	
Discount allowed	1,100	
Discount received		280
Advertising	4,000	
Carriage inwards	1,800	
Furniture	8,000	
Plant and Machinery	50,000	
Sundry Debtors	8,000	

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Sundry Creditors		20,720
Capital		1,00,000
Drawings	5,400	
Cash in Hand	1,600	
Cash at Bank	12,000	
	3,41,000	3,41,000

The following information is also provided:

(a) Transfer of goods from Dept. A to Dept. B at cost Rs. 800.

(b) The items Rent, taxes and insurance, sundry expenses, lighting, salaries and carriage inwards to be appointed 2/3 to Department A and 1/3 to Department B.

(c) Advertising to be apportioned equally.

(d) Discount allowed and received are apportioned on the basis of departmental sales and purchases (excluding tranfers) respectively.

(e) Depreciation at 10% per annum on Furniture and Fittings, on Plant and Machinery. This is to be charged 3/4 to Department A and 1/4 Department B.

(f) Stock as on 31-3-1985.

Department A Rs. 20,000; Department B Rs. 15,000.

Ans:

	Dept. A Rs.	Dept. B Rs.
Gross Profit	19,600	7,600
Net Profit	2,640	3,880

Balance sheet total Rs. 1,08,800

6. From the information given below, prepare departmental Trading and profit and loss account and ascertain the true profit for the year ended 31st, December, 1985.

	Dept. A Rs.	Dept. B Rs.
Stock on January 1, 1985	50,000	10,000
Purchases from outside	2,50,000	40,000
Wages	15,000	10,000
Transfer of goods from Dept. A	—	50,000
Stock on 31st December, 1985	60,000	20,000
Sales to outsiders	3,60,000	80,000

The entire closing stock of Dept. B represents - Goods from Department A which transfers them at 25% above cost. Administrative expenses amount to Rs. 10,000 which are to be allocated between departments A and B in the ratio of 3:2 respectively

Ans: Dept. A – Gross Profit Rs. 1,55,000
Net Profit Rs. 1,49,000

Dept. B – Gross Loss Rs. 10,000
Net Loss Rs. 14,000
Net profit of the business Rs. 1,31,000.

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20.6 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy, M : Advanced Accountancy Sultan Chand & Sons, New Delhi.
2. Shukla, M.C & Grewal, T.S : Advanced Accounts, S. Chand & Co. Ltd., New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

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BLOCK - VII : BRANCH ACCOUNTS

UNIT-21 : BRANCH ACCOUNTS - AN INTRODUCTION

Contents

21.0 Aims and Objectives
21.1 Introduction
21.2 Objects of the Branch Accounting
21.3 Classification of Branches
21.4 Dependent Branches
21.5 System of Accounting
21.6 Accounting Treatment
21.7 Summing up
21.8 Check your Progress Model Answers
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21.0 AIMS AND OBJECTIVES

The aims of this unit are to acquaint you with the objectives of branch accounting, classification of branches and the system of accounts to be followed by the branches.

On completion of this unit, you should be able to :

- explain the objectives of branch accounting
- describe the classification of branches
- give journal entries and prepare Branch Account under Debtors system.

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21.1 INTRODUCTION

In order to have wider market for their products, and to have effective and efficient retailing, business houses may split their business into several divisions. In case the various divisions are located in different parts of the same city or in different towns, they are known as branches. It is necessary to know the profit or loss of each branch so that the efficiency of the branch can be known and necessary steps can be taken to remedy the state of affairs in case any branch is not giving desired results. Therefore, it is necessary to maintain the accounts in such a manner that the profit or loss made at a branch is easily known.

21.2 OBJECTS OF BRANCH ACCOUNTING

The main object of maintaining branch accounts is dependent on the nature of business and the type and needs of particular branch. However the following can be said as the objectives of keeping the branch accounts :

(i) To ascertain the profit or loss of each branch separately,

(ii) To evaluate the performance of each branch and to plan for expansion of the business,

(iii) To know the cash and goods requirements of different branches from time to time,

(iv) To make concrete suggestions for improvement of the working of the branches.

21.3 CLASSIFICATION OF BRANCHES

The branches may be broadly classified into different types, from the accounting point of view. They are :

(i) Branches which do not keep full system of accounting;

(ii) Branches which keep full system of accounting;

The branches are also classified as (i) Dependent branches and (ii) Independent branches, from the point of view of recording transactions in the books of account. Sometimes they are classified as Inland branches and foreign branches. However, we will be discussing about the Inland branches only as Foreign branches are out of of the scope of the syllabi prescribed. The Inland branches may either keep full set of books when they are known as Independent branches or may not keep full set of books when they may be called dependent branches. One point is to be noted carefully i.e., all the branches, whether they are dependent or independent, will have to organise and wor according to the instructions and directions issued by the parent organisation ie., Head office, Therefore, the classification of branches into dependent or independent branches is only from the point of view of recording of transactions in the books of accounts.

21.4 DEPENDENT BRANCHES

These dependent branches may be further divided into following three types :

(I) Branches which receive goods from Head office and sell only for cash,

(II) Branches which receive goods from Head office and sell both for cash as well as credit,

(III) Branches similar to the above but the goods are supplied by the Head office at selling price i.e., at a higher price than the cost price.

The salient features of these branches may be stated as follows :

(i) These branches are required to sell only those goods which are supplied by the Head office and they are not generally allowed to make outside purchases in the open market.

(ii) Goods are supplied by Head office to the branches either at cost price or at selling price which is higher than the cost price.

(iii) All expenses of the branch like salaries, rent etc. are directly paid by the Head office through cheques.

(iv) Petty expenses of the branch are usually paid by the branch. The branch manager is provided with the petty cash from Head office and it is usually maintained on imprest system.

(v) The branch is usually expected to sell the goods for cash only but sometimes it may be authorised to sell on credit basis also.

(vi) All cash received by the branch on account of cash sales or from its debtors is daily remitted to Head office. The Head office account is usually opened in a local bank where all cash collections are daily deposited by the branch.

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(vii) These branches only keep some memorandum books such as stock register but do not maintain complete set of books as mentioned earlier. The branch maintains a Debtors Ledger, when it is authorised to sell goods on credit, in order to find out the amount due for Debtors. The stock register is kept to provide information relating to the movement of goods and balance of stock on hand.

21.5 SYSTEM OF ACCOUNTING

As these branches do not keep complete set of books, the Head office maintains the accounts relating to the branch. The system of accounting to be adopted at Head office depends on the size of the branch and the degree of control to be exercised by the Head office. The Head office may keep branch accounts by following any one of the following methods:

Debtors System

This system is followed in case of branches which are small in size. Under the system, the Head office opens a separate account for each branch to record all the transactions relating to the branches. The branch account opened in the Head office books under the system is in the nature of a nominal account and it is this account which ultimately recveals profit or loss at the branch. The system of finding out profit by preparing one account for one branch is known as Debtors System.

Final account System

Under the system, head office opens a branch trading and profit and loss account to find out the profit or loss at the branch. The Head office may also maintain a branch account, which is in the nature of personal account as different from branch account opened under Debtors system which is in the nature of a nominal account.

Stock and Debtors System

Under this system the Head office maintains a number of accounts for keeping a record of branch transactions in place of one branch account such as branch stock account, branch debtors account, branch assets account, branch expenses account and branch adjustment account to find out profit or loss at the branch.

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Check your progress - 1

(i) What are the various objectives of Branch Accounting?

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(ii) What is the classification of Branch Accounts?

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21.6 ACCOUNTING TREATMENT

The Accounting treatment under the different systems is given below:

Debtors system

The Head office opens a separate account for each branch called ".... Branch account" to find out profit or los at the branch. This account is in the nature of a nominal account. It is debited with whatever the branch has at the begining of the accounting year i.e., the opening stock, debtors, petty cash etc. It is also debited with whatever has been sent by the Head Office, to the branch during the year i.e., cash sent for meeting expenses or for purchases made locally. It is credited with whatever the Head office receives and cash collected from debtors, goods returned by the branch etc. It is also credited with whatever the branch has at the end of the accounting year i.e., The closing stock, debtors, petty cash and any other asset etc.

The accounting entries in the books of Head Office for different branch transactions are as follows:

(i) For goods supplied by the Head office to the branch

Branch Account	Dr.	with the value of goods
To Goods sent to branch account		sent to branch

(ii) For goods returned by the branch to the Head Office:

Goods sent to branch account	Dr.	with the value of goods
To branch account		returned by branch

(iii) For goods returned by branch debtors to the Head office

Goods sent to branch account	Dr.	with the value of goods
To branch account		returned by branch debtors

(iv) For expenses at the branch met by Head office

Branch account	Dr.	with the amount of cheque
To Bank account		or draft sent to the branch

(v) For remittances received from the branch

Bank account	Dr.	with the amount of cheque
To branch account		or draft received from the branch

(vi) For closing balances of assets at the branch

Branch assets account	Dr.	with the closing value of
To branch account		assets such as stock, debtors petty cash etc.

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(vii) For liabilities at the branch at the end of the accounting year.

Branch account	Dr:	with the closing balance of any liabilities (individually) such as outstanding expenses etc.
To branch liabilites account		

At this stage, the branch account, when balanced will reveal profit or loss at the branch. If the credit side is more it is profit and if the debit side is more it is loss.

Note: The assets and liabilities of branch at the end of accounting year will be shown in the Head office balance sheet and at the begining of next accounting year. They will be transferred to branch account by passing the following entries.

(a) For transferring assets:

Branch account	Dr.	with the value of each asset
To branch assets account		

(b) For transferring liabilities

Branch liabilites account	Dr.	with the value of each liability
To branch account		

(viii) For transferring profit or loss at the branch

(a) For profit

Branch account	Dr.	
To General profit and loss account		

(b) For loss

General profit and loss account	Dr.	
To Branch account		

(ix) For transfer of balance in goods sent to branch account

Goods sent to branch account	Dr.	with the balance in goods sent to Branch Account at the end of accounting year
To purchases/trading account		

Note: The balance in goods sent to branch account is transferred to purchases account in case of trading concerns, and trading account in case of manufacturing concerns.

The branch account prepared in the Head office books will appear as under:

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Dr. **Branch Account** Cr.

	Rs.			Rs.
To balance b/fd (opening balance of assets)		By balance b/fd (opening liabilities, if any such as outstanding expenses)		xxx
Stock	xxx	By Bank account:		
Debtors	xxx	Cash sales	xxx	
Petty cash	xxx	Cash received from debtors	xxx	
Furniture	xxx			xxx
Prepaid Insurance etc.	xxx	By goods sent to branch account (goods returned by branch or goods returned by branch debtors directly to Head office		xxx
To goods sent to branch account	xxx			
To bank account (expenses paid by Head office)	xxx			
To balance C/d (closing liabilities, if any, such as outstanding expenses)	xxx			
To General profit and loss account (profit)	xxx	By balance C/d (closing balance of assets)		
		Stock		xxx
		Debtors		xxx
		Petty cash		xxx
		Furniture		xxx
		Prepaid Insurance etc.		xxx
		By general profit and loss account (loss)		xxx
	xxx			xxx

Important points to be noted: The following important points should be remembered while recording transactions in the branch account:

(1) Credit sales, bad debts etc

The Head Office need not make any entry in the branch account in respect of credit sales made at the branch, return of goods by the branch debtors to the branch, discount allowed by the branch to its debtors, bad debts written off by branch, shortage or surplus of stock at the branch. However, these may have to be taken into account for ascertaining closing balance of debtors at the branch.

(2) Depreciation of fixed assets

Depreciation on branch fixed assets is not shown in the branch account. However the branch account is debited with the value of fixed assets at the begining of the accounting year and credited with the value of fixed assets at the end of the accounting year. Thus the difference between the two vlaues, i.e., depreciation, is charged automatically. For example if a branch is having furniture worth Rs. 1,000 at the begining of the accounting year and it is decided to charge depreciation at 10% p.a., the branch account is debited wth Rs. 1,000 at the begining of the accounting year and credited with Rs. 900 at the end of the accounting year. Thus depreciation of Rs. 100 $\frac{100 \times 10}{100}$ is automatically changed to the branch

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(3) Petty expenses

Petty expenses incurred by the branch out of its petty cash is not shown in the branch account. But the branch account is debited with the opening balance of petty cash at the branch and the amount sent by the Head office to the branch for petty expenses. The branch account, at the end of the accounting year, is credited with the closing balance of petty cash at the branch, thus the petty expenses incurred by the branch are automatically charged to the branch account. It is clear from the following example:

Petty cash balance at the branch at the begining of the accounting year	Rs. 50
Petty cash sent by Head office to the branch during the accounting year	Rs. 100
Petty expenses incurred by the branach during the accounting year	125

Then the branch account will be debited with Rs.150 (opening balance Rs.50 + and cash sent by Head office Rs.100) and it will be credited with Rs.25 being the petty cash balance at the end of the accounting year (Rs. 150 – 125). Thus, the branch account is charged Rs. 125 being petty expenses during the year.

(4) Purchase of fixed assets by the branch

The branch may purchase its fixed assets. If the assets are purchased for cash, the remittance of cash to the Head office is reduced to that extent and if they are purchased on credit and the amount is outstanding till the end of the accounting year, liability is created by debiting the branch account. However, the assets so purchased are credited to branch account at the end of the year.

(5) Sale of fixed asset by the branch

The branch may also sell its fixed asset. Any amount realised on sale is remitted to Head office. In case, it is sold on credit, the amount due is shown as debtors at the end of the accounting year. The asset is shown in the branch account, at the end of the accounting year, at its reduced value which is arrived at as follows:

Opening balance of the asset + purchase of fixed asset – sale of the fixed asset. No separate entry is made for profit or loss on sale of fixed asset, since it is automatically taken care of when both opening and closing balances - and the amount realised on sale are recorded in the branch account.

(6) Amount received from Insurance company

In case insurance company admits claim and pays any amount in respect of stock or any other property damaged at the branch, the amount so received by the branch will be remitted to Head office and the remittances from the branch to Head office will increase. In case the claim admitted by Insurance company is outstanding till the end of the accounting year, the amount of claim will be shown as an asset at the branch by crediting the branch account.

Thus, it is important to note that under this system of preparing the branch account, items like credit sales, bad debts, discounts allowed to customers depreciation on fixed assets, loss or gain on sale of fixed asset do not figure in branch account at all. The profit or loss is ascertained by a comparison of the branch assets and liabilities at the begining and close of the accounting year and having regard to remittances, goods sent to the branch and remittances received from the branch (where the branch sells goods only for cash).

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Check Your Progress - 2

1. What is the accounting treatment with regard to pruchase and sale of fixed assets by the branch under debtors system?

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2. How do you treat amount received from insurance company when the stock or any other property damaged at the branach?

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Illustration - 1

The Andhra Textiles Ltd. opened a branch at Hyderabad on 1st January, 1984. From the following particulars, prepare all the accounts for 1984 and branch account 1985 in the books of Head office. Also give journal entries for 1985:

	1984	1985
	Rs	Rs.
Goods sent to Hyderabad branch	90,000	1,70,000
Cash sent to branch for:		
Rent	12,000	12,000
Salaries	9,600	36,000
Other expenses	4,000	6,000
Cash received from the branch	1,40,000	2,20,000
Stock on 31st December	14,000	52,000
Petty cash in hand on 31st December	240	520

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Solution

In the books of Head office

Hyderabad Branch Account

Dr. Cr.

		Rs.			Rs.
1984 Jan.01 to Dec.31	To goods sent to branch account	90,000	1984 Jan.01 to Dec.31	By bank account	1,40,000
"	To Bank account:			By balance c/d	
	Rent 12,000			Branch stock	
	Salaries 9,600			Branch petty cash 14,000	
	Other expenses 4,000				240
		25,600			
"	To General profit and loss account	38,640			1,54,240
		1,54,240			

Goods sent to Branch Account

Dr. Cr.

		Rs.			Rs.
1984 Dec.31	To trading account	90,000	1984 Jan.01 to Dec.31	By Hyderabad branch account	90,000

Branch Stock Account

Dr. Cr.

		Rs.			Rs.
1984 Dec.31	To Hyderabad braanch account	14,000	1984 Dec.31	By balance c/d	14,000
1985 Jan.01	To balance b/d	14,000			

Branch Petty Cash Account

Dr. Cr.

		Rs.			Rs.
1984 Dec.31	To Hyderabad branch account	240	1984 Dec,31	By balance C/d	240
1985 Jan.01	To balance b/d	240			

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Journal Entries for 1985.

Date	Particulars		L.F.	Dr. Rs.	Cr. Rs.
1985 Jan.01	Hyderabad branch account	Dr.		14,240	
	To Branch stock account				14,000
	To Branch petty cash account				240
	(Being the opening balances of stock and petty cash at the branch)				
Jan.01 to Dec.31	Hyderabad branch account	Dr.		2,70,000	
	To goods sent to branch account				2,70,000
	(Being the value of goods sent to branch during the year)				
"	Hyderabd branch account	Dr.		31,600	
	To Bank account				31,600
	(Being the cash sent to branch: Rent Rs. 12,000; salaries Rs. 13,600 and for other expenses Rs.6,000)				
"	Bank account	Dr		2,20,000	
	To Hyderabad branch account				2,20,000
	(Being the remittances received from the branch)				
	Branch stock account	Dr.		52,000	
	Branch petty cash account	Dr.		520	
	To Hyderabad branch account				52,520
	(Being the closing balances of stock and petty cash at the branch)				
"	Hyderabad branch account	Dr.		56,680	
	To General profit and loss account				56,680
	(Being the profit at the branch transferred to general profit and loss a/c)				
"	Goods sent to Branch a/c.	Dr.		1,70,000	
	To Trading account				1,70,000
	(Being goods sent to branch transferred to trading a/c)				

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Dr. **Hyderabad Branch account** Cr.

1985		Rs.	1985		Rs.
Jan.01	To Balance b/fd		Jan.01 to Dec.31	By bank account	2,20,000
	Br. Stock	14,000			
	Br. Petty cash	240		By Balance c/d	
Jan.01 to Dec.31	To goods sent to branch account	1,70,000		Br. stock	52,000
				Br. Petty cash	520
	To bank account				
	Rent 12,000				
	Salaries 13,600				
	other expenses 6,000				
		31,600			
Dec.31	To general profit and loss account (Profit)	56,680			
		2,72,520			2,72,520

Illustration - 2

(Where the branch sells goods for cash as well as on credit)

From the following particulars relating to Tirupathi Br. for the year ending 31st December, 1985, prepare branch account in the Head office books:

		Rs.
Stock at the branch on 1-1-85		15,000
Debtors at the branch on 1-1-85		32,000
petty cash at the branch on 1-1-85		400
Goods sent to branch during the year 1985		2,50,000
Remittances from branch during 1985:		
For cash sales	63,000	
Received from debtors	2,12,000	
		2,75,000
Credit sales durng the year 1985		2,25,000
Cheques sent to branch during 1985:		
For rent and taxes	1,600	
For salaries	9,000	
For petty cash	1,000	
		11,600
Discount allowed to customers		200
Goods returned by customers		400
Goods returned by branch		2,000
Stock at the branch on 31-12-85		23,000
Petty cash at the branch on 31-12-85		200

BRAOU

Solution:

Books of Head Office

Dr. **Tirupathi Branch Account** Cr.

1985		Rs.	1985		Rs.
Jan.01	To Balance b/fd		Jan.01	By bank account	
	Br. Stock	15,000	to	Cash	
	Br. Debtors	32,000	Dec.31	sales 63,000	
	Br. petty cash	400		Cash recd. 2,12,000 debtors	2,75,000
Jan.01 to Dec.31	To goods sent to branch a/c	2,50,000	"	By goods sent to branch a/c (returns)	2,000
"	To bank account		"	By balance c/d	
	Rent &taxes 1,600			Br. Stock	23,000
	Salaries 9,000			Br.debtors	44,400
	Petty cash 1,000			Br.petty cash	200
		11,600			
Dec.31	To general profit and loss accounts (Profit)	35,600			
		3,44,600			3,44,600

Note: As the closing balance of debtors is not given in the question it is to be ascertained by preparing memorandum branch debtors account.

Dr. **Memorandum Branch Debtors Account** Cr.

1985		Rs.	1985		Rs.
Jan.01	To balance b/fd	32,000	Jan.01	By Cash	2,12,000
Jan.01 to Dec.31	To Sales (Cr)	2,25,000	to Dec.31	By discounts allowed	200
				By returns Inwards	400
			Dec31	By Balance c/d (bal.fig)	44,400
		2,57,000			2,57,000

Illustration - 3

The following particulars relate to Vijayawada Branch Account for the year ended 31 December, 1985. Prepare branch account in the books of Head Office.

	Rs.
Stock at branch on January 1, 1985	20,000
Branch debtors on January 1, 1985	8,000
Branach debtors on December 31,1985	9,800
Petty cash at branch on January 1, 1985	1,000
Furniture at branch on January 1, 1985	4,000
Prepaid fire insurance on January 1, 1985	300

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Salaries outstanding at branch on Jan 1, 1985		200
Goods sent to branch during year 1985		1,60,000
Cash sales during the year 1985		1,80,000
Credit sales during the year 1985		80,000
Cash received from debtors		70,000
Discount allowed to debtors		200
Cash sent to branch for expenses:		
Rent	4,000	
Salaries	4,800	
Petty cash	2,000	
Insurance upto March 31, 1986	1,200	
		12,000
Goods returned by the branch		2,000
Goods returned by the debtors		4,000
Stock at branch on December 31, 1985		10,000
Petty expenses paid by the branch		1,700

Depreciation on furniture at 10% p.a. Goods costing Rs. 2,400 were destroyed on account of fire and a sum of Rs. 2,000 was received from the Insurance Company.

