LESSON - 1

Royalty Accounts - I

1.0 Objectives :

After going through this lesson the student can know what is Royalty ?

Who are parties involved in Royalties agreement ?

What are the different terms used in Royalties ?

How these transactions are recorded in the books of lessee can be learned.

Structure :

1.1 Introduction.

Royalty is a periodical payment, based on output or sale, required to be paid by one person to another in consideration of some special rights acquired e.g. the right to exploit a mine or colliery to publish a book or to manufacture an article under a patent. Royalties arises with the agreement between two parties one is the owner of the asset or the person who has rights over the asset. Other is the person who acquired the right of using it for payment of a Royalty. The person who makes the payment to the owner of the asset in exchange for the right to use his asset is known as 'lessee' and the owner of the asset as lessor or landlord.

The lessee making the payment of royalty treats it as ordinary business expenditure and debits Royalty Account. Royalty Account is a nominal account and is closed at the end of every accounting year by transferring it to profit and loss Account. Strictly speaking, royalty based on output is a part of cost of production and as such should be transferred to Trading account, royalty based on sales is a selling expenditure and as such should be transferred to profit and loss Account

Here the student should note that a lump - sum payment for the outright purchase of a patent, mine or book is not treated as royalty but is a capital expenditure and recorded as a fixed asset.

1.2 Explanation of Terms :

In royalty agreement between the lessor and the lessee, usually contains certain clauses as regards ‘minimum rent’ ‘short working’ and Recoupment of short working. Before going to the Accounting treatment of the transactions relating to Royalties, it is necessary to understand these terms.

1. Minium Rent or Dead Rent or Fixed Rent :

In the early days of business, production or sale of any concern will be very low. Hence, there is ever possibility that the Royalty based on production or sale will also be low in that period. To safe guard the interest of the landlord from the low income and also to guarantee him the receipt of a minium amount in case of low output or sale, the minium Rent clause will be included in the Royalties agreement. It also give incentive to the lessee to increase the production or sales. Thus minium rent may be defined as “The minimum amount which is payable by the lessee to the landlord, irrespective of production or sale” In the presence of minimum rent clause in Royalty agreement actual royalty based on output or sales or minium rent whichever is higher is payable For example; Madhu coal CO has taken a lease of coal mine with a rent of Rs 30,000 a year and with a rate of royalty at Rs 5 per tonne of coal extracted and if the production in the first year is 4000 tonnes and in the second year, 8,000 tonnes then Madhu coal CO will have to pay Rs 30,000 the minimum rent in the first year because the benefit derived by Madhu coal co. is less than the minimum rent agreed upon i.e. 4000 5 5 per tonne. It will pay Rs 40,000 in the second year because the benefit derived (Rs. 5 5 8000) is more than the minium rent.

2. Short working

The excess of minimum rent over actual royalty calculated on the basis of output or sales is termed as short working. In the example cited above, there is a short working of Rs. 1,000 i.e. Rs. 30,000 minimum Rent - Rs 20,000 actual royalty for 4000 tonnes @ Rs 5 per ton.

3. Recouping short workings :

Depending upon the nature of business, It is normally seen that in the first few years, the work does not gather the required momentum because of the absorption of time in preparation for starting the production e.g. installation of machines construction of houses and other buildings etc. or pushing up the sales e.g. Lack of knowledge to the consumers. The short working thus arising cannot be attributed to the lapses on the part of lessee. Keeping this in view royalty agreement may contain a clause that short workings i.e.; the excess amount paid in earlier years, are recoverable by the lessee in subsequent years when royalties are in excess of the minimum rent. This right of getting back the excess payment made in the earlier years is called the right of recoupment of short workings, The right of recoupment of shortworkings can be.

a. Fixed

b. Floating

When the lessor promises to compensate the loss only in first few years, say four to five years, the right is said to be fixed, Any short working arising beyond this period cannot be reimbursed. But when the lessor promises to compensate the loss of any year in the next or subsequent two or three years, then the right is said to be floating because this can be availed of in any year when short working arises.

It the Royalties agreement allowed to recoup the short working then the short workings should be carried forward and shown in the Balance sheet so long as they are recoverable and short workings which could not be recouped should be closed by transferring to the profit and loss Account. If there is no provision in the royalty agreement for recoupment of short workings the same should be transferred to the profit and loss Account in the very year of the short workings.

The short working clause thus may permit the lessee :

a. to carry forward the short workings indefinitely or

b. to set off short workings with in a certain number of years following the year in which the short working occurs; or

c. to set off the short workings only within a certain number of years after the commencement of the lease.

The questions of short working or its recoupment does not arise if the royalty agreement does not contain a clause of minium rent. In such a case, the payment of royalty is simply based on output or sales.

1.3 Lease premium in addition to Royalty :

In some cases the lessee may agree to pay lump - sum to the lessor in addition to royalty. This extra payment in addition to royalty is known as lease premium or goodwill. This is a capital expenditure for the lessee which can be written off every year out of the profit and loss Account during the lease period by some suitable method.

1.4. Accounting treatment :

The accounting treatment has been dealt with in the books of lesser as well as in the books of landlord. Journal entries are given below.

1.5 Accounting Entries in the Books of Lessee :

1. If minimum Rent account is not opened in the books.

   i. When production is less than the minimum rent.

      Royalty account Dr (with actual royalty)

      short working account Dr (with the shortage)

      To Landlord account (with minimum rent)

      (Being minimum rent payable)

ii. When royalty paid :

Land lord account Dr (with minimum rent)

To Back Account

(Being minimum rent paid)

iii. When Royalty is transferred :

Profit and loss account

or

Production account Dr

To Royalty account (with actual Royalty)

(Being Royalty transferred to P&L A/c.)

The debit balance of short working Account will be carried forward and shown as an asset in the Balance sheet till it is recoupable.

2. If minimum Rent account is opened in the books :

i.. Minimum Rent account Dr

To Land lord account.

(Being minimum rent payable to Landlord)

ii Royalties account Dr

short workings account Dr.

To Minimum Rent account.

(Being actual Royalties and short workings recorded)

iii. Landlord account Dr.

To bank Account.

(Being Minimum rent paid).

iv. Profit and loss or production account Dr

To Royalties account.

(Being Royalties amount transferred to P&L A/c.)

These entries will be repeated every year.

When the actual royalty due exceeds the minimum rent. The entries will be :

i. Royalties account Dr

To landlord account

(Being the Royalties payable)

ii. Land lord account Dr

To short workings account

To Bank account

(Being the amount paid after recoupment of short workings.)

iii. Profit and loss (or production) account Dr

To Royalties account

(Being actual Royalties transferred to P&L account)

The debit balance, if any in the short workings account which is no longer recoupable should be written off to profit and loss account with the following entry.

Profit and loss account Dr

To short workings account.

(Being transfer of irrecoverable short workings to P&L A/c)

Minimum rent account is opened only for those years when the actual royalty is less than the minimum rent and short working occurs.

1.6 Illustration I :

The Visu coal co LTD took a lease of mine from M/s C.V.K. Co for a period of 25 years from 1st Jan. 2002 upon the terms of a royalty of 50 praise per tonne of coal raised with the minimum rent of Rs 20,000 and short workings if any, can be recouped within the subsequent three years. The following was the production of coal in the first five years.

Year	Production in tonnes
2002	6,000
2003	36,000
2004	48,000
2005	60,000
2006	64,000

Solution : Before solving the problem a Royalty Table is prepared

Year	Production In tonnes	Royalty Rs.	Minimum Rent Rs.	Short Workings	Surplus	S.W. Recouped	S.W. not recouped	C.V.K. co
2002	6,000	3,000	20,000	17,000	-----	---	-----	20,000
2003	36,000	18,000		2,000	-----	-----	-----	20,000
2004	48,000	24,000		-----	4,000	4,000	-----	20,000
2005	60,000	30,000		------	10,000	10,000	3,000	20,000
2006	64,000	32,000		-----	12,000	2,000	-----	30,000

In the books of visu coal co. Ltd.

1st Method : When there is no 'Minimum rent' Account

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2002	Royalty Account Dr		3,000	
	Short workings Account Dr		17,000	
	To M/s C.V.K. Company		20,000	
	(Being Minimum rent payable as Royalty is less than Minimum rent)			
	M/s C.V.K. Company Account Dr		20,000	
	To Bank account			20,000
	(Being minimum Rent paid)			
	Production Account Dr		3,000	
	To Royalty Account.			3,000
	(Being Royalty transferred to Production Account)		18,000	

2003	Royalty Account Dr	2,000	
	Short working Account Dr. To M/s C.V.K. company		20,000
	(Being Minimum rent payable as		
	Royalty is less than minimum Rent)		
	M/s C.V.K company Account Dr	20,000	
	To Bank Account		1,000
	(Being Minimum rent paid)		
	Production Account Dr	18,000	
	To Royalty Account		18,000
	(Being Royalty transferred to production		
	Account)		
2004	Royalty Account Dr	24,000	
	To short workings Account		
	(Being Royalty payable after		4,000
	deduction of short workings)		
	M/s C.V.K. company Account Dr	20,000	
	To Bank account		20,000
	(Being Minimum rent paid)		
	Production Account Dr	24,000	
	To Royalty Account		24,000
	(Being Royalty transferred to		
	production Account)	30,000	
2005	Royalty Account Dr		10,000
	To. S.W Recouped A/c		20,000
	(Being Royalty payable after		
	deduction of short working)	20,000	

	M/s C.V.K.. company A/c	Dr		
	To Bank A/c			20,000
	(Being Minimum rent paid)			
	Production Account	Dr	30,000	
	P&L Account	Dr	3,000	
	To short working A/c			3,000
	To Royalty Account			30.000
	(Being Royalty & short workings not recouped transferred to Production and P&L A/c respectively)			
2006	Royalties A/c	Dr	32,000	
Dec 31	To short workings A/c.			
	To M/s. C.V.K. Company A/c		2,000	
	(Being Royalties payable after			30,000
	deducting short working)			
Dec 31	M/s. C.V.K company A/c	Dr	32,000	
	To Bank Account			30,000
	(Being Royalties paid)			
Dec 31	Production Account	Dr	32,000	
	To Royalties Account			32,000
	(Being Royalties transferred to Production Account)			

Method II :

With minimum Rent A/c Method : The student should note that minimum rent account is opened for the years when there is short workings i.e, the actual royalty is less than the minimum rent. The payment to landlord is always the Royalty or Minimum Rent whichever is higher. The royalty A/c may also be transferred to profit and loss Account. These points can be learned through the following illustration.

Illustration II :

P.K. Rao took a lease of a mine from P.N Rao for a period of 20 years from 1.1.2000 upon the terms of royalty of Re 1 per each tonne of output with a minimum rent of Rs. 40,000 P.K. Rao had the right of recouping short working during the first Four years. The following were the production.

Year	Out put in tonnes
2000	5,000
2001	24,000
2002	40,000
2003	60,000
2004	75,000

Give necessary journal entries in the books of P.K Rao.

Solution : **Royalty Table** **Min. Rent Rs 40,000**

Year	Output tonnes	Royalty Rs.	S.W Rs.	Surplus Rs	S.W Recouped	S.W. not recouped	P.N.Rao
2000	5,000	5,000	35,000	- - - -	- - - -	- - - - - -	40,000
2001	24,000	24,000	16,000	- - - -	- - -	- - - - -	40,000
2002	40,000	40,000	------	-------	------	-------	40,000
2003	60,000	60,000	- - -- -	20,000	20,000	31,000	40,000
2004	75,000	75,000	------	35,000	-----	-----	75,000

In the books of P.K Rao

Journal entries

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2000	Minimum rent A/c Dr		40,000	
Dec31	To P.N. Rao A/c.			40,000
	(Being Minimum rent payable			
	Royalty Account Dr		5,000	

	Short workings Account	Dr	35,000	
	To minimum rent A/c			40,000
	(Being minimum rent transferred) to Royalties Account & short workings Account)			
	P.N Rao Account	Dr	40,000	
	To Bank Account			40,000
	(Being minimum Rent Paid)			
	P&L Account	Dr	5,000	
	To Royalties Account.			5,000
	(Being Royalties transferred to P&L A/c)			
2001	Minimum rent Account	Dr	40,000	
Dec 31	To P.N. Rao A/c.			40,000
	(Being Minimum rent payable)			
	Royalty Account	Dr	24,000	
2001	Short workings Account	Dr	16,000	
Dec 31	To minimum rent A/c			40,000
	(Being minimum rent transferred) to Royalties Account & short workings Account)			
2001	P.N Rao Account	Dr	40,000	
Dec 31	To Bank Account			40,000
	(Being minimum Rent Paid)			
	P&L and Loss Account	Dr	24,000	
	To Royalties Account.			24,000
	(Being Royalties transferred to P&L A/c)			

2002	Royalties Account	Dr	40,000	
Dec 31	To P.N Rao Account			40,000
	(Being Royalty payable)			
2002	P.N Rao Account	Dr	40,000	
	To Bank A/c			40,000
	(Being Royalty paid)			
2002	Profit & Loss Account	Dr	40,000	
Dec31	To Royalties Account			40,000
	(Being Royalties transferred to Profit & Loss Account)			
2003	Royalties Account	Dr	60,000	
Dec 31	To short working A/c			20,000
	To P.N. Rao A/c			40,000
	(Being Royalties Payable after deducting short workings)			
2003	P.N Rao Account	Dr	40,000	
Dec31	To Bank Account			40,000
	(Being amount paid after deducting short workings)			
2003	Profit and loss Account	Dr	91,000	
Dec31	To Royalties A/c			60,000
	To short workings A/c			31,000
	(Being Royalties and short workings not received transferred to profit and loss Account)			

2004	Royalties Account	Dr	75,000	
Dec31	To P.N. Rao Account			75,000
	(Being Royalties payable)			
2004	P.N. Rao Account	Dr	75,000	
Dec31	To Bank Account			75,000
	(Being Royalty paid)			
2004	Profit and loss Account	Dr	75,000	
Dec31	To Royalty Account			75,000
	(Being Royalties transferred to profit and loss Account)			

Illustration - 3

Saroja owned the patent of an Electric Rice cooker. M/s Jaya prada & company acquired the right to manufacture and sell cookers for six years on the following terms.

a. Jaya prada & co to pay saroja a royalty of Rs 10 for each cooker sold with a minimum annual payment of Rs 1,00,000. Accounts to be settled annually on 31st December.

b. If in any year the royalty calculated on cookers sold amounted to less than Rs 1,00,000 Jaya prada & co have the right to deduct the deficiency from the royalty payable in excess of that sum in two following years.

The number of Rice cookers sold was as follows.

Year	Sales
2004	9,000
2005	9,500
2006	12,000
2007	18,000

you are required to prepare necessary ledger accounts to record the above transactions in the books of M/s Jaya prada & company which are closed annually on 31st December.

Solution : **Royalty Table** **Minimum Rent Rs. 1,00,000**

Year	Sales	Royalty	S.W Rs.	Surplus Rs.	S.W Recouped	S.W.not recouped	Saroja
2004	9,000	90,000	10,000	------	--------	-----	1,00,000
2005 1,00,000	9,500	95,000	5,000	------	--------		-----
2006	12000	1,20,000	-----	20,000	10,000	Nil	1,10,000
2007	18,000	1,80,000	------	80,000	5,000	Nil	1,75,000

Ledger Accounts in the book of Jaya Prada & Co.

Dr **Royalties Account** **Cr**

Date	**Particulars**	**Amount Rs.**	**Date**	**Particulars**	**Amount Rs.**
2004			2004		
Dec 31	To Saroja	90,000	Dec 31	By P & L A/c	90,000
2005			2005		
Dec 31	To Saroja	95,000	Dec 31	By P & L A/c	95,000
2006			2006		
Dec 31	To Saroja	1,20,000	Dec 31	By P & L A/c	1,20,000
2007			2007		
Dec 31	To Saroja	1,80,000	Dec 31	By P & L A/c	1,80,000

Dr **Saroja Account** **Cr**

Date	**Particulars**	**Amount Rs.**	**Date**	**Particulars**	**Amount Rs.**
2004	To Bank A/c	1,00,000	2004	By Royalties A/c	90,000
Dec 31			Dec 31	By Short working	10,000

		1,00,000			1,00,000
2005	To Bank A/c	1,00,000	2005	By Royalties A/c	95,000
Dec 31			Dec 31	By Short working	5,000
		1,00,000			1,00,000
2006	To Short workings	10,000	2006	By Royalties A/c	1,20,000
Dec 31	To Bank A/c	110000	Dec 31		
		1,20,000			1,20,000
2007	To Short workings	5,000	2007		180,000
Dec 31	To Bank	17,5000	Dec 31	By Royalties A/c	180,000
		1,00,000			1,80,000

Dr **Short working Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To saroja A/c	10,000	2004	By Balance c/d	10,000
Dec31			Dec31		
		10,000			10,000
2005					
Jan 1	To Bal b/d	10,000	2005		
Dec 31	To Saroja A/c	5,000	Dec31	By Balance c/d	15,000
		15,000			15,000
2006	To Bal b/d	15,000	2006	By saroja	10,000
				By Bal c/d	5,000
		15,000			15,000
2007	To Bal b/d	5,000	2007		
			Dec31	By saroja	5,000
		5,000			5,000

Illustration : 4

Nalini Ltd gave a lease of a mine to the Rajini mines for a period of 20 years from 1st January 2004 on the following terms and conditions.

1. A royalty of Re 1 per every ton of production payable subject to a minimum rent of Rs. 48,000 per annum.

2. Short working can be recovered during the subsequent two years.

The following details are available from accounting records :

Year	Opening stock in metric tons	Sales in metric tons	Closing stock in metric tons
2004	Nil	24,000	4,000
2005	4000	32,000	8,000
2006	8,000	44,000	4,000
2007	12,000	60,000	8,000

Write up the necessary ledger accounts in the books of mining company .

Solution :

Calculation of production :

Production	=	sales	+	cl.stock - opening stock		
2004	=	24000	+	4000 - Nil	=	28,000 tons
2006	=	32000	+	8000 - 4000	=	36,000 tons
2006	=	44000	+	4000 - 8000	=	40,000 tons
2007	=	60000	+	8000 - 12000	=	54,000 tons

Royalty Table

Minimum Rent Rs. 48,000

Year	Production	Royalty	S.W Rs.	Surplus Rs.	S.W Recouped	S.W.not recouped	Nalini Ltd.
2004	28,000	28,000	20,000	------	--------	-----	48,000
2005 48,000	36,000	36,000	12,000	------	--------		-----
2006	40,000	40,000	8,000	------	-------	20,000	48,000
2007	54,000	54,000	------	6,000	6,000	6,000	48,000

Ledger Accounts

in the books of Rajini Mining Ltd.

Dr Royalties Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Dec31	To Nalini Ltd.	28,000	2004 Dec31	By P & L A/c	28,000
2005 Dec31	To Nalini Ltd	36,000	2005 Dec31	By P & L A/c	36,000
2006 Dec31	To Nalini Ltd	40,000	2006 Dec 31	By P & L A/c	40,000
2007 Dec 31	To Nalini Ltd	54,000	2007 Dec 31	By P & L A/c	54,000

Dr Nalini Ltd Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To Bank A/c	48,000	2004	By Royalty A/c	28,000
Dec31			Dec31	By S.W.A/c	20,000
		48,000			48,000
2005	To Bank A/c	48,000	2005	By Royalty A/c	36,000
Dec31			Dec31	By S.W.A/c	12,000
		48,000			48,000
2006	To Bank A/c	48,000	2004	By Royalty A/c	40,000
Dec31			Dec31	By S.W.A/c	8,000
		48,000			48,000
2007	To S.W.A/c	6,000	2007	By Royalty A/c	54,000
Dec31	To Bank	48,000	Dec31		
		54,000			54,000

Dr Short workings Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To Nalini Ltd.	20,000	2004	By Bal c/d	20,000
Dec31			Dec31		
		20,000			20,000

2005					
Jan 1	To Bal b/d	20,000	2005	By Bal c/d	32,000
Dec31			Dec31		
	To Nalini Ltd.,	12,000			
		32,000			32,000
2006					
Jan 31	To Bal b/d	32,000	2006	By P & L A/c	20,000
Dec31			Dec31	By Bal c/d	20,000
	To Nalini Ltd.,	8,000			
		40,000			40,000
2007	To Bal b/d	20,000	2007	By Nalini & Co	6,000
Jan31			Dec31	By P & L A/c	6,000
				By Bal c/d	8,000
		20,000			20,000
2008	To Bal b/d	8,000			

Strike or lock out :

Due to strike or lock out or natural calamity if the production was stopped in any year which is not in the hands of lessee, in the royalties agreement to reduce the minimum Rent proportionately for the period worked or the actual Royalty calculated on the basis of production or sale may be paid in that particular year. This can be understood with the following illustrations.

Illustration. 5 :

A colliery company took a lease which provided for the payment of royalty at Rs. 2-00 per tonne with a minimum rent of Rs. 34,000 per annum. Short workings if any can be recouped during the subsequent three years.

According to Royalties agreement if in any year the normal rent was not attained due to strike or accident the minimum rent was to be reduced proportionately having regard to the length of stoppage

The out put for the year ended 31 Dec was :

2000	16,000 tonnes
2001	16,500 tonnes
2002	17,000 tonnes
2003	18,000 tonnes
2004	15,000 tonnes
2005	48,000 tonnes

During the year ended 31st Dec 2004 there was a stoppage (due to stike) of Production for three months prepare minimum Rent Account, Royalty Account, landlord's account and short workings account in the ledger of the colliery company.

Solution : **Royalty Table** **Min Rent Rs. 34,000**

Year	Production In tonnes	Royalty Rs.	Short Workings	Surplus Rs.	S.W. Recouped	S.W. not Recouped	Land Lord
2000	16,000	32,000	2,000	- - - -	- - - -	- - - -	34,000
2001	16,500	33,000	1,000	- - - -	- - - -	- - - -	34,000
2002	17,000	34,000	- - - -	- - - -	- - - -	- - - -	34,000
2003	18,000	36,000	- - - -	2,000	2,000	- - - -	34,000
2004	15,000	30,000	- - - -	4,500	1,000	- - - -	29,000
2005	48,000	96,000	- - - -	62,000	- - - -	- - - -	96,000

Minimum Rent during 2004 is reduced Proportionately i.e. 34,000 5 $\frac{9}{12}$ = 2,5500

In the ledger of colliery company

Dr **Royalty A/c** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000		32,000	2000	By P & L A/c	32,000
Dec31	To Minimum Rent A/c		Dec31		
2001			2001	By P & L A/c	33,000
Dec31	To Minimum Rent A/c	33,000	Dec31		
2002			2002	By P & L A/c	34,000
Dec31	To Land lord A/c	34,000	Dec31		
2003	To S.W. A/c.	2,000	2003	By P & L A/c	36,000
Dec31	To Land lord A/c	34,000	Dec31		
		36,000			36,000
2004	To Land lord A/c	29,000	2004	By P & L A/c	30,000
Dec31	To S.W. A/c.	1,000	Dec 31		
		30,000			30,000
2005	To Land lord A/c	96,000	2005	By P & L A/c	96,000
Dec 31			Dec31		

Dr **Short working Account** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000 Dec31	To M. Rent A/c	2,000	2000 Dec31	By Balance c/d	2,000
		2,000			2,000
2001 Jan 1	To Bal c/d	2,000	2001		
Dec 31	To M. Rent A/c	1,000	Dec31	By Balance c/d	3,000
		3,000			3,000
2002 Jan1	To Bal b/d	3,000	2002 Dec31	By Bal c/d	3,000
		3,000			3,000
2003 Jan1	To Bal b/d	3,000	2003 Dec31	Royalty	2,000
				By Balance c/d	1,000
		3,000			3,000
2004 Jan	To Bal b/d		2004		
		1,000	Dec31	By Royalty	1,000

Minimum Rent Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000 Dec31	To Landlord A/c	34,000	2000 Dec31	By Royalty A/c	32,000
				S.W A/c	2000
		34,000			34,000
2001 Dec31	To Landlord A/c	34,000	2001 Dec31	By Royalty A/c	33,000
				By S.W A/c	1,000
		34,000			34,000

Dr **Land lord Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000			2000		
Dec 31	To Bank A/c	34,000	Dec 31	By M.Rent A/c	34,000
2001			2001		
Dec 31	To Bank A/c	34,000	Dec 31	By M.Rent A/c	34,000
2002			2006		
Dec 31	To Bank A/c	34,000	Dec 31	By Royalties A/c	34,000
2003			2003		
Dec31	To S.W. A/c	2,000	Dec31	By Royalties A/c	36,000
	To Bank A/c	34,000			
		36,000			36,000
2004			2004		
Dec31	To S.W A/c	1,000	Dec 31	By Royalty A/c	30,000
	To Bank A/c	29,000			
		30,000			30,000
2005			2005		
Dec31	To Bank A/c	96,000	Dec31	By Royalty A/c	96,000

Illustration : 6

Bihar coal co Ltd. leased a piece of land at a Royalty of Rs 3/- per tonne with a dead rent of Rs. 80,000 per annum. short working can be recouped out of the surplus of next five years. In the event of strike and the minimum rental not being reached, the lease provided that the actual royalties earned for the year discharged all rental obligations for that year.

The royalties payable during the years was as follows :

Year	Royalty payable Rs.
2000	26,000
2001	74,000
2002	90,000
2003	1,12,000
2004	1,40,000
2005	70,000 (strike)
2006	1,30,000

Write up the Minimum rent Account, Royalty account, shortworkings account and landlord account in the books of Bihar coal co Ltd.

Solution : **Royalty Table** **Min Rent rs 80,000**

Year	Royalty Rs.	Short Workings	Surplus Rs.	S.W. Recouped	S.W. not Recouped	landlord
2000	26,000	54,000	- - - -	- - - -	- - - -	80,000
2001	74,000	6,000	- - - -	- - - -	- - - -	80,000
2002	90,000	- - - -	10,000	10,000	- - - -	80,000
2003	1,12,000	- - - -	32,000	32,000	- - - -	80,000
2004	1,40,000	- - - -	60,000	18,000	- - - -	1,22,000
2005	70,000	- - - -	- - - -		- - - -70,000	
2006	1,30,000	- - - -	50,000		- - - -1,30,000	

In the ledger of Bihar Coal company.