Solution

Books of Head Office.

Vijayawada Branch Account

Dr.			Rs.				Cr. Rs.
1985				1985			
Jan.01	To Balance b/fd:			Jan.01	By balance b/fd:		
	Branch stock		20,000		Salaries outstanding		200
	Branch debtors		8,000	Jan.01	By Bank account:		
	Branch Petty cash		1,000	to	cash sales	1,80,000	
	Branch furniture		4,000	Dec.31	cash received from debtors	70,000	
	Prepaid Insurance		300		Cash paid by debtors to Head Office	4,000	
Jan.01 to Dec.31	To goods sent to branch a/c		1,60,000		Cash received from Inc.Co.	2,000	2,56,000
"	To Bank account:			"	By goods sent to to branch a/c goods returned by branach)		2,000
	Rent	4,000					
	Salaries	4,800					
	Petty cash	2,000					
	insurance	1,200					
			12,000				
Dec.31	To General profit and loss a/c (profit)		77,900	Dec.31	By balance b/d:		
					Branch stock		10,000
					Branch debtors		9,800

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		Branch petty cash	1,300
		Branch furniture	3,600
		Prepaid Insurance	300
	2,83,200		2,83,200

Working notes:

(i) Calculation of petty cash balance at the end:

	Rs.
Petty cash balance at the begining	1,000
Petty cash sent by Head Office	2,000
Total petty cash with the branch	3,000
Less: Petty expenses paid by the branch	1,700
Petty cash balance at the end	1,300

(ii) Calculation of closing value of furniture:

Value of furniture at the begining	4,000
Less: Depreciation at 10% p.a. $\frac{(4,000 \times 10}{100)}$	400
Closing value of furniture	3,600

21.7 SUMMING UP

A business house may split its business into several divisions and locate them in different places which are known as branches. The objects of branch accounting are to ascertain the profit or loss of each branch and to take suitable measures for improving the performance of the branches. The branches are broadly classified into (i) Branches which don't keep full system of accounting often called Dependent branches and, (ii) Branches which keep full system of accounting known as independent branches.

The features of dependent branches are that they are required to sell only those goods which are supplied by Head office, all the expenses of the branch are paid by the Head Office and all the cash collected by the branch is remitted to Head Office. The Head office maintains the accounts relating to the branch following either Debtors system or Final Accounts system or Stock and Debtors system.

Under Debtors system, the Head office opens a separate account for each branch to find out profit or loss at the branch. This account is debited with opening balance of stock, Debtors, cash etc., and whatever has been sent by the Head office. It is credited with whatever the branch has sent to Head Office and the closing balances of stock, debtors etc. The account is balanced at the end of the year and profit or loss is ascertained. If the credits exceed debits it is profit and if the debits exceed credits it is loss which is transferred to General profit and loss account.

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21.8 CHECK YOUR PROGRESS - MODEL ANSWERS

1. (i) The following are the objectives of branch accounting:

   (a) to find out the profit or loss of each and every branch separately.

   (b) to evaluate the performance of each branch,

   (c) to ascertain the requirements of each branch in respect of cash and goods, and

   (d) to know the financial position of each branch as at a particular date.

   (ii) Branches can be broadly classified into two categories for the purpose of recording transactions in the books of account.

   – Branches which do not keep full system of accounting

   – Branches which keep full system of accounting.

   The other classification is that,

   – Dependent branches, and

   – Independent branches

   Again the independent branches can also be divided into

   – Home branches, and

   – Foreign branches

2. (i) If the assets are purchased for cash by the branch, the remittance of cash to the Head office is reduced to the extent and if they are purchased on credit and the amount is outstanding till the end of the accounting year, liability is created by debiting the branch account. If any branch sells any fixed asset for cash the amount realised on sale is remitted to Head Office. In case, it is sold on credit, the amount due is shown as debtors and the asset is shown in the branch account at the end of accounting year.

   (ii) In case the stock or property is insured, if the insurance company admits claim and pays any amount in respect of the asset damaged at the branch, the amount so received by the branch will be remitted to Head office. In case the claim admitted by insurance company is outstanding till the end of accounting year, the amount of claim will be shown as an asset at the branch by crediting the branch account.

21.9 MODEL EXAMINATION QUESTIONS

A. Answer the following in about 30 lines each.

1. Give a brief explanation of the various accounts opened under debtors system.

B. Answer the following in about 15 lines each.

1. What are branch accounts?
2. How do you classify the branches?
3. What is final account system?

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4. What is stock and debtors system?

5. What are the features of dependent branches?

PROBLEMS

1. A manufacturing company of Hyderabad opened a branch at Madras in 1980. From the following particulars relating to the year 1984, prepare Madras branch account and other necessary accounts in the books of Head Office.

		Rs.
Stock 1st January		30,000
Goods sent to Madras branch		3,40,000
Cash sent to branch for:		
Rent	30,000	
Salaries	48,000	
other expenses	20,000	
		98,000
Cash received from the branch		6,00,000
stock at 31st December		48,000
Petty cash in hand on 31st December		3,000

(Ans. Profit - Rs.1,83,000)

2. From the following particulars relating to Hyderabad Branch for the year ending 31st December, 1985, prepare Hyderabad Branch acount in the Head Office books:

	Rs.
Stock at Branch on 1-1-1985	89,000
Branch Debtors on 1-1-1985	47,000
petty cash at Branch on 1-1-1985	200
Goods sent to Branch during the year	2,84,000
Cash sales during the year	1,58,000
Credit sales during the year	4,04,000
Goods returned by branch	8,000
Cash received from Debtors	3,79,000
Cash sent to Branch for expenses	90,000
Stock at Branch on 31-12-1985	54,000
Branch Debtors on 31-12-1985	72,000
Petty cash at branch on 31-12-1985	300

(Ans. Profit - Rs.1,61,100)

3. From the following details relating to Bomaby Branch, prepare Branch Account to ascertain profit in the books of Head Office.

	Rs.
Stock an 1st January, 1985	20,000
Stock on 31st December, 1985	16,000
Debtors on 31st December, 1985	20,000
Goods sent to Branch during 1985	70,000
Goods returned by branch	8,000
Goods returned by customers to branch	1,500

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Cash sales		43,000
Credit sales		60,000
Cash remitted by Branch to Head Office		1,13,000
Allowances to customers		400
Bad debts		700
Expenses paid by Head Office:		
Salaries and Wages	28,000	
Rent from 1st Jan. 1985 to 31st Jan. 1986	13,000	
Insurance upto 31st March, 1986	18,000	
		59,000

(Ans.Loss Rs. 20,000 Opening balance of debtors Rs. 32,600)

21.10 RECOMMENDED BOOKS

1. Gupta, R.L. and Radhaswamy, M. : Advanced Accountancy, Sultan Chand & New Delhi.
2. Jain,S.P and Narang, K.L. : Advanced Accountancy, Kalyani Publishers, New Delhi & Ludhiana.
3. Maheswari, S.N. : Advanced Accountancy Vikas Publishing House, New Delhi.

21.11 GLOSSARY

Branch : Division of a business located at a different place.

Debtors System : System to find out profit by preparing one account for one branch.

Dependent Branch : Branch which do not keep full system of accounting.

Final Account System : System to ascertain profit by preparing final accounts of the branch.

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UNIT-22 : ACCOUNTS OF DEPENDENT BRANCHES (CASH AND CREDIT SALES)

Contents

22.0 Aims and Objectives
22.1 Introduction
22.2 Adjustment entries
22.3 Summing up
22.4 Check your progress : Model Answers
22.5 Model Examination Questions
22.6 Recommended Books
22.7 Glossary

22.0 AIMS AND OBJECTIVES

This unit is designed to explain you the accounting treatment when goods are sent to the branch at a higher price than the cost price.

On completion of the unit, you will be able to:

- give adjustment entries relating to loading in the invoice price.
- Prepare Branch Account when the goods are sent at a higher price than the cost price.

22.1 INTRODUCTION

The Head office while sending goods to the branch may make them at a higher price than the cost price by adding certain percentage of profit, which price is generally termed as invoice price or selling price. When such a practice is followed the branch generally is required to sell the goods at such invoice price only. The following may be said as the objectives in sending the goods at such a price.

(i) Not to disclose the cost price of the goods and actual profits made by the branch to the people who manage the branch,

(ii) To have an effective control on the stock of goods at the branch and also to know from time to time the position of stock at branch.

The branch account maintained by Head office will be on the lines as already explained earlier, but the entries relating to goods sent to branch, goods returned by branch to head office, opening and closing stocks at the branch will be made at that higher price. In order to find out the true profit or loss at the branch, certain adjustment entries, in addition to the usual entries relating to loading (the difference between invoice price and cost price) in the invoice price will have to be made at the end of the accounting period, in the books of head office.

22.2 ADJUSTMENT ENTRIES

The following are the adjustment entries:

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(i) For adjustment of loading in the invoice price of the goods sent to branch less goods returned by the branch to the Head Office:

Goods sent to branch account	Dr.	(with the excess of invoice price and the price of goods sent to branch less returned to head office)
To Branch account		

(ii) For adjustment of loading in the invoice price of closing stock of goods at the branch:

Branch account	Dr.	(with the excess of invoice price over the cost price of closing stock of goods at the branch)
To Stock reserve account		

(iii) The closing stock of goods at the end of the year becomes opening stock at the commencement of next accounting year and the same will be shown at invoice price on the debit side of the branch account. To adjust the loading in the invoice price of the opening stock, the following adjustment entry is required:

Stock reserve account	Dr.	(with the excess of invoice price over the cost price of opening stock of of goods at the branch)
To branch account		

For ascertaining the excess price (loading) the following procedure may be adopted: For e.g., the goods are invoiced to the branch at cost plus 20%. If the cost price is Rs.100, loading is Rs.20 and therefore the invoice price is Rs. 120. The ratio of loading to invoice price is 20/120 or 1/6th. The adjustment for the excess price will be made on the basis of 1/6th of the invoice price. When the goods are invoiced at cost plus 25%, the loading in the invoice price will be 1/5th. Similarly when the goods are invoiced at cost plus 10%; the loading will be 1/11th.

If the invoice price is given as to yield a certain percentage of profit on sale, the loading in the invoice price is to be calculated as follows: For e.g., the goods are invoiced at 20% on profit on sale, if the sale price is Rs.100, it will give a profit of Rs. 20 and this is the loading in the invoice price. The ratio of loading to invoice price is 20/100 or 1/5th. When the goods are invoiced at a profit of 25% on sale, the loading in the invoice price is 1/4th.

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Check Your Progress - 1

(a) Where are the objectives in sending the goods to the branch at a higher price than the cost price?

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Illustration - 1

Mahesh & Co., has a branch at Bangalore, Goods are invoiced to the branch at cost plus 25%. The branch is required to deposit cash every day in the Head office account in the bank.

All expenses are paid by cheque by the Head officie except petty cash expenses which are paid by the branch manager. From the following particulars relating to 1985, prepare branch account in the Head office books:

	Rs.
Stock on 1st January	5,000
Stock on 31st December	6,000
Sundry debtors on 1st January	2,800
Sundry debtors on 31st December	3,600
Cash remitted to Head office	30,000
Furniture purchased by the branch	2,400
Goods invoiced from Head office	36,400
Expenses paid by the Head office	3,280
Cash sales during the year	21,600
Credit sales during the year	14,000
Petty expenses paid by the branch	240

Solution

In the Books of Head Office Bangalore Branch Account

1985		Rs.	1985		Rs.
Jan.01	To Balance b/fd :		Jan.01	By Bank account	30,000
	Branch stock	5,000	to	(remittances)	
	Branch debtors	2,800	Dec.31		
Jan.01	To goods sent to		Dec.31	By goods sent to branch	
to	branch account	36,400		(loading in the invoice	7,280
Dec.31				price)	
"	To bank (expenses)	3,280			
Dec.31	To stock reserve	1,200	"	By stock reserve (opening)	1,000
	(closing)				
	To general profit &	3,760	"	By balance c/d :	
	loss a/c.			Branch stock	6,000
	(profit)			Branch debtors	3,600
				Branch cash	2,160
				Branch furniture	2,400
		52,440			52,440

Working Notes:

In this problem, cash received from debtors and cash balance at the end is not given. Therefore, these are to be ascertained by preparing Memorandum Branch debtors account and branch cash account.

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(i) For calculation of cash received from debtors

Memorandum Branch Debtors Account.

Dr.					Cr.
		Rs.			Rs.
1985 Jan.31	To balance b/fd	2,800	1985 Jan.01 to Dec.31	By Cash (bal.fig)	13,200
Jan.01 to Dec.31	To Sales (Cr)	14,000	Dec.31	By balance c/d	3,600
		16,800			16,800

(ii) For ascertaining cash at end

Branch cash account

Dr.					Cr.
		Rs.			Rs.
1985 Jan.01 to Dec.31	To Sales (Cash)	21,600	1985 Jan.01 to Dec.31	By remittance to Head office	30,000
	To Debtors	13,200		By furniture	2,400
				By petty expenses	240
			Dec.31	By balance c/d (bal.fig)	2,160
		34,800			34,800

Illustration - 2

Mayur Sales Ltd., has a branch at Warangal. Goods are invoiced to the branch at 20% profit on sale. Branch has been insturcted to send all cash daily to the Head office. All expenses are paid by the Head Office except petty expenses which are met by the Branch Manager. Prepare branch account in the books of Head Office from the particulars given below:

Stock on 1st Jan.85 (invoice price)	30,000
Stock on 31st Dec'85	28,000
Sundry debtors on 1st Jan'85	18,000
Cash in hand on 1st Jan'85	800
Office funiture on 1st Jan'85	2,400
Goods invoiced from Head office (invoice price)	1,60,000
Goods returned to Head office	2,000
Goods returned by debtors	960
Cash received from debtors	60,000
Cash sales	1,00,000
Credit sales	60,000
Discount allowed to debtors	60
Expenses paid by the Head office	
Rent	2,400
Salaries	4,800
Stationery and printing	600
Petty expenses paid by the branch manager	560
Depreciation is to be provided on office furniture at 10% p.a	

BRAOU

Solution

In the Books of Mayur Sales Ltd., Warangal Branch Account

1985		Rs.	1985		Rs.
Jan.01	To Opening Balances:		Jan.01	By Goods sent to	2,000
	Stock	30,000	to	branch a/c	
	Debtors	18,000	Dec.31	(returns)	
	Cash	800		By bank:	
	Office furniture	2,400		Cash sales 1,00,000	
Jan.01	To goods sent to				
to	branch a/c	1,60,000		Cash received from	
Dec.31	To bank (expeses):			Debtors 60,000	1,60,000
	Rent 2,400		Dec.31	By goods sent to	
	Salaries 4,800		"	branch a/c. (loading)	31,600
	Stationery &		"		
	printing 600		"	By stock reserve	6,000
		7,800	"	(opening)	
Dec.31	To stock reserve(closing)	5,600		By closing balances:	
				Stock	28,000
	To general profit and			Debtors	16,980
	loss a/c (profit)	22,380		cash	
				(800–560)	240
				Office furniture	
				(2,400–240)	2,160
		2,46,980			2,46,980

Working Notes:

(1) At the closing balance of debtors is not given, it is to be ascertained by preparing memorandum branch debtors account.

Dr. **Memorandum Branch Debtors Account** Cr.

1985		Rs.	1985		Rs.
Jan.01	To balance b/fd	18,000	Jan.01	By cash received	60,000
Jan.01	To sales (Cr.)	60,000	to	By discount allowed	60
to			Dec.31		
Dec.31				By returns	960
			Dec.31	By balance c/d	16,980
				(balancing fig)	
		78,000			78,000

(2) Cash balance at the end of year is ascertained as follows:

	Rs.
Cash balance at the begining of the year	800
less: Petty expenses paid by branch manager	560
	240

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(3) Balance of furniture at the end of the year is ascertained as follows:

Office furniture at the begining of the year	2,400
Less: Depreciation at 10% p.a	240
Balance at the end of the year	2,160

(4) Loading in the invoice value of goods sent to branch is ascertained after deducting returns to the Head Office i.e., $1,60,000 - 2,000 = 1,58,000 \times 1/5 = Rs.31,600$

Loading in the invoice value of opening stock 30,000 × 1/5 = Rs.6,000

Loading in the invoice value of closing stock 28,000 × 1/5 = Rs.5,600

As the goods are invoiced to the branch at 20% profit on sale, the loading in the invoice price is 1/5th.

Final Account System

Under this system, the profit or loss of a dependent branch is ascertained by preparing branch trading and profit and loss account but not by preparing branch account as was the case under debtors system. This account is prepared at cost of goods sent to branch account but not in the invoice price.

The Head office may also maintain a branch account under this system and the account to be maintained will be in the nature of personal account as different from the branch account maintained under debtors system which is in the nature of nominal account. The branch account maintained under this system usually shows debit balance representing the net assets the branch i.e., Assets-Liabilities at the branch at the specified date.

Illustration - 3

A Hyderabad Company has a branch at Bombay to which goods are charged at cost plus 25%. The Bombay branch keeps its own sales ledger and remits all cash received to the Head office everyday. All expenses are paid from Head office. The transactions of the branch for the year 1985 were as follows:

	Rs.		Rs.
Opening balances:		Cheques sent to branch for:	
Stock (invoice price)	20,000		
Debtors	400	Rent	1,200
Petty cash	200	Wages	400
Cash sales	5,400	Salaries	1,800
Goods sent to branch	42,000	Closing balances:	
Collections from debtors	40,000	Stock (invoice price)	25,000
Goods returned to H.O	500	Debtors	4,000
Bad debts	500	Petty cash	50
Allowance to customers	400		
Returns from customers	900		

Prepare branch trading and profit and loss account and branch account for the year 1985.

Solution

Books of Head office

Bombay Branch Trading and Profit and Loss Account

Dr. for the year ending 31st December, 1985 Cr.

		Rs.			Rs.
To Opening stock (20,000 – 4,000)		16,000	By Sales:		
To Goods sent to branch less returns (42,000—500)=	41,500		Cash	5,400	
			Credit	45,400	
			Less: Returns	900	
				44,500	
Less: loading	8,300				49,900
		33,200	By closing stock (25,000 - 5,000)		20,000
To gross profit C/d		20,700			
		69,900			69,900
To Salaries		1,800	By gross profit b/d		20,700
To wages		400			
To rent		1,200			
To bad debts		500			
To allowance to customers		500			
To petty expenses					
To (200-50)		150			
To net profit transferred to general profit and loss account		16,250			
		20,700			20,700

Dr. **Bombay Branch Account (Personal Account)** Cr.

1985		Rs.	1985		Rs.
Jan.01	To opening balances		Jan.01 to Dec.31	By goods sent to branch (Returns) (500 – 100)	400
	Stock	16,000	"	By bank (remittances)	45,400
	Debtors	400		By balance c/d	24,050
	Petty cash	200			
Jan.01 to Dec.31	To goods sent to branch (42,000 – 8,400)	33,600			
"	To bank (expenses)	3,400			
Dec.31	" General profit and Loss A/c	16,250			
		69,850			69,850

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Note:

(1) The balance shown by branch account Rs.24,050 is equal to net asset at the branch i.e., branch stock at cost price (25,000 – 5,000) Rs.20,000 + Debtors Rs. 4,000 + Petty cash Rs. 50.

(2) Credit sales at the branch can be ascertained by preparing Memorandum Branch debtors account.

Memorandum Branch Debtors Account

Dr.		Rs.			Cr. Rs.
1985 Jan.01	To balance b/fd	400	1985 Jan.01	By Cash	40,000
Dec.31	To Sales (Cr) (bal.fig).	45,400	to Dec.31	By Bad debts	500
				By Allowance to customers	400
				By Returns from customers	900
				By Balance c/d	4,000
		45,800			45,800

22.3 SUMMING UP

Sometimes the Head Office while sending the goods to the branch may mark them at a higher price than the cost price, by adding certain percentage of profit. To find the true profit or loss at the branch, adjustment entries relating to loading in the invoice price will have to be made.

Under final account system, the profit or loss of the dependent branch is ascertained by preparing branch trading and profit and loss account but not by preparing branch account. The trading and profit and loss account is prepared at cost of the goods sent to the branch but not the invoice price. The Head Office may also maintain branch account, which will be in the nature of personal account sharing usually debit balance representing net assets at the branch.

22.4 CHECK YOUR PROGRESS : MODEL ANSWERS

1. (a) (i) Not to reveal the actual cost price of the goods and the actual profits made by the branch.

   (ii) to have an effective control on the stock of goods at the brnach and also to know the position of the stock from time to time.