Minimum Rent Account **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000 Dec31	To Landlord A/c	80,000	2000 Dec31	By Royalty A/c	26,000
				S.W A/c	54,000
		80,000			80,000
2001 Dec31	To Landlord A/c	80,000	2001 Dec31	By Royalty A/c	74,000
				By S.W A/c	6,000
		80,000			80,000

Dr **Royalties Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000 Dec31	To Minimum Rent A/c	26,000	2000 Dec31	By P & L A/c	26,000
2001 Dec31	To Minimum Rent A/c	74,000	2001 Dec31	By P & L A/c	74,000
2002 Dec31	To Land lord A/c	80,000	2002 Dec31	By P & L A/c	90,000
	To S.W A/c	10,000			
		90,000			90,000
2003 Dec31	To Land lord A/c	80,000	2003 Dec 31	By P & L A/c	112,000
	To S.W A/c	32,000			

		112,000			112,000
2004			2004		
Dec31	To Land lord A/c	112,000	Dec31	By P & L A/c	140,000
	To S.W. A/c	18,000			
		140,000			140,000
2005		70,000	2004		70,000
Dec31	To Land lord A/c	70,000	Dec31	By P & L A/c	70,000
2006		1,30,000	2006		1,30,000
Dec31	To Land lord A/c	130,000	Dec 31	By P & L A/c	130,000

Dr **Short workings Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000	To M. Rent A/c	54,000	2000	By Balance c/d	54,000
Dec31			Dec31		
		54,000			54,000
2001					
Jan 1	To Bal c/d	54,000	2001		
Dec 31	To M. Rent A/c	6,000	Dec31	By Balance c/d	60,000
		60,000			60,000
2002			2002	By Royalty A/c	10,000
Jan1	To Bal b/d	60,000	Dec31	By Bal c/d	50,000
		60,000			60,000
2003					
Jan1	To Bal b/d	50,000	2003		
			Dec31	To Royalty A/c	32,000
				By Balance c/d	18,000
		50,000			50,000
2004					
Jan1	To Bal b/d	18,000	2004		
			Dec31	By Royalty A/c	18,000
		18,000			18,000

Dr **Land Lord Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000			2000		
Dec 31	To Bank A/c	80,000	Dec 31	By M.Rent A/c	80,000
2001			2001		
Dec 31	To Bank A/c	80,000	Dec 31	By M.Rent A/c	80,000
2002	To S.W A/c	10,000	2002	By Royalty A/c	90,000
Dec 31	To Bank A/c	80,000	Dec 31		
		90,000			90,000
2003	To S.W A/c	32,000	2003		
Dec31	To Bank A/c	80,000	Dec31	By Royalys A/c	1,12,000
		1,12,000			1,12,000
2004			2004		
Dec31	To S.W A/c	18,000	Dec 31	By Royalty A/c	1,40,000
	To Bank A/c	1,12,000			
		1,40,000			1,40,000
2005			2005		
Dec31	To Bank A/c	70,000	Dec31	By Royalty A/c	70,000
2006			2006		
Dec31	To Bank A/c	1,30,000	Dec31	By Royalty A/c	1,30,000

1.7 Summary :

Royalty is a periodical payment, based on output or sale, required to be made by one person to another in consideration of some special rights acquired. In royalties agreement there will be two parties 1. lessee 2. Land lord. Minimum rent is the amount payble to the land lord irrespective of production or sale. If the Minimum rent is more than the actual Royalties then the diffrence is Known as short workings. these short working can be recouped out of the surplus of the subsequent years, this is known as recoumpment of short workings. Recoupment may be allowed for a fixed period from the date of agreement or it may be for certain years from the year in which short workings arised. short workings not recouped is a loss and should be transferred to profit and loss account in the books of lessee. In case of strike the minimum rent is reduced in the proportion of days worked or actual royalties may discharge the liability.

1.8 Questions :

1. What is meant by Royalties ?
2. What is Royalty? Explain briefly who will pay the Royalty to whom ?

3. Explain Minimum rent.
4. Explain short workings.
5. How can be short workings recouped ?

1.9 Excercises :

1. On 1st January 2002 chittaranjan collieries Ltd. leased a piece of land agreeing to pay therefore a minium rent of Rs 2000 in the first year Rs 4,000 in the second year and there after Rs 6000 per annum merging into a royarly of 40 paise per tonne with power to recoup short workings over the first three years only, the output for four years starting from 2002 - Dec 31, were as follows. 2002 - 1,000; 2003 - 10,000; 2004 - 18,000; 2005 - 20,000 tonnes.

   Record these transactions in the ledger of the company.

2. A colliery is leased to National coal syndicate on a royalty of Re 1 per tonne on the output. A minimum rent of Rs 16,000 a year and allowances for short working porovided in the lease as he can deduct it in the first three years. the coal actually raised is as follows.

Year	Output Tonnes
1	8,000
2	10,000
3	18,000
4	28,000
5	34,000

   Draw up Royalty account land lords Account shortworking Account. Minimum rent account in the books of the syndicated.

3. Sri viswanath wrote a book on Accountancy and got it published with Maruthi publications on the following conditions.

   a. Royalty payable is Rs.20 for copy sold.

   b. Minimum rent payble each year Rs 60,000

   c. short working can be recorded in the first three years of the agreement other details were

Year	No.of copies	Unsold copies,
2003	8,800	800
2004	12,000	1,600
2005	20,000	3,200
2006	28,000	4,000
2007	32,000	5,200

   prepare necessary Accounts in the books of the publisher for the above period.

4. Venkat Ltd., took a mine on lease from suraj on a Royalty of Rs. 2 per tonne with a minimum rent of Rupees 40,000 per year.

   Each years excess of minimum rent over Royalties is recoverable out of the Royalties of next year only. In the event of strike and minium rent not being reached the lease provided that the acual Royalties.earned for the year would be the full Royalty obligation for the year.

The results of the working were as follows.

Year	Actual Royalty
	Rs
1st year	Nil
2nd year	48,000
3rd year	32,000 (strike)
4th year	36,000

Show Royalties Account short workings Account and Suraj Account in the books of Venkat Ltd.

5. Assam Tea Co., took a lease for 10 years on a tea estate, royalty being Rs 1,50 per every KG of tea leaves produced. Minimum rent per annum Rs 31,000. short workings are to be recouped in the next 2 years when the production is distrupted due to any reason, the minimum rent can be reduced to 60%. Production for the first six years was as follows :

Year	Production
	K.G.S
1.	10,000
2.	12,000
3.	28,000
4.	25,000
5.	50,000
6.	15,000

6th year production was reduced because of labour problems. show the necessary accounts in the books of Assam tea Co.

6. Gangadhar took a lease of a coal mine from the landlord on the condition that for every ton of coal raised the Royalty being Re 1 with a minimum rent of Rs 16,000 per annum. The shortworkings if any should be recouped in the next year only. Production was

2000 - 4000 tons 2001 - 20,000 tons,

2002 - 40,000 tons and 2003 - 64,000 tons,

2004 - 70,000 tons and 2005 - 72,000 tons.

Journalise the above transactions in the books of Gangadhar and also show minimum Rent Account.

7. Mr. Prasad wrote a book on cost Accounts and get it published with Everest publishers on the following terms :

a. Minimum rent payable is Rs 20 per copy sold.

b. shortworkings can be recouped in the first three years of agreement. other details were :

Year	M. Rent	Actual Royalty
1	25,000	22,500
2	30,000	27,500
3	35,000	32,500

4	40,000	45,000
5	45,000	50,000
6	50,000	60,000

The deficiency of any year is to be set off against excess payable within the next two years. give Journal entries in the books of X

8. Sri Krishna company took a coal mine on 1-1- 2002 on lease from Rukmini for a period of 20 years. The company agreed to pay Rs 2 per ton with a minimum rent of Rs 50,000. The short workings can be recouped under the agreement during the first five years but on the conditions that only 50% of Royalty in excess of minimum rent can be used for the recoupment of shortworkings. The output of coal for the first five years was 18000, 24,000, 30,000. 40,000 and 48,000. tones respectively.

Prepare necessary accounts in the books of sri krisha company.

9. On 1st January 2002 the Gudur mines leased some land for a minimum rent of Rs 60,000 for the first year Rs 65,000 for the second year and Rs 1,20,000 per annum there after merging into a royalty of Re.1/- per ton with power to recoup short workings over two years of such short working. The outputs were as under.

Year	Output
2002	50,000
2003	90,000
2004	1,30,000
2005	1,70,000
2006	2,00,000
2007	2,50,000

Show the accounts as would appear in the books of Gudur mines.

10. Balaram collieries Co extracted coal under a lease with the following terms; Minimum rent Rs 70,000. Royalty Rs. 2/- Each years short workings are recoverable during the subsequent three years. In the event of strike, if minium rent was not attained, the minium rent was to be regarded as having to the length of the stopage. Out put was as follows.

Year	Out put	Year	Output
1	20,000	4	110,000
2	50,000	5	8,40,000
3	80,000	6	1,70,000

During 5th year there was a strike lasting for 4 Months, prepare short workings A/c, Royalty A/c in the books of BalaRam collieries Co.

1.10 SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal
Financial Accountancy : Jain and Narang
Financial Accountancy : R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda

LESSON - 2

ROYALTY - II

2.0. Objectives :

In the previous lesson the student learned what is Royalty and how these transactions are recorded in the books of lessee. After going through this chapter you can learn how the transactions of royalties are recorded in the books of land lord ? What is sublease ?

Structure :

2.1. Introduction :

In Royalty agreement there must be two parties, one, the owner of an Asset or the person who hade the actual right over the Asset known as Land lord, other person is one who acquires this right of using the Asset and pays some amount as royalty, calculated on the basis of production or sale is known as lessee. In this lesson we will see how the transactions of Royalty have been recorded in the books of Land lord.

2.2. Accounting treatment :

In the books of Landlord :

Royalty receivable is an income to the land lord so Royalty account is credited with the amount.

i) When actual Royalty is less than minimum rent :

Lessee account Dr

To Royalty receivable Account

To short workings suspense Account

(Being minimum rent receivable)

---

ii) When amount received :

Bank Account Dr

To Lessee Account

(Being minimum rent received)

---

iii) To transfer royalty to P & L A/c

Royalty receivable Account Dr

To Profit & Loss Account A/c

(Being royalty transferred to P & L A/c)

2. When actual Royalty is more than minimum rent and if short working recouped.

i) Lessee Account Dr

Short working suspense Account Dr

To Royalty Receivable Account

(Being the amount receivable after deducting short workings)

ii) Bank Account Dr

To Lessee Account

(Being the amount received)

iii) Transfer royalty to P & L A/c

Royalty Receivable Account Dr

To Profit and Loss Account

(Being Royalty transferred to P & L A/c)

3. When short workings are transferred on the expiry of the right of recoupment.

Short workings suspense Account Dr

To Profit and Loss Account

(Being short workings transferred to P & L A/c)

2.3. Illustration I

Mr. Prabhakar who wrote a text book in physics gave the right of publishing the book to Sultan Chand & Sons. The royalty Rs.2 per every book sold. Minimum Rent is Rs.1,50,000/- per annum. Short workings, if any can be recouped with in the first five years of the lease. The sales were as follows :

Year	Sales
1	10,000
2	48,000
3	80,000
4	1,20,000
5	1,20,000

Write up the necessary journal entries in the books of Mr. Prabhakar.

Solution :

Before solving the problem we have to prepare a Royalties table.

Royalty Table **M.Rent Rs.1,50,000/-**

Year	Sales	Royalty	S.w.sug Suspense	Surplus Rs.	S.W. Recouped	S.W. not Recouped	Sultan Chand
	Rs.	Rs	Rs.				
1	10,000	20,000	1,30,000	-	-	-	1,50,000
2	48,000	96,000	54,000	-	-	-	1,50,000

3	80,000	1,60,000	-	10,000	10,000	-	1,50,000
4	1,20,000	2,40,000	-	90,000	90,000	-	1,50,000
5	1,20,000	2,40,000	-	90,000	84,000	-	1,56,000

In the books of Mr. Prabhakar (Land Lord)

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
Ist Year	Sultan chand & Co Account	Dr		1,50,000	
	To Royalty receivable A/c				20,000
	To S.W. Suspense A/c				1,30,000
	(Being minimum rent receivable)				
	Bank Account	Dr		1,50,000	
	To Sultan chand & Co A/c				1,50,000
	(Being Minimum Rent received)				
	Royalty receivable A/c	Dr		1,50,000	
	To Profit & Loss A/c				1,50,000
	(Being Royalty transferred to P & L A/c)				
2nd Year	Sultan chand & Co Account	Dr		1,50,000	
	To Royalty receivable A/c				96,000
	To S.W. Suspense A/c				54,000
	(Being minimum rent receivable)				
	Bank Account	Dr		1,50,000	
	To Sultan chand & Co A/c				1,50,000
	(Being Minimum Rent received)				
	Royalty receivable A/c	Dr		96,000	
	To Profit & Loss A/c				96,000
	(Being Royalty transferred to P & L A/c)				
3rd year					
	Sultan chand & Co Account	Dr		1,50,000	
	Short workings suspense Account	Dr		10,000	
	To Royalty receivable A/c				1,60,000
	(Being Royalty receivable)				
	Bank Account	Dr		1,50,000	
	To Sultan chand & Co A/c				1,50,000
	(Being Royalty received)				
	Royalty receivable A/c	Dr		1,60,000	
	To Profit & Loss A/c				1,60,000
	(Being Royalty Receivable transferred to P & L A/c)				

4th Year			
	Sultan chand & Co Account Dr	1,50,000	
	Short workings suspense Account Dr	90,000	
	To Royalties receivable A/c		2,40,000
	(Being Royalty receivable)		
	Bank Account Dr	1,50,000	
	To Sultan chand & Co A/c		1,50,000
	(Being Royalty received)		
	Royalty receivable A/c Dr	2,40,000	
	To Profit & Loss A/c		2,40,000
	(Being Royalty Receivable transferred to P & L A/c)		
5th Year			
	Sultan chand & Co Account Dr	1,56,000	
	Short workings suspense Account Dr	84,000	
	To Royalty receivable A/c		2,40,000
	(Being Royalty receivable)		
	Bank Account Dr	1,56,000	
	To Sultan chand & Co A/c		1,56,000
	(Being Royalty received)		
	Royalty receivable A/c Dr	2,40,000	
	To Profit & Loss A/c		2,40,000
	(Being Royalty Receivable transferred to P & L A/c)		

Illustration -2

A took a lease of coal mine from S on a roylty of Rs.10 per tonne raised. The output was as under.

Ist year	10,000
2nd Year	16,000
3rd Year	20,000
4th year	16,000

Minimum rent was Rs.1,50,000 per annum. Short workings can be recouped in the first two years of the lease agreement.

Prepare necessary ledger accounts in the books of S, Land lord.

Solution : In the books of S.

Royalty Receivable Table M. Rent Rs.1,50,000

Year	Sales	Royalty	S.w.sus. Rs.	Surplus Rs.	S.W. Recouped	S.W. not Recouped	Sultan Chand
1.	10,000	1,00,000	50,000	-	-	-	1,50,000
2.	16,000	1,60,000	-	10,000	10,000	40,000	1,50,000
3.	20,000	2,00,000	-	50,000	-	-	2,00,000
4.	16,000	1,60,000	-	10,000	-	-	1,60,000

Ledger

Royalties Received Account

Dr. Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
Ist Year	To P & L A/c	1,00,000	Ist Year	By A's A/c	1,00,000
2nd Year	To P & L A/c	1,60,000	2ndYear	By A's A/c	1,50,000
				By S.W. Suspense	10,000
		1,60,000			**1,60,000**
3rd Year	To P & L A/c	2,00,000	3rdYear	By A's A/c	2,00,000
4th Year	To P & L A/c	1,60,000	4thYear	By A's A/c	1,60,000

Short workings suspense account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
Ist Year	To Bal c/d	50,000	Ist Year	By A's A/c	50,000
		50,000			**50,000**
2nd Year	To Royalty Receivable				
	A/c To P & L A/c	10,000	2nd	By Bal.b/d	50,000
		40,000			
		50,000			**50,000**

A's Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
Ist Yr	To Royalty Receivable A/c	1,00,000	Ist Year	By Bank A/c	1,50,000
	To S.W. suspense A/c	50,000			
		1,50,000			**1,50,000**
2nd Yr	To Royalty Receivable A/c	1,50,000	2 year	By Bank A/c	1,50,000
		1,50,000			**1,50,000**
3rd Yr	To Royalty Receivable A/c	2,00,000	3 year	By Bank A/c	2,00,000
		2,00,000			**2,00,000**
4th Yr	To Royalty Receivable A/c	1,60,000	2 year	By Bank A/c	1,60,000
		1,60,000			**1,60,000**

2.4. Sub - lease :

Sometimes the tenant or lessee transfers a part of the right of producing an article or publishing a book or any other type of right acquired by him to sub-tenant or sub - lessee. In such a case the lessee assumes the position of a land lord to the sub-lessee. That means he acts dual role i.e. Lessee to the original landlord and landlord to the sub-lessee. This type of arrangement results in three parties 1. Land Lord, 2. Lessee, 3. Sub -Lessee. The accounting treatment in this case is as follows ;

2.5. Accounting treatment :

1. In the books of original owner of the right : His capacity is that of the landlord and the accounting entries are done exactly in the way explained earlier in this lesson.
2. In the books of the tenant : The tenant of the original Lessee has two capacities i.e.when looked from the point of view of original owner he stands in the capacity of a tenant and when looked from the point of view of subtenant his position is equal to that of owner. Thus, in the books of tenant two sets of entries are made. First from the point of view of lessee and secondly from the point of view of landlord.
3. In the books of sub-tenant, in this case, entries are made from the view of lessee which is explained in the previous chapter.

2.6. In the books of Lessee Accounting treatment :

Lessee prepares two accounts for royalties one for royalty payable and the other for royalty receivable. While calculating royalty payable to the land lord it should be calculated on the production or sale of both tenant and sub-tenant.

Royalties payable account is debited with the total amount of royalty payable to the landlord and is credited with the royalties earned on the grant of sub-lease. The balance of royalties payable account is transferred to production or profit and loss account.

Royalty receivable account is credited with the amount of royalty earned and debited with the amount of royalty payable on such production to the original landlord. The balance of this account is transferred to profit and loss account.

At this level the student must note that the rate of royalty is always higher is sub-lease when compared to original lease.

In case of short workings also he has to prepare a short workings account to show the working between the landlord and tenant, and a short workings suspense account for showing the short working between the tenant and sub-tenant.

All these things can be understood with the following illustration.

Illustration 3 :

On Ist January 2001, Mr. Mahati obtained a mining lease and from that date he sub-leased a part of the mine to Mr. Tumbur. Prepare ledger accounts in the books of Mr. Mahati from the following data.

Year	Output mahati	Ouput Tumbur
2001	4,000 tonnes	2,000 tonnes

2002	5,500 tonnes	3,500 tonnes
2003	7,000 tonnes	5,000 tonnes
2004	8,500 tonnes	6,500 tonnes
2005	10,000 tonnes	8,000 tonnes
2006	12,000 tonnes	9,000 tonnes
Royalty per tonne	Rs.2	Rs.3

	Mahati	Tumbur
Minimum Rent per annum	Rs.20,000	Rs.15,000
Short workings recoverable first	3 years	2 years

Solution

Royalty payable M.Rent Rs.20,000

Year	Total out put in tonnes	Royalty Rs.	S.W. Rs.	Surplus Rs	S.W. recouped Rs.	S.W.not recouped Rs.	Land Lord Rs.
2001	6,000	12,000	8,000	-	-	-	20,000
2002	9,000	18,000	2,000	-	-		20,000
2003	12,000	24,000	---	4,000	4,000	6,000	20,000
2004	15,000	30,000	-	10,000	-	-	30,000
2005	18,000	36,000	-	16,000	-	-	30,000
2006	21,000	42,000		22,000	-	-	42,000

Royalty Receivable Table M.Rent Rs.15,000

Year	Output	Royalty Rs.	S.W. Rs.	Surplus Rs.	S.W. recouped Rs.	S.W. not Recouped Rs.	Tumbur Rs.
2001	2,000	6,000	9,000	-	-	-	15,000
2002	3,500	10,500	4,500	-	-	13,500	15,000
2003	5,000	15,000	-	-	-	-	15,000
2004	6,500	19,500	-	4,500	-	-	19,500
2005	8,000	24,000	-	9,000	-	-	24,000
2006	9,000	27,000	-	12,000	-	-	27,000

Ledger

IN THE BOOKS OF MAHATI

Dr. **Royalty Payable A/c** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2001	To Land Lord	12,000	2001	By R. Receivable A/c	4,000
				By Production A/c	8,000
		12,000			**12,000**
2002	To Land Lord	18,000	2002	By R. Receivable A/c	7,000
				By Production A/c	11,000
		18,000			**18,000**
2003	To Land Lord	24,000	2003	By R. Receivable A/c	10,000
				By Production A/c	14,000
		24,000			**24,000**
2004	To Land Lord	30,000	2004	By R. Receivable A/c	13,000
				By Production A/c	17,000
		30,000			**30,000**
2005	To Land Lord	36,000	2005	By R. Receivable A/c	16,000
				By Production A/c	20,000
		36,000			**36,000**
2006	To Land Lord	42,000	2006	By R. Receivable A/c	18,000
				By Production A/c	24,000
		42,000			**42,000**

Royalty Receivable Account

Date		Particulars	Amount Rs.	Date	Particulars	Amount Rs
2001	To	Royalty Payable	4,000	2001	By Tumbur A/c	6,000
	To	P & L A/c	2,000			
			6,000			**6,000**
2002	To	Royalty Payable	7,000	2002	By Tumbur A/c	10,500
	To	P & L A/c	3,500			
			10,500			**10,500**

2003	To	Royalty Payable	10,000	2003	By Tumbur A/c		15,000
	To	P & L A/c	5,000				
			15,000				**15,000**
2004	To	Royalty Payable	13,000	2004	By Tumbur A/c		19,500
	To	P & L A/c	6,500				
			19,500				**19,500**
2005	To	Royalty Payable	16,000	2005	By Tumbur A/c		24,000
	To	P & L A/c	8,000				
			24,000				**24,000**
2006	To	Royalty Payable	18,000	2006	By Tumbur A/c		27,000
	To	P & L A/c	9,000				
			27,000				**27,000**

Dr. **Short workings Account** Cr.

Date	**Particulars**		**Amount Rs.**	**Date**	**Particulars**		**Amount Rs**
2001	To	Land Lord	8,000	2001	By	Balance c/d	8,000
			8,000				**8,000**
2002	To	Bal.b/d	8,000	2002	By	Balance c/d	10,000
	To	Land lord	2,000				
			10,000				**10,000**
2003	To	Bal b/d	10,000	2003	By Land Lord A/c		4,000
					By	P & L	6,000
			10,000				**10,000**

Dr. **Short working suspense Account** Cr

Date	**Particulars**		**Amount Rs.**	**Date**	**Particulars**		**Amount Rs**
2001	To	Bal c/d	9,000	2001	By	Tumbur	9,000
			9,000				**9,000**
2002	To	Bal c/d	13,500	2001	By	Bal b/d	9,000
					By	Tumbur	4,500
			13,500				**13,500**
2003	To Profit & Loss A/c		13,500	2003	By	Bal b/d	13,500
			13,500				**13,500**

Dr. **Land Lord Account** Cr.

Date	Particulars		Amount Rs.	Date	Particulars		Amount Rs
2001	To	Bank	20,000	2001	By	R. Payable A/c	12,000
					By	S.Workings A/c	8,000
			20,000				**20,000**
2002	To	Bank	20,000	2002	By	R. Payable A/c	18,000
					By	S.Workings A/c	2,000
			20,000				**20,000**
2003	To	Short working	4,000	2003	By	R. Payable A/c	24,000
	To	Bank A/c	20,000				
			24,000				**24,000**
2004	To	Bank	30,000	2004	By	R. Payable A/c	30,000
			30,000				**30,000**
2005	To	Bank	36,000	2005	By	R. Payable A/c	36,000
			36,000				**36,000**
2006	To	Bank	42,000	2006	By	R. Payable A/c	32,000
			42,000				**42,000**

Dr. **Tumbur (Sub-Tenant) Account** Cr.

Date	Particulars		Amount Rs.	Date	Particulars		Amount Rs
2001	To	Royalty		2001	By	Bank A/c	15,000
		Receivable A/c	6,000				
	To	S.W. Suspense	9,000				
			15,000				**15,000**
2002	To	Royalty		2002	By	Bank A/c	15,000
		Receivable A/c	10,500				
	To	S.W. Suspense	4,500				
			15,000				**15,000**
2003	To	Royalty		2003	By	Bank A/c	15,000
		Receivable A/c	15,000				
			15,000				**15,000**

2004	To	Royalty Receivable A/c	19,500	2004	By	Bank A/c	19,500
			19,500				**19,500**
2005	To	Royalty Receivable A/c	24,000	2005	By	Bank A/c	24,000
			24,000				**24,000**
2006	To	Royalty Receivable A/c	27,000	2006	By	Bank A/c	27,000
			27,000				**27,000**

2.7. Summary :

The person who had the actual right over the Asset is known as Landlord. Sometimes the lessee transfers a part of the right to an other person at a higher rate of royalty. This is known as sub-lease. In case of sub-lease the tenant plays dual role i.e.as tenant to the landlord and as landlord to the sub-tenant.

2.8. Self Assessment Questions :

1. Explain sub-lease agreement
2. What is short workings suspense Account ? When it is prepared ?
3. Explain the status of the original lessee on subletting.

2.9 Exercises :

Dheeraj Ltd leased a property from Bhaskar at a royalty of Rs.1.50 per ton with a minimum rent of Rs.10,000 p.a. Short workings can be recouped with in the first three years. Due to any reason production stopped and the minimum rental value not being reached the lease provide that the actual royalties earned for that year discharge all rental obligation for the year.

The results of the working of the property are given below

Year	Actual Royalties Rs
2001	2000
2002	2500
2003	4,000
2004	10,000
2005	11,500
2006	13,000
2007	5,000 (Strike)

Write the necessary ledger accounts in he books of Bhaskar.

2. Bharat Mining company Ltd. takes a lease of coal mine for 10 years from 1-1-2000 on a minimum rent of Rs.24,000 p.a. The Royalty is Rs.1 per tonne of coal raised. Short workings can be recouped during the first three years of lease only. The company closes books on 31st Dec each year. Coal raised is as follows

2000	12000 tonnes
2001	16,000 tonnes
2002	20,000 tonnes
2003	12,000 tonnes
2004	14,000 tonnes
2005	18,000 tonnes
2006	25,000 tonnes

Prepare necessary ledger accounts in the books of land lord.

3. Srinidhi coal limited took a piece of land on a minimum rent of Rs.6000 in the first year, Rs.12,000 in the second years merging into a royalty of Rs.3 per ton of coal raised with power to recoup short workings during the first three years only. The annul output for four years were as follows. 1 Year 1000 tonnes 2nd year 2000 tons 3rd year 3000 tonnes and 4th year 4000 tonnes show necessary ledger accounts in the books of Landlord.

4. Singareni coal Co. Ltd. obtained the lease of a coal field for 99 years from Mr. Sarma on the following terms from Ist January 2000.

1. Royalty will be Rs.2 per tonne of coal raised
2. Minimum rent will be Rs.20,000 for the first year with an annual increase of Rs.1,000 till it reaches Rs.25,000
3. Short workings if any are recoverable only with in the first three years.

The coal raised by mining company is as under.

2000	-	2000 tonnes
2001	-	4000 tonnes
2002	-	6000 tonnes
2003	-	8,000 tonnes
2004	-	10,000 tonnes

Show the necessary ledger account in the books of Mr. Sarma.

5. A colliery company took the lease of a coal field on a royalty of Rs.3 per ton raised with a minimum rent of Rs.30,000 and power to recoup short workings during the first four years of the lease. With the information provided prepare Landlord A/c

Year	Out put in tonnes
2000	2,000
2001	3,000
2002	5,000
2003	6,000
2004	7,500
2005	9,000
2006	10,000

6. Bihar Coal Co is landlord of a mine leased on a royalty of Re 1 per tonne of coal raised with a minimum rent of Rs 18,000 per annum and a power to recoup short workings during the first five years of lease. The output for the first five years was as follows.