22.5 MODEL EXAMINATION QUESTIONS

A. Answer the following in about 30 lines each:

1. What are the objectives of sending goods to the branch at a higher price? Give the adjustment entries relating to loading in the invoice price?
2. What is the special advantage in preparing Memorandum Branch Debtors Account? Show its specimen.

B. Answer the following in about 15 lines each:

1. What are the salient features of dependent branches?

2. Discuss briefly about the final accounting system.

PROBLEMS

1. From the following information, prepare Branch Account in the books of Head office for the year ending 31st December, 1985. All expenses of the branch are paid by Head office. Goods are invoiced by Head Office at 20% above cost.

	Rs.
Stock on 1st January, 1985	30,000
Stock on 31st December, 1985	45,000
Debtors on 1st January, 1985	20,000
Debtors on 31st December, 1985	30,000
Petty cash on 1st January, 1985	50
Petty cash on 31st December, 1985	25
Goods invoiced to Branch	1,50,000
Cash sales	75,000
Cash collected from debtors	80,000
Rent	1,500
Salaries	3,000
Goods returned to Head office	3,000
Sale of Gunny bags	100

Also ascertain credit sales made by branch.

(Ans. Profit Rs. 575; Credit sales Rs. 90,000)

2. A Private Limited company invoiced goods to Branch at cost plus 25% thereon.Both cash and credit sales are effected by the branch. Expenses are paid direct from the head office. All cash received by the branch is remitted to Head office. The following are the transactions. for the year ended 31st March, 1986.

	Rs.
Goods received from Head Office at invoice price	80,000
Returns to Head office at invoice price	1,600
Stock on 1st April, 1985 at invoice price	16,000
Credit sales during the year	60,000
Cash sales during the year	37,400
Debtors as at 1st April, 1985	10,400
Cash received on ledger accounts	57,000
Discount allowed to customers	600
Bad dets written off	1,000
Returns from customers at selling price	1,400
Rent, rates etc.	120
Sundry expenses	600
Salaries & Wages	2,400
Stock on 31st March, 1986 at invoice price	12,000

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Prepare Branch Account and Branch Trading and Profit and Loss Account in the books of Head office.

(Ans. Profit Rs. 25,360/-)

22.6 RECOMMENDED BOOKS

– Gupta, R.L. Radhaswamy, M	:	Advanced Accountancy, Sultan Chand & Sons New Delhi.
– Jain,S.P and Narang, K.L	:	Advanced Accountancy, Kalyani Publishers, New Delhi & Ludhiana.
– Maheswari,S.N	:	Advanced Accountancy, Vikas Publishing House, New Delhi.

22.7 GLOSSARY

Debtors system	:	System to find out profit by preparing one account for one branch.
Dependent Branch	:	Branch which does not keep full system of accounting.
Final Account system	:	System to ascertain profit by preparing final accounts of the branch
Loading	:	The excess of invoice price over the cost price of the goods

BRAOU

UNIT-23 : ACCOUNTS OF DEPENDENT BRANCHES (INCLUDING STOCK AND DEBTORS SYSTEM)

Contents

23.0 Aims and Objectives
23.1 Introduction
23.2 Accounts to be opened in the Books of Head office
23.3 Specimen Journal Entries
23.4 Summing up
23.5 Check Your Progress : Model Answers
23.6 Model Examination Questions
23.7 Recommended Books
23.8 Glossary

23.0 AIMS AND OBJECTIVES

The aim of this unit is to explain the Stock and Debtors System which may be followed for ascertaining the Profit or loss made by the branch and learn the accounts to be opened in the books of Head office under this system.

Having studied this unit, you should be able to:

- explain the different accounts that are opened in the Head office books
- pass Journal entries to the transactions of branch under stock and debtors system.

23.1 INTRODUCTION

Under debtors system discussed in earlier units, the Head office opens in its books only branch account for ascertaining profit or loss at the branch. There is another method known as stock and debtors system to find out the profit or loss at the branch, under which different accounts are opened in the Head office books. This method is used where the branch manager is required to sell the goods only at the selling price fixed by the Head office.

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23.2 ACCOUNTS TO BE OPENED IN THE BOOKS OF HEAD OFFICE

The various accounts opened under this system and a brief description of these accounts is given below:

(i) **Branch stock account:** This account is like goods account and helps the Head office to have an effective control over the stock at the branch. This account reveals the shortage or surplus of stock at branch and it is always prepared at invoice price.

(ii) **Branch debtors account:** This account is maintained to keep a record of all transactions relating to branch debtors and to ascertain the balance of debtors at the end of the accounting year.

(iii) **Branch cash account:** This account is maintained to record all cash transactions of the branch. It will be particularly helpful in those cases where the branch is not required to send immediately all collections of cash but to remit money at regular intervals. This account helps the Head officeto have a control over branch cash.

(iv) **Branch Expenses Account:** This account is prepared to know the total of all expenses incurred at the branch. It is debited with depreciation on fixed assets, bad debts, discounts to debtors, salaries, rent etc. This account is finally transferred to branch adjustment account and closed.

(v) **Branch fixed assets Account:** A separate account for each of the fixed assets at the branch is opened and all transactions relating to that particular asset are recorded therein.

(vi) **Goods sent to branch account:** This account is prepared to ascertain the net value of goods sent to branch. The adjustment relating to loading in the value of goods sent to branch is also made in this account and the balance (net) is transferred to either trading account or purchases account.

(vii) **Branch Adjustment Account:** This account is just like trading and profit and loss account. All loadings in the goods sent to the branch, opening and closing stocks at the branch and shortage and surplus of stock etc., are recorded in this account and gross profit is ascertained. The gross profit or gross loss (if any) is carried down to the second part of the account and branch expenses and all other expenses and gains are recorded in this account. The balance of this account is either net profit or net loss and is transferred to general profit and loss account. The second part of this account is also known as branch profit and loss account when it is separately prepared.

22.3 SPECIMEN JOURNAL ENTRIES

Specimen journal entries under this system are given below:

(1) For goods sent to branch:

Branch Stock account	Dr.	With the invoice value of
To goods sent to branch account		goods sent to branch

(2) For goods returned by branch:

Goods sent to branch a/c	Dr.	with the invoice value of
To branch stock account		goods returned by branch

(3) For sales made by branch:

(a) For cash sales remitted to Head office

Cash Account	Dr.
To branch stock account	

(b) For credit sales:

Branch debtors account	Dr.
To branch stock account	

(4) For goods returned by branch debtors to the branch (at invoice price):

Branch stock account	Dr.
To branch debtors account	

(5) For goods returned by branch debtors directly to the Head office (at invoice price):

Goods sent to branch account	Dr.
To branch debtors account	

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(6) For cash received from debtors:

Cash account Dr.
To branch debtors account

(7) For bad debts, discounts allowed, allowances given etc.,

Branch expenses account Dr.
To branch debtors account

(8) For expenses at the branch paid in cash:

Branch expenses account Dr.
To cash account

(9) For abnormal loss, wastage or shortage of stock:

Branch Adjustment account Dr. (loading)
Branch P&L a/c. Dr. (cost)
To branch stock account

Note:

(i) For surplus of stock at branch, a reverse entry is passed.

(ii) Any amount received from the Insurance company for abnormal loss of stock (when insured) will be debited to cash account and credited to branch adjustment account.

(10) For transferring and closing branch expenses account:

Branch adjustment account Dr.
To branch expenses account

(11) For adjustment of loading in opening stock:

Stock reserve account Dr.
To branch adjustment account

(12) For adjustment of loading in closing stock:

Branch adjustment account Dr.
To stock reserve account

(13) For adjustment of loading in the invoice value of goods sent to branch (net):

Goods sent to branch account Dr.
To Branch adjustment account

(14) For transfer of Net Profit to general profit and loss account:

Branch adjustment account Dr.
To general profit and loss account

Note: If there is loss at the branch, the above entry is reversed.

(15) For closing the goods sent to branch account:

Goods sent to branch account Dr.
To Trading/purchases account

Illustration - 1

Ajay Sales Ltd. has a branch at Hyderabad. Goods are invoiced to the branch at cost plus 25%. Branch remits all cash received to Head office and all expenses are met by the Head office.

BRAOU

From the following particulars, give journal entries and prepare necessary accounts in the books of head office under stock and debtors system to show the profit or loss earned by the branch in 1985.

	Rs.	Rs.
Stock on 1st January, 1985 (Invoice price)		10,000
Debtors on 1st January, 1985		8,000
Goods invoiced to the branch		60,000
Sales at branch:		
Cash sales		26,000
Credit sales		35,000
Cash collected from debtors		32,000
Goods returned by branch to Head office		1,500
Goods returned by debtors to branch		1,000
Surplus in stock		1,500
Discount allowed to debtors		200
Branch expenses paid by Head office:		
Rent	3,000	
Salaries	2,400	
Other expenses	1,200	
		6,600

Solution

Books of Ajay Sales Ltd. (H.O)

Journal

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
1985 Jan.01 to Dec.31	Branch stock account Dr.		60,000	
	To goods sent to branch account			60,000
	(Being goods sent to branch at invoice price)			
"	Cash account Dr.		26,000	
	To Branch stock account			26,000
	(Being cash sales at Branch)			
"	Branch debtors account Dr.		35,000	
	To Branch stock account			35,000
	(Being credit sales at the branch)			
"	Cash account Dr.		32,000	
	To branch debtors account			32,000
	(Being cash collected from branch debtors)			
"	Goods sent to branch account Dr.		1,500	
	To Branch stock account			1,500
	(Being goods returned by branch at invoice price)			

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"	Branch stock account To branch debtors account (Being goods returned by branch debtors to branch)	Dr.		1,000	1,000
"	Branch stock account To branch adjustment account (Being surplus in branch stock)	Dr.		1,500	1,500
"	Branch expenses account To branch debtors account (Being discounts allowed to branch debtors)	Dr.		200	200
"	Branch expenses account To Cash account (Being branch expenses, rent Rs. 3,000, salaries Rs. 2,400 and other expenses Rs.1,200 paid)	Dr.		6,600	6,600
"	Stock reserve account To branch adjustment account (Being the loading in the invoice value of opening stock at branch)	Dr.		2,000	2,000
"	Goods sent to branch account To branch adjustment account (Being the loading in the invoice value of net amount of goods sent to branch i.e., goods sent minus returns to Head office)	Dr.		11,700	11,700
"	Branch adjustment account To stock reserve account (Being the loading in the invoice value of closing stock at the branch)	Dr.		2,000	2,000
"	Branch adjsutment account To branch expenses account (Being the balance in branch expenses account transferred to branch adjustment account)	Dr.		6,800	6,800
"	Goods sent to branch account To trading account (Being goods sent to branch (net) transferred to trading account)	Dr.		46,800	46,800
"	Branch adjsutment account To general profit and loss a/c. (Being the net profit of the branch transferred to general profit and loss account)	Dr.		6,400	6,400

BRAOU

LEDGER

Branch Stock Account

Dr. Cr.

		Rs.			Rs.
1985 Jan.01	To balance b/fd	10,600	1985 Jan.01 to Dec.31	By cash account (cash sales)	26,000
Jan.01 to Dec.31	To goods sent to branch account	60,000	"	By branch debtors a/c (credit sales)	35,000
	To branch debtors account (returns)	1,000		By goods sent to branch a/c	1,500
Dec.31	To branch adjustment account (surplus)	1,500			1,500
			Dec.31	By balance c/d	10,000
		72,500			72,500
1986 Jan.01	To Balance b/d	10,000			

Goods Sent to Branch Account

Dr. Cr.

		Rs.			Rs.
1985 Jan.01 to Dec.31	To branch stock account (returns)	1,500	1985 Jan.01 to Dec.31	By branch stock account	60,000
Dec.31	To branch adjustment account (loading)	11,700			
Dec.31	To trading account	46,800			
		60,000			60,000

Branch Debtors Account

Dr. Cr.

		Rs.			Rs.
1985 Jan.01	To balance b/fd	8,000	1985 Jan.01 to Dec.31	By cash account	32,000
Jan.01 to Dec.31	To branch stock account (credit sales)	35,000	"	By branch stock account (returns)	1,000
			"	By branch expenses account (discounts allowed)	200
			Dec.31	Bybalance c/d	9,800
		43,000			43,000

BRAOU

Dr. **Branch Expenses Account** Cr.

1985		Rs.	1985		Rs.
Jan.01 to Dec.31	To branch debtors account (discounts allowed)	200	Dec.31	By branch adjustment account	6,800
	To cash account (expenses)	6,600			
		6,800			6,800

Dr. **Branch Adjustment Account** Cr.

1985		Rs.	1985		Rs.
Jan.01	To Stock reserve account (loading in closing stock)	2,000	Dec.31	By branch stock account (loading in surplus)	300
"	To gross profit c/d	12,000	"	By stock reserve account (loading in opening stock)	2,000
			"	By goods sent to branch account (loading in goods sent to branach, net i.e 58,000 × 1/5)	11,700
		14,000			14,000
1985			1985		
Dec.31	To branch expenses	6,800	Dec.31	By gross profit b/d	12,000
"	To net profit transferred to general profit & loss a/c	6,400	"	By branch stock (Surplus at cost)	1,200
		13,200			13,200

Dr. **Stock Reserve Account** Cr.

1985		Rs.	1985		Rs.
Jan.01	To branch adjustment account	2,000	Dec.31	By balance b/fd	2,000
1985			1985		
Dec.31	To balance c/d	2,000	Dec.31	By branch adjustment account(reserve on closing stock)	2,000
			1986		
			Jan.01	By balance b/d	2,000

Notes: Surplus is divided into two parts. The loading in the surplus is credited to the first part of the branch adjustment account and the actual cost of it is credited to second part.

BRAOU

Check Your Progress - 1

(a) What are the various accounts to be prepared in the books of Head office under stock and debtors system?

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(b) Draw the distinction between stock and Debtors system and Debtors system.

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.....

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Illustration - 2

Jain Brothers have a branch at Nizamabad. All purchases are made by he Head office and goods sent to the branch are invoiced at selling price which is 20% above cost. All sales by the branch are on credit terms. Branch expenses are paid by Head office and all cash received by the branch is remitted to Head office. The balances relating to branch in the Head office books on 1st Jan, 1985 and the transactions for the year ended 31st Dec. 1985 were given below:

Branch stock account (invoice price) 1-1-1985	7,200
Branch debtors 1-1-85	5,150
Transactions during the year to 31st Dec.1985	
Goods sent to branch(invoice price)	64,920
Returns from branch (invoice price)	1,284
Cash received from debtors	62,000
Discounts allowed to debtors	1,150
Branch expenses paid by Head office	6,000
Branch stock account (invoice price) 31-12-85	9,636
Branch debtors 31-12-85	2,000

Ascertain the profit or loss at the branch by stock and debtors system by preparing the necessary accounts in the Head office ledger:

BRAOU

Solution

LEDGER

Books of Jain Brothers (H.O)

Dr. **Branch Stock Account** Cr.

1985		Rs.	1985		Rs.
Jan.01	To balance b/fd	7,200	Jan.01 to Dec.31	By goods sent to Br.a/c (returns)	1,284
Jan.01 to Dec.31	To goods sent to branch a/c	64,920	"	By Br.debtors (credit sales)	60,000
			Dec.31	By Br.adjustment a/c (shortage) (bal.fig)	1,200
				By balance c/d	9,636
		72,120			72,120

Dr. **Goods sent to Branch Account** Cr.

1985		Rs.	1985		Rs.
Jan.01 to Dec.31	To branch stock account (returns)	1,284	Jan.01 to	By branch stock account	64,920
	To branch adjustment a/c	10,606			
Dec.31	To purchases a/c	53,030			
		64,920			64,920

Dr. **Branch Debtors Account** Cr.

1985		Rs.	1985		Rs.
Jan.01	To balance b/fd	5,150	Jan.01	By cash acount	62,000
Jan.01 to Dec.31	To branch stock account(credit sales) (bal.fig)	60,000	Jan.01 to Dec.31	By branch expenses account (discounts)	1,150
				By balance c/d	2,000
		65,150			65,150

Dr. **Branch Expenses Account** Cr.

1985		Rs.	1985		Rs.
Jan.01 to Dec.31	To branch debtors account (discounts allowed)	1,150	Dec.31	By branch adjustment account	7,150
	To cash account (expenses)	6,000			
		7,150			7,150

BRAOU

Stock Reserve Account

Dr.		Rs.			Cr. Rs.
1985 Jan.01	To branch adjustment account	1,200	1985 Jan.01	By balance b/fd	1,200
1985 Dec.31	To balance c/d	1,606	1985 Dec.31	By branch adjustment account (loading in closing stock)	1,606
			1986 Jan.01	By balance b/d	1,606

Branch Adjustment Account

Dr.		Rs.			Cr. Rs.
1985 Dec.31	To Stock reserve account (loading in closing stock)	1,606	1985 Dec.31	By stock reserve account (loading in opening stock)	1,200
"	To branch stock account (loading in shortage)	200	"	By goods sent to branch (loading in net goods sent to branch)	10,606
	To gross profit c/d	10,000			
		11,806			11,806
1985 Dec.31	To branch stock account (cost of shortage)	10 00	1985 Dec.31	By gross profit b/d	10,000
"	To branch expenses account	7,150			
	To net profit transferred to general profit & loss account	1,850			
		10,000			10,000

Notes:

(i) Credit sales made by branch are ascertained by preparing branch debtors account.

(ii) The difference in branch stock account after recording stock is taken as shortage.

(iii) Shortagee is divided into two parts. The loading in the shortage is debited to the first part of the branch adjustment account and the actual cost of shortage is debited to the second part of branch adjustment account. This procedure is to be followed for ascertaining the gross profit and net profit of the branch.

EGRAOU

Illustration - 3

M/s Sannath Bros have a retail branch at Kurnool. Goods are sent by the head office to the branch marked at selling price which is cost plus 25%. All the expenses of the branch are paid by the head office. All cash collected by the branch is deposited to the credit of head office.

From the following particulars of the branch, prepare branch stock account, branch debtors account, branch expenses account and branch adjustment account in the books of Head office:

	Rs.
Debtors on 1-1-1985	6,000
Debtors on 31-12-1985	7,000
Inventory with the branch at invoice price	
on 1-1-1985	8,000
on 31-12-1985	8,500
Cash sales during the year	30,000
Total amount deposited in the Head office account during the year	63,500
Return of goods to Head office at invoice price	2,500
Salaries paid	3,000
Rent paid	2,000
Discount allowed to customers	1,000
Bad debts written off	500
Spoilage	1,000

Solution

In the Books of Sannath Brothers (H.O.)

LEDGER

Dr. **Branch Stock Account** Cr.

1985		Rs.	1985		Rs.
Jan.01	To balance b/fd	8,000	Jan.01 to Dec.31	By Cash sales)	30,000
Jan.01 to Dec.31	To goods sent to branch account (balancing fig.)	70,000		By branch debtors account (credit sales)	36,000
			"	By goods sent to branch a/c (Returns to Head office)	2,500
			Dec.31	By branch adjustment account (spoilage)	1,000
				By balance c/d	8,500
		78,000			78,000

BRAOU

Branch Debtors Account

Dr.		Rs.			Cr. Rs.
1985 Jan.01	To balance b/fd	6,000	1985 Jan.01 to Dec.31	By Cash received from debtors)	33,500
Jan.01 to Dec.31	To branch stock account (credit sales) (balancing fig.)	36,000	"	By branch expenses (discount)	1,000
			"	By branch expenses account (bad debts)	500
			Dec.31	By balance c/d	7,000
		42,000			42,000

Branch Expenses Account

Dr.			Rs.			Cr. Rs.
1985 Jan.01	To cash account			1985 Dec.31	By branch adjustment account	6,500
"	Salaries	3,000				
Dec.31	Rent	2,000				
			5,000			
"	To branch debtors account (discount)		1,000			
	To branch debtors account (bad debts)		500			
			6,500			6,500

Branch Adjustment Account

Dr.		Rs.			Cr. Rs.
1985 Dec.31	To branch stock (loading in spoilage)	200	1985 Dec.31	By stock reserve account (loading in opening stock)	1,600
Dec.31	To stock reserve account (loading in closing stock)	1,700	,,	By goods sent to branch account (loading)	13,500
Dec.31	To gross profit c/d	13,200			
		15,100			15,100
1985 Dec.31	To branch stock (cost of spoilage)	800	1985 Dec.31	By gross profit b/d	13,200
"	To branch expenses (transfer)	6,500			
	To net profit transferred to Gen. Profit & loss account	5,900			
		13,200			13,200

BRAOU

Notes:

(i) Goods sent to branch is ascertained by balancing branch stock account.

(ii) Cash received from debtors is ascertained as follows:

Amount received from debtors = total amount deposited in Head office account – Cash sales

= 63,500 – 30,000 = Rs.33,500

23.4 SUMMING UP

Under the stock and debtors system, different accounts are opened in Head office books, instead of only Branch account under Debtors System, to ascertain profit or loss at the branch. This method is used where the branch manager is required to sell the goods only at the selling price fixed by the Head office. The various accounts opened under the system are (a) Branch Stock Account (b) Branch Debtors Account (c) Branch Cash Account (d) Branach Expenses Account (e) Branch Fixed assets account (f) Goods sent to branch Account (g) Branch Adjustment Account. The Branch Adjustment account is usually devided into two parts, the first part revealing gross profit or gross loss and the second part showing net profit or net loss.