Year	Tonnes
1	7,000
2	10,000
3	20,000
4	25,000
5	27,500

Write up the necessary ledger Accounts in the books of coal company

7. Gangadhar and co took a lease of coal mine from the landlord on the condition that for every ton of coal raised the Royalty being Re 1 with a minimum rent of Rs 80,000 per annum. The short working if any should be received in the next year only.

Out of this Gangadhar leased a piece of land to Mr. Visweswar on the condition that for every ton of coal raised the Royalty being Rs 2 with a minimum rent of Rs 40,000 per annum. The short working if any should be recouped in the first there years of agreement. Production was as follows.

Year	Gangadhar in tonnes	Visweswar in tones
2000	35,000	15,000
2001	45,000	25,000
2002	60,000	40,000
2003	75,000	50,000

Show the necessary ledger accounts in the books of landlord and Gangadhar to record the above transactions

8. A owned certain patent rights. He granted a licence to B to use such rights on royalty basis. B appointed a sub-lessee, to sold the product in a particular areas the following are the relevant particulars.

year	sales B Rs	sales C Rs.
1	2,00,000	5,00,000
2	2,50,000	60,000
3	3,00,000	70,000
4	3,50,000	80,000
5	4,00,000	90,000
Minimum rent per Annum	40,000	10,000
Royalty	5% on sales	10% on sales
Recoupment of short working within	2years	3 years

Prepare necessary ledger accounts in the books of both the parties.

2.10 SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal
Financial Accountancy : Jain and Narang
Financial Accountancy : R.L. Gupta & V.K. Gupta

- Dr. Ch. Suravinda

LESSON - 3

Hire Purchase system - I

3.0 Objective : By going through this lesson the student is able to understood what is Hire purchase system ? What are its features and How these transactions are recorded in the books of Accounts

Structure :

3.1 Introduction :

Most of the trade now - a - days carried on the basis of not only on credit but also under instalment payment that means the buyer need not pay the cost of goods. Immediately, certain percentage is paid on the date of agreement and the remaining in instalment. This system of purchase is known as Hire purchase system or Instalment Purchase system.

3.2 Features:

Under hire purchase system, the buyer acquires the possession of the goods immediately and agrees to pay the total hire purchase price in instalments. Each instalment being treated as hire charges till the payment of last instalment. After payment of last instalment the ownership of goods is passes from the seller to the buyer If the buyer makes default in payment of any instalment the seller has a right to take back the goods from the buyer, and the amount already received is treated as a hire charge. But if the buyer is paying all the instalments on the due dates the sellers has no right to repossess these goods from the buyer. The purchaser can also return the goods at anytime without having to pay further instalments that means he has an option to buy the goods. Thus this system is advantageous both to the buyer and the seller. The buyer gets the facility of paying the total amount in instalments under this system and the seller is able to sell more goods under this system. Under the Hire purchase Act, the purchaser has certain rights the chief of which is that. if a certain proportion of the total amount due is paid, the goods cannot be repossessed without sanction of the court. There is also a ceiling on the interest that can be charged.

3.3 Instalment system

In case of instalment system, both the possession and ownership of goods are transferred to the buyer immediately on signing the contract, In case the buyer defaults, the seller cannot take back the goods sold, he can only sue for non payment of the instalments.

3.4 Distinction between Hire purchase system and instalment purchase system

The following are the main Points of distinction between the two systems.

Hire purchase	Instalment purchase
1. It is an agreement of Hiring.	1. It is an agreement of sale.
2. The ownership remains with the seller until the payment of last instalment	2. The ownership passes from seller to the buyer immediatly on entering the agreement.
3. Goods can be returned if the buyer does not want to pay rest of the instalments.	3. The goods cannot be returned by the buyer to the seller unless there is some default on the part of the seller.
4. Under this system the buyer cannot sell destroy transfer damage or pledge the goods.	4. The buyer can do all these things.
5. Under this system the seller can reposses the goods if the buyer was in default of payment of any instalment	5. Under instalment purchase the seller can sue in the court of law if the buyer was in default in payment of any instalment.

In case of both Hire purchase and instalment system, the buyer has to pay more than the cash price. This is because of the fact that hire purchase price includes interest. It is called as hire charges or finance charges, The buyer cannot debit the whole amount paid to the cost of asset acquired. Only the cash price should be debited to asset account and interest is to be charged to profit and loss account treating it as a revenue expense.

3.5 Systems of Accounting Records :

The systems of maintaining records for hire purchase transactions is different in each of the following circumstances.

1. When goods of substantial sales value are the subject matter of sale. e.g.trucks, heavy machinery.
2. When goods of small sales value are the subject matter of sale.

As we have already seen that there are two parties in the hire purchase agreement. i.e. buyer and seller.

3.5.1 Goods of considerable value

In case the hire purchase transactions relating to goods of substantial sales value, in the Books of buyer's there are three methods of recording hire purchase transactions in the books of the buyer.

1. Treating the goods not becoming the property of the buyer

Under this method goods purchased under hire purchase system will not become the property of the buyer until at the instalment are paid.

3.6 Journal entries in the books of buyer

1. When an asset is purchased on hire Purchase

    No Entry

2. For down Payment on the date of agreement

    Asset Account Dr.

    To cash account.

3. When first instalment due

    Asset Account Dr

    Interest Account Dr

    To Hire vender Account.

4. When Instalment Paid.

    Hire vender A/c Dr

    To cash Account.

5. When depreciation charged.

    Depreciation Account Dr

    To Asset A/c.

6. When depreciation and Interest transferred to P & L Account

    Profit & Loss Account Dr

    To interest Account Dr

    To Depreciation Account

Note : Entries 3 to 6 will be repeated in the subsequent years until last instalment paid.

2. Treating the goods as outright property

When the goods purchased on hire purchase system is treated as property of the business, the following entries appears in the books of the buyer.

1. When an asset is purchased on hire purchase system.

    Asset Account Dr

    To Hire Vendor Account

2. For down payment on the date of agreement

    Hire vendor Account Dr

    To Cash / Bank Account.

3. Before 1st instalment date for Interest due

    Interest Account Dr

    To vendor Account

4. For the payment of 1st instalment

    Hire vendor Account Dr

    To Bank Account

5. For depreciation.
   Depeciation Acount Dr
   To Asset Account
6. For transfer of interest and depreciation to profit and loss account.
   Profit and loss Account Dr
   To Interest Account
   To Depreciation Account.

Note : Entries 3 to 6 appears in all the years,

3. Interest suspense Method :

Under this method, the total interest payable due to purchase of asset under Hire purchase is debited to interest suspense account, Interest included in each instalment is credited to interest suspense account by giving debit to interest account. The following entries appears in the books of the buyer.

1. When an asset is purchased on hire purchase system.
   Asset Account Dr
   Interest suspense A/c Dr
   To Hire vender A/c.
2. For down payment on the date of agreement.
   Hire vender Account Dr
   To Bank A/c.
3. For interest due at the end of the year
   Interest Account Dr
   To Interest suspense Account.
4. For the payment of the first instalment
   Hire vendor Account Dr.
   To Bank Account.
5. For depreciation at the year end
   Depreciation Account Dr
   To Asset Account
6. For transfer of interest and depreciation to profit and loss account
   Profit and Loss account Dr
   To Interest account
   To Depreciation account.

Note : Entries from 3 to 6 will appear every year.

Generally the second method is adopted in the absence of any specific method in the examination Questions.

3.7 Journal Entries in the books of Hire vendor

Under the first Method :

1. When goods are sold on hire purchase
   Hire purchaser's Account Dr
   To sales Account.

2. For cash received on the date of agreement.

   Bank Account Dr

   To Hire purchaser's Account.

3. For interest due on instalment at the end of the year.

   Hire purchasers Account Dr

   To Interest Account.

4. For receipt of the instalment.

   Bank Account Dr

   To Hire purchasers Account.

5. For transferring the balance of interest to profit and loss account.

   Interest Account Dr

   To Profit and loss Account.

Note : Entries of 3 to 5 will appear in every year.

Interest suspense Method :

Under this method, the differences between the hire purchase price and the cashprice is credited to the interest suspense account. As and when the interest becomes due on each instalment, it is credited to interest account and corresponding debit given to interest suspense account. The following entries passed under this method.

1. When goods are sold on hire purchase

   Hire purchaser's Account Dr

   To sales Account

   To Interest suspense Account

2. For cash received on delivery

   Bank Account Dr

   To Hire purchaser's Account

3. For interest due on instalment at the end of the year.

   Interest suspense Account Dr

   To Interest Account

4. For receipt of the amount of instalment

   Bank Account Dr

   To Hire purchaser's Account

5. For transfer of Interest to P & L A/c

   Interest Account Dr

   To P & L A/c

Note : Entries from 3 to 5 appears every year. Interest in the last instalment will be difference between the instalment payable and amount remaining unpaid by way of principal.

3.8 Illustration – I

'Y' acquires from 'X' machine on hire purchase system on 1-1-2004. The cash price is Rs. 60,000. Payment is to be made as follows Down payment Rs 1,00,00 and 21,000 annually for three years. Interest is to be charged @ 12%. p.a pass the necessary journal entries and ledger accounts in the books of both the parties under three Methods.

Solution :

calculation of Interest :

1 - 1 - 2004	**Cash price**	**Instalment**	**Interest included Purchase In instalment**
Down payment on	60,000		----
1-1-2004	10,000	10,000	
due on 1-1-2004.	50,000		
Interest @ 12% on In first instalment	15,000	21,000	6,000
due on 31-12-2004	35,000		
Interest included in 2nd			
instalment @ 12% on 35,000	16,800	21,000	4,200
due on 31-12-2005			
Interest included in	18,200		
3rd instalment			
(Difference between	18,200	21,000	2,800
21,000 - 18,200)			
Due on 31-12-2005			
Total	Nil	73,000	13,000

	Calculation of Depreciation :	Rs.
	Cash price on 1-1-2004	60,000
Less	Depreciation @ 20% for 2004	12,000
	Balance on 1-1-05	48,000
Less	Depreciation @ 20% for 2005	9,600
	Balance on 1-1-06	38,400
Less	Depreciation @ 20% for 2006	7,680
	Balance on 1-1-07	30,720

Solution :

First Method : In the books of y & co.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2004	Machinery A/c	Dr		10,000	
Jan1	To Bank A/c.				10,000
	(Being down payment paid)				
Dec 31	Machinery Account	Dr		15,000	
	Interest A/c	Dr		6,000	
	To x's A/c				21,000
	(Being Instalment due)				
Dec 31	X's A/c	Dr		21,000	
	To Bank A/c				21,000
	(Being Instalment paid)				
Dec 31	Depreciation A/c	Dr		12,000	
	To Machinery A/c				12,000
	(Being Depreciation charged)				
Dec31	Profit & loss Account	Dr		18,000	
	To Interest A/c				6,000
	To Depreciation A/c				12,000
	(Being interests & Depreciation transferred to P & L A/c)				
2005	Machinery A/c	Dr		16,800	
Dec31	Interest A/c	Dr		4,200	
	To X's A/c				21,000
	(Being 2nd instalment due)				
Dec 31	x's A/c	Dr		21,000	
	To Bank A/c				21,000
	(Being 2nd Instalment paid)				
Dec 31	Depreciation A/c	Dr		9,600	
	To Matchinery A/c				9,600
	(Being Depreciation charged on Asset)				
Dec 31	Profit & loss Account	Dr		13,800	
	To Interest A/c				4,200
	To Depreciation A/c				9,600
	(Being interests & Depreciation transfered to P&L A/c)				
2006	Machinery A/c	Dr		18,200	
Dec31	Interest A/c	Dr		2,800	
	To x's A/c				21,000
	(Being 3rd instalment due)				

Dec31	x's A/c	Dr	21,000	
	To Bank A/c			21,000
	(Being 3rd instalment paid)			
Dec31	Depreciation A/c	Dr	7,680	
	To Machinery A/c			
	(Being Depreciation charged on Asset)			7,680
Dec31	Profit & loss Account	Dr	10,480	
	To Interest Account			2,800
	To Depreciation Account			7,680
	(Being Interest and Depreciation transferred to P & L Account)			

LEDGER

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

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004			2004		
Ja1	To Bank	10,000		By Depreciation A/c	12,000
Dec31	To Bank	15,000	Dec 31	By Bal c/d	13,000
		25,000			25,000
2005					
Jan1	To Bal b/d	13,000	2005	By Depreciation	9,600
Dec 31	To Bank A/c	16,000	Dec 31	By Bal c/d	20,200
		29,800			29,800
2006					
Jan1	To Bal b/d	20,200	2006	By Depreciation	7,680
Dec 31	To Bank A/c	18,200	Dec31	By Bal c/d	30,720
2007					
Jan1	To Bal b/d	38,400			38,400

Dr **Interest Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To x Account	6,000	2004	By P & L A/c	6,000
Dec31			Dec 31		
2005			2005		
Dec31	To x Account	4,200	Dec31	By P & L A/c	4,200
2006			2006		
Dec31	To x Account	2,800	Dec31	By P & L A/c	2,800

Dr. **Depriciation Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Dec31	To Machinery A/c	12,000	2004 Dec 31	By P & L A/c	12,000
2005 Dec31	To Machinery A/c	9,600	2005 Dec31	By P & L A/c	9,600
2006 Dec31	To Machinery A/c	7,680	2006 Dec31	By P & L A/c	7,680

Second Method :

Dr **Journal Entries** **Cr**

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2004 Jan1	Machinery A/c	Dr		60,000	
	To x's A/c				60,000
	(Being Machinery purchased on Hire purchase)				
Jan1	x's A/c	Dr		10,000	
	To Bank A/c				10,000
	(Being down payment paid)				
Dec 31	Interest A/c	Dr		6,000	
	To x's Account				6,000
	(Being interest due)				
Dec 31	To x's Account	Dr		21,000	
	To Bank A/c				21,0001
	(Being1st instalment paid)				
	Depreciation A/c	Dr		12,000	
Dec31	To Machinery A/c				12,000
	(Being Depreciation charged on asset)				
Dec31	Profit & loss Account	Dr		18,000	
	To Interest Account				6,000
	To Depreciation Account				
	(Being Interest & Depreciation				12,000
	transferred to P & L A/c)				
2005	Interest Account	Dr		4,200	
Dec31	To x's A/c				4,200
	(Being interest due)				

Dec 31	x's A/c	Dr	21,000	
	To Bank A/c			21,000
	(Being 2nd instalment paid)			
Dec 31	Depreciation Account	Dr	9,600	
	To Machinery Account			9,600
	(Being Depreciation charged on Asset)			
Dec31	Profit & loss Account	Dr	13,800	
	To Depreciation Account			9,600
	To Interest Account			4,200
	(Being Interest & Depreciation transferred to P & L A/c)			
2006	Interest Account	Dr	2,800	
Dec31	To x's Account			2,800
	(Being interest due)			
Dec31	x's Account	Dr	21,000	
	To Bank Account			21,000
	(Being 3rd instalment Paid)			
Dec31	Depreciation Account	Dr	7,680	
	To Machinery Account			7,680
	(Being Depreciation charged on Asset)			
Dec31	Profit & loss Account	Dr	10.480	
	To Depreciation A/c			7680
	To Interest Account			2,800
	(Being Interest & Depreciation transferred to P & L A/c			

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

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004					
Jan1	To x's A/c	60,000	2004	By Depreciation A/c	12,000
Dec 31			Dec 31	By Bal c/d	48,000
		60,000			60,000
2005					
Jan1	To Bal b/d	48,000	2005	By Depreciation	9,600
			Dec31	By Bal c/d	38,400
		48,000			48,000

2006					
Jan1	To Bal b/d	38,400	2006	By Depreciation	7,680
			Dec31	By Bal c/d	30,720
2007		38,400			38,400
Jan1	To Bal b/d	30,720			

Dr 'X' Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004			2004		
Dec31	To Bank	10,000	Jan 1	By Machinery A/c	60,000
	To Bank	21,000	Dec 31	By Interest A/c	6,000
Dec 31	To Bal c/d	35,000			
		66,000			66,000
2005			2005		
Dec 31	To Bank	21,000	Jan 1	By Bal b/d	35,000
Dec 31	To Bal c/d	18,200	Dec 31	By Interest A/c	42,000
		39,200			39,200
2006			2006		
Dec 31	To Bank	21,000	Jan 1	By Bal b/d	18,200
			Dec 31	By Interest A/c	2,800
		21,000			21,000

Dr Interest Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004			2004		
Dec31	To x's A/c	6,000	Dec31	By P & L A/c	6,000
2005			2005		
Dec 31	To x's A/c	4,200	Dec31	By P & L A/c	4,200
2006					
Dec 31	To x's A/c	2,800	2006	By P & L A/c	2,800
			Dec31		

Depreciation Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004				2004	
Dec31	To Machinery A/c	12,000	Dec31	By P & L A/c	12,000
2005				2005	
Dec 31	To Machinery A/c	9,600	Dec31	By P & L A/c	9,600
2006					
Dec 31	To Machinery A/c	7,680 Dec31	2006	By P & L A/c	7,680

Journal Entries

Dr Cr

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2004	Machinery A/c	Dr		60,000	
Jan1	Interest Suspense A/c	Dr		13,000	
	To x's A/c				73,000
	(Being Machinery purchased on Hire purchase)				
Jan1	x's Account	Dr		10,000	
	To Bank A/c				10,000
	(Being down payment paid)				
Dec 31	Interest Account	Dr		6,000	
	Interest suspense Account				6,000
	(Being interest due)				
Dec 31	To x's Account	Dr		21,000	
	To Bank A/c				21,000
	(Being 1st instalment paid)				
Dec31	Depreciation Account	Dr		12,000	
	To Machinery Account				12,000
	(Being Depreciation charged on asset)				
Dec31	Profit & loss Account	Dr		18,000	
	To Depreciation Account				12,000
	To Interest Account				6,000
	(Being Interest & Depreciation transferred to P & L A/c)				
2005	Interest Account	Dr		4,200	
Dec31	To Interest suspense A/c				4,200
	(Being Interest due)				

Dec31	x's Account	Dr	21,000	
	To Bank Account			21,000
	(Being 2nd instalment paid)			
2005	Depreciation Account	Dr	9,600	
Dec31	To Machinery Account			9,600
	(Being Depreciation charged on Machinery)			
Dec31	Profit & loss Account	Dr	13,800	
	To Depreciation A/c			9,600
	To Interest A/c			4,200
	(Being Depreciation and Interest transferred to P & L A/c)			
2006	Interest Account	Dr	2,800	
Dec31	To Interest suspense A/c			2,800
	(Being interest due)			
Dec 31	x's Account	Dr	21,000	
	To Bank A/c			21,000
	(Being 3rd instalment paid)			
Dec31	Depreciation Account	Dr	7,680	
	To Machinery Account			7,680
	(Being Depreciation charged)			
Dec31	Profit & loss Account	Dr	10,480	
	To Interest Account			2,800
	To Depreciation Account			7,680
	(Being Interest & Depreciation transferred to P & L A/c)			

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

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Jan1	To x Account	60,000	2004	By Depreciation	6,000
			Dec31	By Bal c/d	48,000
		60,000			60,000
2005 Jan1	To Bal b/d	48,000	2005	By Depreciation	9,600
			Dec31	Bal c/d	38,400
		48,000			48,000
2006 Jan 1	To Bal b/d	38,400	2006	By Depreciation	7,680
			Dec31	By Bal c/d	30,720
		38,400			38,400
2007	To Bal b/d	30,720			

Dr **Interest suspense A/c** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Jan1	To x' Account	13,000	2004	By Interest A/c	6,000
			Dec31	By Bal c/d	7,000
		13,000			13,000
2005 Jan1	To Bal b/d	7,000	2005	By Interest A/c	4,200
			Dec31	By Bal c/d	2,800
		7,000			7,000
2006 Jan1	To Bal b/d	2,800	2006 Dec31	By Interest A/c	2,800

Dr **X's Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004Jan1	To Bank A/c	10,000	2004 Jan1	By Machinery A/c	60,000
Dec 31	To Bank A/c	21,000	Jan1	By Interest suspence A/c	13,000
Dec31	Bal c/d	42,000			
		73,000			73,000
2005 Dec31	To Bank A/c	21,000	2005	By Bal b/d	42,000
Dec31	To Bal c/d	21,000	Jan1		
		42,000			42,000
2006 Dec31	To Bank A/c	21,000	2006 Dec31	By Bal c/d	21,000
		21,000			21,000

First Method : **In the books of 'x'**

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2004	y's Account	Dr		60,000	
Jan1	To sales Account				60,000
	(Being Machine sold on Hire purchase)				
Jan 1	Bank Account Dr	Dr		10,000	
	y's Account	Dr			10,000
	(Being down payment received)				
Dec 31	y's Account	Dr		6,000	
	To Interest A/c				6,000
	(Being Interest in 1st instalment)				

Date	Particulars		Dr	Cr
Dec 31	Bank Account	Dr	21,000	
	To y's Account			12,000
	(Being 1st instalment received)			
Dec31	Interest Account	Dr	6,000	
	To Profit & loss Account			6,000
	(Being interest transferred to P & L Account)			
2005	y's Account	Dr	4,200	
Dec 31	To Interest Account			4,200
	(Being interest received)			
Dec31	Bank Account	Dr	21,000	
	To y's Account			21,000
	(Being 2nd instalment received)			
Dec31	Interest Account	Dr	4,200	
	To Profit & Loss Account			4,200
	(Being interest transferred to P & L Account)			
2006	y's Account	Dr	2,800	
Dec 31	To Interest Account			2,800
	(Being Interest due)			
Dec31	Bank Account	Dr	21,000	
	To y's Account			21,000
	(Being 3rd instalment received)			
Dec31	Interest Account	Dr	2,800	
	To Profit & Loss Account			28,00
	(Being interest transferred to P & L A/c)			

LEDGER

Dr **y's Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To H. Sales A/c	60,000	2004 Jan1	By Bank A/c	10,000
Jan1	To Interest A/c	6,000	Dec 31	By Bank A/c	21,000
			Dec 31	By Bank c/d	35,000
Dec31		66,000			66,000
2005Jan1	To Bal b/d	35,000	2005	By Bank A/c	21,000
Dec31	To Interest A/c	4200	Dec31	By Balance c/d	18,200
		39,200	Dec 31		39,200
2006					
Jan1	To Bal b/d	18,200	2006		
Dec31	To Interest A/c	2,800	Dec31	By Bank A/c	21,000
		21,000			12,000

Dr Interest Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Dec1	To P & L Account	6,000	2004	By y's Account Dec31	6,000
2005 Jan1	To P & L Account	4,200	Dec31	2005 By y's Account	4,200
2006 Dec31	To P & L Account	2,800	Dec31	2006 By y's Account	2,800

2nd Method :

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2004	y's Account	Dr		73,000	
Jan1	To Interest suspense A/c				13,000
	To Hire sales Account				60,000
	(Being Machine sold on Hire) and total interest payable for it)				
Jan1	Bank Account Dr	Dr		10,000	
	To y's Account				10,000
	(Being down payment received)				
Dec 31	Interest suspense Account	Dr		6,000	
	To Interest A/c				6,000
	(Being Interest due in 1st instalment)				
Dec 31	Bank Account	Dr		21,000	
	To y's Account				12,000
	(Being 1st instalment received)				
Dec31	Interest Account	Dr		6,000	
	To Profit & loss Account				6,000
	(Being interest transferred to P & L Account)				
2005	Interest Suspense Account	Dr		4,200	
Dec31	To Interest Account				4,200
	(Being interest due)				
Dec31	Bank Account	Dr		21,000	
	To y's Account				21,000
	(Being 2nd instalment received)				
Dec31	Interest Account	Dr		4,200	
	To Profit & Loss Account				4,200
	(Being interest transferred to P & L Account)				

2006	Interest Account	Dr	2,800	
	To Interest Account			2,800
	(Being Interest due)			
Dec31	Bank Account	Dr	21,000	
	To y's Account			21,000
	(Being 3rd instalment received)			
Dec31	Interest Account	Dr	2,800	
	To Profit & Loss Account			2,800
	(Being interest transferred to P & L A/c)			

LEDGER

Dr **y's Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To H. Sale	60,000	2004Jan1	By Bank	10,000
Jan1	To Interest sus A/c	13,000	Dec 31	To Bank	21,000
			Dec 31	Bal c/d	42,000
		73,000			73,000
2005Jan1	Bal b/d	42,000	2005	By Bank	21,000
			Dec31	By Bal c/d	21,000
		42,000			42,000
2006					
Jan1	To Bal b/d	21,000	2006		
			Dec31	By Bank	21,000
		21,000			21,000

Dr **Interest suspense A/c** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To Interest A/c	6,000	2004	By y's Account	13,000
Dec31	To Bal c/d	7,000	Jan1		
		13,000			13,000
2005	To Interest A/c	4,200	2005		
Dec31		2,800	Jan1	By Bal b/d	7,000
		7,000			7,000
2006			2006		
Dec31	To Interest A/c	2,800	Jan1	By Bal b/d	2,800
		2,800			2,800

Dr **Interest Account** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Dec31	To P & L A/c	6,000	2004 Dec31	By Interest suspense	6,000
2005 Dec31	To P & L A/c	4,200	2005 Dec31	By Interest suspense	42,000
2006 Dec31	To P & L A/c	2,800	2006	By Interest suspense	28,000

Illustration – II

When there are different amount of instalments.

Surya purchased a machine on hire purchase system. The total cash price of the machine is 67,000, payable Rs 16,000 down and there instalments of Rs 24,000 Rs. 20,000 and Rs. 18,700 payable at the end of the first, second and third year respectively. Interest is charged at 5% P.a. Charge depreciation at 10% on straight line method. Prepare ledger Accounts in the books of surya.

Solution :

calculation of Interest and Depreciation

year of Payment	Total	Instalment Price	Interest	Cash Price	Deprecation
Machine Purchased	67,000				
Down Payment	8,000	8,000	----	8,000	-----
	59,000				
At the end of	21,050	24,000	2,950	21050	6,700
1st year	37,950				
At the end of	20,100	22000	1900	20100	6,700
2nd year	17,850				
At the end of					
3rd year	17,850	18,700	850	17850	6700
	Nil	72700	5700	67000	

Dr **Machinery Account** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Hire vendor A/c	67,000	Year end	By Depreciation	6,700
			end	By Bal c/d	60,300
		67,000			67,000

2nd year	To Bal b/d	60,300	2nd year end	By Depeciation	6,700
				By Bal c/d	53,600
		60,300			60,300
3rd	To Bal b/d	53,600	3rd year end	By Depreciation	6,700
				By Bal c/d	46,900
		53,600			53,600
4th	To Bal b/d	46,900			

Dr **Hire vendor Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1st year	To Bank A/c	8,000	1st Year	By Machinery	67,000
	To Bank A/c	24,000		By Interest	2,950
	To Bal c/d	37,950			
		69,950			69,950
2nd year	To Bank A/c	22,000	2nd year end	By Bal b/d	37,950
	To Bal c/d	17,850		Interest A/c	19,000
		39,850			39,850
3rd	To Bank	18,700	3rd year end	By Bal b/d	17,850
				By Interest A/c	850
		18,700		By (bal fig)	18,700

Dr **Interest Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1st	To Hire vendor	2,950	1st	By Profit & loss	2950
2nd	To Hire vendor	1900	2nd	By P & L A/c	1900
3rd	To Hire vendor	850	3rd	By P & L A/c	850

Dr **Depreciation Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1st	To Machinery	6,700	1st	By P & L A/c	6,700
2nd	To Machinery	6,700	2nd	By P & L A/c	6,700
3rd	To Machinery	6,700	3rd	By P & L A/c	6,700

When the instalments are exclusive of interest :

Illustration - 3

On 1st January 2,000 vindhya purchased a machine from Nivedita on Hire - purchase basis. The particulars are as follows;

Cash price is Rs 50,000 payable as follows on signing the agreement Rs 20,000 and balance in three instalments of rs 10,000 each plus interest. Interest is charged at 5% on outstanding balance Depreciation at 10% p.a on written down value method. Prepare Nivedita Account in the books of vindhya.