23.5 CHECK YOUR PROGRESS : MODEL ANSWERS

1 (a) The various accounts to be opened under stock and Debtors system are :

(i) Branch Stock Account, (ii) Branch Debtors Account, (iii) Branch Cash Account (iv) Branch Expenses Account, (v) Branch Fixed Assets Account (vi) Goods sent to Branch Account and (vii) Branch Adjustment Account

(b) In the case of stock and debtors system various accounts are opened in the books of Head Office as against a single Branch Account under Debtors system.

23.6 MODEL EXAMINATION QUESTIONS

A. Answers the following in about 30 lines each:

1. Give a brief description of the accounts to be opened under stock debtors system.
2. Give specimen journal entries under stock and debtors system.

B. Explain the following in 15 lines each:

1. Explain the Branch Adjustment Account.

PROBLEMS

1. Hargopal of Hyderabad opened a branch at Madras. Goods are invoiced from Head office at cost plus 331/3%. Branch is allowed to make sales at invoice price only. Expenses of the branch are paid by the head office. Calculate (i) Gross profit and (ii) Net profit made by the branch by "Stock and Debtors" System. Transactions during the year were as under.

BRAOU

	Rs.
Stock on 1st Jan. 1985 at invoice price	4,000
Goods invoiced by the Head office	44,000
Cash sales	25,000
Credit sales	18,000
Returns of branch debtors	400
Goods returned by branch to Head office	1,000
Stock on 31st December, 1985 at invoice	
Price	3,500
Branch expenses	2,865

(Ans. Net Profit Rs. 7,110/-)

2. A limited company at Madras has a branch at Hyderabad. All purchases are made by Head Office and goods sent to branch are invoiced at selling price which is 20% above cost. Branch sells goods on credit. Branch expenses are paid by Head office and all cash received by the branch is remitted to Head office. All branch transactions are recorded in Head office books.

Following information is given to you.

Branch stock at invoice price on 1st January, 1984	7,400
Branch debtors on 1st Jan. 1984	5,150
Transactions during the year 1984 were:	
Goods sent to branch at invoice price	64,920
Returns to Head office from branch at invoice price	1,284
Branch sales	67,560
Returns from customers of branch	708
Cash received from Branch debtors	65,696
Discount allowed to branch debtors	2,830
Branch expenses paid	8,054
Branch stock at invoice price on 31st December, 1984	3,924
Expenses outstanding on 31st Dec. 1984	100

Your are required to show branch stock account, Goods sent to Branch Account, Branch debtors account, Branch expenses account and Branch adjustment in the books of Head Office for the year 1984.

(Ans. Net Loss Rs. 59/-)

23.7 RECOMMENDED BOOKS

1. Gupta, R.L & Radhaswamy, M. : Advanced Accountancy, Sultan Chand & Sons, New Delhi
2. Shukla, M.C & Grewal, T.S : Advanced Accounts, S.Chand & Co, Ltd, New Delhi.
3. Jain, S.P & Narang, K.L : Advanced Accountancy, Kalyani Publishing House, New Delhi.

BRAOU

: Branch which does not keep full system of accounting.

: The excess of invoice price over cost price.

: System where different accounts are maintained to record the branch transactions and also to ascertain profit of the branch.

UNIT-24 : ACCOUNTS OF INDEPENDENT [illegible]

Contents

24.0 Aims and Objectives
24.1 Introduction
24.2 Meaning of Independent Branch
24.3 Characteristics of the Accounting System
24.4 Incorporation of Branch Trial Balance in Head Office Books
24.4.1 Detailed Incorportion Method
24.4.2 Abridged Incorporation Method
24.5 Summing up
24.6 Check Yout Progress : Model Answers
24.7 Model Examination Questions
24.8 Recommended Books
24.9 Glossary

24.0 AIMS AND OBJECTIVES

The aim of this unit is to discuss the system of accounting to be followed by the Independent Branches.

At the end of this unit, you should be able to:

- explain about the Independent Branch
- recognise the system of accounting to be followed by the independent branch
- incorporate the branch Trial Balance in Head office books.

24.1 INTRODUCTION

In unit 23, we have dealt with how Head office opens various accounts in its books to ascertain the profit or loss at the branch. This is all about dependent [illegible] concentrate on accounting aspects of independent branches. Generally [illegible] prepare accounts of their own independently. At the end of the accounting year, [illegible] prepares trail balance and it is sent to the Head office. The Head office [illegible] all branches in its books and prepares a General Profit and Loss Account [illegible] Sheet. Let us discuss these accounting aspects in detail.

24.2 MEANING OF INDEPENDENT BRANCH

Independent branch means a branch which maintains its own set [illegible] besides geting goods from the head office, also itself in manufacturing [illegible] goods to head office. The branch meets its own expenses and all [illegible] its own account. The branch may remit money from time to time to [illegible] operates as on independent unit for all practical purposes subject to the [illegible] of the head office.

...ICS OF THE ACCOU... SYSTEM

... are characteristics of the accounting system of an independent branch:

1. ... branch keeps a complete set of its books of accounts. It may purchase goods ... supplies and may even supply goods to Head office and other branches. ... a separate bank account. Cash may be remitted to Head office from time ... per their instructions.

2. ... prepares its own trial balance and final accounts at the end of the year, the ... are sent to Head office. The Head office incorporates the branch trial ... in its books.

3. ... maintains Head office account in its books and this is in the nature of ... account. All instructions relating to Head office are recorded in this account. ... is debited with cash remitted to Head office, goods supplied to head office ... is credited with cash received from head office, goods received from head office etc.

   The Head office also maintains a branch account in its books and it is debited and credited with the transactions with the branch. Entries are similar to those which are explained in the previous units. The branch account in the head office books is also in the nature of personal account. The branch account maintained in the Head office books normally shows debit balance and Head office account maintained in branch books shows credit balance. This represents the investment made by the Head office ... Therefore, the trial balance prepared by the branch at the end of the ... does not contain capital account, instead it will contain Head office account.

4. Profit or loss disclosed by branch accounts is transferred to Head office account. The ... is credited with the profit and debited with the loss.

5. ... the Head office is having several branches, it maintains a separate account for ... Sometimes transactions may take place in between the branches. The ... do not maintain the accounts of other branches in their books but any ... which are taking place with other branches will be recorded as if they are taking place with the head office. This will reduce a lot of clerical work at the branch level.

6. ... office, on receipt of trial balance and final accounts from the branch, reconciles ... as revealed by Head office account in the books of branch with the branch ... in the books of Head office. Necessary adjustment entries for reconciliation ... are passed. Then the branch trial balance is taken up and the various ... are incorporated in Head office books for which the incorporation entries are ...

POINTS TO BE NOTED:

... fixed assets. Usually, the accounts relating to fixed assets used by the branch are ... in the Head Office books even though they are paid for by the branch when the fixed asset ... Adjustment entries are passed in the books of Head Office and branch.

	Books of branch	
1) Fixed asset is purchased and payment is made by branch	Branch asset a/c To branch a/c	Dr.
2) Fixed asset is purchased and payment is made by H.O.	Branch asset A/c To Bank	Dr.

2. Depreciation on Fixed Assets: When the accounts of [illegible] in Head office books, it is necessary to record the depreciation on such [illegible] both Head office and branch. The entries are:

Books of Head office:		Books of branch:	
Branch a/c To Branch Fixed asset A/c	Dr.	Depreciation A/c To Head office A/c	Dr.
Note: As the branch used asset, the branch account is debited		Note: As the branch used the asset, depreciation is recorded in the books of the branch	

The effect of the two entries will be to debit the branch profit and loss account and credit branch fixed asset account maintained in the head office books.

3. Head office expenses: The Head office does some service to the branches [illegible] office usually charge the branch at the end of the year with a reasonable [illegible] of fact, a part of the time of Head office staff may be taken in doing the work of the [illegible] The adjustment entries passed in the books of Head office [illegible]

Books of Head office:		Books of branch:	
Branch A/c To Profit and Loss A/c	Dr.	Head office expenses A/c To Head office A/c	Dr.
Note: Instead of crediting the profit and loss a/c the salaries a/c can be credited but the ultimate effect will be same in both cases.		Note: Head office [illegible] will be transferred to [illegible] and loss a/c	

The net effect of the above two entries will be to charge the branch [illegible] and to reduce the expenses of the Head office to the extent of [illegible] relation to the branch.

4. Reconciliation of transit items: The Head office account (in branch [illegible] account (in head office books) must show the same balance, i.e., the [illegible] credit balance and branch account showing debit balance. But, often [illegible] the balance shown in these accounts when they are compared on a [illegible] for such differences may be:

(i) **Cash in transit:** The branch may have sent cash to Head office [illegible] accounting year which has not been received by the [illegible]

Dr.

Dr.

Dr.

Dr.

	Head office		Branch	
	Dr. Rs.	Cr. Rs.	Dr. Rs.	Cr. Rs.
	25,000			20,000
		30,000	30,000	

X. Inter branch transactions: When the head office is having ... transactions takes place between the branches themselves, it will become ... considers the transactions with other branches as if they are with Head office. ... Hyderabad Head office is having branches at Warangal and Karimnagar and ... sends goods of the value of Rs.5,000/- to Karimnagar branch under ... office. The entries to be passed in the books will be:

In Warangal branch books:			
Head office account	Dr.	5,000	
To goods supplied to branch Account			5,000
In Karimnagar branch books:			
Goods received from Head office Account	Dr.	5,000	
To Head office account			5,000
In Hyderabad Head office books:			
Karimnagar branch account	Dr.	5,000	
To Warangal branch account			5,000

Check Your Progress - 1

(a) What do you mean by cash-in-transit?

.....

.....

(b) What do you mean by goods-in-transit?

.....

.....

(c) What do you mean by Inter branch transactions? Which account is debited and which account is credited in the books of H.O.?

.....

.....

24.4 INCORPORATION OF BRANCH TRIAL BALANCE IN ... BOOKS

Since the Head office has to prepare a consolidated balance sheet, it ... and loss account, for presentation to its shareholders and outsiders, ... to incorporate the branch trial balance in its books. The process ... sheet of the whole business is prepared is known as incorporation. ... can be done by any of the two methods: (i) Detailed incorporation ... incorporation method.

Incorporation Method

Under this method, all items relating to trading and profit and loss account are incorporated in the books besides incorporation of branch assets and liabilities. The trading and profit and loss account is prepared in the usual way in the books of Head office. The entries are as follows:

(i) For incorporating items which are shown on the debit side of the trading account:

Branch Trading Account Dr. with the total of items debited to trading account such as opening stock, purchases, wages etc.

(ii) For incorporating items shown on the credit side of the Trading account:

Branch Trading Dr. with the total of items credited to trading account such as opening stock, sales, closing stock.

(iii) For transferring the gross profit to Branch profit and loss account:

Branch Trading Account Dr. with the gross profit revealed by trading account

To Branch P. & L. a/c.

In case of gross loss the above entry is reversed.

(iv) For transferring the items shown on the debit side of the profit and loss account:

Branch profit and loss account Dr. with the total of items debited toprofit and loss account such as salaries, rent, commission, discount, depreciation etc.

To Branch a/c.

(v) For incorporating the items shown on credit side of profit and loss account:

[illegible] with the total of items credited to profit and loss account such as Interest received, discount received etc.

(vi) For transferring the net profit revealed by profit and loss account:

Branch profit and loss account Dr. with the net profit revealed by profit and loss a/c.

To Branch net loss account

In case of net loss, the above entry is reversed.

The above entries will enable the preparation of consolidated Branch Trading and Profit and loss account. At this stage, if the branch account is balanced, it will show a balance equal to net worth i.e., the total assets minus liabilities. If it is felt necessary to close the books completely and to record the branch assets and liabilities for the purpose of preparing balance sheet, the following two entries should be passed.

For recording branch assets:

Branch Asset Account Dr. with the value of every asset after adjustment, if any, such as branch stock, branch debtors

[illegible] for incorporating [illegible]

Branch account Dr. with the value of each [illegible]
To Branch [illegible] if any, such as [illegible] expenses outstanding [illegible]

As a result of the above entries, the branch account in the head office [illegible] closed. At the beginning of next year, the various assets and liabilities [illegible] to the branch account by passing reversal entries of the above VII and [illegible]

24.4.2 Abridged Incorporation method

Under this method, the branch trading and profit and loss account [illegible] in a memorandum account only. The [illegible] or net loss of the [illegible] are passed only for incorporating [illegible] such. Net profit or [illegible] the full trading or profit [illegible] account and the [illegible] or last six entries passed under [illegible] incorporation method [illegible] and the entry Nos. VII and VIII are passed for incorporating [illegible]

For incorporating Branch Net profit

Dr.

Branch account
To General profit and loss account

For incorporating Branch Net loss, the above entry is reversed.

Entries in the Books of the Branch

The branch books have also [illegible] at the end of the accounting [illegible] may be passed according to one [illegible]

1. Detailed Incorporation: A [illegible] each item of trading [illegible] will be transferred to Head [illegible] not provides the items [illegible] entries are as follows:

(i) For transfer of items appearing [illegible] side of trading [illegible]

Head office account Dr.
To Opening stock
To Purchases
To goods received from Head [illegible]
To wages
To Rent
To General expenses etc.

(ii) For transfer of items appearing [illegible] of trading [illegible]

Sales account Dr.
Closing stock account Dr.
Interest received account Dr.
Discount received account Dr.
To Head office account

(iii) For transfer of Branch assets:

Head office account Dr.
To various assets (Individually)

(iv) For transfer of Branch Liabilities:

Various liabilities (Individually) a/c. Dr.
To Head office account

As a result of these entries, Head office account in the branch books will be completely closed.

2. **Abridged Incorporation** Under this method, the branch trading and profit and loss account is prepared and the net profit/net loss revealed by it only will be transferred to Head office account. The entry is:

In case of Net profit:

Profit and loss account Dr
To Head office account

In case of net loss, the above entry is reversed.

The entries for transferring the branch assets and liabilities will be same as explained under detailed incorporation method.

Illustration - 1

Pass necessary adjusting entries in the books of Hyderabad Head office for the following transactions:

(i) Goods supplied to Vijayawada Branch on 28th December, 85, worth Rs. 10,000 were received by the branch on 4th January, 1986.

(ii) Cash remited by Waltair Branch to the Head office on 29th December, 1985 amounting to Rs.6,000 was received by the Head office on 3rd January, 1986.

(iii) Goods were supplied by Vijayawada Branch to Waltair Branch under instructions from Head office amounting to Rs. 4,000

(iv) Depreciation at 10% on Vijayawada Branch Furniture worth Rs. 5,000 is to be provided. The Branch furniture account is maintained in Head ofifce books.

(v) General administrative expenses of Rs. 3,000 already incurred by Head office are to be allocated equally to the two branches.

(vi) Waltair branch paid Rs. 4,000 for a machine purchased by the Head office for its use.

BRAOU

Solution

Books of Hyderabad Head Office
Journal

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
1985 Dec.31	Goods in transit account Dr. To Vijayawada Branch account (Being goods sent to Vijayawada Branch but not received by branch)		10,000	10,000
"	Cash in transit account Dr. To Waltair branch account (Being cash sent by Waltair branch but not received till date)		6,000	6,000
"	Waltair branch account Dr. To Vijayawada Branch account (Being goods supplied by Vijayawada Branch to Waltair branch)		4,000	4,000
"	Vijayawada branch account Dr. To branch furniture account (Being depreciation on branch furniture)		500	500
"	Vijayawada branch account Dr. Waltair branch account Dr. To General expenses account (Being general expenses incurred allocated to branches)		1,500 1,500	3,000
"	Machinery account Dr. To Waltair branch account (Being the amount paid by Waltair branch for the machine purchased)		4,000	4,000

Illustration - 2

The Madras Branch of Universal Traders, closed its books on 30th June, 1985 when the following trail balance was extracted from its books:

	Dr. Rs.	Cr. Rs.
Sundry debtors	48,000	
Sundry creditors		34,400
Cash in hand	7,600	
Furniture & Fixtures	25,000	
Stock at 1st July, 1984	9,000	
Goods from Head office	1,36,000	
Purchases	2.65,800	
Sales		4,50,000

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Wages and salaries	22,000	
Trade expenses	21,000	
Head office account		50,000
	5,34,400	5,34,400

The closing stock on 30th June, 1985 was Rs.10,400. Close the branch books. Prepare trading and profit and loss account and balance sheet in the branch books and incorporate branch figures in the Head office books by giving journal entries.

Solution

Books of Madras Branch

Trading and Profit and loss account
for the year ended 30th June, 1985.

Dr.			Cr.
To opening stock	9,000	By sales	4,50,000
To goods from Head office	1,36,000	By Closing stock	10,400
To purchases	2,65,800		
To gross profit c/d	49,600		
	4,60,400		4,60,400
To Wages and salaries	22,000	By Gross profit b/d	49,600
To trade expenses	21,000		
To Net profit transferred to Head office account	6,600		
	49,600		49,600

Balance Sheet as at 30th June, 1985

Liabilities	Rs.	Assets	Rs.
Sundry creditors	34,400	Cash in hand	7,600
Head office account	56,600	Sy. Debtors	48,000
		Closing Stock	10,400
		Furniture & Fixtures	25,000
	91,000		91,000

Head Office Account

Dr.			Cr.
1985	Rs.	1985	Rs.
June.30 To balance c/d	56,600	June.30 By balance b/fd	50,000
		By profit & Loss account (Net Profit)	6,600
	56,600		56,600
		1985	
		July.01 By balance b/d	56,600

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Books of Madras Branch

Journal

Date	Particulars		L.F.	Dr. Rs.	Cr. Rs.
1985 June.30	Head office account	Dr.		4,53,800	
	To opening stock				9,000
	To goods from Head office				1,36,000
	To purchases				2,65,800
	To wages and salaries				22,000
	To trade expenses				21,000
	(Being the debit balances of revenue items transferred to Head office account)				
"	Sales account	Dr.		4,50,000	
	Closing stock account	Dr.		10,400	
	To Head office account				4,60,400
	(Being credit balances of revenue items transferred to Head office account)				
"	Head office account	Dr.		91,000	
	To Cash in hand				7,600
	To stock				10,400
	To Sundry debotrs				48,000
	To furniture & fixtures				25,000
	(Being the assets transferred to Head office account)				
"	Sundry creditors account	Dr.		34,400	
	To Head office account				34,400
	(Being creditors transferred to Head office account)				

Books of Universal Traders (Head Office)

Journal

Date	Particulars		L.F.	Dr. Rs.	Cr. Rs.
1985 June.30	Madras branch trading account	Dr.		4,10,800	
	To Madras branch account				4,10,800
	(Being the incorporation of opening stock, goods from Head office and purchases)				
"	Madras branch acount	Dr.		4,60,400	
	To Madras branch trading account				4,60,000
	(Being the incorporation of branch sales and closing stock)				

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"	Madras Branch account To Madras Branch profit and loss a/c (Being the gross profit transferred to profit and loss a/c)	Dr.		49,600	49,600
"	Madras Branch Profit & Loss a/c To Madras Branch account (Being the incorporation of wages or salaries and trade expenses)	Dr.		43,000	43,000
"	Madras Branch profit and Loss a/c To General profit and Loss account (Being the net profit of the branch transferred to general profit and loss account)	Dr.		6,600	6,600
"	Madras Branch cash in hand a/c	Dr.		7,600	
	Madras Branch sundry debtors a/c	Dr.		48,000	
	Madras Branch closing stock a/c	Dr.		10,400	
	Madras Branch furniture and fixtures a/c	Dr.		25,000	
	To Madras Branch account (Being the incorporation of branch assets)				91,000
"	Madras Branch account To Madras Branch sundry creditors a/c (Being the incorporation of branch creditors)	Dr.		34,400	34,400

Illustration - 3

The Head office of a business and its branch keep their own books and each prepares its own profit and loss accout. The following balances are appearing in the two sets of books as on 31st December, 1985 after ascertaining of profits and after making all adjustments except these referred to below:

Particulars	Head office		Branch	
	Dr. Rs.	Cr. Rs.	Dr. Rs.	Cr. Rs.
Capital		2,00,000		
Fixed assets	72,000	—	32,000	—
Stock	68,400	—	21,480	—
Debtors and Creditors	15,640	7,920	9,680	3,840
Cash	21,480	—	2,840	—
Profit and loss		29,320	—	—
Branch office account	59,720	—	—	—
Head office account				56,040
	2,37,240	2,37,240	66,000	66,000

Set out the balance sheet of the business as on 31st December, 1985 and journal entries necessary (in both sets of books) to record the adjustments dealing with the following:

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(a) On 31st December, the branch had sent a cheque for 2,000 to the head office, not received by them nor credited to the branch till next month.

(b) Goods valued at Rs.880 had been forwarded by the Head office to the branch and invoiced on 30th December, but were not received by the branch nor dealt with in their books till next month.

(c) Stock stolen in transit from the head office to the branch and charged to the branch by the head office but not credited to the head office in the branch books as the branch manager declined to admit any liability, Rs.820 (not covered by insurance).

(d) It was agreed that the branch should be charged with Rs. 600 for administrative services, rendered by the head office during the year.

(e) Depreciation of branch assets, of which accounts are maintained by the head office, not provided for Rs.500

(f) The balance of profit shown by the branch is to be transferred to the head office.

Solution

Books of Head office

Journal

Date	Particulars	L.F.	Dr. Rs.	Cr. Rs.
1985 Dec.31	Goods in Transit account Dr. To Branch account (Being goods invoiced on 30th December, but not received by the branch)		880	880
"	Profit and loss account Dr. To Branch account (Being stock stolen in transit not covered by insurance)		800	800
"	Branch account Dr. To Profit and loss account (Being the administrative services rendered to branch)		600	600
"	Branch account Dr. To Branch fixed assets a/c (Being the depreciation on branch assets, the accounts of which are maintained in Head office books)		500	500
"	Branch account Dr. To General profit and loss a/c (Being branch profit transferred to general profit and loss account)		5,020	5,020

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

1985		Rs.	1985		Rs.
Dec.31	To Branch account (stock stolen in transit)	800	Dec.31	By branch b/fd	29,320
Dec.31	To Balance c/d	29,120		By Branch account	600
		29,920			29,920
			1986		
			Jan.01	By balance b/d	29,120

Dr. **Branch Account** **Cr.**

1985		Rs.	1985		Rs.
Dec.31	To Balance b/fd	59,720	Dec.31	By goods in transit	800
"	To profit and loss account	600	"	By profit & Loss a/c	800
"	To branch fixed assets	500	"	By balance c/d	64,160
"	To general profit & loss account	5,020			
		65,840			65,840
1986					
Jan.01	By balance b/d	64,160			

Books of Branch

Journal

Date	Particulars		L.F.	Dr. Rs.	Cr. Rs.
1985					
Dec.31	Cash in transit account	Dr.		2,000	
	To Head office account				2,000
	(Being cheque sent but not received by Head office)				
"	Head office expenses account	Dr.		600	
	To Head office account				600
	(Being the administrative services charged by Head office)				
"	Depreciation account	Dr.		500	
	To Head office account				500
	(Being the depreciation on assets the accounts of which are maintained in Head office books)				
"	Profit and loss account	Dr.		5,020	
	To Head office account				5,020
	(Being the transfer of profit to Head office account)				

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Dr. Profit and Loss Account Cr.

1985		Rs.	1985		Rs.
Dec.31	To Head Office expenses account	600	Dec.31	By balance b/fd	6,120
"	To Depreciation a/c.	500			
"	To Head Office a/c.	5,020			
		6,120			6,120

Dr. Head Office Account Cr.

1985		Rs.	1985		Rs.
Dec.31	To balance c/d	64,160	Dec.31	By balance b/fd	56,040
			"	By cash in transit account	2,000
			"	By Head office expenses a/c	600
			"	By depreciation a/c	500
			"	By profit and loss a/c	5,020
		64,160			64,160
			1986		
			Jan.01	By balance b/d	64,160

Balance Sheet as at 31st December, 1985

Liabilities		Rs.	Assets		Rs.
Creditors:			Cash:		
Head office	7,920		Head office	21,480	
Branch	3,840		Branch	2,840	
			In transit	11,760	26,320
Profit and loss account			Debtors:		
Head office	29,120		Head office	15,640	
Branch	5,020		Branch	9,680	
		34,140			25,320
Capital		2,00,000	Stock		
			Head office	68,400	
			Branch	21,480	
			In transit	880	90,760
			Fixed assets:		
			Head office	71,000	
			Less:Depreciation	500	
				71,500	
			Branch	32,000	1,03,500
		2,45,900			2,45,900

Notes:

(i) The student is advised to check whether the balance as shown by the Head office account in branch books and the branch account in Head office books reconcile or not.

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(i) ... there is a difference of Rs.3,000 and the difference is on account of (i) cash in transit (ii) goods in transit and (iii) stock stolen in transit. The adjustment entries are passed for these differences.

(iv) The net profit of Head office and branch is ascertained by preparing profit and loss accounts in both the books.

(v) In the consolidated balance sheet of the Head office and the branch the balance in branch account in the books of Head office and the balance in Head office account in the books of branch will not appear as they are contra to each other.

(vi) Balance in branch account in Head office books i.e., Rs.64,160 represents net assets at the branch i.e., fixed assets Rs.32,000 + Stock Rs.21480 + Debtors Rs.9680 + Cash Rs.2,840 + Cash in transit Rs.2,000 = 68,000 – creditors Rs.3,840 = Rs.64,160.

Check Your Progress - 2

1. What is the difference between detailed incorporation and abridged incorporation?

.....

.....

.....

.....

2.5 SUMMING UP

Independent branch is one which maintains its own set of books. The branch meets its own expenses and all cash received is deposited in its own account. It gets goods from Head office and purchases goods from outside suppliers. Sometimes the branch may engage itself in manufacturing activity and even supply goods to Head office and other branches. The branch prepares its own Trial Balance and final accounts at the end of the year. The Head office incorporates the Branch Trial Balance in its books by passing incorporation entries.

2.6 CHECK YOUR PROGRESS : MODEL ANSWERS

(a) Cash in transit implies cash remitted by the branch but not received by the Head office before the accounting year or before the closing date of accounting year.

(b) When goods invoiced to the branch by the Head office, the same might not have been received by the branch within the accounting year. Such goods are known as goods in transit.

(c) Those transactions which took place among the branches are called inter branch transactions. The branch which received the goods is debited and the branch which sends the goods is credited, in the books of H.O.

In the case of detailed incorporation method, all items of Trading and Profit and Loss Accounts are incorporated in H.O books together with branch assets and liabilities. On the other hand, under abridged incorporation method, the H.O Prepares a memorandum Trading Account of Trading and Profit and Loss Account to find out the profit. Further entries are also passed for the incorporation of branch assets and liabilities in the books of H.O.

24.7 MODEL EXAMINATION QUESTIONS

A. Answers the following in 30 lines each:

1. Discuss the characteristics of the accounting system of an independent branch.
2. What is meant by reconciliation of transit items? Explain with examples.
3. Give the entries for incorporation of trial balance in Head office books.

B. Answers the following in 15 lines each:

1. What are the methods of incorporation?
2. What are the inter-branch transactions?

PROBLEMS

1. The Kurnool branch closed its books on 31st December, 1985 when the following trial balance was prepared:

	Dr. Rs.	Cr. Rs.
Sundry Debtors	12,000	
Sundry Creditors		1,000
Cash in hand	1,900	
Furniture & Fixtures	6,250	
Stock at 1st Jan. 1985	2,250	
Goods from Head office	24,000	
Purchases	80,000	
Sales		1,00,000
Salaries & Wages	5,500	
Trade expenses	5,250	
Head Office account		25,000
	1,37,150	1,37,150

The closing stock on 31st December, 1985 was Rs 2,600. Close the branch trading and profit and loss account and balance sheet. Incorporate Branch trial in Head office books by giving journal entries.

(Ans. Gross Profit Rs. 12,400;
Net Profit Rs 1,050;
Balance Sheet Rs. 22,750)

[illegible] goods from Head office at cost [illegible] The [illegible] set of books. On 31st December, 1985 the following trial balance

	Head Office		Branch Office	
	Dr.	Cr.	Dr.	Cr.
	—	60,000	—	—
	92,000	—	16,000	—
[illegible] 1st January, 1985	—	8,000	—	—
	28,000	—	3,800	—
[illegible] Creditors	34,000	20,000	3,600	4,100
	6,000	—	2,000	—
[illegible]	2,40,000	2,80,000	13,500	65,000
	30,000	—	4,500	—
[illegible]	—	24,000	23,000	—
	22,000	—	—	16,700
	3,92,000	3,92,000	65,800	65,800

[illegible] be depreciated at 10%. Stock on 31st December, 1985: Head Office [illegible] Rs.4,200.

[illegible] company's profit and loss account for the year ended 31st December, 1985 and [illegible] on that date.

[illegible] — Head Office Rs.56,000; Branch Rs.8,900;

[illegible] Profit — Head Office Rs.22,400; Branch Rs.2,800

[illegible] Rs.17,700)

[illegible] necessary adjusting entries in the books of Head Office for the following transactions.

[illegible] Warangal branch on 28th December, 1985 amounting to Rs.5,000 [illegible] the branch on 3rd January, 1986.

[illegible] by Vijayawada branch to Head office on 29th December, 1985 amounting [illegible] received by the Head office on 2nd Jan, 1986.

[illegible] supplied by the warangal branch to Vijayawada branch under instructions [illegible] amounting to Rs.2,000.

[illegible] at 10% on Warangal branch furniture worth Rs.10,000 is to be provided. [illegible] account is maintained in Head office books.

[illegible] expenses of Rs.4,000 already paid by Head office are to be allocated to [illegible] equally.

[illegible] the branches close their books on 31st December every year.

24.8 RECOMMENDED BOOKS

1. Gupta, R.L. & Radhaswamy, M. : Advanced Accountancy, Sultan Chand & Sons, New Delhi.
2. Shukla, M.C. & Grewal, T.S. : Advanced Accounts, S.Chand & Co. Ltd., New Delhi.
3. Jain, S.P. & Narang, K.L. : Advanced Accountancy, Kalani Publishers, Ludhiana, New Delhi.

24.9 GLOSSARY

Cash in Transit : Cash sent by the branch/Head office not received by the other as at the close of the year.

Goods-in-Transit : Goods sent by the Head office to branches not received by the branch as at the close of the year.

Incorporation of Branch Trial Balance : The process by which consolidated balance sheet of whole business is prepared.

Independent Branch : Branch which keeps full system of accounting.

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UNIT 29 BANK ACCOUNTS-I

Structure

29.0 Aims and Objectives

29.1 Introduction

29.2 Basic Features

29.3 Essential Information of Book-keeping system

29.4 Slip System of Ledger Posting

29.5 Proforma of Profit and Loss Account

29.6 Explanation of Profit and Loss Account Items

29.6.1 Provision for Doubtful Debts and Bad Debts

29.6.2 Income Tax and Provision for Tax

29.6.3 Interest

29.6.4 Loss on sale of Investments

29.6.5 Interest on Doubtful Debts

29.6.6 Interest

29.6.7 Rebate on Bills Discounted

29.7 Summing up

29.8 Check Your Progress : Model Answers

29.9 Model Examination Questions

29.10 Glossary

29.0 AIMS AND OBJECTIVES

The aim of this unit is to discuss the preparation of Profit and Loss Account of a Bank as per the Banking Regulation Act of 1949.

After the study of this unit, you will be able to :

- describe the Book-keeping system that is to be followed by banks
- explain the slip system of ledger posting
- give proforma of profit and Loss Account
- prepare profit and Loss Account of Banks.

29.1 INTRODUCTION

Banks are also a kind of business concerns. They receive deposits, give loans and render various services to their customers. Banks collect money and make payments on behalf of their customers. They issue Letter of Credit, Travellers' cheques, under write the issue of shares, discount bills, provide lockers, and accept and endorse obligations on behalf of their customers.

There are some special features in banking business.

- Banks deal with money in the business.

amount of deposits collected [illegible]
of the bank.

3. Banks have to record the transactions immediately in their [illegible] withdrawals are not recorded immediately in the customer's account, [illegible] than the balance of the deposits, or may dishonour the cheques [illegible] has sufficient bank balance.

4. Banks need strong and effective internal check system for the [illegible]

A bank can be started as a sole trading concern, or a partnership [illegible] it is started as a partnership firm, the number of partners should not [illegible]

25.2 LEGAL ASPECTS

Every bank has to take licence from Reserve Bank of India, to do [illegible] country. R B I has the power to cancel the licence even after issuing it [illegible]

1) **Accounting year :** The Accounting Year for all the banking companies [illegible] i.e. 31st March (Section 29).

2) **Share capital :** The subscribed capital of a bank must not be less than [illegible] capital and the paid up capital must not be less than half of the subscribed [illegible] 12).

3) **Statutory Reserve :** 20% of the profit before declaration of dividend must be transferred to Reserve Fund and that must be separately disclosed.

4) **Prohibition of trading :** A banking company can neither itself nor on behalf of any [illegible] deal in buying or selling of goods except in connection with the [illegible] to or held by it (Section 8).

3 GENERAL INFORMATION RELATING TO BOOK-KEEPING

In order to understand the real nature of the working of a bank, a knowledge of the important books, ledgers and registers is necessary.

Cash Section

Cash book : Detailed records will be maintained by a bank for [illegible] relating to cash as the main business of a bank is to accept cash and [illegible] 2 cash books. (1) Rough cash book and (2) Fair cash book.

Generally there will be two cashiers, one for receiving cash and [illegible] and rough cash books are maintained by the cashiers.

All paying-in-slips received by the receiving cashier, and cheques [illegible] the paying cashier are passed on to a different person, who writes them [illegible] books called "Fair Cash Book". This procedure provides a very [illegible] recording of cash transactions, as the transactions in the fair cash [illegible] rough cash book.

Cash Balance Book : In this book the cash balance at the close of [illegible] expenditure of the day is recorded.

daily transactions of the bank, preparing various statements, checking

maintains various types of ledgers for different purposes. The recorded in the books will be posted in these ledgers with the help of ledgers maintained by a bank are current account ledger, savings ledger, over due fixed deposit ledger, fixed deposit interest ledger, general ledger etc.

some books and ledgers on double entry system, every bank maintains A part of double entry system.

: This register contains particulars regarding the bills deposited by for collection.

register particulars pertaining to the securities held by the bank by it will be maintained.

contains full details regarding the Jewellery pledged by the customers

: Customers of a bank may give instructions to the bank to make on their behalf. This register contains all such standing

contains the details of cheques returned by the bank

: It contains the details of the drafts issued by other branches for

LEDGER POSTING

banking companies is that the transactions have to be recorded taken place. This is because the bank requires to know the balance they follow "Slip System of Ledger Posting". Under this method account maintained under the double entry bookkeeping system bundle of leaves of Journals or Cash book, for example cheques transactions will be recorded as they occur. These slips will be Ledger clerks concerned for immediate posting in the accounts the cheques and pay-in-slips will be treated as vouchers. The credit the cash account and pass on the cheques to the ledger account. The cashier receiving the pay-in-slips will debit the slips to the ledger keeper for crediting the customers accounts from the customer account to the savings account of the same transference from one current account to another customer. In this case the Bank itself prepares the vouchers.

under this system, the loss of time is avoided and accuracy is ensured as the vouchers are filled up by the customers themselves.

25.5 PROFORMA OF PROFIT AND LOSS ACCOUNT

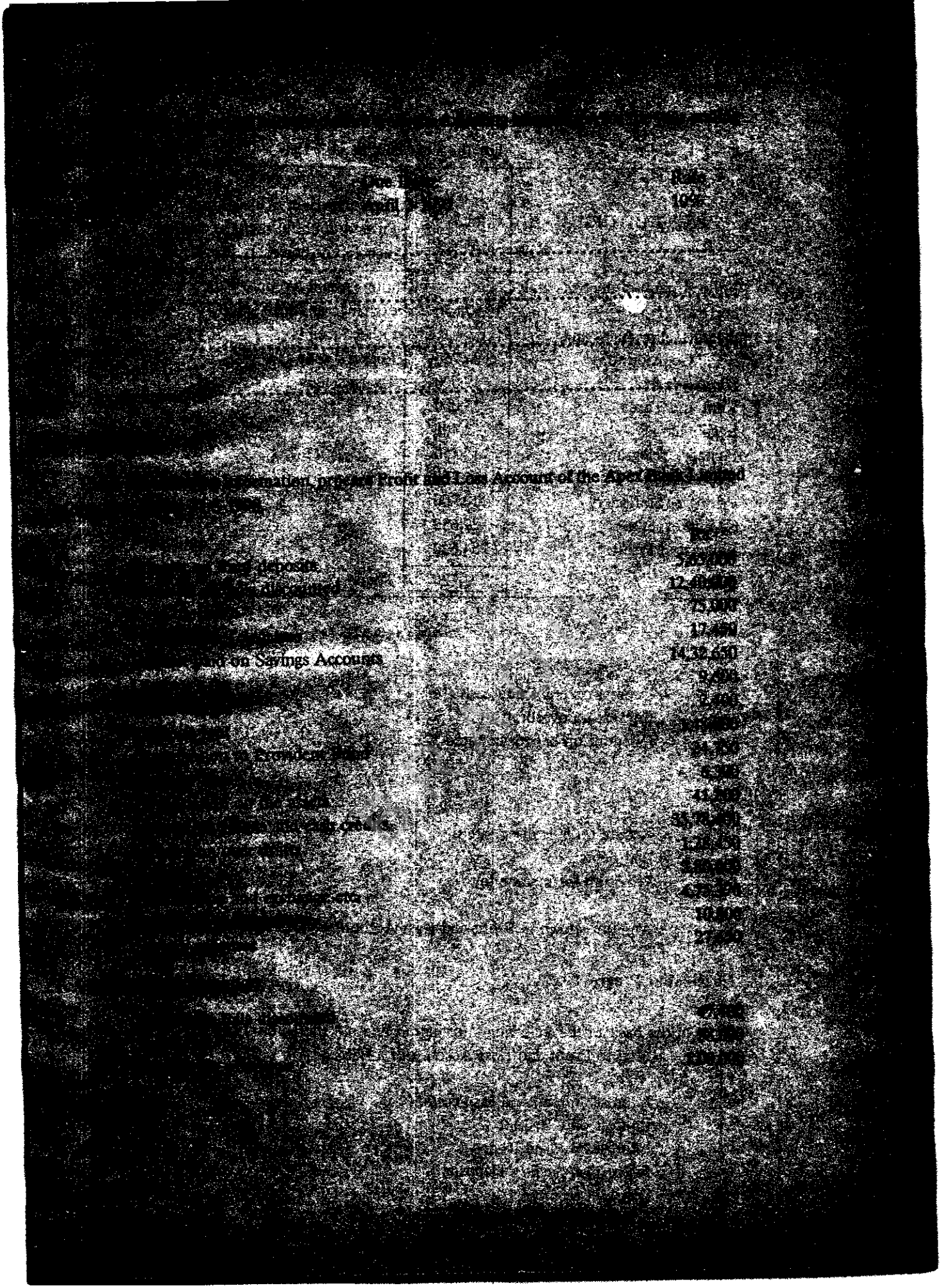
Profit and Loss Account of a banking company with reference to the year ending 31st December is to be prepared in Form B of third schedule (Section 29) of the Banking Companies Act. It is not customary to write 'To and By' in the profit and loss account of the banks.

FORM-B

Profit and Loss Account

For the year ended 31st December, 1986

EXPENDITURE	INCOME (Less provision against the [illegible] doubtful debts and [illegible] sary provisions)
1. Interest paid on Deposits, borrowings etc.	1. Interest and discount.
2. Salaries, allowances and provident fund (showing separately salaries and allowances to Managing Director, Manager, or Chief Executive Officer.)	2. Commission, exchange and brokerage.
3. Directors and local committee members fees and allowances.	3. Rents.
4. Rent, taxes, insurance, lighting, etc.	4. Net profit on [illegible] of investments, Gold and Silver, [illegible] Premises and other assets (not credited to reserves or any particular fund or account.)
5. Law charges.	5. Net Profit on revaluation of investments, gold [illegible] and other assets (not credited to reserves or any particular fund or account.)
6. Postage, telegrams and Stamps.	6. Income from non-banking assets and profit from sale of or dealing with non-banking assets.
7. Auditors fee.	7. Other receipts.
8. Depreciation on and repairs to the banking company's property.	8. Loss (if any)
9. Stationery, printing, Advertisement etc.	
10. Loss from sale of, or dealing with non banking assets.	
11. Other expenditure	
12. Balance of profit.	



Dr. Profit and Loss Account of Arora Bank Ltd. Cr.

For the year ending 31-3-[illegible]

EXPENDITURE	Rs.	INCOME	Rs.
Interest paid on deposits and borrowings	39,27,650	Interest and discount (Less provision made for and doubtful debts and actual or necessary pay...	[illegible]
Salaries, allowances and P.F.Contributions	5,04,750	Other receipts, exchange and brokerage	
Director's fee	9,000	Lockers rent	
Rent and Taxes	75,800	Transfer fees	
Legal charges	2,400		
Postage, Telegrams	17,450		
Depreciation	43,200		
Printing & Stationery	10,300		
Sundry expenses	27,650		
Balance of Profit	23,94,820		
Total	73,71,120	Total	

Notes

Income

- Interest on loans and cash credits
- Interest on overdrafts
- Discount on bills purchased

Less

- Rebate on bills discounted
- Bad debts
- Provision for income tax

Amount shown in Profit and Loss Account

Check Your Progress - 2

(a) On the basis of the following information find out the amount to be credited to Profit and Loss Account of a Bank.

- Interest on loan and cash credits
- Interest on overdrafts
- Interest on Fixed Deposits
- Interest on Savings Deposits
- Discount on bills

... Bills Discounted ... 10,000

... Doubtful Debts ... 38,000

... for Taxation ... 22,000

... of Discount to be credited to Profit and loss account.

	Rs.
... Bills Discounted (1-1-1990)	10,000
...	60,000
... Bills Discounted (31-12-1990)	5,000

... Reserve (Sections - 17) to be provided.