Dr **Nivedita Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000 Jan1	To Bank A/c	20,000	2000	By Machinery A/c	50,000
Dec 31	To Bank A/c	11,500	Jan1	By Interest A/c	1,500
Dec31	To Balance c/d	20,000	Dec31		
		51,500			51,500
2001			2001		
Dec31	To Bank A/c	11,000	Jan1	By Bal b/d	20,000
Dec 31	To Bal c/d	10,000	Dec31	By interest A/c	1,000
		21,000			21,000
2002			2002		
Dec31	To Bank A/c	10,500	Jan1	By Bal b/d	10,000
			Dec31	By interest A/c	500
		10,500			10,500

Calculation of interest when rate is not given

If the rate of interest is not given in the problem, first total interest will be calculated by deducting cash price from the total hire purchase price. Then the total interest is distributed in the ratio of outstanding balance of each year.

Illustration 4

On 1st January 2000 Akhil took delivery from Nikhil co Ltd of a machine on hire purchase system. Rs 6000 being paid on delivery and the balance in five instalments of Rs 12,000 each payable annually on 31st December. The cash price of the machine was Rs 60000. Calculate the amount of interest of each year.

Solution :

			Rs
2000	Amount Outstanding	After down payment	60,000
2001	Amount Outstanding	After 1st instalment	48,000
2002	Amount Outstanding	After 2nd instalment	36,000
2003	Amount Outstanding	After 3rd instalment	24,000
2004	Amount Outstanding	After 4th instalment	12,000

Total interest for all the five years is Rs 6,000. (66000 - 60000) Which should be divided in the ratio of 5 : 4 : 3 : 2 : 1 for five years.

Hence the interest comes to

2000	Rs 6,000 5 $\frac{5}{15}$	=	Rs 2000
2001	Rs 6,000 5 $\frac{4}{15}$	=	Rs 1600
2002	Rs 6,000 5 $\frac{3}{15}$	=	Rs 1200
2003	Rs 6,000 5 $\frac{2}{15}$	=	Rs 800
2004	Rs 6,000 5 $\frac{1}{15}$	=	Rs 400

Calculation of cash price when it is not given

Sometimes in the question the cash price is not given. For solving the problem first we have to find out the cash price with which the asset account is debited For calculating the cash price first take the final instalment an deduct interest from it. Interest can be calculated by using the formula = Rate of interest /100 + rate of interest. The remaining amount after deducting the interest represents the amount due at the beginning of the year. The opening balance of the current year also represent the closing balance of the previous year after payment of instalment. The total of these two will give the amount due at the end of the last but one year. This procedure followed until the first instalment To that amount add down payment then we can find the cash price of the asset this can be better understood with the following illustration.

Illustration 5

On January 1st sai purchased a machine on Hire Purchase under a Hire purchase agreement which provided for an initial payment of Rs 30,000 and the balance in four equal annual instalments of Rs 40,000 each, rate of interest is 6% per annum find out the cash price of the machine.

Solution:

No of instalments	Balance Rs	Amount of instalments	Total Rs	Interest at 6/106	Opening balance Rs
4	Nil	40,000	40,000	2264	37,736
3	37,736	40,000	77,736	4400	73,336
2	73,336	40,000	1,13,336	6415	1,06,920
1	1,06,920	40,000	1,46,920	8320	1,38,600

Cash = 1,38,600 + 30,000(Down payment) = Rs 1,68,600

Illustration 6

Little Masters purchase a machinery on instalment basis from Machine Manufacturing co Ltd on the following terms :

a. Cash down payment at the time of signing agreement Rs 24,000

b. Five annual instalments of Rs 15,400

c. Interest at 10% p.a, is charged by the seller.

d. Depreciation at 20% p.a. on W,D.V basis is written off on machinery.

g. Machinery is sold for Rs 30,000 on completion of payments of instalments

show the machinery account for the entire period.

Solution :

In the books of Little Masters.

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

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
I	To Machine Manufacturers A/c	82,378	I	By Depreciation	16,476
				By Balance c/d	65,902
		82,378			82,378
II	To Balance b/d	65,902	II	By Depreciation	13,180
				By Balance c/d	52,722
		65,902			65,902
III	To Balance b/d	52,722	III	By Depreciation	10,544
				By Balance c/d	42,178
		52,722			52,722
IV	To Balance b/d	42,178	IV	By Depreciation	8,436
				By Balance c/d	33,742
		42,178			47,178
V	To Balance b/d	33,742	V	By Depreciation	6,748
				By Balance c/d	26,994
		33,742			33,742
VI	To Balance b/d	26,994	VI	By Bank A/c	30,000
	To P & L	3,006			
		30,000			30,000

Working :

Calculation of Cash Price.

No of instalments	**Balance Rs**	**Amount of instalments**	**Total Rs**	**Interest at 6/106**	**Opening balance Rs**
V	NiL	15,400	15,400	1,400	14,000
IV	14,000	15,400	29,400	2,672	26,728
III	26,728	15,400	42,128	3,830	38,298
II	38,298	15,400	53,698	4,882	48,816
I	48,816	15,400	64,216	5,838	58,378

$\therefore$ Cash Price = 58,378 + 24,000 (Down payment) = Rs 82,378

3.9 Summary :

Most of the trade now - a - days carried on the basis of not only on credit but also under instalment payment, under hire purchase system the buyer acquires the possession of the goods immediately and agrees to pay the remaining balance in instalments. After payment of last instalment the ownership of goods is passed from the seller to buyer. If the buyer makes default in payment of instalment the seller has righ to take back the goods from the buyer. The amount already paid is treated as hire charges for using the asset.

3.10 Self Assessment Questions :

1. What do you mean by hire - purchase system ?
2. What is instalment purchase ?
3. Write down the differences between hire purchase and instalment purchase.
4. Write down the features of hire - purchase system.
5. Explain the methods of recording hire purchase transactions in purchaser's book.
6. Explain cash price hire purchase price and down payment.
7. In the absence of Interest rate how can it be calculated ?
8. In the absence of cash price, how can it be calculated ?

3.11 Excercises :

1. Nani purchased a Machine under hire purchase system at a cash price of Rs 56,000. He has to make down payment of Rs 24,000 Further he has to make payment of Rs 10,000 each in four annual instalments. Calculate the interest included in each instalment.
2. PQR company purchased an asset from EFG Co Ltd. On 1-1-2000 on hire purchase system and paid Rs 30,000 at the time of signing the agreement and agreed to pay the balance in four equal instalments of Rs 40,000 each on 31st December every year. Vendor company charges 5% rate of interest per year depreciate the asset at 10% p.a. On straight line mouthod. Write up the ledger accounts in the books of both the parties.
3. Mr. Venkat purchased a machine from Hari on 1st January 2000 on Hire purchase system. The cash price of machine Rs 50,000. Down payment is Rs 26,000. Balance in three equal installments of Rs 10,000 each. Find out how much interest is included in each instalment.
4. Mr. Kartik purchased a truck on Hire purchase system for Rs 56,000. Payment to be made Rs. 15,000 down and three instalments of Rs 15,000 each at the end of each year. The rate of interest is charged at 5% p.a. on the balance due. The purchaser is depreciating the truck at 10% p.a.on reducing balance method. Write down the necessary journal entries and ledger accounts to record the above transaction in the books of both the parties.
5. On 1st April 2002. Somu purchased a machine on hire purchase by paying Rs 1,500 as initial payment and the balance in four equal instalments of Rs 2,000 each at the end of every year. The rate of interest charged is at 6% p.a. Determine the cash price of the machine.
6. 1-4-2000. Surat Transport company purchased from Metro Motors Ltd., three trucks costing Rs 5,00,000/- each on Hire purchase system. Payment was to be made, Rs 3,00,000 down and the remainder in three equal instalments together with interest at 9% p.a. at the end of each year. Surat transport company writes off depreciation at 20% on reducing balance. Write up the necessary ledger accounts in the books of both the parties.

7. Mr. white purchased a Machinery on hire purchase system and agreed to pay in five instalments at the end of each year, It also agreed to pay interest at 10% p.a. on the balance due of cash price every year. Calculate the interest included in each instalment.

Instalment	Amount paid
	Rs
1	2,250
2	2,100
3	1,950
4	1,800
5	1,650

8. A Ltd purchased three Buses from B Ltd costing Rs 75,000 each on Hire purchase system. Payment was to be made Rs 45,000 cash down and the remainder in three equal yearly instalments together with interest at 12% p.a B Ltd writes off depreciation at 20% p.a on diminishing balance method. Prepare necessary Accounts in the books of A Ltd.

9. Mr. Mani purchased a machine under Hire - purchases agreement from siddhartha Motars a machine costing Rs 31,000, The payment was to be made as follows.

	Rs
on siging the agreement	6,000
1st, 2nd & 3rd instalments	10000 each

Calculate interest for each year.

10. The Rajastan Transport company purchased three lorries from leyland Motars on Hire purchase system on 1st January 2000. Paying cash Rs 20,000 and agreeing to pay further three instalments of Rs 20,000 each on 31st December each year the cash price of the lorry is Rs 74,500. And the leyland Ltd charge interest at 5% p.a The Madras Transport company writes off 10% o.a. as depreciation on the reducing instalment system. Pass Journal entries and prepare necessary ledger accounts in the books of Rajastan Transport company.

11. A company hires a machine on the hire purchase system. The hire purchase price was Rs. 32,000 payable Rs. 8,000 down and rest in three instalments of Rs 8,000 company is writing off depreciation at 10% on written down value, open necessary ledger accounts in the books of the company.

12. Nikhil delivers a machine on hire purchase system for Rs 150,000 including interest at 10% p.a. on cash value to be paid as follows, Down payment Rs 24,000 1st instalment Rs 36,000, 2nd instalment Rs 66,000 and third instalment Rs 24,000 at end of each year. Show ledger accounts in the books of vendor.

13. Anirudh purchases a L.C.D TV set on Hire purchase basis for Rs 1,00,000 and makes the payment in the following order.

Down payment	Rs 20,000
1st instalment	Rs 40,000
2nd instalment	Rs 20,000
3rd instalment	Rs 20,000
The cash Price is	Rs 86,000

Prepare necessary ledger account in the books of vender.

14. Gowtami purchased a truck on Hire purchase system. The cash price of the truck was Rs 1,49,000. He paid Rs 40,000 on signing of the agreement and rest in three annul instalments of rs 40,000 each calculate interest for each year.

15. Sahiti purchased an asset on hire purchase system on agreement to pay as follows. On down payment Rs 40,000 at the end of first year Rs 56,000, at the end of second year 52,000, at the end of third year Rs 48,000 and at the end of fourth year Rs 44,000. Annul interest rate is 10% prepare necessary ledger accounts in the books of both the parties.

3.12 SUGGESTED READINGS :

Financial Accountancy	**:**	**Shukla Grewal**
Financial Accountancy	**:**	**Jain and Narang**
Financial Accountancy	**:**	**R.L. Gupta & V.K. Gupta**

Dr. Ch. Suravinda

LESSON - 4

HIRE PURCHASE II

4.0. Object : In the previous lesson you learned what is Hire purchase ? How these transactions are recorded in the books of both hire purchaser and hire vendor. Already we learned that if a hire purchaser failed to pay any installment the hire vendor had a right of repossession. After going through the current lesson the student can know how the transactions of repossession recorded in the books ? What is instalment system ? What is the difference between these two ?

Structure :

4.1. Introduction
4.2. Types of repossession
4.3. Accounting treatment in case of complete repossession.
4.4. Accounting treatment in case of partial repossession.
4.5. Accounting treatment in case of small value items.
4.6. Hire purchase trading Account
4.7. Stock and Debtors system
4.8. Summary
4.9. Self Assessment Questions
4.10. Exercises
4.11 Suggested Readings

4.1. Introduction :

When the hire purchaser failed to pay any instalment the vendor has a right to repossess the goods sold on hire purchase. The amount already paid is forfeited by treating it as hire charges for using the asset.

4.2. Types of repossession :

There are two methods of repossession. They are :

1. The vendor takes the complete repossession of asset and
2. The vendor takes repossession of only a part of the total asset sold on hire purchase system. This is known as partial repossession.

   The accounting treatment for these two methods is different. Hence, we discuss them separately.

Accounting treatment in case of complete repossession

4.2.1 In the books of Hire purchaser :

The following steps should be followed by the student to record the transactions relating to complete repossession :

1. In the year of default, entries for interest and Depreciation should be passed as usual

that means except the entry for payment, all the entries are passed.

2. Close the account of vendor by transferring the balance to asset account by debiting the vendor's account and crediting the asset account.
3. Balance left in the asset account will represent loss on default and will be closed by transferring to the profit and loss account.

4.2.2. In the books of vendor :

The following steps are necessary in the books of vendor in case of complete repossession.

1. Entry for interest due is passed as usual in the year of default.
2. Close the account of hire purchaser by transferring its balance to repossessed stock account i.e. hire purchaser account is credited and repossessed stock account is Debited.
3. The repossessed stock account is further debited with expenses incurred in repairing or overhauling.
4. When these stock is sold again, with the sale price, the repossessed stock account is credited.
5. The balance in this account represent either profit or loss, this account is closed by transferring this balance to profit and loss account.

This can be better understood with the following illustration.

Illustration - I

M/s Sri Rama Motar transport Co purchased a truck on hire-purchase system for Rs.2,50,000 on Ist January 2004. Payment to be made Rs.1,00,000 down and three annual installments of Rs.75,000 each payable on 31st December every year. Rate of interest is 25% per annum. The buyer depreciates the truck at 20 percent per annum on written down value method.

Because of Financial difficulties M/s. Sri Rama Motor Transport Co, after having paid down payment and first instalment at the end of Ist year, could not pay second installment and the vendor took possession of the truck. Vendor, after spending Rs.75,000 on repairs of the asset sold it away for Rs.1,62,500/-

Open necessary ledger accounts in the books of both the parties to record the transactions of repossession.

Solution :

Calculation of Interest and Depreciation

Date of Payment	Total Cash Price	Instal- ments	Interest	Cash Price	Depreci- ations
Ist Jan 2004	2,50,000				
Down Payment	1,00,000	1,00,000	---	1,00,000	---
31st Dec 2004	1,50,000				
	37,500	75,000	37,500	7,5000	50,000
	1,12,500				
31st Dec 2005	46,875	75,000	28,125	46,875	40,000
31st Dec 2006	65,625	75,000	9,375	65,625	32,000
	65,625	75,000	9,375	65,625	32,000
	Nil	3,25,000	75,000	2,50,000	

In the books of Sri Rama Motor transport company

Dr. Truck Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004			2004		
Jan1	To Hire Vendor A/c	2,50,000	Dec 31	By Depreciation	50,000
			Dec 31	By Bal c/d	2,00,000
		2,50,000			**2,50,000**
2005			2005		
Jan 1	Bal b/d	2,00,000	Dec 31	By Depreciation	40,000
			Dec 31	By Hire Vendor	1,40,625
				By P & L A/c	19,375
		2,00,000			**2,00,000**

Hire Vendor Account

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2004			2004		
Jan 1	To Bank A/c	1,00,000	Jan 1	By Truck A/c.	2,50,000
Dec31	To Bank A/c	75,000	Dec 31	By Interest A/c	37,5000
Dec 31	Balance C/d	1,12,500			
		2,87,500			**2,87,500**
2005			2005		
Dec 31	To Truck A/c	1,40,625	Jan 1	By Balance b/d	1,12,500
			Dec 31	By Interest a/c	28,125
		1,40,625			**1,40,625**

In the Book of Hire Vendor

Sri Rama Motar Transport Company

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2004		2004			
Jan 1	To Sales a/c	2,50,000	Jan 1	By Bank A/c	1,00,000
Dec31	To Interest a/c	37,500	Dec 31	By Bank a/c	75,000
				By Balance c/d	1,12,500
		2,87,500			**2,87,500**
2005			2005		
Jan 1	To Balance b/d	1,12,500		By Respossed stock	1,40,625
Dec31	To Interest a/c	28,125			
		1,40,625			**1,40,625**

Repossessed Stock Account

Dr Cr

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2005			2005		
Dec31	To Sri Rama Motor Transport Company A/c	1,40,625	Dec 31	By Bank	16,2,500
Dec31	To Bank a/c	7,500			
Dec31	To P & L A/c	14,425			
		1,62,500			**1,62,500**

4.4. Accounting treatment in case of partial repossession :

The following method is followed in case the seller takes possession of only part of the total assets sold to buyer.

1. In the year of default also pass the entries for interest due and for depreciation as done in the case of complete repossession.
2. In this case both buyer and seller do not close seller's and buyer's account in their respective books. The entry is passed with the agreed value of the asset which is taken away by the seller. The seller always calculate the asset value taken over at a higher rate of depreciation.
3. The buyer finds out the value of asset still left with him using the normal rate of depreciation with this balance the asset account is continued, i.e. this account shows the balance of that asset which is left to him by the seller.
4. After crediting the asset account with the value of asset taken away by the seller and after keeping the balance of the asset left as calculated above the difference shown by the asset account represents either profit or loss on default. This difference is transferred to profit and loss account.

This can be better understood by the following illustration.

Illustraiton II

A Transport company purchased 2 trucks costing Rs.1,60,000 each from Seshagiri Auto Ltd., on Ist January 2004, on the basis of hire purchase system. The terms were; payment on delivery Rs.40,000 for each truck. Remainder in 3 equal instalments together with interest at 10% per annum to be paid at the end of each year.

Transport company writes of off 25% depreciation each year on the diminishing balance method. Transport Ltd paid the instalments due on 31st December 2004 and on 31st December 2005 but could not pay the final instalment.

Seshagiri Auto Ltd., repossessed one truck adjusting its value against the amount due. The repossession was done on the basis of 30% depreciation on the diminshing balance method. The vendor spend Rs.16,000 for the repairs and over hauling of the truck and sold it for Rs.80,000.

Write up the ledger accounts in the books of both parties.

Solution

In the books of Transport company

Dr Trucks Account Cr

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2004			2004		
Jan 1	To Seshagiri Auto Ltd A/c	3,20,000	Dec 31	By Depreciation A/c	80,000
				By Balance c/d	2,40,000
		3,20,000			**3,20,000**
2004					
Jan1	To Balance b/d	2,40,000	Dec 31	By Depreciation A/c	60,000
			Dec 31	By Balance c/d	1,80,000
		2,40,000			**2,40,000**
2006			2006		
Jan 1	To Balance b/d	1,80,000	Dec 31	By Depreciation A/c	45,000
			Dec 31	By Seshagiri Auto Ltd.A/c	54,880
			Dec 31	By P & L A/c	12.620
			Dec 31	By Balance c/d	67,500
		1,80,000			**1,80,000**

Dr. Seshagiri Auto Ltd. Cr

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2004			2004		
Jan 1	To Bank	80,000	Jan 1	By Trucks A/c	3,20,000
	To Bank	1,04,000	Jan 1	By Interest A/c	24,000
Dec31	To Balance c/d	1,60,000			
		3,44,000			**3,44,000**
2005			2005		
Dec31	To Bank A/c	96,000	Jan 1	By Balance b/d	1,60,000
Dec31	To Balance c/d	80,000	Dec 31	By Interest A/c	16,000
		1,76,000			**1,76,000**
2006			2006		
Dec31	To Truck A/c	54,880	Jan 1	By Balance b/d	80,000
Dec 31	To Balance c/d	33,120	Dec 31	By Interest A/c	8,000
		88,000			**88,000**
2007					
Jan 1	By Balance b/d	33,120			

In the books of Seshagiri Auto ltd.

Dr. Transport Company Account Cr

Year	**Particulars**	**Amount Rs.**	**Year**	**Particulars**	**Amount Rs.**
2004			2004		
Jan 1	To Sales A/c	3,20,000	Jan 1	By Bank A/c	80,000
Dec31	To Interest A/c	24,000	Jan 1	By Bank	1,04,000
			Dec 31	By Balance c/d	1,60,000
		3,44,000			**3,44,000**
2005			2005		
Jan 1	To Balance b/d	1,60,000	Dec 31	By Bank A/c	96,000
Dec31	To Interest A/c	16,000	Dec 31	By balance c/d	80,000
		1,76,000			**1,76,000**
2006			2006		
Jan 1	To Balance b/d	80,000	Dec 31	By Repossessed Stock A/c	54,880
Dec31	To Interst A/c	8,000		By Balance c/d	33,120
		88,000			**88,000**
2007					
Jan 1	To Balance b/d	33,120			

Dr Re possessed Stock Account Cr

Year	**Particulars**	**Amount Rs.**	**Year**	**Particulars**	**Amount Rs.**
2006			2006		
Dec31	To Seshagiri transport Co.A/c	54,800	Dec 31	By Bank A/c	80,000
Dec31	To Bank A/c (expenses)	16,000			
Dec31	To Profit & Loss A/c	9,120			
		80,000			**80,000**

Working Notes :

1. Value of truck repossessed :

Cost 2004		1,60,000
Less:	Dep. at 30% P.A.	48,000
	Balance on 1-1-2005	1,12,000
Less :	Dep. for 2005 @ 30%	33,600
	Balance on 1-1-2006	78,400
Less :	Dep. for 2006@ 30%	23,520
		54,880

2. Value of truck retained :

Cost 2004		1,60,000
Less :	Dep. for 2004 @25%	40,000
	Balance on 1-1-2005	1,20,000
Less :	Dep. for 2005 @ 25%	30,000
	Balance on 1-1-2006	90,000
Less :	Dep. for 2006@ 25%	23,500
		67,500

4.5. Accounting treatment for sales of small value items :

When seller sells goods of small value on hire purchase system, it may become inconvenient for him to maintain separate accounts for each customer, as in the case of considerable high value items. Hence under such circumstances he maintains a subsidiary book and records there the date of contract, name of customer, description of the article, number of instalments and dates of payment of instalments.

Profit for this type of business is calculated in two ways 1. by preparing hire- purchase trading account and 2. by preparing hire purchase adjustment account. In detail we will see how these accounts are prepared.

4.6 Hire purchase trading Account :

To prepare a hire purchase trading account the following information is needed.

1. **Opening Stock :** This information is not needed if the business is run as a department of the main shop. Like simple trade account, this figure is shown on the debit side of hire-purchase trading account.
2. **Instalment unpaid and not due :** This information is needed whether the business is run as a department or as an independent business. This information is available at hire purchase price so it must be reduced to cost price and then shown on the debit side of hire-purchase trading account.
3. **Purchases :** If the business is run independently then purchases term is used. But when business is run as a department, then the information relating to purchases made by the department is given under the term, 'goods sold during the year'. Since goods sold during the year are given at hire purchase price, they are reduced to cost price. This is shown on the debit side of hire purchase trading account.

   Sales : Hire purchase trading account is credited with sales. But in hire purchase trading account, instead of showing single figure of sales three figures are shown. Opening balance of instalments due but not received is shown on the debit side of the trading account and cash received from customers during the year and closing balance of instalments due but not received are shown on the credit side.
4. **Stock at the end :** This is shown on the credit side of hire purchase trading account except in case of department of the main shop.
5. **Stock with customers :** This is shown on the credit side of hire-purchase trading account as cost price irrespective of the type of business. It is also termed as instalments unpaid and not due.

This can be better understood with the following illustration.

Illustration 3:

Vinod sells goods on hire-purchase system at cost plus 60 percent. From the following prepare

Hire-purchase Trading Account.

2006		
April 1	Goods out on hire purchase at	**Rs.**
	hire purchase price	1,60,000
2007 March 31	Instalments not due and unpaid	3,60,000
	Instalments due and unpaid	20,000

The following transactions took place during the year :

1. Goods sold on hire purchase system at hire purchase price 8,00,000
2. Cash received from customers on hire purchase price 5,60,000
3. Goods received back on default (Instalments due Rs.20,000) valued at 4,000

Solution :

Dr. **Hire Purchase Trading Account** **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Goods out on hire purchase at cost			B Cash received	5,60,000
				By Instalment due	20,000
	$(1,60,000 \times \frac{100}{160})$	1,00,000		By Returns	4,000
	To Goods sold at Cost			By Instalments not due at cost	
	$(8,00,000 \times \frac{100}{160})$	5,00,000		$(3,60,000 \times \frac{100}{160})$	2,25,000
	To Net profit	2,09,000			
		8,09,000			**8,09,000**

Note : When goods are received back they are included into stock at cost price or market price whichever is lower and are shown in the trading account on the credit side.

Illustration 4 :

Vyshnavi & Co has a hire-purchase department and goods are sold on hire-purchase at cost plus 60%. From the following information prepare Hire purchase Trading Account to ascertain the profit or loss made in the hire-purchase department.

2006

April 1 Goods with Hire purchase customers at (H.P. Price) 3,20,000

March 31	Goods sold on hire-purchase during the year at H.P. price	16,00,000
	Cash received during the year from customers	11,20,000
	Repossed goods valued at (Instalments due Rs.40,000)	6,000
	Goods with the H.P. customers at H.P. price	7,20,000

Solution :

Vyshnavi & Co

Dr. **Hire purchase Trading Account** Cr.

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2006			2006		
April	To Stock	3,20,000	April.1	By Bank	11,20,000
	To Goods sold	16,00,000		By Repossessed stock	6,000
	To Stock Reserve (72,000 x 60/160)	2,70,000		By Instalments due	40,000
	To P & L	4,16,000		By Hire purchase Stock	7,20,000
				By Stock Reserve A/c (3,20,000 x)	1,20,000
				By Goods sold on H.p. (16,00,000 x 60/100)	6,00,000
		26,06,000			**26,06,000**

Dr. **Goods sold on Hire Purchase Account** **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2007			2006		
Marh31	To Hire purchase (Loading)	6,00,000	April 1	By H.P. Trading A/c	16,00,000
	To Purchases A/c	10,00,000			
		16,00,000			**16,00,000**

Dr. **Instalments due Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2007			2007		
Mar31	To H.P. Trading A/c.	40,000	Mar 31	By Balance c/d	40,000
		40,000			**40,000**
Aprl1	To Balance b/d	40,000			

Dr. **Hire Purchase Stock Account** Cr

Date	**Particulars**	**Amount Rs.**	**Date**	**Particulars**	**Amount Rs.**
2007			2006		
APrl1	To Balance b/d	3,20,000	April 1	By H.P,. Trading A/c. (transfer)	3,20,000
Mar31	To H.P. Trading A/c	7,20,000	Mar 31	By Balance c/d	7,20,000
	To Balance b/d	7,20,000			

Dr. **Stock Reserve Account** Cr.