	Rs.
...	20,000
...	60,000

... is prepared at the end of every financial year with a view to ... loss of the bank. The debit side of the profit and loss account will ... the bank on various deposits, salaries, expenses of the bank, loss on ... The credit balance of profit and loss account represents the income ... for bad debts, provision for doubtful debts and other necessary ... bad debts, provision for bad and doubtful debts and loss ... deducted from interest and discount income. Profit and Loss ... prepared in case of Banking Companies.

(c) [illegible]

(d) (i) Rs.2,76,000

(ii) Rs.65,000

(iii) Rs.12,000

2021 MODEL EXAMINATION QUESTIONS

A. Answer the following in about 30 lines each:

(1) What are the various Ledger and Registers maintained by the Bank?

(2) Give the proforma of Imaginary Profit and Loss Account.

B. Answer the following in about 15 lines each:

(1) What are the various Registers maintained by the Bank?

(2) What is skip payment of posting?

(3) Explain Rebate on Bills Discounted.

(4) Explain the treatment of the following:

(a) Provision for Doubtful debts

(b) Provision for Taxation

(c) Loss on sale of Investments

(d) Interest accrued on Investments

(5) How do you treat interest on Doubtful Debts?

PROBLEMS

1. From the following information prepare Profit and Loss [illegible] for the year ended 31-3-1993:

Interest on Loans

Interest on Fixed Deposits

Commission

Establishment expenses

Discount on bills discounted

Interest on cash credits

Rent and Taxes

Salaries and Allowances

Directors' fee

Auditors' fee

Interest on [illegible]

Postage & Telegrams

Printing & Stationery

[illegible] for the year ended 31st March, 1995 of Ghana Lorry Bank

[illegible]

	Rs.
[illegible]	2,50,000
[illegible]	[illegible]
[illegible]	[illegible]
[illegible]	[illegible]
[illegible]	50,000
[illegible] account	20,000
[illegible]	10,000
[illegible]	1,20,000
[illegible]	40,000
[illegible]	5,000
[illegible]	35,000
[illegible] and brokerage	15,000
[illegible]	15,000
[illegible]	10,000
[illegible]	[illegible]

[illegible] taken from the Profit & Loss Appropriation Account for the year ending 31st March, 1995

	Rs.
[illegible]	3,00,000
[illegible] paid to General Manager Rs.24,000/- and	30,000
[illegible]	[illegible]
[illegible]	20,000
[illegible] provident fund Rs.6,000/- and	18,000
[illegible]	[illegible]
[illegible]	40,000
[illegible]	2,50,000

[illegible] dated and 1,00,000 for income Taxes to be [illegible]

1. Statutory Reserve	It is the reserve which is [illegible] current year profits.
2. Rebate on Bills	This is the discount which is [illegible]

UNIT - 26 : BANK ACCOUNTS - II

Contents

26.0 Aims and Objectives
26.1 Introduction
26.2 Explanation of some items of the Balance sheet
26.3 Proforma of the Balance Sheet
26.4 Preparation of Schedule of Debtors
26.5 Summing up
26.6 Check Your Progress : Model Answers
26.7 Model Examination Questions
26.8 Glossary

26.0 AIMS AND OBJECTIVES

The aim of this unit is to discuss the preparation of Balance Sheet of a Bank as per the Banking Regulations Act of 1949 :

On the completion of this unit, you will be able to :

* explain some important items of the Bank Balance Sheet
* give proforma of the Balance Sheet
* Prepare Balance Sheet and schedule of Debtors as per the Banking Regulation Act.

26.1 INTRODUCTION

The Profit and Loss Account enables a Bank to find out of net profit for the period. In addition to Profit and loss account, Balance Sheet is also prepared at the end of every calendar year. It is also known as 'Position Statement' as it reveals the financial position of the Bank. A balance sheet may, therefore, be defined as a statement showing the financial position of the Bank It will be seen that the asset side of the balance sheet is arranged in the liquidity order, i.e., what is the most liquid asset is put as the first item (Cash in hand) and what is less liquid is put as the second item (balances with other banks) and then still less liquid as the third item and so on.

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26.2 EXPLANATION OF SOME ITEMS OF THE BALANCE SHEET

A. Liability side:

1. Capital: The various classes of shares if any should be distinguished.

2. Reserve Fund and other reserves: The Statutory reserve maintained under section 17 has to be shown separately.

3. Bills for collection being Bills Receivable as per contra: Now-a-days, banks are helping the traders in collecting money from their debtors in the case of credit sales. Usually, the seller dispatches goods to the place of the buyer and hands over the documents authorising the delivery of the goods (Ex: Railway receipt, Lorry receipt etc.) to the bank. A bill will be given

to the Bank drawn on the buyer by the seller. As per the instructions of the client, banker presents the bill to the buyer and after receiving the amount from him, hands over the necessary documents authorising him to take the delivery of the goods. After deducting his commission (which he charges for rendering his services) the banker will hand over the balance amount to his client. The bank maintains a register to record the particulars of the bills received by it from its customers for collection. When the money is collected, cash account will be debited and the customers account will be credited. For the commission earned, the debit will be given to the customer's account and the Credit to the commission account.

But on 31st March of every year the bank may have some bills received by it from its customers for collection, but not yet collected. They are brought into books by passing the following entry.

Bills receivable being bills for collection a/c.	Dr.
To Bills for collection being bills receivable a/c.	

The former appears on the Asset side of Balance Sheet (as No.6) and latter on the Liability side (as No.6). As it appears on both the sides, it is known as 'Contra'. Since these bills are not collected and the bank is given the authority to do so, hence it is an asset. But this amount has to be paid to the clients ultimately,so its is a Liabillity.

4. Acceptances, endorsements and other obligations as per contra: This is another item which appears on both the sides of a bank Balance Sheet. The seller may not be satisfied with the personal guarantee given by the buyer regarding the payment of the price of the goods purchased on credit basis. The buyer may ask the bank to stand as a surety. The bank can help the buyer in the following three ways:

(a) By accepting a bill on behalf of the buyer drawn on him by the seller.

(b) By making an endorsement on the the promisory note drawn by the buyer in favour of the seller.

(c) By giving a gurantee to make the payment on behalf of the buyer. on 31st March of a year a part of the above acceptances, endorsements and gurantees may remain unexpired. So it is a Liability. But the banker's position is that of the surety who can recover the amount paid by him to the seller on behalf of the buyer from the buyer. Morover, bank safeguards its position by taking some security from the buyer before giving gurantee etc. So it is an asset. The above amount will brought into books by passing the following entry.

Constituents Liability for acceptances, endorsements and other obligations a/c	Dr.
To Acceptances, endorsements and other obligations.	

5. Contengency Account: Provision for Income tax is shown under this heading. But the amount will be merged with the amount of current accounts, so that the public cannot know the amount of provision maintained for Income-tax.

B. Asset Side

Bank arranges its assets in the Balance-Sheet in their liquidity order.

1. Gold and Silver: Bank shows its Gold stock as one of the investments, but whereas Silver is shown in other Assets

2. Investments: The mode of valuation of investments must always be shown, i.e., whether they are appearing at cost or at market value. Investments may be divided into two. Quoted investments and unquoted investments. The market value of Quoted investments must be shown as an information.

3. Money at call and short notice: This is inter-bank transaction. Under this arrangement one bank will borrow money from another bank for a temporary period. The rate of interest varies every day, sharply depending on the demand and supply of money. Money at call and short notice is money refundable in 24 hours and 7 days notice respectively.

4. Advances: Advances comprises of Loans, Cash credits and over-drafts and bills discounted and purchased. Bad debts or provision for bad debts wil not be deducted from Advances openly in the inner column. Only the net amount will be shown in the outer column after deducting bad debts and provision for bad debts, without revealing the same. Particulars of advances will be shown separately in the form of a statement.

Cash credit: is an arrangement by which a bank agrees to lend some money upto a certain limit. But it is not necessary for the customer to withdraw the full amount immediately. Bank charges interest on the actual amount withdrawn only. But bank has to maintain full amount sanctioned by it ready as the customers can withdraw the amount at any time. The loss on the idle amount will be compensated by charging interest at a higher rate than that charged on loans.

Bank over-draft: It will be given to only those who are having current accounts with the bank. Over-drafts are granted with in the limits fixed by bank authorities. The account holder is allowed to withdraw more than the amount credited to his account. The rate of interest will be higher than ordinary loans.

5. Non-banking assets: A bank may acquire some assets in satisfaction of the claims. These assets have to be disposed within 7 years from the date of acquisition. The value of these assets in the Balance-Sheet should not be more than the market value.

Check Your Progress - 1

(a) Give the treatment of Provision for Income-tax.

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(b) Give the treatment of Statutory Reserve.

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.....

(c) Give the treatment of Bold and Doubtful Debts

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(d) Give the treatment of Acceptances, Endorsements and other obligations as per contra.

.....

.....

26.3 PROFORMA OF THE BALANCE SHEET

FORM OF BALANCE SHEET

THE THIRD SCHEDULE FORM A

As per the Sec.29 of Banking Companies Act of 1949.

Liabilities	Assets
1. Capital : Authorised capital shares of Rs. each Issued capital. shares of Rs. each Subscribed capital. shares of Rs. each Amount called up at Rs. per share Less: Calls unpaid Add: Forfeited shares.	1. Cash : Cash in hand Cash in R.B.I. and S.B.I.
2. Reserve fund and other reserves:	2. Balance with other Banks: (1) In India (2) Outside India
3. Deposits and other accounts: Fixed Deposit Savings Bank deposit Current Accounts and Contingency Accounts	3. Money at call and short notice
4. Borrowings from other Banks, Agents, etc: (1) In India.	4. Investments (1) Securities and Treasury bills of the Central and State Government.
(2) Outside India. Particulars (1) Secured (Stating nature of securities) (2) Unsecured	(2) Shares of all the kinds fully paid and partly paid (3) Debentures on Bonds (4) Other investments (5) Gold.
5. Bills payable:	5. Advances: (other than Bad and doubtful debts for which provision has been made to the satisfaction of the auditors). (1) Loans, cash credits and over-drafts. (a) In India. (b) Outside India.
6. Bills for collection being Bills receivable as per contra: (1) Payable in India (2) Payable outside India.	(2) Bills discounted and purchased (other than the treasury bills of Central and State Govt.) (a) Payable in India. (b) Payable outside India. 6. Bills receivable Bills for collection as per contra:

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7. Other Liabilities: Unclaimed dividends, advance payments Rebate on Bills discounted, Liabilities to subsidiary companies.	(1) Payable in India. 2. Payable Outside India
	7. Constituents Liability for acceptances and endorsements and other obligations as per contra:
8. Acceptances endorsements and other obligations as per Contra	8. Premises: (Less Depreciation)
9. Profit and Loss Account: As per the last Balance Sheet Add: Profit for the year brought forward from Profit & Loss account Less: Appropriations	9. Furniture and Fixtures: (less Depreciation)
10. Contingent Liabilities: Ex. Claims against the banking company not acknowledged as debts Arrears of cumulative Preference shares of dividends Liability on bills of exchange rediscounted. Liability on account of outstanding. Forward exchange contracts. Partly paid shares (uncalled amount) (Give simply by way of note, not extended to outer column)	10. Other assets: Silver Preminary organisation formation expenses. Development expenditure commission and brokerage on shares. Interest accured on investements
	11. Non-banking assets:
	12. Profit and Loss account: (Accumulated loss).

26.4 PREPARATION OF SHEDULE OF DEBTORS

S.No.	Particulars	Rs.
1.	Debts considered good, in respect of which the bank is fully secured.	
2.	Debts considered good, for which the bank holds no other security than the debtor's personal security.	
3.	Debts considered good, secured by the personal security of one or more parties in addition to the personal securities of the debtors.	
4.	Debts considered doubtful or bad - not provided for.	
5.	Debts due by Directors or Officers of the banking company or any of them either severally or jointly with any other person.	
6.	Debts due by companies or firms in which the directors of the bank are interested as directors, partners or managing agents or in case of private company, as members.	
7.	Maximum total amount of advances including temporary advances made at any time during the year to director, managers, or officers of the banking company, or any of them either severally or jointly with any other person.	
8.	Maximum total amount of advances including temporary advances granted during the year to the companies or firms in whch the directors of the bank are interested as directors, Partners or managing agents or in case of Private Companies as members.	
9.	Due from Banking companies.	

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The schedule of debtors is divided into 9 parts. The total of the first 4 paras only will be shown as Advances in the Balance Sheet. The next 5 items give further particulars regarding the pattern of advances. These parts of the schedule is not totalled.

Illustration - 1

Following particulars are available from the books of Kavina Bank Limited as on 31st March, 1989, regarding the loans and advances given by it.

		Rs.
1.	Loans to corporate sector fully secured (excluding banks, but including companies in which directors are interested)	20,00,000
2.	Loan o Anugraha Bank Limited (fully secured)	5,00,000
3.	Debts due by Officers (excluding directors) fully secured	3,00,000
4.	Loan to non corporate sector fully secured	10,00,000
5.	Loan to Vasu Bank Ltd. (fully secured)	5,00,000
6.	Debt due by a director of a bank (fully secured)	2,00,000
7.	Debts considered good which are unsecured	8,00,000
8.	Debts considered good guaranteed by 3rd parties.	10,00,000
9.	Debts due by companies in which the directors are interested fully secured (Maximum amount of debts at any time during the year Rs.20,00,000)	10,00,000
10.	Doubtful debts	
11.	Provision for bad and doubtful debts	
12.	Maximum amount of debt due by officer and directors at any time during the year	8,00,000

Schedule of Debtors

1.	Debts considered good in respect of which the bank is fully secured	45,00,000
2.	Debts considered good in respect of which the bank holds to security other than debtors personal security	8,00,000
3.	Debts considered good secured by the personal liability of one or more persons in addition to the personal security of debtors	10,00,000
4.	Debts considered doubtful or bad not provided for	10,00,000
	Total Advances to be shown in Balance Sheet	63,00,000
5.	Debts due by directors or officers of the banking company or any of them either severally or jointly with any other person	5,00,000
6.	Debts due by companies or firms in which the directors of the bank are interested as directors, partners or managing agents or in case of Private Companies as members	10,00,000
7.	Maximum total amount of advances including temporary advances made at any time during the year to directors, managers, or officers of the banking company, or any of them either severally or jointly with any other person.	8,00,000
8.	Maximum total amount of advance including temporary advances granted during the year to the companies or firms in which the Directors of the bank are interested as directors, partners or managing agents or in case of private companies as members	20,00,000
9.	Due from other Banking companies	10,00,000

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Illustration - 2

From the following figures taken from the Books of Vandana Bank Limited, you are required to draft as at December 31, 1986 (a) a Balance Sheet (b) a Profit and loss account.

	Rs.
Share Capital (Authorised and Issued)- 12,000 shares of Rs.100 each Rs.50/- paid	6,00,000
Reserve fund	3,50,000
Fixed Deposit Accounts	9,50,000
Savings Bank Deposits	30,00,000
Current Accounts	80,00,000
Money at call and short notice	3,00,000
Investments (at cost)	30,00,000
Interest accrued and paid	2,00,000
Salaries (including salary to General Manager Rs.24,000/- and Director's fee Rs.5,000/-)	80,000
Rent	20,000
General Expenses (including stationery Rs.5,000/- and Auditor's fee Rs.2,000/-)	10,000
Non-Banking Assets	30,000
Profit and Loss Account (Cr.) on 1-1-1986)	2,10,000
Dividend for 1985	50,000
Premises (after depreciation upto 31st Dec.1985 Rs.1,00,000/-)	12,00,000
Cash in hand	60,000
Cash with Reserve Bank	15,00,000
Cash with other Banks	13,00,000
Borrowed from Banks	7,00,000
Interest and Discounts	7,50,000
Bills discounted and Purchased	6,00,000
Bills Payable	8,00,000
Loans Overdrafts and Cash Credits	70,00,000
Unclaimed dividends	30,000
Sundry Creditors	30,000
Bills for collection	1,40,000
Acceptances and endorsement on behalf of customers	2,00,000
Furnitures	40,000
Other assets	30,000

Rebate on bills discounted and purchased for unexpired term amounted to Rs.5,000/. Allow 5% depreciation on premises on orginal cost. A provision for doubtful debts amounting to Rs.30,000/- is required. The Bank has no business outside India.

Create a provision of Rs.1,00,000/- for taxation.

BRAOU

Solution

Vandana Bank Limited

Profit and Loss Account for the year ended December 31,1966

EXPENDITURE			INCOME (less provision made during the year for bad and doubtful debts and other usual or necessary provisions)	
		Rs.		Rs.
To Interest paid on deposits including accrued		2,00,000	By Interest and Discounts	6,15,000
To Salaries				
General Manager	24,000			
Others	51,000			
		75,000		
To Directors fees		5,000		
To Rent		20,000		
To Auditors fees		2,000		
To Depreciation on premises		65,000		
To Stationery		5,000		
To General Expenses		3,000		
To Balance of Profit		2,40,000		
		6,15,000		6,15,000

From Rs.7,50,000, Rs.30,000 for provision for doubtful debts, Rs.5,000 for rebate on bills discounted Rs.1,00,000 as provision for taxation have been deducted (Rs.7,50,000 – Rs.30,000 – Rs.5,000 – Rs.1,00,000 = Rs.6,15,000)

Balance Sheet of Vandana Bank

as at December 31, 1986

CAPITAL AND LIABILITIES			PROPERTY AND ASSETS	
Share Capital:			1. Cash in hand and with Reserve Bank	15,60,000
Suthorised, Issued and Subscribed 12,000 share of Rs.10 each Rs.50/- paid		6,00,000	2. Balance with other Banks	13,00,000
Reserve fund and other Reserves:			3. Money at Call and Short notice.	3,00,000
Under Sec.17:			4. Investments (at cost)	30,00,000
Balance b/d	3,50,000		5. Advances:	
Add trasfer from Current years profits	48,000	3,98,000	Loans, Cash credits and overdrafts (other than bad & doubtful debts for which provision has been made to the satisfaction of auditors)	69,70,000
Deposit & Other A/cs.			(b) Bills discounted & purchased	6,00,000
Fixed Deposits	9,50,000			75,70,000

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	Savings Bank	30,00,000	1,20,50,000	6.	Bills receivable being bills for collection as per contra.	1,40,000
	Current contingency	81,00,000				
4.	Borrowing from other Bank		7,00,000	7.	Constituents Liabilities and acceptances, Endorsements and Guarantees as per contra.	2,00,000
5.	Bills payable		8,00,000			
6.	Bills for collection being bills receivable as per contra.			8.	Premises: Cost 13,00,000 Less: Depwritten off to date 1,65,000	11,35,000
7.	Other Liabilities :			9.	Furniture & Fixtures	40,000
	Unclaimed dividends	30,000		10.	Other Assets	30,000
	Sundry Creditors	30,000		11.	Non-banking Assets	30,000
	Unexpired Discount	5,000	65,000			
8.	Acceptances, Endorsement and other obligations as per contra.		2,00,000			
9.	Profit and Loss A/c Balance as per Last Balance Sheet	2,10,000				
	Less: Dividend of 1985	50,000				
	Add: Profit for 1986	1,60,000				
		2,40,000				
		4,00,000				
	Less: 20% of Rs.2,40,000 added to Statutory reserve (Sec.17)	48,000				
			3,52,000			
			1,62,05,000			1,62,05,000

Notes:

(1) Provision for taxation is added to current and contingency accounts

(2) Provision for doubtful debts is deducted from loans, cash credits and overdraft.

Illustration - 3

From the following figures taken from the books of M/s.SUJANA BANK LITED you are required to prepare as at 31st December, 1983 (a) Profit and Loss Account (b) Balance Sheet as per the requirements of the Balancing Companies Regulations Act.

BRAOU

	Rs.
Share Capital	
3,000 equity shares of Rs.200 each, Rs.100 per share paid up	3,00,000
Bad debts written off	12,871
Reserve fund investments	1,00,000
General Expenses	18,242
Current accounts	20,24,422
Interest paid	16,052
Deposit Accounts	6,92,023
Profit and Loss Account (Cr.)	22,934
Acceptances for customers	1,54,282
Discount	24,376
Bills Receivable	1,00,000
Endorsements and guarantee	7,402
Commission	4,424
Cash in hand	22,654
Interest receivable	53,226
Cash with banks	3,01,210
Endorsements and gurantees	7,402
Overdrafts	20,044
Customers liability for acceptances	1,54,282
Short loans (Cr.)	6,48,206
Loans	15,45,670
Investments	9,88,254
Bills discounted	6,22,824
Premises	2,21,790
Bills for collection	1,00,000
Reserve Fund	1,00,000

Additional information

1. During the year Interim dividend of Rs.15,000 was paid.
2. Reserve Rs.6,438 for Rebate on Bills discounted.
3. Provide Rs.10,000 for taxation reserve.

Solution

M/s. Sujana Bank Limited Profit and Loss Account
for the year ended 31st December, 1983

EXPENDITURE		INCOME (less provision made during the year for bad and doubtful debts and other usual or necessary provisions)	
	Rs.		Rs.
Interest paid	16,052	Interest and discount	48,293
General expenses	18,242	Commission	4,424
Profit for the year	18,423		
	52,717		52,717

BRAOU

Working notes:

Discount	24,376	
Interest received	53,226	
		77,602
Less:		
1. Bad debts	12,871	
2. Rebate on bill discounted	6,438	
3. Taxation Reserve	10,000	
		29,309
		48,293

M/s Sujana Bank Limited Balance Sheet
as on 31st December, 1983.