Date	**Particulars**	**Amount Rs.**	**Date Rs.**	**Particulars**	**Amount**
2007			2006		
Mar31	To H.P. Trading A/c (Transfer)	1,20,000	Aprl.1	By Balance b/d	1,20,000
2007			2007		
Mar31	To Balance c/d	2,70,000	Mar.31	By H.P. Trading A/c	2,70,000
			Aprl	By Balance b/d	2,70,000

Working

Calculation of instalments due :		Rs.
Op.Stock (H.P. Price)		3,20,000
Good sold		16,00,000
		19,20,000
	Rs.	
Less : Cash received	11,20,000	
Repossessed goods (H.P. Price)	40,000	
Stock with customers	7,20,000	18,80,000
Instalments due		40,000

4.7. Stock and Debtors system:

Under this method the following ledger accounts are prepared

1. Hire purchase stock account
2. Shop stock account
3. Hire purchase debtors account
4. Goods on hire -purchase account.
5. Hire purchase adjustment account.

The following journal entries are passed to record the transactions under this system.

1. When goods are made available for sale on hire purchase:

Shops stock A/c Dr
To Purchase A/c (at Cost price)
(Being goods available for Sale)

2. When goods sold on HP.

a) Hire purchase stock A/c Dr
To goods sold on H.P. A/c
(at sale price)

b) Goods sold on H.P. A/c (Sale price) Dr
To Shop stock A/c (Cost price)
To H.P. Adjustment A/c

3. When instalments become due
Hire purchase debtors A/c Dr
To Hire purchase Stock A/c

4. When cash is received
Cash A/c Dr
To Hire purchase Stock A/c

5. For loading included in instalment not due
H.P. Adjustment A/c Dr
To Stock Reserve A/c

6. For instalments not paid of repossessed goods
Repossessed goods A/c Dr
To Hire purchase debtors A/c

7. For Profit
H.P. Adjustment A/c
To P & L A/c

8. For Loss
P & L A/c Dr
To H.P. Adjustment A/c

Illustration 5 :

A trader sold out goods on hire purchase at a profit of 25% on cost price. Prepare a. Hire purchase stock Account b. Shop stock account and cl. Hire purchase Debtor's account in the books of the Trader from the following details.

	Rs.
Stock in godown :	
On 1-4-2006	1,20,000
On 31-3-2007	1,00,000
Over due instalments :	
On 1-4-2006	8,000
On 31-3-2007	12,000
Goods with customers on hire purchases	
On 1-4-2006	1,44,000
Purchases	2,58,400
Installments received	2,40,000

Solution :

H.P. Stock A/c

Date	**Particulars**	**Invoice**	**Amount Rs.**	**Date**	**Particulars**	**Invoice**	**Amount Rs.**
1-1-06	To Bal b/d	1,44,000	1,15,200	31-3-07	By H.P. Debtors A/c	2,44,000	2,44,000
31-3-07	To Goods sold	3,48,000	2,78,400	31-3-07	By Bal c/d	2,48,000	1,98,400
31-3-07	ToGross profit	---	48,899				
		4,92,000	4,42,400			4,92,000	4,42,400

Dr. **Shop Stock A/c** **Cr.**

Date	**Particulars**	**Amount Rs.**	**Date**	**Particulars**	**Amount Rs.**
1-4-06	To Bal b/d	1,20,000	31-307	By Cost of goods	
31-3-07	To purchase A/c	2,58,400	31-3-07	Sold on H.p.	2,78,400
			31-3-07	(Bal fig)	
			31-3-07	By Bal c/d	1,00,000
		3,78,400			3,78,400

Dr. **H.P.Debtors A/c** **Cr.**

Date	**Particulars**	**Amount Rs.**	**Date**	**Particulars**	**Amount Rs.**
1-4-06	To Bal b/d	8,000	31-307	By Bank A/c	2,40,000
31-3-07	To H.P. Stock A/c	2,44,000	31-3-07	By Balance c/d	12,000
		2,52,000			**2,52,000**

4.8. Summary

The hire - vender can repossess the goods sold on hire purchase if the purchaser commits default in payment of any instalment Repossession can be complete or partial. Partial repossession occurs when the vender sells different goods on hire purchase to the same party and allows him to continue his business with goods not repossessed. When hire purchase transactions are of small value, the hire vender may prepare Hire purchase trading account on stock method. Under stock and debtors method, hire purchase stock account, goods on hire purchase account and Hire purchase adjustment account are prepared.

4.9 Self Assessment Questions :

1. What is Hire purchase trading account ? Why is it prepared ? Give a proforma.
2. What is the difference between hire purchase trading account and Hire purchase adjustment account.
3. Explain the methods of repossession.

4.10 Exercises :1

1. X Purchased a machine on 1st Jan 2000 on Hire - purchase system. The cash price of the machine is Rs 149000. The terms of the agreement provided for payment of Rs 40,000 at the end of every six months over two years. The first payment was to be made on 30th June 2000. Rate of interest is 6% p.a. Wrote off 10% Depreciation on the reducing balance system and closed his books on 30th June every year. Could not pay the instalment due on 30th June 2001 and as a result, the hire vender took back the machine give the machine a/c and vender account in the books of X.

2. Y Ltd purchased a machine from Z Ltd on 1st January 2001 on the Hire purchase system. The cash price of the machine was Rs.1,20,000, payment was to be made Rs 40,000 half yearly over two years. The first payment was to be made on 30th June 2001. Rate of interest 5% p.a. Depreciation to be written off @ 10% p.a on the diminishing balance method. The books of accounts were closed on 30th June every year. The instalment due on 30th June 2002 could not be paid and as a result of which the vender took repossession of the machine. Prepare machine account and hire vender account in the books of Ltd.

3 Pavan purchased six trucks on hire - purchase on 1st July 2002. The cash price of each truck was Rs 2,50,000. He was to pay 20% of the cash purchase price at the time of delivery and the balance in five yearly instalments starting from June 2003 with interest at 20% per annum.

   On pavan's failure to pay the instalment due on June 2004 it was agreed that pavan would return 3 trucks to the vendor and remaining would be retained by him. The returned trucks were valued at 30% per annum where as pavan depreciates trucks at 20% p.a.

   Vender after spending Rs 5000 on repairs sold away all the three trucks for Rs 2,00,000

   Show necessary accounts in the books of both the parties.

4. On January 2000 Yogesh acquires 3 machines on hire purchase from Somesh at 10% p.a interest Yogesh immediately pays Rs 1,20,000 and also agrees to pay in three annual instalments of Rs. 2,00,000 each. The first instalment becoming due at Dec 31, 2000. Yogesh duly pays the first instalment but fails to pay thereafter, on yogesh's default somesh repossessed all machines yogesh is charging depreciation at 20% p.a on straight line basis at 31st December each year, show the relevant ledger accounts in the books of both the parties.

5. Naveen purchased four machines of Rs 70,000 each from Praveen under hire purchase system. The down payment is Rs 75,000 and three instalments of Rs 75,000 each at the end of each year. Naveen depreciates the machines at 10% per annum on the straight line method. Down payment and first instalment were paid. Naveen could not pay the second instalment and therefore praveen took back three machines leaving one machine with Naveen. The

machines were taken at 20% depreciation on written down method. Praveen repaired the machines at a cost of Rs 15,600 and sold them for Rs 1,75,000.

Prepare necessary ledger accounts in the books of both the parties.

6. Nitin sells goods on hire purchase price which is made of profit at 50% on hire purchase Price. Calculate profits from the information given below by preparing Hire Purchase trading and Hire - purchase adjustment accounts.

2006		Rs.
April	Instalments due	4,50,000
2007		
March 31	Instalments due during the year	12,00,000
	Cash received during the year	15,00,000
	goods sold during the year	12,60,000
	Instalments unpaid (not due)	
	On 31 March 2007	3,00,000
	Goods repossessed during the year	
	(amount due 15,000) valued at	1,500

7. Rajesh sells goods at hire - purchase price. Hire purchase price is made of profit at 50% on hire purchase price. Calculate profit from the information given below by preparing hire - purchase trading account.

2007		Rs.
Jan 1	Instalments due in the beggning	75,000
Dec 31	Installments due during the year	2,00,000
	Cash received during the year	2,50,000
	goods sold during the year	2,10,000
	Instalments unpaid (not due)	
	on 31st December	50,000
	goods repossessed during	
	the year (amount due Rs 2,500)	500

8. Comfort furnishers supply the furnishing on hire purchase. Terms at a profit of 50% over the cost. The following are the transactions for the year ended 31st Dec 2007.

2007		Rs.
Jan 1	stock out on hire at cost	1,20,000
Jan 1	Instalments due (customers still paying)	10,800
	goods repossessed during the year	
	(for instalments unpaid) evaluated at	900
	instalments realised during year.	234000
Dec31	stock out on hire at cost	114000
Dec 31	Instalments due (customers still paying)	18,000

Prepare hire purchase stock account Hire purchase debtors account and Hire- purchase adjustment account.

4.11 SUGGESTED READINGS :

Financial Accountancy	**:**	**Shukla Grewal**
Financial Accountancy	**:**	**Jain and Narang**
Financial Accountancy	**:**	**R.L. Gupta & V.K. Gupta**

Dr. Ch. Suravinda

LESSON - 5

Single Entry - I

5.0. Objective : After going through this lesson the student can know a different system of accounting, (other than double entry) which is usually adopted by small proprietors, traders and professional people, famously known as single entry system of accounting.

Structure :

5.1 Introduction.

Single Entry system is the method of maintaining accounts which does not exactly follow the principles of double entry system. Under this method the principles of the double entry system are not being followed for all transactions, that means both the aspects of certain transactions are recorded while only one aspect is recorded for certain transactions. Under this methods usually the personal accounts of the debtors and creditors are kept and real and nominal accounts may not be maintained in the books. Small traders general merchants, medical practitioners, lawyers and other professional people usually adopt this system joint stock companies cannot adopt this system because they are required to maintain complete records of all transactions under the companies Act 1956.

5.2 Definition :

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

Thus single entry is not any practical system of accounting but rather the double entry system in an incomplete and disjoined form.

There are two types of single entry.

1. Pure single Entry : Under this system only the personal accounts of the debtors and creditors are kept, all real and nominal accounts are not maintained.

2. Single Entry in the popular sense: This method of single entry along with personal accounts of Debtors and creditors, real accounts like cash and bank accounts are maintained.

5.3 Features :

Single entry system has the following features

1. Books according to this system can be kept only by a sole trader or by a partnership firm. Joint stock companies cannot keep books on single entry system.
2. In this system it is very common to keep only personal accounts and to avoid real and nominal account.
3. It is vert common in this system to keep one cash book which mixes up business as well as private transactions.
4. Under this system for any information one has to depend on original vouchers, For example in the case of credit sales, the proprietor may keep the invoice without recording it any where and at the end of the year the total of the invoices gives an idea of total credit sales of the business.
5. This system lacks uniformity as it is a mere adjustment of double entry system according to the convenience of the person.
6. It is difficult to prepare trading, profit and loss account and balance sheet due to the absence of nominal and real accounts in the ledger.

5.4.Difference between single Entry and Double entry :

The following are the main differences between these two systems

Single Entry	Double Entry
1. It is an incomplete record of final transactions	1. It is a complete record of the financial transactions
2. Under this system only personal accounts are maintained.	2. All accounts personal as well as inpersonal are maintained in the double entry method.
3. Books maintained by the single entry system are not reliable because a complete record of transactions is not maintained.	3. As the books are maintained systematically, they are reliable.
4. Due to lack of complete record of transactions trial Balance can not be prepared to check arithmetical accuracy.	4. Trial Balance can be prepared under this system.
5. In the absence of nominal accounts a Trading and profit and loss Account can not be prepared to ascertain profit.	5. Profit and loss account can be prepared because a complete record of all transactions is available in the books.
6. As The information regarding Assets is not available, we cannot prepare the Balance sheet.	6. Under this system a complete record of real accounts is available so we can prepare the Balance sheet.

5.5. Defects of single Entry:

Single entry system is an incomplete system of accounts. Hence it suffers from the following defects or limitations.

1. This system is an unscientific method of accounting.
2. It does not record both the aspects of a transactions therefore at the end of the year arithmetical accuracy of the books cannot be checked by preparing a trial balance.
3. In the absence of check the possibility of fraud or misappropriation is grater in case of single entry than in the case of double entry system.
4. In the absence of nominal accounts, trading and profit and loss account can be prepared to ascertain profit or loss.
5. In the absence of real accounts. It is not possible to know the exact financial position of the business on any particular day by preparing a Balance sheet.
6. No correct price of the business is available and thus it is a set back at the time of sale of the business.
7. Information obtained from the records cannot be relied upon because of lack of test and free from doubt.
8. It is difficult to get loans from banks and other financial institutions as proper and reliable balance sheet is absent.
9. Financial strength or soundness of the firm cannot be judged because true and reliable figure of net profit or asset and liabilities is not available.
10. It is very difficult to ascertain the value of goodwill of the business.
11. The proprietor cannot know the progress made by the business over past year as the figures of sales and net profit and rate of net profit on sales cannot be known.

Inspite of the above defects the single entry method of maintaining accounts is quite popular with small firms which cannot afford to spend money on maintenance of accounts under double entry.

5.6 Methods of Ascertaining Profits :

In the absence of real accounts in the books maintained on the single entry it is not possible to prepare the Balance sheet of the business. Similarly in the absence of nominal accounts profits cannot be calculated by preparing trading and profit and loss account. Therefore to find the profit of a period and to judge the financial position of the business we can adopt any of the two methods.

a. Statement of Affairs or net worth Method.
b. Conversion Method. The working of both the methods has been discussed one after the other.

5.7 Preparation of statement of Affairs :

The following points should be considered while preparing statement of Affairs.

1. The cash book should be balanced. Cash in hand should be verified with the balance as shown by the cash book.
2. The bank balance as per cash book should be reconciled with the pass book balance.

3. The list of debtors and creditors should be prepared from the personal accounts maintained in the ledger.
4. Stock in trade should be taken and valued at cost or market price whichever is lower
5. The values of fixed assets should be ascertained from the information as may be available.
6. Depreciation if any on fixed assets should be provided.
7. All out standing expenses and incomes should be considered and shown in statement of Affairs.
8. Expenses paid in advance and incomes received in advance should also be provided and shown in the statement of Affairs.
9. The excess of assets over liabilities will represent the capital on that date.

5.8 Difference between statement of Affairs and Balance sheet :

The purpose of preparation of both the statements is to show the financial position of the business on a particular date but there are certain differences between these two, those can be explained as follows.

Statement of Affairs	Balance sheet
1. The financial position disclosed by the statement of Affairs is not reliable.	1. Financial position disclosed by the Balance sheet is reliable.
2. It is prepared with the information available in the incomplete books.	2. It is prepared with balances extracted from books maintained on the double entry system.
3. It helps in ascertainment of trading profit or loss for a particular period, as well as the financial position on a particular date.	3. The primary purpose of a Balance sheet is to a Balance sheet is to show the financial position of the business on a particular date.
4. Due to incomplete record there is a possibility of omission of some facts.	4. No fact is omitted or committed because complete record for the transactions takes place.

5.9 Statement Affairs or net worth Method:

Statement of Affairs method is one of the methods of ascertaining profits under the single Entry system. Trading and profit and loss account cannot be prepared from books maintained on single entry basis because nominal accounts are not maintained in the ledger. Hence we prepare a statement of affairs for the purpose of calculation of profits. The following procedure is followed:

1. First of all, a statement of affairs at the beginning of the year is prepared to determine the amount of capital at the beginning of the year.
2. Similarly, a statement of Affairs at the close of the year is prepared to determine the amount of capital at the end of the year.
3. Drawings are added to the capital at the end because drawings made during the year can reduce capital at the end.

4. Similarly capital introduced during the year should be deducted from the capital at the end for the reason that the capital at the end would have been less by that amount if such addition to the capital is not made during the year.

5. Capital at the beginning of the year as ascertained in step one should be deducted from the adjusted capital ascertained in step four and the difference will be either a trading profit or ;loss. If the adjusted capital at the end exceeds will be profit for the year. If the adjusted capital at the end of the year is less than the capital at the beginning of the year, the difference will be loss for the year.

6. Interest on capital and interest on drawings is adjusted to profit or loss to arrive at the net profit or loss for the year.

This can be betterly understood with the following illustration.

Illustration I

Arun keeps his books on the single entry system and the following information is available.

	1st Jan 2007	**31st Dec 2007**
	Rs.	**Rs.**
Furniture	4,000	4,000
Stock	56,000	61,000
Sundry Debtors	42,000	68,000
Cash	3,000	4,000
Sundry creditors	35,000	38,000
Bills payable	------	6,000
loan	------	10,000
Investments	------	20,000

He has drawn out of the business Rs 10,000 during the year.

Prepare a statement showing his profit for the year ended 31st December 2007 after writing off 10% depreciation on furniture and making a provision for bad debts of 10% on sundry debtors.

Solution:

Statement of Affairs of Mr. Arun as on 1-1-2007

Liabilities	**Amount Rs**	**Assets**	**Amount Rs**
Sundry creditors	35,000	Cash	3,000
Capital Account	70,000	Sundry debtors	42,000
(Balancing figure)		Stock	56,000
		Furniture	4,000
	1,05,000		1,05,000

Statement of Affairs of Mr. Arun as on 1-1-2007

Liabilities	Amount Rs	Assets		Amount Rs
Bills payable	6000	Cash		4,000
Sundry creditors	38,000	Investments		20,000
Loan	10,000	Sundry Debtors	68,000	
Capital Account	95,800	Less Provision	6,800	61,200
(Balancing figure)		for bad debts		
		Stock		61,000
		Furniture	4,000	
		Less Depreciation	400	3,600
	1,49,800			1,49,800

Statement of profit of Mr. Arun for the year ended 31st December 2007	Rs.
Capital at the end of the year	95,800
Add : Drawings during the year	10,000
	1,05,800
less : Capital at the beginning of the year	70,000
Profit for the year.	35,800

Illustration 2

Varun keeps his books by the single Entry method. His position on 31st March 2007 was as follows.

Cash in hand Rs 7,200; cash at Bank Rs 76,500 Debtors Rs 55,200; stock Rs 85,800 Furniture Rs 15,000; creditors for goods Rs 56,100 Expenses outstanding Rs 6,000

On 1st october, 2007, varun introduced Rs 30,000 as further capital in the business and withdrew on the same date Rs 21,000 out of which he spent Rs 15,000 on the purchase of a machine for the business on 31st March 2008 his position was as follows :

Cash in hand Rs 6,300; cash at bank Rs. 82,500; stock Rs 94,500; Debtors Rs 72,600 Furniture Rs 18,000; creditors Rs 75,600; prepaid Insurance Rs 600.

Prepare the necessary statement showing the profit or loss made by him during the year ended 31st March 2008 after making the following adjustment. Depreciate Furniture and Machine @ 10% p.a; baddebts Rs.3,600 for doubtful debts @5%. Goods taken for personal use amounted to Rs.4,500. Also provide interest on capital @ 10% p.a.

Solution :

Statement of Affairs of Varun as on 31st March 2007.

Liabilities	Amount Rs	Assets	Amount Rs
Creditors	56,100	Cash in hand	7,200
Expenses outstanding	6000	Cash at Bank	76,500
Capital	1,77,600	Debtors	55,200
(Balancing figure)		Stock	85,800
		Furniture	15,000
	2,39,700		2,39,700

Statement of Affairs of Varun as on 31st March 2008.

Liabilities	Amount Rs	Assets	Amount Rs.	Amount Rs
Creditors	75,600	Cash in hand		6,300
Capital	20,4,450	Cash at Bank		82,500
(Balancing figure)		Stock		94,500
		Debtors	72,600	
		less Bad debts	3,600	
				69,000
		less Provision	3,450	65,550
		Prepaid Insurance		600
		Furniture	18,000	
		less Depreciation		
		on 1,5000 for		
		1year 1500		
		on 3,000 for		
		1/2year 150	1650	16,350
		Machinery	15,000	
		less Depreciation		
		for 1/2 year	750	14,250
	2,80,050			2,80,050

Note : Date of purchase of new furniture is not given in the question, so depreciation on this furniture has been charged for half year.

Statement of Profit of Varun as on 31st March 2008.

	Amount Rs.	Amount Rs.
Capital as at the 31st March 2008		204450
Add Drawings	6000	
Cash (21000 - 15000) goods	4500	10500
		214950
less Additional capital introduced		30000
		184950
less capital as at 1-4-2007		177600
profit before allowing interest on capital		7,350
less Interest on capital @ 10% p.a		
on Rs 1,77,600 for 1year.	17760	
on Rs 30000 for 1/2 year.	1500	19260
loss for the year.		11910

Illustration 3

Nalini, Rajani, sujani were in partnership and towards the end of 2007 most of their books and records were destroyed in the fire. The Balance sheet as on 31st December. 2006 was as follows:

		Rs		Rs
Creditors		22,000	Cash	9,600
Capital			Debtors	14,400
Nalini	18,000		Stock	26,000
Rajini	12,000		Machinery	5,760
Sujani	6,000	36,000	Fixtures & Fittings	2,400
Current A/cs:				
Nalini	580		Currant Account	
Rajini	400	980	Sujani	680
		58,980		58,980

The partners drawing during 2007 have been proved at A- Rs 5600, B- Rs 4000 and C-Rs 2,600. on 31st Dec, 2007 the cash was Rs 12,800, Debtors Rs 16,100, stock Rs 2360 Advance payments Rs 100 and creditors Rs 24,160. Machinery is to be depreciated by 10% per annum and Fixtures and fillings at 71/2%. 5% Interest is to be allowed on capitals. The partners share profits in the proportions of 1/2, 1/3 and 1/6.

You are required to prepare a statement showing the net trading profit for the year 2007 and the division of the same between the partners, together with the Balance sheet as on 31st December 2007.

Statement of affairs of M/s Nalini, Rajani, Sujani as at 31st December 2007

Liabilities	Amount Rs	Amount Rs	Assets	Amount Rs	Amount Rs
Creditors			Cash		12,800
Capitals		24,160	Debtors		16,100
			Stock		23,600
Nalini	18,000		Prepaid expenses		100
Rajani	12,000		Machinery	5,760	
Sujani	6,000	36,000	less Depreciation	576	5,184
			Fixtures & Eittings	2,400	
			less Depreciation	180	2,220
			Combined current		
			Account of		
			Nalini, Rajani, sujani		156
		60,160			60,160

Statement of Profit of Profit & Loss
For the year ending 31st Dec 2007.

	Amount Rs.	Amount Rs.
Combine of current Accounts of		
Nalini, Rajani, Sujani on 31-12-07		-156
Add Drawings during the year:		
Nalini	5600	
Rajani	4000	
Sujani	2600	12200
less Combined current Account 1-1-07		12,044
Nalini	580	
Rajani	400	
Sujani	-680	300
profit before allowing interest		117,44
on capital		
less Interest on capital @ 5% p.a		
Nalini	900	
Rajani	600	
Sujani	300	1,800
Net profit made during the year		9,944
Devided among Nalini, Rajani Sujani		
as follows :		
Nalini - 1/2 of 9944		4,972
Rajani - 1/3 of 9944		3,316
Sujani - 1/6 of 9944		1,656

Balance sheet Nalini, Rajani and Sujani
as at 31st December 2007.

Liabilities	Amount Rs	Amount Rs	Assets	Amount Rs	Amount Rs
Creditors		24,160	Cash		12,800
Capitals			Debtors		16,100
			Stock		23,600
Nalini	18,000		Prepaid expenses		100
Rajani	12,000		Machinery	5,760	
Sujani	6,000	36,000	less Depreciation	576	5,184
Nalini Curent A/c			Fixtures & Eittings	2,400	

Balance on 1-1-07	580		less Depreciation	180	2,220
Add Interest	900				
Profit	4,972				
	6,452				
less Drawings	5,600	852	Sujani Current Account		
Rajani Current A/c	400		Balance on 1-1-07	680	
Balance of 1-1-07			Add Drawings	2,600	
Add Interest	600			3,280	
Profit	3,316		less Interest 300		
	4,316		Profit 1650	1.956	1324
less Drawings	4,000	316			
		61,328			61,328

5.10 Summary

Small proprietors, traders and professional people usually adopt a system of keeping incomplete book - keeping records, This is known as single entry system. Limited companies cannot adopt this system of acounting. Under this system only personal accounts are kept. Real and nominal accounts are generally not maintained. One cash book is kept in which business and private transactions of the proprietor are mixed up. This system lacks uniformity. It is an adjustment of double entry system to suit the convenience of a person. It is difficult to prepare final accounts in the absence of real and nominal accounts. Single entry system is full of defects. Arithmetical accuracy of the books cannot be checked by preparing a trial balance. Frauds are common under this system.

Profits can be ascertained under two methods. 1. Statement of Affairs or net worth Method 2. Convertion method. Under networth method, to find out the capital on the opening and closing days, the accounting equation “capital = Assets - Labilities to outsiders” is used and statement of affairs prepared accordingly. Adjustments with regard to drawings, capital introduced, depreciation etc. are made to closing capital and then true profit or loss is ascertained.

5.11. Self Assessment Questions :

1. What do you mean by single entry system ?
2. How does profit can be ascertained under single entry system.
3. What are the features of single entry system ?
4. Briefly describe the limitations of single entry system.
5. Distinguish single entry system from double entry system.
6. What is a statement of Affairs.
7. What are the differences between a statement of Affairs and a Balance sheet.
8. What are the methods of ascertaining profit under single entry system.

5.12. Exercises :

1. Kusuma a Retail merchant commenced business with a capital of Rs 75,000 on 1-1-2006. subsequently on 1st May 2006, she invested a further sum of Rs 35,000 as capital in the business, During the year he has with drawn Rs 15,000 for his personal use. On 31-12-2007 her assets and liabilities were : cash at Bank Rs 30,000, Debtors Rs 40,000, stock of goods Rs 160,000, Furnitures Rs 20,000 and sundry creditors Rs 50,000

   Ascertain profit or loss for the year 2006.

2. Subba Rao keeps books by the single entry system. Assets and liabilities on 31st December 2006 and 2007 were as under :

	31 - 12 - 2006	**31 - 12 - 2007**
Cash in hand	1,200	1,800
Cash at Bank	1,800	12,000
Stock	1,20,000	1,14,000
Sundry debtors	51,000	84,000
Furniture	10,800	9,000
Plant and Mechinery	90,000	1,62,000
Sundry creditors	1,32,000	1,74,000

During the year Subba Rao introduced Rs 30,000 as further capital in the business and with drew Rs 4,500 per month.

From the above prepare a statement showing the profit or loss made by him for the year ended 31-12-2007.

3. Chalapati kept their books on single Entry system their position on 31-12-2006 was as follows:

Cash in hand Rs 1400; cash at Bank Rs 21,000 stock Rs 14,0000! Sundry Debtors Rs 59,500; Fixtures and Fittings RS 12,600; plant and Machinery Rs. 1,05,000; Sundry Creditors Rs 1,54,000.

Chalapati put Rs 3,5000 during the year as new capital and his drawings were @ Rs 5,250 per month.

His position on 31st Dec 2007 was as follows:

Cash in hand Rs 2,100 : Cash at Bank Rs 14,000: sundry Debtors Rs 98,000 stock Rs 1,33,000 plant and Machinery Rs 1,89,000: Fixtures and Fittings Rs. 10,500 sundry creditors Rs 2,03,000.

From the above information prepare a statement of Affairs showing profit or loss during the year 31-12-2007.