CAPITAL AND LIABILITIES		PROPERTY AND ASSETS		
1 Share Capital:		1 Cash in hand and with Reserve Bank		
3,000 Equity shares of Rs.200/- each. Rs.100 per		of India		22,654
share paid up	3,00,000	2 Balance with other banks		3,01,210
2 Reserve fun dand other		3 Money at call and short notice		
Reserve:		4. Investements:		
Reserves fund 1,00,000		Reserve fund		
Add:Transferred from		Investments		1,00,000
current year provision 3,685	1,03,685	Other Investments		9,88,254
3 Deposit and other accounts		5 Advances:		
Deposit Account	6,92,023	(a) Loans, cash credits and overdrafts		
Current Account &		(other than bad and doubtful debts		
contingency accounts	20,34,422	for which provision has been made		
4 Borrowings from		to the satisfaction of		
Short loans	6,48,206	Auditors)	15,65,714	
5 Bills payable	-	(b) Bills discounted	6,22,824	21,88,538
6 Bills for collection				
being bills recievable				
as per contra	1,00,000			
7 Other Liabilities:		6 Bills receivable being		
Rebate on bills discounted	6,438	bills for collection as		
8 Acceptances, Endorsements		per contra		1,00,000
and other obligations as		7 Constituents Liabilities		
per contra		and acceptances, Endorsements		
9 Profit and Loss a/c		and other obligations as		
Balance as per Last Balance		per contra		1,61,684
Sheet 37,934		8 Premises		2,21,790
Less:Interim dividend		9 Funiture & Fixtures		-
paid 15,000		10 Other liabilities		-
22,934		11 Non-banking asset		-

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Add: Profit for the year	18,423		
	41,357		
Less:Transferred to statutory reserve at 20% on current year's profit	3,685		
		37,672	
TOTALS		40,84,130	40,84,130

Notes: Provision for taxation is added to current and contingency accounts.

(Rs.20,24,422 + 10,000 = Rs.20,34,422)

Illustration - 4

The Trail Balance of Maha Laxmi Bank Ltd. was as follows on 31.3.1989

	Rs.	Rs.
Share Capital		3,00,000
Cash in hand, with Bank	46,350	
Investments	1,94,370	
Gold	1,70,760	
Savings Accounts Balance		7,420
Current Account Ledger Control Account		97,000
Fixed deposits		23,050
Share premium Account		90,000
Statutory Reserve		1,40,000
Silver Bullion	26,620	
Acceptances and endorsements	56,500	56,500
Security deposit of employees		15,000
Buildings	65,000	
Furniture	5,000	
Borrowings from Banks		77,230
Money at call and short notice	26,000	
Advances	2,00,000	
Profit & Loss Account balance		6,500
Bills discounted and purchased	12,500	
Bills for collection	43,500	43,500
Interest	7,950	72,000
Commission, Brokerage		25,300
Discount on bills discounted		42,000
Audit fees	5,000	
Loss on sale of furniture	1,000	
Directors fees	1,200	
Salaries	21,200	
Postage	50	

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Rents received		15,600
Profit on Bullion		1,200
Managing directors remuneration	12,000	
Miscellaneous income		1,200
Loss on the sale of investments	30,000	
Deposits with RBI	75,000	
Branch adjustments	20,000	
Depreciation reserve on Buildings		20,000
Bad debts	25,000	
	10,45,000	10,45,000

The following adjustments are to be made:

1. Provide Rebate on Bills discounted Rs.5,000
2. Accured intest Rs.10,000
3. A claim by employees for Bonus Rs.15,000 is pending award of arbitration.
4. Depreciation on Building amounts Rs.5,000
5. Directors proposed a dividend of 8%.
6. A security of current accounts reveals that, there are some accounts that are over drawn to the extent of 25,000, and the total of the credit balances is Rs.1,22,000/-.

Prepare the Profit and Loss Account for the year ending with 31.3.89 and Balance sheet as on that date, as per the Banking Companies Act.

Solution

Profit and Loss Account of Maha Laxmi Bank Ltd. for the year ended 31.3.89.

EXPENDITURE		INCOME(Less Provision made for Bad debts, and other usual and necessary provisions)	
Interest on deposits	7,950	Interest and discount	64,000
Salaries	21,200	Commission and Brokerage	25,300
Managing Directors remuneration	12,000	Rents	15,600
Directors fees	1,200	Profit on Bullion	1,200
Postage	50	Miscellaneous income	12,700
Auditors fees	5,000		
Depreciation on Buildings	5,000		
Loss on sale of furniture	1,000		
Balance of Profits	65,400		
	1,18,800		1,18,800

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Notes:

		Rs.	Rs.
1	Interest and Discount		
	Interest	72,000	
	Outstanding interest	10,000	
	Discount	42,000	1,24,000
	(–) Loss on sale of investments	30,000	
	Rebate on Bills discounted	5,000	
	Bad debts	25,000	60,000
	Amount credited to P & L Account		64,000

Balance Sheet of Maha Laxmi Bank Ltd. as on 31.3.1989.

	Capital & Liabilities		Rs.		Property and Assets		Rs.
1	Share Capital		3,00,000	1	Cash in hand		46,350
2	Reserve Fund and			2	With Banks		
	Other Reserves			3	Cash with RBI		75,0000
A	Statutory Reserve			4	Money at call and short		26,000
		1,40,000			Notice		
	(+) 20% of current year			5	Investments		
	Profits	13,080	1,53,080		Investments	1,94,370	
	Share Premium		90,000		Gold	1,70,760	3,65,130
3	Deposits and Other			6	Advances (Other than Bad		
	accounts				and doubtful debts for which a		
	Fixed deposits	23,050			provision is made)		
	Savings Bank deposits	7,420			Loans, cash credits	2,25,000	
	Current and	1,22,000			Bills discounted	12,500	2,37,500
	Contingency A/c.		1,52,470	7	Bills for Collection		43,500
4	Borrowings from Other				as per contra		
	Banks		77,230				
5	Bills Payable		--	8	Acceptances and endorsements		
6	Bills for Collection				as per contra		56,500
	as per contra		43,500				
7	Other Liabilities:			9	Buildings		
	Security deposit of				(–) Depreciation		40,000
	employers	15,000		10	Furniture		5,000
	Rebate on bills						
	discounted	5,000					
	proposed dividend	24,000	44,000				
8	Acceptances and endorsements			11	Other Assets		
	as per contra		56,500		Accrued interest		10,000

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9	Profit and Loss A/c.			Branch Adjustment Account	20,000
	Previous Year Balance	6,500		Silver	26,620
	(+) Profit of the year	65,400			
		71,900			
	(-) Transfer to S.Reserve	13,080			
	Proposed dividends	24,000			
		37,080			
			34,820		
10	Contingent Liability				
	Claim for bonus pending arbitration	15,000			
			9,51,600		9,51,600

Notes:

1	Advances		
	Loans, cash credits and overdrafts		2,00,000
	(+) Over drawn current accounts		25,000
	Amount shown in Balance sheet		2,25,000
2	Buildings		
	Amount given in Trial Balance		65,000
	(–) Depreciation Reserve in Buildings	20,000	
	Current year depreciation	5,000	
			25,000
	Amount shown in Balance Sheet		40,000

Illustration - 5

The following Trial Balance was extracted from the books of Hyderabad City Bank Ltd. as on 31.3.90.

	Rs.	Rs.
Share Capital		15,00,000
Statutory Reserve		1,50,000
Cash on hand and with RBI	2,50,000	
Money at call and short Notice	80,000	
Investments	5,60,000	
Interest on loans		3,20,000
Contribution to Provident Fund	25,000	
Depreciation on Building	20,000	
Interest on fixed deposits	60,000	
Interest on cash credits		80,000
Postage and Telegrams	12,000	
Saving Bank deposits		8,20,000
Loans, cash credits, over drafts	26,00,000	
Cash with other banks	1,10,000	
Locker Rent		5,000
Salaries (including 30,000 to General Manager)	1,50,000	

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Audit fees	8,000	
Other Expenses	3,000	
Commission, Exchange, Brokerage		1,50,000
Interest on overdrafts		90,000
Directors fees	15,000	
Discount on Bills discounted		1,20,000
Interest on Saving Bank Accounts	30,000	
Transfer fees		2,000
Legal Expenses	4,000	
Current Accounts		16,25,000
Fixed deposit Accounts		11,25,000
Buildings	8,50,000	
Furniture, Fittings	7,00,000	
Bills discounted and purchases	6,00,000	
unclaimed dividends		13,000
Rebate on Bills discounted		15,000
Accured interest on investments	23,000	
Acceptances and endorsements	3,00,000	3,00,000
Bills payable		1,00,000
Bills for collection	50,000	50,000
Printing and stationery	10,000	
Insurance	5,000	
	64,65,000	64,65,000

You are required to prepare a profit and loss account for the year ended 31.3.90, and a balance sheet as on that date, after considering the following:

1. Provide Rs.25,000 towards provision for Bad and doubtful debts.
2. Provide Rs.40,000 for Income-tax
3. The Market value of the investments is Rs.5,50,000. It is decided to show the investments at their market value.
4. Outstanding Audit fees Rs.2,000/-
5. Depreciate the furniture and fittings at 5%.

Solution

Profit and Loss Account of Hyderabad City Bank Limited for the year ending with 31-3-1990.

Expenditure			Income (Less Provision made for RBD and other usual and necessary provision)	
		Rs.		Rs.
Interest on deposits:			Interest and discount	5,35,000
Interest on Fixed deposits	60,000		commission, Exchange, Brokerage	1,50,000
Interest on Savings Bank A/cs	30,000	90,000	Locker Rent	5,000
			Transfer fees	2,000

Salaries:				
Paid to G.M	30,000			
Paid to others	1,20,000	1,50,000		
Contribution to P.F		25,000		
Directors fees		15,000		
Insurance		5,000		
Legal Expenses		4,000		
Postage and Telegrams		12,000		
Audit fees	8,000			
(+) Outstandidng	2,000	10,000		
Depreciation on:				
Furniture		35,000		
Buildings		20,000		
Printing, stationery		10,000		
Other Expenses		3,000		
Balance of Profit		3,13,000		
		6,92,000		6,92,000

Balance Sheet of Hyderabad city Bank Limited as on 31-3-1990.

Capital & Liabilities		Rs.	Property & Assets	Rs.
I Share Capital		15,00,000	I Cash on hand And and with RBI	2,50,000
II Reserve fund and other reserves:			II Other Banks	1,10,000
Statutory Reserve	1,50,000		III Money at call and short notice	80,000
(+) 20% from current year Profits	62,000		IV Investments (at market value)	5,50,000
		2,12,600	V Advances (Other than Bad and doubtful for which provision is made)	25,75,000
III Deposits and other accounts:			Loans, Cash Credits, overdrafts	
Fixed deposits		11,25,000	Bills discounted	6,00,000
Saving Bank Accounts		8,20,000	VI Bills for collection as per contra	50,000
Current Accounts and contingency Accounts		16,65,000		
IV Bills payable		1,00,000		
V Bills for collection as per contra		50,000		
VI Other Liabilities:				
unclaimed dividends		13,000		
Rebate on Bills discounted		15,000		
Outstanding Audit fees		2,000		
VII Acceptances and endorsements as per contra		3,00,000	VII Acceptances and endorsements as per contra	3,00,000
VIII Profit & Loss Account	3,13,000		VIII Buildings	8,50,000
(-) Transfered to			IX Furniture	7,00,000

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S.Reserve	62,000		(–) Depreciation	35,000	
		2,50,400			6,65,000
			X Other assets		
			accured interest on investment		23,000
		60,53,000			60,53,000

Notes:

1) Interest and discount:

Interest on Loans	3,20,000	
Interest on cash credits	80,000	
Interest on overdrafts	90,000	
Discount on Bills discounted	1,20,000	
		6,10,000
Less:		
Provision for Bad debts	25,000	
Provision for Income Tax	40,000	
Loss due to revaluation of investments of investments	10,000	
		75,000
Amount shown in P & L Account		5,35,000

2) Current Account and other contingency Accounts

Balance in current Accounts	16,25,000
(+) Provision for Income Tax	40,000
Amount shown in Balance Sheet	16,65,000

3) Loans, cash credits and overdrafts:

Amount given in Trial Balance	26,00,000
(–) Provision for bad debts	25,000
Amount shown in Balance Sheet	25,75,000

4) Rebate on Bills discounted & accrued interest on investments given in the Trial Balance should come only once i.e., as a liability and Asset respectively in the Balance Sheet.

26.5 SUMMING UP

The Balance Sheet shows the financial position of the bank on a certain date. The various assets are shown on the right-hand side of the Balance Sheet and the liabilities and capital on the left-hand side. The main difference between the preparation of the final accounts of a Banking company and other companies can be grouped into the following points.

(i) Silent treatment of Bad debts, provision for doubtful debts, provision for Taxation and loss on sale of investments.

(ii) Provision of 20% statutory reserve every year on the currnet year profits before the declaration of dividends.

(iii) Incorporation of particulars of Advances in the Balance Sheet.

26.6 CHECK YOUR PROGRESS : MODEL ANSWERS

No. 1

(a) If it is given in the Trial Balance:
Add silently to current and contingency Accounts.

If it is given in the adjustment:

Less: from Discount and Interest received.

Add: to current and contingency Accounts (No.3).

(b) Deduct 20% on the current year profit (No.9) and Add the same to Reserve Fund (No.2),

(c) (i) Less: from Discount and Interest received.

(ii) Less: from Advances (No.5).

(d) It is Liability under (No.8) and also an asset under (No.7).

26.7 MODEL EXAMINATION QUESTIONS

A. Answer the following in about 30 lines each:

1. What are the special features of banking business?
2. Draw up a proforma balance sheet of a Banking Company with imaginary figures.
3. Draw up a proforma of schedule of Debtors with imaginary figures.

B. Answer the following in about 15 lines each:

1. Explain the Statutory Reserve
2. What are contingent liabilities ?
3. What are the non-banking assets?
4. Explain the following terms.
   (a) Money at call and short notice.
   (b) Cash credits and overdrafts.

PROBLEMS

1. The balances extracted from the books of Indian Banking Corporation Limited on December 31, 1990 were as follows:

	Rs.
Paid up Capital	10,00,000
Local Bills discounted	9,00,000
Reserve Fund	3,85,000
Cash credits and overdrafts	14,00,000
Unclaimed dividends	5,000
Loans	23,00,000

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Current and saving deposits	25,00,000
Furniture	20,000
Fixed Deposits	20,00,000
Profit & Loss (Cr.)	1,10,000
Stamps & Stationery (in hand)	5,000
Cash in hand	2,50,000
Cash at Bank	6,50,000
Investment at cost	4,75,000

Out of the total debts, debts for Rs.2,85,000/- were doubtful and the rest were considered good. Out of the debts considered good, Rs.24,00,000/- were fully secured and for debts amounting to Rs.4,00,000/- (including Rs.1,15,000/- due by a director) the bank held personal securities of one or more persons in addition to the personal security of the debtors and for the rest the bank held no securities other than the debtors personal security.

The directors require the bank's investments to be shown in the balance sheet at market value which is Rs.5,25,000/-

The authorised capital of the bank is Rs.12,00,000/- Prepare balance sheet as on 31-12-1990.

(Balance Sheet total Rs.60,50,000/-)

2. From the following ledger balances of Laxmi Bank Limited, prepare the profit and loss account and balance sheet as on 30th June, 1990.

Share capital 12,500 ordinary share of Rs.100/- each	12,50,000
Reserve fund	6,00,000
Currrent accounts and deposits	77,31,450
Acceptances on behalf of customers	12,00,000
Profit and loss account (balance)	15,300
Interest accured and paid	25,500
Government securities	6,00,000
Other securities	8,25,000
Shares and stock	6,37,500
Current expenditure, salaries, rent etc.	71,250
Amount added to staff retirement fund	3,000
Premises account-amount writen off	22,500
Interest,discount and commission	2,44,500
Cash in hand & with Reserve Bank of India	15,84,750
Money at call and short notice	2,74,250
Bills discounted	3,79,500
Loans and advances	46,65,000
Premises and furniture	3,37,500
Freehold and leasehold property	1,80,000

Make provision for rebate on bills discounted Rs.2,450.

(Profit Rs.1,19,800; Balance sheet total Rs.1,09,19,000/-; Difference in trial Balance Rs.2,35,500/- (Dr.).

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3. The following is the trial balance of Dhanpati Bank Ltd., as on December 31,1990.

	Rs.
Loans, Cash credits and overdrafts	2,85,000
Premises	50,000
Indian Government Securities	4,00,000
Salaries	28,000
General Expenses	27,400
Rent, rates and taxes	2,300
Directors' fee	1,800
Stock of Stationery	8,500
Bills purchased and discount	46,000
Interim dividend paid	17,000
Shares	50,000
Cash in hand and with Reserve Bank	1,93,000
Money at call and short notice	80,000
	11,89,000
Subscribed capital 50,000 equity shares of Rs.10/- each fully paid	5,00,000
Reserve fund	2,50,000
Current deposits	1,00,000
Fixed deposits	1,25,000
Savings Bank deposits	50,000
Profit and Loss account (1.1.1990)	16,000
Interest and discount	1,28,000
Recurring deposits	20,000
	11,89,000

The following information should be considered: (1) Provision for bad and doubtful debts is required amounting to Rs.5,000/-; (2) Interest accrued on investments was Rs.8,000/-; (3) Unexpired discount amounts to Rs.380/-; (4) Interim dividend declared was 4 per cent actual; (5) Endorsement made on behalf of customers totalled Rs.1,15,000/- (6) Authorised capital was 80,000 equity shares of Rs.10/- each (7) Rs.10,000/- were added to the premises during the year. Depreciation at 5 per cent on the opening balance is required and (8) Market value of India Government securities was Rs.3,90,000/-

Prepare profit and loss account for the year ended December 31, 1990 and balance sheet as on that date in the prescribed forms.

(Net profit Rs.69,120/-; Balance Sheet total Rs.12,28,500/-)

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4. The following balances have been extracted from the books of Bharat Commercial Bank Ltd., as on 31st December, 1990. Prepare the relevant Profit and Loss Account and Balance Sheet.

	Rs.		Rs.
Paid up capital	10,00,000	Commissions & Exchange	1,02,225
P& L A/c (Cr.)	40,323	Investments Reserve	35,000
Current A/cs.	34,12,604	Branch Adjustment (Cr.)	36,894
Fixed Deposits	38,95,554	Postage & Telegram	1,153
Saving Bank Deposits	25,68,000	Printing & Stationery	3,390
Directors' fees	4,980	Rent, Taxes & Premium	8,500
Auditors' fees	1,000		
Furniture		Provident Fund Contribution	10,000
(Cost Rs.50,000)	37,280	Salaries	42,150
Interest & Discounts	2,10,223	Unexpired Insurance	437
Stamps in hand	189	Statutory Reserve fund	65,000
Land & Buildings		Legal expenses	1,650
(cost- Rs.3,00,000)	2,05,000	Cash in hand	4,16,324
Deposit with the Reserve		Deposit with other banks	12,05,125
Bank of India	4,00,000	Reserve fund	2,00,000
Book Debts, Cash Credits &		Investments	8,78,125
Overdrafts	70,00,000	Bills discounted	14,00,520
Contingency Reserve	50,000		

The authorised capital of the Bank is Rs.20 lakhs divided into 20,000 shares of Rs.100 each. All shares have been subscribed but only half the face value has been called up. The Bank has accepted on behalf of customers bills worth Rs.2 lakhs against securities of the value of Rs.3 lakhs lodged with the Bank. Depreciation is to be writen off Rs.8,000 from Land and Buildings and Rs.3,500 from funiture. The market value of investments on 31st December, 1990 was Rs.8,40,000; the investments are to be written down to this figure.

Create Provision for Taxation, Rs.1,10,000

(Net Profit Rs.1,15,000; Total of Balance Sheet Rs.1,16,93,375).

5. The following Ledger Balances of Laxmi Bank Limited as at 31st December, 1989 are supplied to you. Prepare Profit and Loss Account and Balance Sheet as per requirements of law:

	Rs.		Rs.
Reserve fund	1,20,000	Constituents liabilities for endors ementand guarantees	57,500
Bad debts written off	12,800	Balance with foreign	
General Expenses	18,200	correspondents	1,20,600
Current Accounts	20,24,500	Bills for collection	1,50,000
Interest paid	16,000	Borrowings from banks	6,48,200
Deposit Accounts	6,92,000	Cash credits and overdrafts	15,45,700
Profit & Loss A/c	22,900	Investments	9,88,200
Bills receivable for collection	1,50,000	Commission	4,500
Discount	24,400	Cash balance in hand	22,500
Endorsements and gurantees	57,500	Bills discounted	6,22,800
Interest earned	55,000	Premises	2,21,700
Balance with Reserve bank	2,03,000	Share capital	2,00,000

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The following further information is provided:

(i) Rebate on bills discounted to be provided Rs.6,400

(ii) The Bank had paid an interim dividend of Rs.20,000 during the year.

(Profit 30,500; B/s Total Rs.39,32,000)

26.8 GLOSSARY

1. **Contingent Liabilities**	:	These are the liabilities which may arise in future on the occurrence of a certain event.
2. **Final Accounts**	:	Banks are required to prepare final accounts for every financial year i.e., 31st March.
3. **Cash Credit**	:	It is an arrangement by which the customer is granted the right to borrow money from time to time upto a certain limit.
4. **Discounting of the Bills**	:	Discounting of a Bill means making the payment of the bill before the maturity date of the bill.
5. **Non-Banking Assets**	:	The assets which are taken by the bank when bank fails to repay the loans.
6. **Bills Payable**	:	These represent bank drafts or telegraphic transfers which are issued by the bank but remianed uncashed on the last date of the finanical year
7. **Branch Adjustments**	:	A Bank having serveral branches will receive periodical statements having debit or credit balances with the Bank. Those statements are called Branch adjustments.

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ANDHRA PRADESH OPEN UNIVERSITY

B.COM. III YEAR

COMMERCE : GROUP-A; COURSE-III

UNDERGRADUATE PROGRAMME

ADVANCED ACCOUNTANCY

SYLLABUS

BLOCK-I : ACCOUNTS FROM INCOMPLETE RECORDS

Unit 1 : Single Entry System
Unit 2 : Capital Comparison Method
Unit 3 : Conversion Method

BLOCK-II : ACCOUNTS OF NON-TRADING ORGANISATIONS

Unit 4 : Accounts of Non-Trading Organisations-I
Unit 5 : Accounts of Non-Trading Organisations-II

BLOCK-III : SELF BALANCING AND SECTIONAL BALANCING

Unit 6 : Self-Balancing and Sectional Balancing-I
Unit 7 : Self-Balancing and Sectional Balancing-II

BLOCK-IV : HIRE-PURCHASE AND INSTALMENT PURCHASE SYSTEM

Unit 8 : Hire-Purchasse and Instalment Purchase Systems - An Introduction
Unit 9 : Hire-Purchase System
Unit 10 : Instalment Purchase System

BLOCK-V : PARTNERSHIP ACCOUNTS

Unit 11 : Partnership Accounts - An Introduction
Unit 12 : Methods of Maintaining Capital Accounts
Unit 13 : Final Accounts
Unit 14 : Admission of a Partner
Unit 15 : Retirement and death of a Partner
Unit 16 : Dissolution of firm
Unit 17 : Insolvency of a Partner
Unit 18 : Sale to a Company

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BLOCK-VI : DEPARTMENTAL ACCOUNTS

Unit 19 : Departmental Accounts-I

Unit 20 : Departmental Accounts-II

BLOCK-VII : BRANCH ACCOUNTS

Unit 21 : Branch Accounts - An Introduction

Unit 22 : Accounts of Dependent Branches (Cash and Credit Sales)

Unit 23 : Accounts of Dependent Branches (including stock and debtors system)

Unit 24 : Accounts of Independent Branches

BLOCK-VIII: BANK ACCOUNTS

Unit 25 : Bank Accounts-I

Unit 26 : Bank Accounts-II

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FACULTY OF COMMERCE

B.Com. III Year (3 Year Degree Course) Examination

GROUP-A : PAPER-III : ADVANCED ACCOUNTS

MODEL QUESTION PAPER

Time 3 Hours *Max.Marks 100*
Min. Marks 35

SECTION A - (Marks 4× 15 = 60)

Answer any FOUR of the following.
Each Question carries 15 marks.
Answer the theory questions in about 30 lines each.

1. Define Capital Income and Revenue Income and explain the accounting differences between them.

2. Distinguish between Hire Purchase and Instalment Purchase Systems.

3. Explain briefly the principle enunciated in Garner *Vs.* Murray decision.

4 Pass necessary adjusting entries in the books of Hyderabad Head office for the following transactions:

   (i) Goods supplied to Vijayawada Branch on 28th December, 85, worth Rs.10,000 were received by the branch on 4th January, 1986.

   (ii) Cash remited by Waltair Branch to the Head office on 29th December, 1985 amounting to Rs.6,000 was received by the Head office on 3rd January, 1986.

   (iii) Goods were supplied by Vijayawada Branch to Waltair Branch under instructions from Head office amounting to Rs.4,000

   (iv) Depreciation at 10% on Vijayawada Branch Furniture worth Rs.5,000 is to be provided. The Branch furniture account is maintained in Head ofifce books.

5. The Balance Sheet of Ramakrishna Mission Library stood as follows on 31st March 1983:

Liabilities	Rs.	*Assets*	Rs.
Outstanding		Cash at Bank	4,000
Creditors for Expenses	700	Subscription due	1,000
Creditors	4,300	Rent receivable	400
Capital Fund	70,000	5% Investements	6,000
		Library Books	20,000
		Furniture	3,500
		Buildings	40,000
		Prepaid Insurance	100
	75,000		75,000

The cash transactions for the year ending 31st March 1984 are as follows:

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Receipts	Rs.	*Payments*	Rs.
To Balance	4,000	By Payments to Creditors	4,300
" Entrance Fees	1,200	" Additions to Library	1,400
" Subscriptions	12,500	" Electric Light	300
" Proceeds from Entertainments	4,500	" Muncipal Taxes	1,100
" Rents	1,500	" Repairs	800
" Interest on Investments	200	" Insurance	350
" Sale of old Newspapers	450	" Electric Installation Expenses	2,000
" Sale of old Furniture	100	" Payments to Creditors for Expenses	700
		" Printing and Stationery	500
		" Sundry Expenses	250
		" Postage	420
		" Subscriptions to periodicals	1,400
		" Investments purchased	3,000
		" Salaries	3,600
		" Balance	4,330
	24,450		24,450

Insurance was prepaid to the extent of Rs. 75 and subscriptions oustanding amounted to Rs. 1,800. Rent receivable is Rs. 300 and Rs. 400 for interest on investments had accrued due. Creditors outstanding for the purchase of Almirah during the year amounted to Rs. 1,500. Also outstanding were salaries Rs. 600 and stationery Rs. 50. Entrance Fees has to be capitalised. Depreciate buildings by 2%, furniture by 10% and library books 10%. Such depreciation to be calculated on the opening balance of the assets in question.

You are required to prepare Income and Expenditure Account for the year as on 31st March 1984.

6. On 1st January 1980, Ram Transport Company bought Trucks from Engineers Ltd. on hire-purchase basis, cash price of the Trucks being Rs. 74,500.

According to the aggreement Rs. 20,000 has to be paid on signing the agreement and the balance to be paid in three yearly instalments of Rs. 20,000 each. Interest to be calculated at the rate of 5% per annum. Trucks to be depreciated at the rate of 20% annualy on diminishing balance of cash value.

Give journal entries, in the books of both the parties, to record the above agreement.

7. Ghanshyam keeps is books by Single Entry System. From the following available information prepare Trading and Profit and Loss Account for the year ended 31st December 1983 and Balance Sheet as on that date:

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CASH BOOK

Receipts–31-12-1983	Rs.	*Payments*–1-1-1983	Rs.
To Debtors	1,25,000	By Bank Overdraft 31-12-1983	20,000
" Sales	75,000	By Interest	500
		" Drawings	10,000
		" Salaries	42,500
		" Expenses	39,500
		" Creditors	75,000
		" Balance C/d – Bank	12,125
		Cash	375
	2,00,000		2,00,000

Position of Assets and Liabilities as on:

	1-1-1983 Rs.	31-12-1983 Rs.
Stock on Hand	45,000	51,100
Creditors	40,000	27,500
Debtors	1,10,000	1,50,000
Premises	75,000	75,000
Furniture	5,000	5,000

Provide 5% interest on capital.
Rs. 3,000 for doubtful debts.
10% depreciation premises and furniture.

8. *A, B* and *C* are partners in a firm. Their Balance Sheet stood as follows as on 1st January 1982:

Liabilities	Rs.	*Assets*	Rs.
Bank Overdraft	30,000	Cash on Hand	10,000
Sundry Creditors	50,000	Sundry Debtors	25,000
Capital Accounts:		Stock-in-Trade	30,000
A	20,000	Furniture	10,000
B	15,000	Buildings	50,000
C	10,000		
	1,25,000		1,25,000

They agreed to admit *D* into partnership and give him a fourth share in future profits, on the following conditions:

(a) Balance Sheet to be revalued as follows: Stock and Furniture to be depreciated by 5%; Buildings to be appreciated by Rs. 10,000; 5% provision to be created for doubtful debts; Provision of Rs. 1,200 towards liability on account of discounted bill to be made.

(b) Firm's goodwill to be valued at Rs. 48,000 of which *D* is to introduce his share in cash.

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(c) *D* to introduce Rs. 15,000 towards his share of capital of which Rs. 10,000 is in cash and balance in the form of two typewriters, each valued at Rs. 2,500.

Prepare necessary accounts to give effect to the above arrangement of admission and prepare Balance Sheet of the firm after *D*'s admission.

SECTION B - (Marks 5× 8 = 40)

SHORT QUESTIONS

Answer any FIVE of the following.
Each Question carries 15 marks.
Answer the theory questions in about 15 lines each.

9. What are points on which provisions are usually made in partnership deed? What legal provisions apply in the absence of partnership deed?

10. Write a short note on different methods, of maintaining branch accounts.

11. Explain the important account books and registers maintained in a bank.

12. Explain insolvency procedure.

13. Explain the lists to be prepared by an insolvent person.

14. From the following prepare Income and Expenditure Account of Bombay Sports Club for the year ended 31st December 1987:

Receipts	Rs.	*Payments*	Rs.
To Balance 1-1-87	300	By Rent	5,200
" Entrance Fees	550	" Stationery, Expenses, etc.	3,068
" Subscriptions, 1986	200	" Wages	5,330
" Subscriptions, 1987	16,900	" Billiards table	3,900
" Subscriptions, 1988	300	" Repairs	806
" Locker Rents	500	" Interest	1,500
" Special subscriptions for Governor's Party	3,450	" Balance 31st Dec. 1987	2,396
	22,200		22,200

Locker rent Rs. 60 referred to 1986 and Rs. 90 is still owing Rent Rs. 1,300 pertained to 1986 and Rs. 1,300 is still due. Stationery expenses etc. Rs. 312 relating to 1986 and Rs. 364 is still owing. Subscriptions unpaid for 1987 Rs. 468.

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15. From the following particulars, prepare Bought Ledger Adjustment Account as it would appear in General Ledger.

		Rs.
1987 March 1	Total creid balances	14,842
31	Total goods purchased during the month	22,359
	Returns outwards	971
	Cash paid to creditors	20,523
	Discount allowed by creditors	980
	Total acceptances given to creditors during the month	10,800

16. *P* and *Q* share profits and losses equally, but by agreement *Q* out of his share pays *P* a salary of Rs. 500 per month. The accounts at 31st December, 1981 show the following results:

Capitals: *P*–Rs. 38,430
Q–Rs. 41,790

Net profit before charging interest on capital Rs. 23,505.

Drawings: *P*–Rs. 7,500
Q–Rs. 10,500

Paid by *Q* to *P* in cash privately on account of salary: Rs. 3,000

After charging 5% interest on capital write up the capital account of each partner at the year end.

17. Gopal commenced business on 1st January 1985 with a capital of Rs. 12,000. He bought furniture for Rs. 1,200 and machinery Rs. 2,000. During the year he withdrew at Rs. 200 per month for private use. He introduced additional capital of Rs. 1,600.

On 31st December 1985 his financial position was as follows: Cash in hand Rs. 300; Cash at bank Rs. 3,200; Sundry debtors Rs. 5,300; Stock-in-Trade Rs. 5,600; Bills receivable Rs. 2,400; Sundry creditors Rs. 800; Outstanding rent Rs. 100. Depreciate furniture and machinery by 10%. Ascertain profit or loss made by Gopal during 1985.

18. From the following information prepare Memorandum Stock-Account of the branch showing balance of stock as on 31st December, 1987:

	Rs.
Stock on 1st January 1987	8,900
Goods sent to branch during the year	64,500
Goods returned by the branch during the year	2,400
Sales during the year: Cash	20,500
Credit	41,600
Goods returned by the customers	1,400
Leakage and spoilage	700

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ANDHRA PRADESH OPEN UNIVERSITY

UNDERGRADUATE COURSE : III YEAR

SUBJECT : COMMERCE

COURSE : ADVANCED ACCOUNTS

ASSIGNMENT - I

N.B.

1. Do not copy the answer directly from any of the books.
2. As far as possible try to answer the questions independently in your own words.
3. If it is necessary to quote from any source, give the correct reference.
4. Use your own foolscap pages for writing the assignment.
5. Leave sufficient margin for the comments of the evaluator.
6. Completion of this assignment normally should not take more than two hours' time.

SECTION - A

Answer the following questions in about 30 lines each

1. Distinguish between Receipts and Payments Account and Income and Expenditure Account.
2. From the following particulars prepare: i) Total Debtors Account, ii) Total Creditors Account, iii) Bills Receivable Account, and iv) Bills Payable Account.

	Rs.
On 1.1.89 :	
Total Debtors	10,000
Total Creditors	3,500
Bills Receivable	4,000
Bills Payable	1,500
Transactions during the year:	
Cash Received from debtors	7,000
Discount allowed to debtors	1,500
Bad debts written off	700
Returns Inward	1,000
Cash Sales	5,000
Cash Purchases	2,000
Cash received against B/R	3,000
Cash paid to suppliers	2,000
Cash paid against B/P	1,000
Discount received from suppliers	500
B/P dishonoured	200
On 31.12.89 :	
Total Debtors	20,000
Total Creditors	10,000
Bills Receivable	5,000
Bills Payable	3,000

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3. *A* purchased a machinery from *B* on hire purchase basis. The cash price of the machinery was Rs. 31,000. The hire purchaser to make payments as under:

	Rs.
On signing the agreement	6,000
First year end	10,000
Second year end	10,000
Third year end	10,000

Make necessary entries in the books of both the parties.

SECTION - B

Answer the following questions in about 15 lines each

1. What do you mean by self-balancing system?

2. Prepare Income and Expenditure Account from the following information for the year ended 31st December, 1989.

Receipts	Rs.	*Payments*	Rs.
To Balance b/d	5,000	By Purchase of Sports material	2,100
" Subscriptions for '88	200	" Salaries	1,000
" Subscriptions for '89	3,000	" Printing & Stationery	200
" Subscriptions for '90	500	" Rent	400
" sale of old furniture	1,000	" Subscriptions to Newspapers	100
" Proceeds from entertainments	3,500	" Purchase of Investments	3,500
		" Balance c/d	6,900
	13,200		13,200

3. From the following particulars, prepare Debtors Ledger Adjustment Account as it would appear in General Ledger.

		Rs.
1989 Jan. 1	Debtors	10,000
31	Credit Sales month	1,00,000
	Cash received from debtors	50,000
	Bad debts written off	500
	Returns Inward	1,000
	Discount allowed	1,500
	Bills Receivable received	5,000
	Bills Receivable dishonoured	1,000
	Interest charged to debtors	500
	Allowances to debtors	300

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UNDERGRADUATE COURSE : III YEAR

SUBJECT : COMMERCE

COURSE : ADVANCED ACCOUNTS

ASSIGNMENT - II

N.B.

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PART - A

Answer the following questions in about 30 lines each.

1. What is partnership deed? What are the contents of it?
2. The following is the Balance Sheet of *A* and *B*

Liabilities		Rs.	*Assets*	Rs.
Creditors		40,000	Bank	20,000
Bills Payable		20,000	Debtors	30,000
Capitals:			Furniture	5,000
A	40,000		Building	65,000
B	20,000	60,000		
		1,20,000		1,20,000

They agreed to admit *C* into partnership on the following conditions:

i. Goowill Account be raised in the books at Rs. 20,000.

ii. Furniture and Building Account be depreciated by 10%.

iii. A Provision for doubtful debts be created at 5% on debtors.

iv. Capital Accounts of all the partners be adjusted on the basis of new partner's share.

v. *C* brings Rs. 20,000 as his share of capital for 1/3rd share in future profits.

Prepare Revaluation Account, Capital Accounts and Balance Sheet of the firm after *C*'s admission.

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3. Raja, Roja and Taneja who were sharing profits and losses in 3:1:1 ratio. Their Balance Sheet as on 31st December 1989 is as follows:

Liabilities	Rs.	*Assets*	Rs.
Bank overdraft	30,000	Cash in hand	1,000
Creditors	20,000	Bills Receivable	2,000
Raja's Capital	18,000	Debtors	23,000
Taneja's Capital	17,000	Stock	25,000
		Plant	20,000
		Goodwill	4,000
		Roja's capital	10,000
	85,000		85,000

The assets realised Rs. 48,000 after paying Rs. 1,000 for realisation expenses. The creditors were paid 70 paise for every rupee of loan. Show the adjustment among the partners assuming that all are insolvent.

PART - B

Answer the following questions in about 15 lines each.

1. What are the features of partnership?
2. *X, Y, Z* are partners sharing profits in 2:2:1 ratio. Their capitals were Rs. 10,000, 12,000 and 6,000 respectively. The profit for the year ended 31st December, 1989 was Rs. 11,000.

   Show the profit sharing:

   i. When interest on capital is calculated at 6%

   ii. When *Y* is paid a salary of Rs. 2,000 p.a.

3. *A, B* and *C* are partners sharing profits in 3:2:1 ratio. Their capitals were Rs. 29,000, Rs. 15,000 and Rs. 10,000. On 1-1-90 *C* retires and the Goodwill is valued at Rs. 18,000. Show the entries when Goodwill Account is raised and written off.

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UNDERGRADUATE COURSE : III YEAR

SUBJECT : COMMERCE

COURSE : ADVANCED ACCOUNTS

ASSIGNMENT - III

N.B.

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PART - A

Answer the following questions in about 30 lines each.

1. What are the special features of Banking business?
2. From the following Trial Balance and adjoined information prepare Departmental Trading and Profit and Loss Account for the year ended 31st December, 1985 and a Balance Sheet as on that date.

TRIAL BALANCE AS ON 31ST DECEMBER, 1985.

	Debit Rs.	Credit Rs.
Stock on 1-1-1985:		
Department A	30,000	
Department B	25,000	
Purchases:		
Department A	70,000	
Department B	40,000	
Wages:		
Department A	18,000	
Department B	12,000	
Sales:		
Department A		1,50,000
Department B		1,00,000
Capital		0,000
Carriage Inwards:		
Department A	1,000	
Department B	2,000	

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Salaries	20,000	
Travelling Expenses	2,000	
Rent and Taxes	8,000	
Insurance	2,400	
Advertisement	600	
General Expenses	6,000	
Cash at Bank	5,000	
Bills receivable	4,000	
Bills payable		8,000
Sundry Creditors		30,000
General Reserve		20,000
Plant and Machinery	50,000	
Furniture and Fittings	10,000	
Sundry Debtors	20,300	
Buildings	30,000	
Printing and Stationery	500	
Discount allowed	1,200	
	3,58,000	3,58,000

Additional information:

a) Stock on 31st December, 1985, Department A Rs. 15,000; Department B Rs. 10,000

b) Wages outstanding: Department A Rs. 800 Department B Rs. 500.

c) Salaries outstanding Rs. 3,000.

d) Taxes prepaid Rs. 500.

e) Write off Bad debts Rs. 300 and make a provision for doubtful debts at 5% on sundry debtors.

f) Depreciate Plant and Machinery at 10% and Buildings at 5%.

All unallocated expenses are to be apportioned on the basis of turnover.

3. From the following particulars relating to Hyderabad Branch for the year ending 31st December, 1985 prepare Hyderabad Branch account in the Head Office Books:

	Rs.
Stock at Branch on 1.1.1985	89.000
Branch Debtors on 1.1.1985	47,000
Petty cash at Branch on 1.1.1985	200
Goods sent to Branch during the year	2,84,000
Cash sales during the year	1,58,000
Credit sales during the year	4,04.000
Goods returned by branch	8,000
Cash received from Debtors	3,79,000
Cash sent to Branch for expenses	90,000
Stock at Branch on 31.12.1985	54,000
Branch Debtors on 31.12.1985	72,000
Petty cash at branch on 31.12.1985	300

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SHORT QUESTIONS

Answer the following questions in about 15 lines each.

1. What do you mean by Deficiency Account? Why is it prepared.

2. Prepare Profit & Loss account for the year ended 31st December, 1981 of Dhana Laxmi Bank Limited from the following particulars.

	Rs.
Interest on Loans	2,50,000
Interest on saving accounts	1,50,000
Interest on cash credits	1,60,000
Interest on Fixed Deposits	1,90,000
Interest on overdrafts	50,000
Amount charged against current accounts	20,000
Rebate on bills discounted	19,000
Salaries and allowances	1,20,000
Discount on bills discounted	40,000
Rent, Taxes, Insurance	5,000
Contribution to Provident Fund	35,000
Commission, Exchange and brokerage	15,000
Managing Director's salary	15,000
Sundry Expenses	10,000

3. What do you mean by Rebate on bills discounted?

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