4. Aravind commenced business on 1-1-2006 with capital of RS 2,00,000. He immediately bought furniture for Rs 48,000 During the year he borrowed Rs 120000 from his wife and introduced a further capital of his own amounting to Rs 76,000. He had withdrawn Rs 7200 at the end of each

month for family expenses. On 31st December 2006, his position was as follows.

Cash in hand Rs 4,800; cash at Bank Rs 62,400 sundry Debtors; Rs 1,15,200; stock Rs 1,63,200: Bills Receivable Rs 38,400: sundry creditors Rs12,000; Rent due Rs 3600.

Furniture to be depreciated by 10% Ascertain the profit or loss made by Aravind during 2006.

5. Phalgun commenced business on 1st january 2007 with a capital of Rs 18,0000. Soon after he bought furniture and fixtures for Rs 32,000. On 30th June 2007 he borrow Rs 90,000 from his brother at 12% per annum (interest not yet paid) and introduced a further capital of his own amounting Rs 2700. He withdrew @ Rs 5400 per month at the end of each month for household expenses. On 31st December 2007 his position was as follows.

Cash in hand Rs 3600: Cash at Bank Rs. 46,800 sundry Debtors Rs 86,400: stock Rs 90,000: Bills Receivable Rs 28,800: sundry creditors Rs 9,000 and owing for rent Rs 2,700.

Furniture and fixtures are to be depreciated by 10% Ascertain the profit or loss made by phalgun during 2007.

6. Vijay commended business on 1st January 2007 with a capital of Rs 1,00,000 which he paid into Banking Account opened for that purpose. On the same date he bought stock valved at Rs 65,000 and furniture which cost Rs 20,000. He kept his books on single entry basis. On 31st December 2007, stock was valued at Rs 83,000. There were book debts amounting to Rs 34,000 of which Rs 2000 represented debts which were irrecoverable. Creditors amounted to Rs 36,000 and the cash book showed a balance of Rs 16,500, but according to pass Book, the balance at vijays credit was only Rs 14500 he having given his son Rs 2,000 and omitted to enter in the cash book. Vijay with drew Rs 18,000 from the business for his private expences and in addition he used Rs 5000 worth of goods from his shop He took RS 10,000 as loan from his wife during the year.

Prepare a statement showing vijay's profit or loss in the business for the year ended 31-12-2007 from the above information.

7. Sobhan and Bharat are equal partners in a business in which the books are kept by single entry. The position of affairs on 1st January was as follows:

Liabilities	**Rs**	**Assets**	**Rs**
Bills payable	12,920	Cash in hand	540
Sundry creditors	40,580	Cash at bank	4,400
Capital Accounts		Bills Receivable	8,140
Sobhan	1,46,800	Sundry Debtors	97,360
Bharat	1,46,800	Stock	65,700
		Plant	1,60,360
		Furniture	10,600
	3,47,100		3,47,100

The following was the state of affairs on 31st December; cash in hand Rs 8000; Cash at Bank Rs 11,680; Debtors Rs 1,12,580; Bills Receivable Rs 13,680 stock Rs 73,460; Creditors Rs 42,940; Bills payable Rs 11,900. The partners had drawn Rs 9,000 each and were further entitled to interest on their capital at 5% per annum. It was agreed to depreciate plant at the rate of 10% and furniture at 5%. Draw up the final accounts.

8. Chinna, Madhu, Vasu are in partnership and keep their books by single entry. The state of Affairs of the firm as on 30th september 2006 was as under.

Liabilities		Rs	Assets	Rs
Bills payable		2,100	Cash in hand	3,750
Expenses outstanding		1,950	Cash at bank	10,350
Creditors		23,100	Bills Receivable	9,000
Capital Accounts			Debtors	30,600
Chinna	15000		Stock	25,200
Bharat	15000		Madhu's Current A/c.	2,790
Vasu	15000	45,000		
Chinna Current A/c		6,450		
Vasu Current A/c		3,090		
		81,690		81,690

The position of the firm on 30th September 2007 was :

Cash in hand Rs 4,200 : Cash at Bank Rs 10,710; Debtors Rs 36,900; stock Rs 28,080; Bills payable Rs 1500; creditors Rs 18,600 and 4% investment of the face value of Rs 6,000 purchased at 97%

Each partner had drawn Rs 750 per month at the beginning of every month during the year. 8% interest on capital and drawings drawn during the year is to be charged. On Ist April 2007 each partner had introduced Rs 4,500 as further capital in the firm.

Ascertain the profit or loss made by the firm during the year ending september 30,2007 and show the Balance sheet as on that date.

5.13 SUGGESTED READINGS :

Financial Accountancy	**:**	**Shukla Grewal**
Financial Accountancy	**:**	**Jain and Narang**
Financial Accountancy	**:**	**R.L. Gupta & V.K. Gupta**

- Dr. Ch. Suravinda

LESSON - 6

SINGLE ENTRY - II

6.0 Objective : In the previous lesson you learned that the profit under single entry system can be ascertained under two methods i.e. statement of Affairs Method and convertion method. As we have already seen how the statement of Affairs is prepared, In the present lesson you can learn the convertion method how the account under single entry can be converted into double entry system.

Structure :

6.1 Introduction.
6.2 Conversion of Books of last year from single entry into Double entry
6.3 Some important points for conversion
6.4 Illustrations
6.5 Summary
6.6 Questions
6.7 Excercises
6.8 Suggested Books

6.1 Introduction.

The word conversion denote the change of accounts prepared under single entry system into Double entry system. If any business concern desire to change the system of accounting from single entry to double entry on a given date the following procedure should be adopted :

A statement of Affairs should be prepared on the date on which the change is to be made. For bringing into books the various assets and liabilities appearing in the statement of Affairs an opening journal entry should be made as follows :

Various Assets Account Dr
To various liabilities Account
To Capital Account
(Being balance brought forward from the statement of Affairs)

The books will thus be opened under the double entry. In future all transactions should be recorded according to the double entry system. i.e: first through proper subsidiary books and then posted to the ledger.

6.2 Conversion of Books of last year

If a businessman wants to convert the books of the 2000 maintained on single entry system into double entry system in 2001, he should follow the following procedure, which is based on the assumption that proper subsidiary books have been maintained under the single entry system.

1. A statement of Affairs at the beginning of the year 2000 should be prepared and posted from it all those accounts which have not been maintained already.

2. The cash book should be gone through and entries relating to impersonal accounts should be posted to their respective accounts as these items were not posted to impersonal accounts under the single entry system. This would complete the double entry of the cash book

3. The Debtors and creditors accounts which have already been kept under the single entry system Should be scrutinised in order to find out the items which have been made direct there in without passing through the accounts e,g, debts, discouns, allowances etc should be posted to their respective impersonal accounts so that the two-fold effect of such transactions may be completed.

4. If a petty cash book is maintained, the monthly analysis should be posted to the debit of the various accounts for expences and the total credited to petty cash account.

5. After completing the double entry of all the transactions of the previous year, a trial balance should then be prepared to test the arithmetical accuracy of the books. After taking into consideration the necessary adjustments like outstanding expenses and incomes, depreciation, provision for bad debts and discounts, Trading and profit and loss account and Balance sheet should be prepared in the usual manner.

6.3 Important points for conversion

For the convenience of the students for converting the single entry into double entry some important points are given below.

1. Ascertainment of credit sales and credit purchases.

Usually a question on single entry does not give the figures of credit sales and credit purchases so to find them out a Total Debtors Account and a Total creditors account is prepared.

Illustration I

From the following information you are required to calculate total purchases :

	Rs.
Cash purchases	2,55,000
Creditors as on April 1, 2006	1,20,000
Cash paid to creditors	4,65,000
Purchases returns	15,000
Creditors as on March 31st 2007	2,01,000

Solution :

Dr **Total Creditors Account** **Cr**

	Amount Rs		Amount Rs
To cash	4,65,000	By Balance b/d	1,20,000
To returns	15,000	By Purchases made	
To Balance c/d	2,01,000	during the year	56,100
		(Balancing figure)	
	6,81,000		68,1000

Total Purchases = Cash purchases 2,55,000
Credit purchases 5,61,000
8,16,000

Illustration 2

From the following information calculate Total sales :

	Rs.
Opening debtors	20,000
Cash received from debtors	40,000
Cash sales	40,000
Closing debtors	32,000
Returns inward	2,000
Bad debts	8,000

Solution :

Dr **Total Debtors Account** **Cr**

	Amount Rs		Amount Rs
To Balance b/d	20,000	By Cash	40,000
To credit sales		By Returns	2,000
(Balancing figure)	62,000	By Bad debts	8,000
		By Balance c/d	32,000
	82,000		82,000

Total Sales = Cash Sales = 40,000
Credit Sales = 62,000
1,02,000

2. Ascertainment of opening and closing Debtors and creditors when credit sales and purchases are given :

In such a case the opening or closing balance of debtors and creditors can easily be ascertained by preparing the total Debtors and total creditors account as already explained. The balancing figure in the Total Debtors Account and the Total creditors Account will be opening or closing balance of debtors and creditors.

Illustration 3

Calculate debtors balance at the end :

	Rs
Opening debtors	1,00,000
Total sales	4,00,000
Bad debts	10,000
Returns inwards	2,500
cash sales	50,000
cash received from customers	1,50,000
Bills Received from customers	45,000

Solution :

Dr **Total Debtors Account** **Cr**

	Amount Rs		**Amount Rs**
To Balance b/d	1,00,000	By Bad debts	10,000
To Sales		By Returns	2,500
(4,00,000 – 50,000)	3,50,000	By Cash	1,50,000
		By B/R	4,500
		By Balabce c/d	2,42,500
	4,50,000		4,50,000

Illustration 4

Calculate creditors balance at the end.

	Rs.
Sundry creditors on the Opening day	7,600
Cash paid to creditors	1,750
Discount Received	250
Credit Purchases	9,300
Acceptances given to creditors	5,870

Solution :

Dr **Sundry Creditors Account** **Cr**

	Amount Rs		Amount Rs
To Cash	1750	By Balance b/d	7,600
To Discount250		By Credit purchases	9,300
To Bills payable	5870		
To Balance c/d			
(Balancing figure)	9030		
	16,900		16,900

3. Ascertainment of Bills Receivable and Bills payable :

Sometimes the question may not give the opening or closing balances of Bills Receivable and Bills payable. Such figures can be found out by preparing the Bills Receivable Account and Bills payable Account as shown below:

Illustration 5

Calculate opening Balance of Bills receivable from the following information.

	Rs.
Bills Receivable accepted during the year	41,800
Bills Receivable en cashed during the year	41,800
Bills Receivable Dishonoured	3,600
Bills Receivable at the end of the year	12,000

Solution :

Dr **Bills Receivable Account** **Cr**

	Amount Rs		Amount Rs
To Balance b/d	15,600	By cash	41,800
(Balancing fig)		By Bills dishonoured	3,600
To Bills received	41,800	By Balance c/d	12,000
	57,400		57,400

Illustration 6

From the following data calculate the opening Balance of Bills payable.

	Rs.
Cash paid during the year on Bills	44,500
Closing Balance of Bills payable	35,000
Bills accepted during the year	54,500

Bills Payable Account

Dr **Cr**

	Amount Rs		**Amount Rs**
To Cash	44,500	By Balance b/d	25,000
To Balance c/d	35,000	(Balancing figure)	
		By Creditors (acceptances)	54,500
	79,500		79,500

4. Ascertainment of opening and closing stock when Rate of gross profit is given.

These figures will be calculated as follows :

Opening stock = Cost of goods sold + Cl. stock - Purchases.

Closing stock = Opening stock + Purchases - Cost of goods sold

Illustration 6

Calculate the stock at the end

	Rs.
Stock in the beginning	20,000
Cash Sales	60,000
Credit sales	40,000
Purchases	70,000

Rate of gross Profit on cost 1/3

Solution :

Total sales Rs

Cash sales = 60,000

Credit sales = 40,000

=1,00,000

Cost of goods sold is = 100000 5 3/4 = 75,000

Closing stock = op. stock + purchases – cost of goods sold.

= 20,000 + 70,000 – 75,000

= Rs 15,000

Note : If gross profit Ratio on Cost of goods is given in the problem, first we have to convert it on sales.

On cost of goods	=	on sales
25%	=	20%
33/3%	=	25%
50%	=	33 1/3%
662/3%	=	50%
1/2	=	1/3
1/3	=	1/4
1/3	=	1/5

1/4	=	1/5	
1/5	=	1/6	
1/6	=	1/7	and so on

In the above problem grass Profit is 1/3 on cost of goods sold. It is equal to 1/4 of sales i.e. 100000 5 1/4 = Rs 25,000.

5. Ascertainment of opening Balance of capital, an Asset or a liability.

Such a missing figure can be ascertained by preparing the opening statement of Affairs. The missing item would be the balancing figure in the statement of Affairs.

This can be seen in the following example.

Illustration 7

calculate the capital in the beginning.

	Rs.
Profit made during the year	48,000
capital at the end	1,60,000
Capital introduced during the year	40,000
Drawings	24,000

Solution :

Dr **Capital Account** **Cr**

	Amount Rs		**Amount Rs**
		By Balance b/d (Balance figures)	96,000
To Drawings	24,000	By Cash	40,000
To Balance c/d	160,000	By Profit	48,000
	184,000		184,000

It can be calculated by the following equation :

Profits = Capital at the end + Drawings – Capital Introduced – Capital in the beginning.

Capital in the begginning = Rs 16,0000 + Rs 24,000 – Rs 40,000 – Rs 48,000 = 96,000

6. Ascertainment of cash and Bank Balances :

Sometimes opening and closing balance of cash in hand or cash at Bank are not given, such figures can be ascertained by preparing the columnar cash Book. When all the known items are written up in the cash Book, the balancing figure would be the missing item.

Illustration 8 :

From the following information find the cash balance on the opening day.

	Rs.
Cash received from the Debtors	25,000
Cash sales	15,000
Interest paid	1,100

Drawings	3,000
Salaries	9,500
Expenses paid	8,900
Amount paid to creditors	16,000
Cl. Balance of cash	4,500

Solution :

Cash Book

Recipts	**Amount Rs**	**Payments**	**Amount Rs**
To Balance b/d (Balancing figure)	3,000	By interest	1,100
		By Drawings	3,000
To Sales	5,000	By Salaries	9,500
To Debtors	25,000	By Expenses	8,900
		By Creditors	16,000
		By Balance c/d	4,500
	43,000		43,000

Illustration 9

From the following particulars extracted from the books of a trader kept under the single Entry system, you are required to find out the figures for credit sales and credit purchases by showing the total Debtors Account and total creditors Account. Show also the Bills Receivable Account and Bills payable Account,

Balance 1-1-2007 :

	Amount Rs		**Amount Rs**
Total Debtors	1,14,400	Discount allowed to customers	8,400
Bills Receivable	8,000	Returns from customers	3,250
Total creditors	52,800	Return to suppliers	2,660
Bills Payable	5,000	Bad debts written off`	7,080
H is transaction for the year			
Cash paid to creditors	1,40,500		
Discount allowed by suppliers	5,300	Cash received against bills receivable	28,400
Cash received from customers	270800		
Payment made agains Bills payable	14,000	Closing Balances 31-12-07	

Bills receivable Dishonoured	22,00	Total debtors	1,11,200
Bad debts previously written off now recovered	2000	Total creditors	56,800
		Bills receivable	2,000
cash sales during the year	31,600	Bills payable	6,000
Cash purchases during the year	38,500		

Solution :

Dr — Total Debtors Account — Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2007			2007		
Jan 1	To Bal b/d	1,14,400	2007 Jan1 to	By cash By Discount	2,70,800 8,400
Jan 1	To Bills Receivable A/c	2,200	Dec31	By Returns in words	3,250
to	To Credit sales	3,08,730		By Bad debts	7080
Dec31	(Balancing figure)			By Bills Receivable A/c	24,600
				By Balance c/d	1,11,200
		4,25,330			4,25,330
2008					
Jan 1	To Bal b/d	1,11,200			

Dr — Total Creditors Account — Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2007	To cash	1,40,500	2007		
Jan 1	To Discount	5,300	Jan 1	By Balance b/d	52,800
to	To Returns out words	2,660	Jan 1	By credit purchases	1,67,460
Dec31	To Bills payable	15,000	to	(Balancing big)	
Dec31	To Balance c/d	56800	Dec31		
		2,20,260			2,20,260
			2008		
			Jan	By Balance b/d	56,800

Dr — Bills Receivable Account — Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2007	To Balance b/d	8,000	2007		
Jan 1	To Total Debtors (B/R)	24,600	Jan 1	By cash	28,400
to Dec31	(Balancing figure)			By Total Debtors A/c	2200
			Dec31	(Bills dishonoured)	2,000

			Dec31	Balance c/d	
		32,600			32,600
2008 Jan 1	To Balance b/d	2,000			

Dr **Bills Payable Account** **Cr**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2007 Jan 1 to	To Cash (B/R)	14000	2007 Jan 1	By Balance b/d	5,000
Dec31	To Balance c/d	6000	Jan 1 to Dec31	By Total creditors (Bills accepted) (Balancing fig)	15,000
		20,000			20,000
			2008 Jan 1	By Balnce b/d	6,000

Illustration 10 :

Anil carries on a small business, but he does not maintain a complete set of account books. He banks all receipts and makes all payments only by means of cheques. He maintains properly a cash book, a sales ledger and a purchase ledger. He also makes a proper record of the assets and labilities as at the close of every accounting year. From such records you are able to gather the following facts :

Receipts	Amount Rs	Payments	Amount Rs
From sundry Debtors	52,875	New plant purchased	1,875
Cash sales	12,375	Drawings	4,500
Paid in by the proprietor	7,500	Salaries	3,375
		Interest paid	225
		Telephone	375
		Rent	3,600
		Light and power	1,425
		Sundry expenses	6,375
		Sundry creditors (Purchase ledger Accounts)	22,875
	72,750		72,750
Assets and liabilities :			

	As at 31-12-2006	As at 31-12-2007
	Rs	Rs
Sundry Creditors	7,575	7,200
Sundry Debtors	11,250	18,375
Bank	1,875	------
Stock	18,750	9,375
Plant	22,500	21,975

From the above data, prepare the profit and loss Account for the year ended 31st December, 2007 and the Balance sheet as on that date.

Solution :

Trading and profit and loss Account of Mr. Anil for the year ended 31-December 2007.

Particulars	Amount Rs	Particulars		Amount Rs
To opening stock	18,750	By sales		
To Purchases	22,500	Cash	12,375	
To wages	20,175	Credit	60,000	72,375
To Light and power	1,425			
To gross profit c/d	18,900	By closing stock		9,375
	81,750			81,750
To salaries	3,375			
To Interest	225			
To Telephone	375	By gross profit b/d		18,900
To Rent	3,600			
To sundry expenses	6,375			
To Depreciation	2,430			
To Net - profit	2,520			
	18,900			18,900

Balance sheet of Mr. Anil
as on 31st December 2007,

Libilities	Amount Rs	Amount Rs	Assets	Amount Rs	Amount Rs
Sundry creditors		7200	Cash at Bank		98,25
Capital Account			Sundry Debtors		18,375
as on 1-1-07	46,800		Stock		9,375
Add Additional					
capital	7,500		Plant on 1-1-07	22,500	
Net profit	2,520		Add Purchase	1,875	
	56,820			24,375	
Less Drawings.	4,500	52,320	less Depreciation	2,430	21945
		59,520			59520

Working Notes :

1. Calculation of credit purchases :

Creditors Account.

	Rs		Rs
To cash account	22,875	By Balance b/d	7,575
Balance c/d	7,200	By credit purchases	22,500
		(Balancing fig)	
	30,075		30,075

2. Calculation of credit Sales :

Sundry Debtors Account

	Rs		Rs
To balance b/d	11,250	By Cash	52,875
To credit sales	60,000	By Balance b/d	18,375
		(Balancing fig)	
	71,250		71,250

3. Calculation of Depreciation of Plant :	**Rs.**
Book value of plant on 1-1-07	22,500
Add Plant purchased	1,875
	24,375
less Book value of plant on 31-12-07	21,945
Depreciation for the year	2,430

4. Calculation of Balance at Bank :	**Rs.**
Balance as on 1-1-07	1,875
Add Receipts for the year	72,750
	74,625
less Payment made during the year	64,800
Balance as on 31-12-07	9,825

5. Computation of capital as on 1-1-07

Statement of Affairs

Liabilities	**Rs**	**Assets**	**Rs**
Sundry creditors	7,575	Cash at Bank	1,875
Capital (Balancing figure)	46,800	Sundry Debtors	11,250
		Stock	18,750
		Plant	22,500
	54,375		54,375

Illustration : 11

Mr. Ajay Kumar keeping his books under single Entry system has placed the following facts before you :

1. His statement of Affairs as on 1st Jan 2007.
2. A summary of cash transactions for the year 2007.
3. A list of remaining transactions for the year.

1.

	Rs		Rs
Bank over draft	1,00,000	Debtors 300000	
creditors	2,00,000	less Provision 15000	28,500
Bills payable	12,000	Bills Receivable	72,000
Outstanding exp	8,000	Stock	2,80,000
Capital Account	6,08,000	Plant	2,00,000
		Building	80,000
		Cash in hand	11,000
	9,28,000		9,28,000

2.

	Rs		Rs
To Balance on 1-1-07	11,000	By payment to crs	7,20,000
To Bills Receivable	2,00,000	By cash purchases	1,60,000
To Debtors	8,72,000	By Bills payable	3,20,000
To cash sales	1,64,000	By salaries	60,000
To Mrs. Ajay kumar	1,00,000	By Rent	32,000
		By general exp	18,000
		By Drawings	21,600
		By Balance c/d	11,400
	13,47,000		13,47,000

3.

	Rs		Rs
Total sales	16,10,000	Stock on 31-12-07	3,40,000
Total purchases	14,40,000	Outstanding general expenses	12,000
Discount allowed	4,000		
Discount Received	8,000	Bad debts	8,000
Bills Receivable 31-12-07	1,20,000	Prepaid rent	7,200
Bills payable accepted during the year.	3,72,000		

Provide 5%. For doubtful debts and 2 1/2 % for discount on debtors. Depreciate building by 2% and plant by 10%.

You are required to prepare trading and profit and loss account and Balance sheet of M.r Ajay Kumar form the above particulars.

Solution :

Trading & Profit and Loss Account of Mr. Ajay Kumar
For the year ending 31 Dec 2007.

	Rs	Rs		Rs	Rs
To opening stock		2,80,000	By sales		9,825
To purchases			Cash	1,64,000	
Cash	1,60,000		Credit	14,46,000	16,10,000
Credit	12,80,000	14,40,000	By closing stock		3,40,000
To G Profit c/d		2,30,000			
		19,50,000			19,50,000
To salaries		60,000			
To rent	36,000		By gross profit b/d		2,30,000
less prepaid	7,200	28,800			
To gen. expences	18,000		By Discount		
less out standing	8,000		Received		8,000
last year	10,000				
Add out standing	12,000	22,000			
this year					
To Discount allowed		4,000			
To Bad Debts	8,000				
Add provision for	30,700				
Doubtful debts	38,700				
less Existing	15,000	23,700			
provision					
To provision for					
Discount on Drs		14,584			
To Depreciation :					
Buildings	1,600				
Plant	20,000	21,600			
To Net profit		63,316			
		2,38,000			2,38,000

Balance sheet of Mr. Ajay Kumar
as on 31st December 2007.

Liabilities	Rs	Rs	Assets	Rs	Rs
Out standing expenses		12,000	Cash in hand		11,400
Bills payable		64,000	Bills Receivable		1,20,000
Creditors		3,80,000	Debtors	6,14,000	

Bank O.D		1,00,000	less provision	30,700	
Mrs. Ajay's loan		1,00,000	for Bad debts		
Capital A/c				6,44,700	
on 1-1-2007	6,08,000		less Provision		
less Drawings	21,600		for Discount	14,584	5,68,716
	5,86,400		Stock	3,40,000	
Add Net profit	63,316	6,49,716	Prepaid Rent		7,200
			Plant	2,00,000	
			less Depreciation	20,000	1,80,000
			Buildings	80,000	
			less Depreciation	1,600	78,400
		13,0,5716			13,05,716

Workings Notes :

1. Calculation of Debtors as on 31-12-07

Total Debtors Account

	Rs		Rs
To Balance b/d	3,00,000	By Cash	8,72,000
To credit sales	14,46,000	By Bills Receivable A/c	
			2,48,000
		By Discount allowed	4,000
		By Bad debts	8,000
		By Balance c/d	6,14,000
	17,46,000		17,46,000

Bills Receivable Account

	Rs		Rs
To Balance b/d	72,000	By Cash	2,00,000
To Debtors Account	2,48,000	By Balance c/d	1,20,000
(Balancing figure)			
	3,20,000		3,20,000

Total creditors Account

	Rs		Rs
To cash	7,20,000	By Balance b/d	2,00,000
To Discount8,000	By Total credit	1,20,000	
To Bills payable Account	3,72,000	Purchases	
To Balance c/d	3,80,000		
	14,80,000		14,80,000

Bills payable Account

	Rs		Rs
Tocash	3,20,000	By Balance b/d	12,000
To Balance c/d	64,000	By Total creditors A/c	3,72,000
(Balancing figure)			
	3,84,000		3,84,000

Illustration 12

Sri Gopi krishna a small producer of machine parts has supplied the following details of his business transactions.

	Rs.
Cash and Discount credited to Debtors	3,21,000
Discount Received	1,000
Expences paid in cash	17,000
Bad debts	2,500
Cash withdrawal from Bank	22,500
Expensed paid by cheque	17,500
Cash collections from Debtors	1,01,500
Cash deposit in Bank	77,500
Cash drawings	7,500
Cheques collected from Debtors	2,16,000
Drawings by cheques	21,000
Cash in hand on 30-9-2007	11,000
Discount allowed	3,500
Cheques paid to creditors	2,67,000
Total sales	3,45,500
Cash purchases	10,500
Cash paid to creditors	31,500

	As on 1-10-2006 Rs	**As at 1-10-2007** Rs
Debtors	?	75,000
Cash and Bank Balance	69,500	26,500
Stock	43,500	52,500
Plant	28,000	23,000
Furniture	11.000	11.000
Creditors	30,000	47,000
Labilities for expenses	2,500	4,000

You are required to prepare Trading and profit and loss Account for the year ending 30-9-07 and Balance sheet as at that date for Sri Gopi Krishna..

Solution :

Trading and profit and loss Account of Gopi Krishna for the year ending 30-9-07

Dr Rs	Rs	Rs		Rs	Cr Rs
To opening stock		43,500	By sales		
To purchases			Cash	11,500	
Cash	10,500		Credit	3,34,000	3,45,500
Credit	3,16,500	3,27,000	By closing stock		52,500
To Gross profit c/d		27,500			
		3,98,000			3,98,000
To Expences			By gross profit b/d		27,500
by cash	17,000		By Discount Received		1,000
by cheque	17,500		Net loss		18,500
	34,500				
less out standing	2,500				
last year					
Add out standing	32,000				
this year	4,000	36,000			
To Discount allowed		3,500			
To Bad Debts		2,500			
To Depreciation		5,000			
On palant		5,000			
(28000 - 23000)		47,000			47,000

Balance sheet of Shri Gopi Krishna as on 30th september, 2007.

Liabilities		Rs	Assets		Rs
Creditors		47,000	Cash in hand		11,000
Outstanding Expenses		4,000	Cash at Bank		15,500
Capital			Stock		52,500
As on 1-10-06			Debtors		75,000
	184000		Furniture		11,000
less:Drawings28,500			Plant	28,000	
Net loss 18,500			less Depreciation	5,000	23,000
	47,000	1,37,000			
		1,88,000			188,000

Working Notes :

Dr Particulars	Cash Rs.	Bank Rs	Particulars	Cash	Bank Rs. Cr
To Balance b/d		50,000	By Expenses	17,000	17,000
(Balance fig for bank)			By Cash		22,500
(69500 - 50,000)	19,500		By Bank	77,500	
To Bank, cash	22,500	77,500	By Drawings	7,500	21,000
Debtors	1,01,500	2,16,000	By Creditors	31,500	2,67,000
Cash sales	11,500		By Purchases	10,500	
(Balafig)			By Balance c/d	11,000	155,00
	15,50,000	3,43,500		1,55,000	3,43,500

Dr **Sundry Debtors Account** Cr

		Rs		Rs
To Balance b/d		64,500	By Cash	1,01,500
(Balancing figure)			By Bank	2,16,000
To credit sales			By Discout	3,500
Total sales	3,45,500		By Bad debts	2,500
less cash sales	11,500	3,34,000	By Balance c/d	75,000
		3,98,500		3,98,500

Dr **Balance sheet as at 1-10-2006** Cr

	Rs		Rs
Creditors	30,000	Cash	19,500
Out standing Expenses	25,000	Bank	50,000
Capital (Balancing figure)	1,84,000	Debtors	64,500
		Stock	43,500
		Furniture	11,000
		Plant	28,000
	2,16,500		1,16,500

Dr **Creditors Account** Cr

	Rs		Rs
To Bank	2,67,000	By Balance b/d	30,000
To Cash	31,500	By credit purchases	
To Discout	1,000	(Bal - fig)	3,16,500
To Balance c/d	47,000		
	3,46,500		3,46,500

6.5 Summary :

Under single Entry system profits can be ascertained by either statement of affairs method or by conversion method. Conversion method involves a number of steps necessary to convert single entry or incomplete records into double entry records. For this purchase, cash/Bank account, Total debtors account, Total creditors accounts, Bills receivable and Bills payable accounts are prepared to find out the missing figure of credit purchases or credit sales. Opening capital is found out by preparing the opening statement of affairs. After finding out the missing figures final account can easily be prepared.

6.6 Self Assessment Questions

1. State the necessary steps that are required to be taken to convert single entry into double entry.

2. State briefly how you would convert a set of books, which had been kept on the single Entry into the Double Entry.

6.7 Excercises

1. Mr. Krishna commenced business as a cloth merchant on 1st January , 2007 with a capital of Rs 20,000. On the same date he purchased furniture for cash Rs 6,000. The books are maintained by single Entry method. From the following particulars calculate cash in hand on 31st December, 2007. Prepare trading and profit and loss account for the year ending 31st December, 2007 and the Balance sheet as on that date.

	Rs
sales (including cash sales Rs 14,000)	34,000
Purchases (including cash purchases Rs 8,000)	30,000
Drawings	2,400
Salaries	4,000
Bad debts written off	1,000
Business Expenses	1,400
Stock of goods on 31-12-2007	13,000
Sundry Debtors on 31-12-2007	10,400
Sundry creditors on 31-12-2007	7,200

Provide depreciation on furniture at 10% p.a.

2. Mani a trader does not keep proper books of account he is able to give you the following information regarding his assets and liabilities.

	As on Dec 31 2006		As on Dec 31 2006
Creditors for goods	21,000		19,000
Creditors for expenses	1,500		1,800
Bills payable	8,700		11,500
Sundry debtors	35,000		34,000
Stock (at cost)	28,000		25,000
Furniture	10,000		12,000
Cash	5,100		?

The following additional information is also available in respect of his business for 2007.

	Rs
Bills payable issued	20,800
Payments to creditors	31,000
Cash sales	15,000
Expenses paid	6,600
Drawings	8,000

Bad debts during the year amounted to Rs 900 As regards sales, he informs you it is his practice to sell goods at cost + 25% . Prepare the annual accounts for 2007 provide for depreciation on furniture at 10%.

3. From the following details, prepare Trading profit and loss Account and Balance sheet.

	As on 1-1-2007		As on 1-1-2007
Stock	25,000		12,500
Debtors	62,500		87,500
Cash	6,250		10,000
Furniture	2,500		2,500
Creditors	37,500		43,750

Bad debts Rs 1250, Discount received Rs 3,750 Discount allowed Rs 2,500. Sundry expenses Rs 7,500 payable to creditors Rs 1,12,500 Received from debtors Rs 1,33,750. Drawings Rs 10,000, sales returns Rs 3,750 Purchase returns Rs 1,250 charge depreciation on furniture at 5%.

4. Sri Ram commenced business on 1st Jan 2007 with a capital of Rs 25,000 out of this he purchased furniture Rs 4,000. During the year he borrowed from his wife Rs 5,000. and introduced a further capital of Rs 3,000.

From the following particulars extracted from his books prepare the Trading and profit and loss account and Balance sheet as on 31-12-2007.

	Rs.
Receipts from debtors	46,700
Cash sales	30,000
Cash purchases	10,000
waged paid	1,000
Salaries to staff	6,200
Trade Expenses	3,400
Cash Drawings	7,700
Paid to creditors	50,000
Discounts Allowed to debtors	800
Bad debts	1,500

Sri Ram used goods worth Rs 1,300 for private purpases which was not recorded in the book. On 31-12-2007 his debtors were worth Rs 21,000 and creditors Rs 15,000 stock in trade is Rs 10,000 Furniture is to be depreciated at 20% per annum.

5. The following information is supplied from which you are required to prepare the p & L Account for the year ended 31st Dec 2007.

	1-1-2007	31-1-2007
	Rs	**Rs**
Sundry Assets	18,000	20,000
Stock	1,400	19,000
Cash in hand	8,200	4,800
cash at a Bank	2,200	8,000
Debtors	?	26,000
Creditors	12,000	9,800
Outstanding expenses	1,000	600

Details of transactions for 2007

	Rs.
Receipts from and discount credited to Debtors 2,45,000	
Returns from debtors	6,000
Bad debts	1,000
Sales cash and credit	3,00,000
Returns to creditors	3,000
Payments to creditors by cheque	2,36,200
Receipts from debtors deposited into Bank	2,43,000
Cash purchases	10,000
Salary paid out of bank	18,000
Expenses paid by cash	5,000
Drawings cash	9,400
Purchase of sundry assets by cheque	2,000
Cash with drawn from bank	21,000
Cash sales deposited in Bank	?
Discount allowed by creditors	4,000

Debtors at the beginning Rs 50,000 and at the end Rs 60,000 cash received from debtors Rs 40,000. Allowances Rs 4,000, Bad debts Rs 6,000 Discount allowed Rs 2,000. Draw the relevant ledger account and calculate credit sales.

7. Suneel maintained his books under single entry system. He maintained a cash book and a debtors ledger and creditors ledger. He desires you to prepare final accounts for the year ended 31st December 2007. The analysis of his cash book showed the following.

Receipts	Rs	Payments	Rs
Received from debtors	17,625	New plant	625
Cash sales	4,125	Drawings	1,500
Additional capital	2,500	wages	7,200
		Salaries	1,125
		Interest	75
		Telephone	125
		Rent	1,200
		Printing	2,125
		Creditors	7,625
	24,250		21,600

Additional Information :

	1-1-2007		31-12-2007
Creditors	2525		2400
Debtors	3750		6125
Bank	625		?
Stock	6250		3125
Plant	7500		7315

8. Balaji maintains his records under single - entry method. His financial position as on 1-1-2007 was as follows.

Capital Rs 70,000; Creditors Rs 17,000; Freehold property Rs 50,000; Stock Rs 25,000; Debtors Rs 20,000; Furniture Rs 20,000.

Cash Account

Receipts	Rs	Payments	Rs
To debtors	15,000	By Bank O.D.	10000
To Cash sales	80,000	By Drawings	3,000
		By Expenses	50,000
		By Payments to Creditors	20,000
		By Balance c/d	12,000
	95,000		95,000

Additional information :

Balance on 31-12-2007, stock Rs 30,000; Debtors Rs 25,000; Creditors Rs 20,000; Depreciate Free hold property and furniture at 10% and 15% respectively. Create 2 1/2% Reserve for doubtful debts on debtors.

Show the trading account, profit and loss Account and Balance sheet as on that date.

6.8 SUGGESTED READINGS :

Financial Accountancy	:	Shukla Grewal
Financial Accountancy	:	Jain and Narang
Financial Accountancy	:	R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda

LESSON - 7

NON TRADING CONCERNS - I

7.0 Object : After going through this lesson the student can know what is a Non trading concern> What are the books maintained by them ? How a Receipt and Payment account and an Income and Expenditure account is prepared ?

Structure :

7.1. Introductions :

The purpose of every trading or manufacturing activity is to make profit. But there are certain charitable and social institutions which are created not with a profit making object but for the development of welfare activities, both for the general public and for its members such as educational institutions, hospitals, clubs, charitable trusts etc. are called non - trading concerns.

These non profitable institution are not interested in the quantum of profits earned by them during the year but certainly they are interested in knowing the receipts and expenditure during the year and their financial position at the end of each year. To achieve these objectives they prepare the following statements.

a. Receipts and payments account.

b. Income and Expenditure account.

c. Balance sheet.

The concepts of capital and revenue are very important in the preparation of Final accounts of Non - Trading concerns, Therefore let us first know the distinction between capital and revenue items.

7.2. Capital and Revenue :

One of the objects of Accounting is to determine whether the business has earned profit or not. For this purpose a proper distinction between capital and revenue, as regards expenditure receipts and losses, is required. Failure or neglect to discriminate capital and Revenue will falsify the whole of the results of accounting For example, plant may purchased and charged to the purchases account, some of the fixed assets may be sold and the proceeds may be treated as income. In each case both the profit and loss account and Balance sheet will be affected while preparing the final accounts, all revenue items are included in the revenue account i.e. Trading and profit and loss account and all capital items in the balance sheet. Any error committed in distinguish between "capital" and "Revenue" will effect the ascertainment of correct profit.

It is very different to give a clear cut rule as to distinguish capital and revenue expenditure. However, the following rules may serve as a guide for making distinction between capital and revenue expenditure.

7.3. Capital Expenditure :

Capital expenditure is such an expenditure which benefits the business over a long period. It includes assets acquired for the purpose of earning and not for resale, improving and extending fixed assets, increasing the earning capacity of the business and raising capital for the business. Purchase of new plant, additions to the building, brokerage and commission paid for procuring long term loans are a few examples of such expenditure. All items of capital expenditure appear on the asset side of the Balance sheet.

7.4. Revenue Expenditure :

Revenue expenditure consists of expenditure incure on one accounting period and the full benefit of it is enjoyed in the same period. Therefore, it is normally of recurring nature. Such an expenditure does not increase the earning capacity of the business and it does not bring into existence an asset. It includes expenses incurred for acquiring assets for resale at a profit or for conversion into finished products, for maintaining fixed assets for resale at a profit or for conversion into finished products for maintaining fixed assets in good working order e.g. normal repairs and renewal of plant, white washing of building replacement of machinery etc; for keeping the organization going eg. Rent, rates and taxes, wages and salaries, insurance and other trade charges. All items of revenue expenditure appear in the trading and profit and loss Account.

7.5. Revenue Expenditure becoming capital Expenditure or capitalised Expenditure:

An expenditure which is primarily of revenue nature but incurred for the purpose of acquiring any asset or additing to its value is termed as capitalised expenditure. The following are some of the examples of revenue expenditure becoming capital expenditure.

1. Repairs : Repairs are usually revenue expenditure but if we purchase a second hand machinery and pay for repairs necessary to make it suitable for our purpose, then repairs become capital expenditure and should be added to the cost of the machinery.

2. Wages : Wages are usually a revenue charge but if paid to the employees for the construction or erection or installation of the fixed assets of the business ,then these become capital expenditure and should be added to the cost of the fixed asset concerned.

3. Legal expenses : Legal expenses are usually a revenue charge but if paid on acquiring a property should form an additional cost of the asset acquired.

Those are usually a revenue items but payments made for transporting newly acquired asset will form additional cost of the asset thus being treated as capital expenditure.

4. Freight and carriage : These are usually a revenue items but payments made for transporting newly acquired asset will form additional cost of the asset thus being treated as capital expenditure.

5. Interest : Interest on borrowing and capital generally a revenue item is allowed to be treated as capital item if paid during the period of construction.

6. Preliminary expenses : Initial expenses, connected with the formation of a company though revenue in nature are allowed to be capitalised and can be shown as and asset in the balance sheet.

7. Brokerage and stamp duty : Normally these are revenue items but, brokerage paid on the purchase of a property and also the stamp duty on it may be treated as capital expenditure as an additional cost of purchase

8. Development Expenditure : In concerns like mines, tea, calories, horticulture, rubber plantations etc. a sizeable amount is spent during the period of development and upto the time they begin to earn. Such expenses must be treated as capital expenditure.

9. Advertising : A huge sum spent on advertising in a year, the benefit of which shall accrue in future years, also may have the effect of creating a future good will and thus sums spent may be capitalised. For example, lakhs of rupees are spent in changing the name from Binaca to cibaca and Hutch to oda.

10. Raw materials and stores : They are usually a revenue charge but if consumed in making of a fixed assect they must be treated as a part of the cost of the asset.

Deferred revenue Expenditure : It is the expenditure which would normally be treated as revenue expenditure but, it is not written off in one year as its benefit is to completely exhaustible in the year in which it is incurred or is of a non - recurring and special nature and large in amount. It may be spread over a number of years a proportionate amount being charged to the profit and loss account of each year and the balance is carried forward to subsequent years as deferred revenue expenditure and is shown as an asset in the balance sheet. Sometimes extraordinary losses are also treated as deferred revenue expenditure and charged to profit and loss account for four to five years.

7.6. Usual items of capital expenditure :

The following items usually represent capital expenditure.

1. Cost of acquisition of fixed asset like good will, land, building, leasehold promises, tools and equipment, furniture, trade marks etc.
2. Expenses of putting a new asset in a working condition like installation and erection expenses of any fixed asset.
3. Additions or extensions or structural improvements to the existing assets leading to their working efficiency or revenue earning capacity or cost reduction e.g. refurnishing of the sitting accommodation of a cinema hall etc.

4. Development nature like development of mines and plantation.
5. Formation expenses of a business are called priliminary expenses like preparing and filing the legal documents required for starting a business etc.

7.7 Usuall items of Revenue Expenditure :

The following are usuall items of revenue expenditure.

1. Expenses incurred in the ordinary conduct and administration of the business e.g rents, salaries, wages, advertisement etc.
2. Expenses incurred in purchasing raw materials or stock of finished goods for resale and supplies like grease, cotton, oil for machines etc.
3. Expenses incurred to maintain assets in working order like ordinary repairs renewals or alterations etc.
4. Expenses incurred on maintaining or pushing sales like, carriage of finished goods, commission, travelling expenses, free samples and gifts etc.
5. Loss arising from sale of fixed assets.
6. Loss arising from damage, destruction, theft of stock in trade, cash etc.
7. Loss arising from depreciation in the values of fixed assets or book values of assets discarded.
8. Annual renewal fees of patents etc.

Illustration 1

which of the following expenditures are capital, revenue or deferred revenue expenditure.

1. Rs 10,000 spent on dismantling, removing and reinstallation of machinery.
2. Rs 2,00,000 was spent on putting up a gallery in a theatre hall.
3. Rs 3,000 paid as insurance premium.
4. The freight and cartage on the new machinery amounted to Rs 5,000 and the erection charges cost Rs 1000
5. A machinery whose book value was Rs 17,000 and was sold for Rs 7,000
6. Rs 15,000 was paid as compensation for cancellation of a contract.
7. An amount of Rs 1000 was spent as legal expenses for maintaining an existing title to the assets of the business.
8. Rs 1,50,000 was spent on advertising a new product in the market.
9. Rs 20,000 was spent on white washing and painting of the factory building.
10. Rs 1,500 was spent by a chartered accountant on books helping in his profession.

Solution :

1. Rs 10,000 spent on dismantling, removing and reinstallation is a capital expenditure.
2. Rs 2,00,000 spent on putting up a gallery in a cinema hall is a capital expenditure
3. Insurances premium paid is a revenue expenditure
4. Rs 5,000 spent on freight and cartage and the erection charges Rs 1,000 on new machinery is a capital expenditure and it shall be added to the cost of the machinery
5. Rs. 10,000 incurred as a loss on the sale of an old machinery being manageable is a revenue loss and to be debited to the profit and loss account of the year in which it occurs.

6. Rs 15000 paid for cancellation of contract is a capital expenditure since it has resulted in avoiding an unnecessary investment.
7. Rs 1000 spent as legal expenses on defending the title to the assets of the business as revenue expenditure.
8. Rs 1,50,000 spent on advertising is a heavy amount, so it should be capitalised and the portion of current year should be debited to profit and loss account and the remaining portion should be shown in the balance sheet till it is completely wiped off.
9. Rs 20,000 spent on white washing and painting of the factory building is a revenue expenditure.
10. Rs 1,500 spent by a chartered Accountant on books helping in his profession is a revenue expenditure.

7.8. Capital and Revenue Receipts :

Capital receipts of business comprise capital contributed by partner or by the share holders, loans sale proceeds of any fixed assets etc. In case of clubs and associations, receipts on account of life subscriptions, entry free, government grants, legacies and endowments are capital receipts, Revenue receipts, received commission, interest on investment etc. In case of club etc annual subscriptions, sale of golf balls, receipts arising out of the premises being given to others for use on charges are revenue receipts, Revenue receipts are treated in the revenue account while the capital receipts are treated in the balance sheet.

Guidelines for deciding a receipt as capital or revenue :

The following guidelines may be stated to decide whether a particular receipt is capital or revenue.

1. Nature of receipts is to be determined by its character in the hands of the person receiving it not by the source from which payment was made e.g. payment of interest out of capital by a company still under construction is capital expenditure for the company but revenue receipt in the hands of the person receiving it.
2. In case of a single transaction of purchase and sale of property the motive of the owner will decide whether the receipt is capital or revenue ex; A sells shares held by him as investment it is a capital receipt but if A sells the shares with speculative motive it will be a revenue receipt.
3. A receipt on account of fixed asset is a capital receipt while a receipt on account of current assect is a revenue receipt, for ex; sale proceeds of building, plant etc constitute capital receipt while sale of stock - in - trade is revenue receipt.
4. Where a receipt is in substitution of a source of income there it is a capital receipt but if it is in substitution of income alone it is a revenue receipt. For eg; if a railway passenger meets with an accident and dies or is permanently disabled, compensation received from the railway department is capital receipt because this receipt is in substitution of source of income i.e his life, but if he is rendered only temporarily disabled the receipt will be revenue one as it is in substitution of income alone i,e loss of earnings during the period of disablement.
5. Where a sum is received for the surrender of certain right, there it is a capital receipt but where the sum received is in the nature of compensation for loss of future profits there it is a revenue receipt. For eg. A the lease holder of fire field and manufacturer of

fire - clay goods was prevented by the railway company for working on the field adjacent to the railway lines. Amount paid by the railway company to A is a capital receipt because it is the receipt in lieu of his right to work upon the clay field.

Examples of capital Receipts :

1. Compensation received for the loss of right of future remuneration.
2. Compensation received for suspension of export license.
3. Compensation received by one partner of a partnership from another partner for relinquishing all his rights in the partnership etc.

Examples of Revenue Receipts :

1. Receipts of annuities for transfer of a capital asset.
2. Lump - sum received in consideration of reduction of remuneration
3. Compensation received for premature termination of contract.
4. Considerations received for transfer of permits etc.

Capital and Revenue losses :

Revenue loss is the loss of some revenue receipts in the course of the business and is incidental to it. Any loss which can’t be termed as revenue loss is a capital loss. For eg: loss of stock - in - trade by fire, white ants or by theft is a revenue loss where as loss of fixed assect like building plant etc. By fire or accident or earth quake is a capital loss.

Loss caused to the business by reason of cash being is appropriated by an employee is a revenue loss but if the fund reach home of the owner and there after if the funds are lost, then the loss is outside the trade and not incidental to the business therefore it is a capital loss ($Exceptions are banks or lending houses).

7.9. Receipts and payments Account :

It is a summary of cash transactions at the end of a particular period showing the receipts and payments of cash during the period under different heads.

Features :

The features of Receipts and payments account are as follows.

1. It is prepared by non - trading concerns in lieu of cash book of trading concerns.
2. It is a real account.
3. It starts with the opening balance of cash in hand and at bank.
4. All receipts and payments of cash are entered on the debit and credit side respectively.
5. No distinction is made between the capital and revenue items while entering the receipts and payments.
6. All receipts and payments whether they are relating to the current, preceding or succeeding period, are written in this account.
7. Opening balance of this account shows cash in hand at the begining of the accounting period and closing balance shows cash in hand at the end of accounting period.
8. All types of Accounts i,e, personal real and nominal are written in this account.
9. No adjustments, outstanding expenses, prepaid expenses provision for doubtful debts or depreciation are made in this account as it is prepared on cash system of accounting.

10. It does not reveal the financial results or the financial position of the account of the accrued incomes and outstanding expenses.

The following is a specimen of the receipts an payments account of a club for a particular year.

Receipts and payments Account of ....
for the year ending 31 March 2007.

Dr. Cr

Receipt		Rs	Payment		Rs
To	Balance b/d	xxx	By	Rent	xxx
To	Subscriptions	xxx	By	Furniture	xxx
To	Entrance fee	xxx	By	Sports Material purchased	xxx
To	Legacy	xxx	By	Building	xxx
To	Donations for building	xxx	By	Ground maintenance	xxx
To	Interest received	xxx	By	Salaries	xxx
To	Sale of furniture	xxx	By	Honorarium	xxx
To	Sale of old Sports material	xxx	By	Match expenses	xxx
To	Match fund	xxx	By	Stationery	xxx
			By	Investments	xxx
			By	Entertainment	xxx
			By	Balance c/d	xxx
		xxx			xxx

Illustration 1

Jimkhana club kept its accounts on cash basis and the figures for the year 2006-07 are given below. You are required to prepare Receipts and payments Account

	Rs.		Rs.
Subscriptions	received	watchmans wages	27,200
2005 - 06	8000	salaries	40,000
2006 - 07	72,000	postage	4,800
		stationery	12,000
Receipts from			
common Room	50,000	Rent	20,000
Hiring Rooms	4,000	cash in hand	
Billiards Rooms	24,000	1 - 4- 2006	7,200
supplies room	34,000		

Receipts and payments Account of JimKhana Club for the year ending on 31 - 3- 2007

Dr. Cr

Receipts	Amount Rs	Payment	Amount Rs.
To Balance b/d	7,200	By supplies for	
To Subscriptions		Entertainment Room	34,000

2005-2006	8,000	By Watchman's wages	27,200
2006-2007	72,000	By Salaries	40,000
To Receipts from		By Postage	4,800
Common Room	50,000	By Stationery	12,000
Hiring Room	4,000	By Rent	20,000
Billiards Rooms	24,000	By Electricity	16,000
		By Balance c/d	11,200
	1,65,200		**1,65,200**

7.10. Income and Expenditure Account :

It is prepared by non - trading concerns in lieu of profit and loss Account. To know whether during a particular period the income of the concern or organisation have exceeded or faller short of the expenses this account is prepared. In this account current expenses are compared with current incomes. The features of this account are.

1. It does not start with any opening balance.
2. It is a nominal account Expenses are shown on the debit side and incomes on the credit side.
3. Only revenue items are recorded in it capital items are totally excluded.
4. Only incomes and expenses of the concerned year are recorded in it and income and expenditure relating to the preceding or succeeding periods are excluded while preparing this account.
5. This account is prepared on mercantile system of accountancy and thus all adjustments relating to prepaid or outstanding expenses and incomes, provision for depreciation or doubtful debts will be made.
6. Only nominal accounts are taken into consideration for the preparation of this account and for personal and real accounts a Balance sheet must be prepared along with this account.

Difference between Receipts and payments.
Account and Income and Expenditure Account

The following are the main differences between a Receipts and payments Account and Income and Expenditure Account.

Receipts and payments account	It come and Expenditure Account.
1. It is a real Account	1. It is a nominal account.
2. It is like cash book prepared by trading concerns.	2. It is like profit and loss account prepared by non - trading concerns.
3. It starts with a balance being cash at the being of the year.	3. It does not start with any opening balance.
4. Receipts are shown on the debit sid and payment on the credit side.	4. Incomes are shown the credit side and expenditure on the debit side.

5. All items whether of capital or revenue nature are shown in this account.	5. Only revenue items are shown in this account.
6. All receipts and payments whether they are of preceding, current or succeeding period are entered in it.	6. Income and expenditure of the current year only shown in it.
7. Outstanding receipts and payments are not shown in it as it is prepared on cash basis.	7. Income and expenses are shown after including all outstanding income and expenses on accrued basis.
8. The closing balance represents cash in hand on that date.	8. The closing balance represents surplus or deficit for the concerned period.
9. It is not necessary to prepare Balance sheet along with this account.	9. The Balance sheet must be prepared in order to accommodate real and personal accounts a long with this account.

7.11. Preparation of Income and expenditure Account from Receipts and payments Account :

The following steps are to be taken to convert a receipts and payments account into an Income and Expenditure account:

1. Leave the opening and closing balance of cash given in the Receipts and payments account.
2. Take only revenue items of income and expenditure and leave all those items which are of capital nature.
3. Make all adjustments for outstanding and prepaid incomes and expenses, provision for depreciation or bad debts etc.
4. Take items only of the current period i.e; items relating to the preceding and succeeding periods are to be ignored.
5. In Income and Expenditure account expenditure is recorded on the debit side and income is recorded on the credit side.
6. Once Income and Expenditure Account is balanced it shows either surplus or deficit, If credit balance is more than Debit balance it is called surplus and if the debit balance is more than credit balance, it is called as Deficit.

Illustration - 2

From the following particulars prepare Income and Expenditure account of Guntur club for the year ended 31st Dec 2007.

Subscriptions received for 2007	22,000	
Entrance fees received for 2007	3,000	
subscriptions and entrance fee for 2006 (estimated Rs 600 realised)	1120	
subscriptions and entrance fees for 2008	6,200	
subscriptions for 2007 to be taken at	4000	
Miscilenious Expenses	840	
Expenses for 2007 paid		32,000

Expenses unpaid	920
Liabilities for 2007 paid	
(estimated Rs 2800)	2400
Audit fees for 2007 not paid	800
Profit on service account net	9200
Interest on loan paid	1280
capital expenditure written off	4800
surplus from 2006 account	1600
capital expenditure in 2007	8240
provide for depreciation	
for this year	2680
cash in hand	7200

Solution :

Guntur club Income And Expenditure Account for the year ended 31st December 2007.

	Expenditure **Rs**	**Amount**		**Income** **Rs**	**Amount**
To	Expenses		By	subscription and	
	(32000 + 920)	32,920		Entrance fees	
To	Audit Fees	800		(22000 + 3000 + 4000 +520)	29,520
To	Interest on loan	1,280	By	Miscellaneous Expenses	8,400
To	Capital Expenditure	4,800			
	(Written off)		By	Liabilities provided	
To	Depreciation	2,680		in excess last year	
	Surplus	5,040		(2800 - 2400)	400
			By	Profit on service account.	9,200
		47,520			**4,7520**

7.12. Summary :

The institution which are created not with a Profit making object but for the development of Welfare activities both for the General Public and for its members are called Non-trading concerns. Even this concerns are not started with Profit motive these concerns also will have certain expenses and incomes, Assets and Liabilities. At the end of the year to know the total expenses, Incomes and to know the Financial positions of the concerns they prepare certain accounts such as receipts and payments account, Income and Expenditure account and Balance sheet. Receipt and Payment account is a in lieu of cash book, and incoming expenditure account is in lieu of profit and loss account of the trading concerns.

7.13.Self Assessment Questions :

1. What is Capital Expenditure ? Illustrate.
2. What is Revenue Expenditure ? Illustrate.
3. Distinguish Capital and Revenue Expenditure giving illustrations.
4. What is Deferred Revenue Expenditure ? Illustrate.
5. What are Capital and Revenue receipts ? Explain with illustrations.
6. Explain the importance of distinguishing the Capital and Revenue items while preparing final accounts of concerns.
7. What types of accounts are prepared by non-trading concerns ?
8. What is Receipts and Payments account ?
9. What is Income and Expenditure account ?

7.14. Exercises

1. From the following items find out which are of Capital and Revenue items.
   1. Amount paid on goods purchased Rs.1,000
   2. Rs. 2,000 paid for whitewash of cinema theatre.
   3. Rs. 2,500 paid for repairs of second hand lorry purchased.
   4. New machinery purchase and erection charges paid Rs.5,000.
   5. Repairs on machinery Rs.1,000.
   6. Spare parts of machinery Rs.1,500.
   7. Equipment purchased for improving the production capacity Rs.10,000.

2. The following are the expenses paid by the Padmalaya Ltd. for construction of cinema theatre upto 30th June, 1999. Find out whether they are Capital Expenditure or Revenue Expenditure.

		Rs.
1.	Purchased second hand furniture	50,000
	Repairs of furniture	5,000
	Wages paid for erection	4,000
2.	Licence fee	25,000
3.	Fine paid for violation of rules	1,000

4. Fire Insurance 2,000
5. Construction of temporary accommodation to workers at site, which is demolished after completion of construction work 11,000

3. Out of the followings which are Capital and Revenue items.
   1. Cost of dismantling, removing and re-installing plant Rs.8,000
   2. For transporting goods to the new spot Rs.1,600.
   3. Sale of old machinery Rs.6,000 which had a book value of Rs.10,000. Installation of new machinery at a cost of Rs.15,000.
   4. Installation expenses of new machinery Rs.500.
   5. Repairs paid Rs.2,500.
   6. Construction of new factory building with a cost of Rs.5,00,000. Cost of preparation of plan (blue print) Rs.30,000, repairs of old building Rs.20,000.
   7. Fire Insurance Premium Rs.2,000.

4. From the following particulars prepare a Receipts and Payments A/c

	Rs.	
Cash in hand	1,000	
Cash at Bank	5,000	
Subscription Receive	33,000	
Donations received	2,600	
Investments purchased	10,000	
Rent paid	4,000	
General expenses	2,100	
Postage & Stationery	700	
Sundry expenses		300
Cash balance at close	200	

(Ans : Cash at Bank closing Rs.24,300)

5. Prepare a Receipt and Payment account from the following particulars.

		Rs.	
Opening balance of cash in hand		1,800	
Rent paid		450	
Stationery purchased		540	
Subscriptions received			
Previous year	1,800		
Current year	4,050	5,850	
Honorarium paid			810
Sale of old furniture		1,890	

Flood relief expenses	684	
Repairs	756	

(Ans : Cash in hand closing Rs.6,300)

6. From the following particulars prepare Income and Expenditure account

	Rs.	
Fees collected (Including Rs.24,000 on account of last year)	2,24,000	
Fees for the year outstanding	40,000	
Salary paid (including Rs.2,400 on account of last year)	19,200	
Salary outstanding	3,200	
Entertainment expenses	4,000	
Tournament expenses	8,000	
Meeting expenses	16,000	
Travelling & Conveyance	6,400	
Purchase of books	16,000	
Periodicals		8,000
Rents	9,600	
Postage, Telephone and Telegrams	13,600	
Printing and Stationery	4,000	
Donations received	6,400	

(Ans : Surplus Rs.1,56,800)

7. Following is the Receipt and Payments account of Visakapatnam cultural club for the year ended 31-12-2000.

Dr. Cr.

Receipts	**Rs**	**Payments**	**Rs**
To Donations	25,000	By Salaries	900
To Life membership	2,000	By Cricket	300
To Sports competition fund	5,000	By Tennis	270
To Subscription	1,600	By Inusrance	180
(including Rs.50 for 2001)		By Garden maintenance	85
To Locker rent	50	By Printing	15
To Interest on securities	200	By Telephone	125
To Cricket	150	By Investments	9,000
To Tennis	100	By Balance c/d	1,825
To Billiards	100		
	34,200		**34,200**

Subscriptions receivable for 2000 Rs.150, outstanding salaries Rs.100. Half of the donations are to be capitalised, accrued interest Rs.300, Prepaid insurance Rs.30.

Prepare Income and Expenditure Account for the year ended 31-12-2000.

(Asn : Surplus Rs.13,155)

7.15 SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal

Financial Accountancy : Jain and Narang

Financial Accountancy : R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda

LESSON - 8

NON TRADING CONCERNS II

8.0. Object : In the previous lesson you learned what is a Non trading concern and how a receipt and payment account and an Income and Expenditure Account is prepared? After going through this lesson the student can know how the Balance sheet of a Non - Trading concern is prepared ? And what are the items appear in this statement ?.

Structure :

8.1 Introduction.
8.2 Some special terms pertaining to Non -Trading concerns.
8.3 Illustrations
8.4 Summary
8.5 Self Assessment Questions
8.6 Excercises
8.7 Suggested Readings

8.1 Introduction

Even a non - Trading concern is established with service motive, these concerns also will have some assets as well as liabilities for expenses etc. Hence the Income and Expenditure Account is accompained by the Balance sheet like in trading concerns a balance sheet is to be prepared even by non - Trading concerns to complete the double entry effect. The Balance sheet covers all those items such as assets, capital fund etc. Capital Fund is similar to capital Account of Trading concerns. Non - Trading concerns do not have formal capital like that of Trading concerns. Hence, excess of income over expenditure and capital receipts or receipts that are capitalised are accumulated under the heading “ capital Fund” and shown as liability in the Balance sheet.

8.2 Some special terms pertaining to Non - Trading 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 As it is non - recurring and capital nature, it is to be capitalised. But if the amount is small it can be taken as an in come.

2. Donation : Donations are often received by these organisations from both individuals and institutions, 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 building. This amount should be utilised only for the purpose for which it is received.

b) General Donations : A general donation is the amount given by parties without specifically mentioning the purpose for which it should be utilised. This amount can be spent for any purpose.

However, normally general donations of big amounts are capitalised and small amounts are treated as revenue income.

3. Endowment Fund : " Endowment is the money or property given by parties so as to provide a permanent source of income to support the institution, e.g: the corpus fund of a university since the fund provides a permanent means of support, any amount received on account of this is capitalised and shown as a liability, but the interest or dividend received on account of this fund is treated as income.

4. General fund : Amounts which are received for no specific purpose and which are capitalised are shown under this head on the liabilities side of Balance sheet. But the income obtained on account of this fund is taken to the credit side of income and expenditure account.

5. Specific funds : Amounts received for a specific purpose are capitalised and shown in the Balance sheet on its liablities side e.g; price fund tournment fund, building fund, receipts and incomes on account of these specific funds should be added to the fund account and should not be taken to Income and Expenditure Account. All expenses on account of these funds should be deducted from the particular fund in the Balance sheet only. In case the expenses exceed the fund amount the excess expenses should be charged to the debit side of the income and Expenditure Account.

6. Subscription : Amounts agreed to be paid by the members or subscribers regularly at periodical intervals are called subscriptions : They are a regular source of income to the organisation. Hence subscriptions are shown as income.

7. Admission or Entrance fees : This is the amount received from a member at the time of his initial admission or readmission into the organisation. There is a difference of opinion about the treatment of this item in accounts. Some people argue that it should be capitalised since it is not a recurring item as each member pays it only once. However, there are others who contend that though it is paid by each member only once, the club or college receives it regularly and that as such, according to them, it should be treated as income, whatever the arguments are, in the absence of specific instructions to capitalise. entrance or admission fees, it may be treated as revenue income i.e. shown as the credit side of income and expenditure account.

8. Honourarium : It is taken payment made to certain people for their services. It is generally treated as revenue expenditure and charged to the Income and Expenditure Account. But if the amount is paid on account of a specific programme conducted in connection with a specific fund the amount should be deducted from the specific fund in the Balance sheet.

9. Sale of old Assets : Any receipt from the sale of an old asset such as furniture, is a capital receipt and as such it should not be taken to Income and Expenditure account, It should be deducted from the concerned asset in the Balance sheet. However, any loss on the sale of 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 news papers etc: The amount received on account of sale of old news papers or old sports material etc. treated as revenue income.

Illustration I

From the following Receipts and payments account of a Hospital for the year ending 31-12-2007 prepare an Income and Expenditure Account and Balance sheet as at the date.

Receipts and Payments Account
for the year ended 31-12-2007.

Receipts	Amount Rs	Payment	Amount Rs
To Cash in hand	3,565	By Medicine	15,295
To Subscriptions	23,998	By Doctors honourarium	4,500
To Donations	7250	By Salaries	13,750
To Interest on		By petty expenses	230
investments @ 7%	3,500	By Equipment	7,500
To Proceeds from charity	5,225	By Expenses on charity show	375
		Cash in hand	1,888
	43,538		43,538

Additional Information

	1-1-2007	31-12-2007
1. Subscriptions due	120	140
2. Subscriptions received in Advance	32	55
3. Stock of medicines	4405	4870
4. Estimated value of equipment	10,600	15,800
5. Buildings (cost less depreciation)	20,000	19,000

Solution :

Balance sheet as on 1-1-2007

Liabilities	Rs	Assets	Rs
Subscriptions received		Buildings	20,000
in advance	32	Equipment	10,600
Capital fund		Stock of medicines	4,405
(Balancing figure)	88,658	Investments	50,000
		Cash in hand	3565
		Subscriptions due	120
	88,690		88,690

Income and Expenditure Account for the year ended 31st December , 2007.

Dr Expenditure	Amount Rs	Assets	Cr Amount Rs
To cost of medicines	14,830	By subscription	23,995
To Salaries	13,750	By Donations	7,259
To Doctors honourarium	4,500	By Interest on investments	3,500
To Petty expences	230	By proceeds from	
To Depreciation		charity show	5m225
Equipment 2300			
Buildings 1000	3,300	Less expenses 375	4850
To Excess of Income			
over expenditure	2985		
	39,595		39595

Balance sheet as on 31-12-2007

Dr Liabilities	Amount Rs	Assets	Cr Amount Rs
subscription received		Buildings 20,000	
in advance	55	less Depreciation 1,000	19,000
Capital fund 88658	4,500	Equipment 10,600	
Add Excess		Add additions 7,500	
of Income		18,100	
Over expend		Less: Depreciation 2,300	15,800
deture 2,985	91,643	Stock of medicines	4,870
		Investments	50,000
		Cash in hand	1,888
		Subscriptions due	140
	91,698		91,698

Working Notes :

1. Cost of Medicines used	Rs.
Stock of Medicines 1-1-2007	4,405
Add Purchases during the year	15,295
	19,700
Less Stock of Medicines on 31-12-2007	4,870
	14,830

2. Subscriptions :		Rs
Actual amount received		23,998
less Received for 2006	120	
Received in advance	55	175
		23,823
Add Due at the end of the year	140	
Received in advance in 2006	32	172
		23,995

3. Depreciation on Equipment	Rs.
Equipment on 1-1-2007	10,600
Add Additional during the year	7,500
less Equipment on 31-12-2007	18,100
	15,800
	2,300

Illustration II

The following is the statement of assets and liabilities of the city central library as at 30-6-2006.

Liabilities	Amount Rs	Assets		Amount Rs
Out standing expences	6,500	Cash		32,000
Capital Fund	4,43,500	Furniture		48,500
		Debtors :		
		Subscriptions outstanding	7500	
		For use of lecture hall	3500	11,000
		Books Account		1,68,500
		Investments		50,000
		Buildings		1,40,000
	4,50,000			4,50,000

The following were the cash transactions for the year ending 30-6-2007

Particulars	Amount Rs	Particulars	Amount Rs
To Balance b/d	32,000	By salaries	24,000
To Entrance Fee	26,000	By Municipal taxes	7,000
To subscriptions	85,000	By Insurance on builder	5,000
To sale of furniture	6,000	By Additions to library	12,500
To sale of old News Papers	600	By Outstanding creditors of last year paid	6,500
		Repairs	2,500

To rent on library hall	10,400	By Electric installation expenses	45,000
To proceeds from		By printing & stationery	4,000
lectures and entertainments	30,000	By postage	500
		By sundry expenses	1500
		Balance c/d	81,500
	1,90,000		1,90,000

It was ascertained that Rs 11,000 was outstanding by way of subscriptions and Rs 3,750 for use of library hall. Insurance on building was prepaid to the extent of 1,750. There were creditors outstanding for expenses to the extent of Rs 8000,

You are required to prepare an Income and Expenditure Account and Balance sheet as at 30-6-2007 after providing for depreciation on building @ 2 1/2% and writing down investments by 5% and library books by 10%.

Solutions:

Dr City Central Library Income & Expenditure for year ending 30-6-2007 Cr

Expenditure	Amount Rs	Income		Amount Rs
To Salaries	24,000	By subscriptions	85,000	
To municipal taxes	1,000	<u>Add</u> Outstand	11,000	
			96,000	
To insurance 5000				
<u>less</u> prepaid 1750	3250	less last year	7500	88,500
To repairs	2500	By sale of old Newspaper		600
To sundry expenses	1500	By rent of library hall	10,400	
To printing & stationery	4000	<u>Add</u> Out standing	3,750	
To postage	500		14,150	
To outstanding expenses	8000	<u>less</u> Last year	3500	10,650
To Depreciation	3500	By proceeds from		
Buildings				
Investment	25,00	lectures and entertainment		30,000
Library books	18,700			
To surplus (excess of income over expenditure)	54,100			
	1,29,750			1,29,750

Dr City central Library Balance sheet as on 30-6-2007 Cr

Liabilities (1)		Amount Rs. (2)	Assets (3)		Amount (4) Rs
Capital fund	4,43,500		Buildings	1,40,000	
<u>Add</u> surplus	54,900		<u>less</u> Depreciation	3,500	1,36,500
Entrance fees	26,000	5,24,400	Furniture	48,500	
outstanding express		8,000	<u>less</u> furniture sold	6,000	42,500
			Electric Installation		45,000
			Library books	1,68,500	

			Add Additions	12,500	
				1,81,100	
			less Depreciation	18,100	1,62,900
			Investments	50,000	
			Less Depreciation	2,500	47,500
			Sundry debtors		
			For subscriptions		11,000
			For rent of library hall		3,750
			Prepaid insurance		1,750
			Cash		81,500
		5,32,400			5,32,400

Sometimes income and Expenditure and Recipts and payment amounts are given in the question and it is required to prepare the balance sheet both at the beginning and at the end of the period, in such case following procedure may be adopted.

1. From the particulars given in the questions prepare the balance sheet in the biginning of the year.

2. Compare the 'receipts side' of the Receipts and payments amount to income side of income and expenditure about to ascertain (i). Subscription in arears, previous and current years (ii). income received in advance and (iii) sale of an asset during the year

3. Similarly compare the payment side of the Receipts and payment account to expenditure side of the income and expenditure account to ascertain, (i) outstanding expenses during the year. (ii) prepaid expenses during the year. (iii) stock of stationery in hand (iv) depreciation on assets and (v) purchase of an asset during the year.

Illustration 5

From the following information relating to Hyderabad sports club prepare the balance sheet as on 1-1-2007 and 31-12-2007. Assets and liabilities as on 1-1-2007 club grounds and pavilion Rs,250,000 sports equipments Rs, 1,50,000, Furniture Rs 3,51,000 and subscription in assets on that date Rs 5000. Creditors For stationery Rs 5,000.

Receipts and payment for the year
Ending on 31-12-2007

Receipts	**Amount Rs**	**Payment**	**Amount Rs**
To Balance b/d	25,000	By printing and stationery	15,000
To Subscription			
2006	4,500	By Salaries	55,000
2007	90,000	By Advertising	10,000
2008	2,500	By Fire insurance	7,500
To Sale of old news papers	1,500	By Furniture	10,000
To Rent received	11,000	By Investment	90,000
To Entrance fees	60,000	By Balance c/d	7,000
	1,94,500		1,94,500

Dr Income and expenditure Account for the year ending on 31-12-2007 Cr

Expenditure	Amount Rs	Income	Amount Rs
To Salaries	60,000	By subscriptions	95,000
To Printing and stationery	14,000	By entrance fees	60,000
To Audit fees	2500	By rent received	12,000
To Advertising	10,000	By sale of old news paper	1,500
To fire insurance	6,000		
To Depreciation on sports equipment	30,000		
To Furniture	4,000		
To excess of income over Expenditure	42,000		
	1,68,500		1,68,500

Solution :

Dr Balance sheet As on 1-1-2007 Cr

Liabilities	Amount Rs	Asserts	Amount Rs
Creditors for stationery	5000	Cash	25,000
Capital Fund	4,60,000	Ground and pavilion	2,50,000
		Sports equipment	1,50,000
		Furniture	35,000
		Subscription outstanding	3,000
	4,65,000		4,65,000

Dr Balance sheet As on 31-12-2007 Cr

Liabilities	Amount Rs	Asserts	Amount Rs
Creditors for stationery	4000	Cash	7000
Salary outstanding	5000	Ground and pavilion	2,50,000
Audit fees out standing	2500	Sports equipment	1,20,000
		(1,50,000 - 30,000)	1,20,000
Subscriptions in advance	2500	Furniture	41,000
		(35,000 + 10,000 - 4000)	
Capital Fund 4,60,000			
Add surplus 42,000	5,02,000	Investments	90,000
		Subscription outstanding	
		2006 500	
		207 5000	5,500
		Insurance prepaid	1,500
		(7500 - 6000)	
		Rent Due	1000
		(12000 - 11,000)	
	5,16,000		5,16,000

Some times Income and expenditure account is given along with notes and it is required to prepare the receipts and payments account. In such a case the following producer may be adopted.

1. All expenditure, whether capital or revenue or relating to the current succeeding and preceding period incurred during the year must be shown on the credit side of this account.

2. All receipt of cash, whether capital. Revenue or relating to the current, seding and preceding period, should go to debit side of this account.

3. Opening and closing balance of receipts and payment account are to be taken into consideration.

4. Eliminate all adjustments relating to provisions for doubtful debts or depreciation which are madefor preparing income and expenditure account.

5. Purchase or sale of assets can be calculated by comparing the net value of asset on two dates beginning and the end of the year.

Illustration 6

The following is the Income and expenditure account of Guntur stadium club for the year ended 31st March 2007.

Dr **Income and Expenditure Account** **Cr**

For the year ended 31-3-2007

Expenditure	**Amount Rs**	**Income**	**Amount Rs**
To salaries	7,800	By subscription	27,200
To Rent	1,800	By Donation	2000
To Printing	300		
To Insurance	200		
To Audit fees	300		
To Games & sports	1,400		
To Subscription written off	140		
To Miscellaneous expences	5,800		
To loss on sales of furniture	1,000		
To Depreciation on sports Equipment	24,00		
To furniture	1,240		
To excess of income over expenditure	6,820		
	29,200		29,200

Additional information :

	31-3-2006	**31-3-2007**
Subscription in areas	1040	1,480
Advance subscription	400	600
<u>Outstanding expences</u>		
Rent	200	320

Salaries	480	140
Audit fees	200	300
Sports equipment loss depreciation	10,000	9,600
Furniture less depreciation	12,000	11,160
Prepaid Insurance	-----	60

Book value of furniture sold is Rs 2,800

Entrance fees capitalised Rs 1600. On 1st April 2007 there was no cash in hand but there is bank overdraft for Rs. 6,000 on 31st march 2007, cash in hand amounted to Rs 340 and the remaining was Bank balance.

Prepare the receipts and payment amount of the club for the year ended 31st march 2007.

Solution:

Dr **Guntur stadium club receipt and payments Account for the year ended 31-3-2007** **Cr**

Receipts	**Amount Rs**	**Income**	**Amount Rs**
To subscription Received		By Balance b/d	6000
(27,200 + 1040)+ 600) - (1480 - 400)	26,820	By sports equipments	2000
-140)	2000	(9600 + 2400 – 10,000)	
To Donations received	1,600	By Furniture purchased	32,00
To Entrance Fees	1,800	(11,160 + 2800 + 1240	
To sale of furniture		- 12,000)	
(2800 - 1000)		By salaries	8140
		(7800 + 480 – 140)	
		By Rent	
		(1800 + 200 – 320)	1680
		By printing	300
		By Insurances (200 + 60)	260
		By Games & Sports	1,400
		By Misc, expences	5,800
		By closing balance	
		Cash in hand 340	
		Cash in hand 2900	3,240
	32,220		32,220

Illustration - 7

Secunderabad club had the following assets and libilities as on 1-1-2007. cash in hand Rs 12,000, subscription receivable Rs 12,00. Furniture Rs 6000, Sports material Rs 3600. Investments Rs 15,000, buildings Rs 30,000 outstanding for supplies Rs 1,800 and capital fund Rs 66,000

During the year 2007 the club did the following business.

Subscriptions received (including the arrears) Rs 18,000 subscriptions due Rs 18,00 paid to the outstanding creditors for supplies, subscriptions to News papers Rs 3000, Sports material purchased Rs 6,000, sale of old newspapers Rs 300, meeting expenses Rs 2,700; lighting charges Rs 2,400 salaries of establishments RS 6,000 stocks of sports material at the end Rs 3,000 interest received on incestment RS 450 (out standing Rs 150) Borrowing Rs 12,000, donations received Rs 10,800 (hay to be capitalised) provide depreciation at 5% on furniture and buildings

Prepare a Receipts and payment amount an Income and expenditure amount for the year 31st Dec 2007, and a Balance sheet as on that date.

Secundrabad club Receipts and payment Account
for the year ended 31-12-2007

Dr **Cr**

Receipts	**Amount Rs**	**Payments**	**Amount Rs**
To Balance b/d	12,000	By outstanding creditors	1800
To Subscriptions	18,000	for supplies	
To Sale of old news paper	300	By subscription to news papers	3,000
To Interest on investments	450	By purchase of sports materials	
To Borrowings	12,000	By meeting expenses	6,000
To Donations	10,800	By lighting charges	2,700
		By salaries of establishment	6,000
		By purchase of furniture	2,400
		By Annual function expenses	2,250
		By Balance c/d`	27,000
	53,550		53,550

Income and expenditure Account for the year 31-12-2007

Dr **Cr**

Expenditure	**Amount Rs**	**Income**	**Amount Rs**
To subscription to		By subscription	
News papers	3000	(18000 + 1800 – 1200)	18,600
To sports materials used			
(6000 + 3,600 – 3,000)	6,600	By sale of old News papers	300
To Meeting expenses	2,700	By interest on investments	600
To lighting charges	2,400	By Donations	5,400
To salaries of establishement	6,000		
To functions expenses			
To annual function expenses	2,250		
To Depreciation on			
Furniture 300			

Buildings	1500	1,800		
To Surplus		150		
		24,900		24,900

Dr Balance sheet as on 31-12-2007 Cr

Liabilities		Amount Rs	Assets	Amount Rs
Borrowing		12,000	Cash in hand	27,000
Capital fund	66,000		Subscriptions due	18,00
Add surplus	150		Furniture	8,100
Donations	5,400	71,550	(6000 + 2400 – 300)	
			Stock of sports material	3000
			Investment	15,000
			Accured Interest	150
			Buildings (30,000 - 1,5000)	28,500
		83,550		83,550

8.4 Summary :

Non trading concerns Income and Expenditure account is accompanied by the Balance sheet like in case of Trading concerns. Capital Fund appear in the Balance sheet of Non-Trading concerns is similar to capital Account of Trading concerns, Non - trading concerns do not have formal capital like that of Trading concerns. The Exceed of income over expenditure and capital receipts or receipts that are capitalised are accumulated under the heading “Capital fund” and shown as liability in the Balance sheet. While preparing Final accounts of Non - Trading organisations special items like legacies Donations Endowment fund, general fund , special fund Entrance fees, Honorarium etc should be given importance.

8.5 Self Assessment Questions :

1. Explain the meaning of the following terms
   a. Legacies
   b. Donation for specific purpose
   c. Life member ship fees
   d. Entrance fees
   e. Endowment fees.
   f. Receipts for tournament fund.
2. How will you prepare the Balance sheet both at the beginning and at the end of the accounting period from a given Receipts and payments Account and an income and Expenditure Account.
3. What special items are considered while preparing accounts of Non-trading Concerns?
4. What is legacy ?

5. How will you treat the following items while preparing final accounts of non-trading concerns ? a) Specific donations b) Entrance fees
6. How do you convert Income and Expenditure account into Receipts and Payments account?

8.6 Excercises :

1. From the following Trial Balance prepare an Income and Expenditure Account of the Mumbai club for the year ended 31-12-2007 and a Balance sheet as on that date.

Depreciate furniture by 10% billards tabels and accessories by 20% China glass cuttlery etc. by 33 1/3. of the subscriptions Rs 2,400 is paid in advance and Rs 1500 is in arrears Rs 1,800 is owing for salaries to staff.

	Debit Rs		Credit Rs
Furniture	15,000	Members subscription	63,360
Billiards table (brought in 2005)	7500		
Chinaglass cuttlery	1998	Sundry receipts from Billiards etc	10,458
Repairs	4404		
Salaries and wages	13,572	Sale of Tickets for entertainment	19,404
Rent and Telephone	19,164	Sundry creditors	15,600
Fuel and light	9,708	Entrance fees	2,688
Cost of entertainment	13,140	capital fund	24,000
Sundry expences	9,600		
Cost of annual dinner	4,560		
Sundry debtors	7020		
Cash at bank	28,800		
Cash in hand	1,044		
	1,35,510		135,510

2. From the following receipts and payments account for the year ending 31-12-2007 prepare an income and Expenditure account for the period ending 31-12-2007 and a Balance sheet as on that date.

Receipts	**Rs**	**Payments**	**Rs**
To Donations	35,000	By salaries	37,500
To subscriptions	1,15,000	By Help to poor	37,000
To life membership fees	50,000	By Expenses on free dispensary	34,500
To Legacy	75,000	By postage & stationery	3,500
To Interest received	4000	By Furniture	50,000
		By Investments	75,000
		By Cash in hand	41,500
	2,79,000		2,79,000

Additional Information :

1. Subscriptions outstanding for the current year Rs 5,000.
2. Salaries unpaid Rs 5,000
3. Help to poor students promised but unpaid Rs 16,000
4. Expenses of dispensary outstanding Rs 3,000
5. Postage and stationery expenses yet to be paid Rs 4,000

3. Prepare Income and Expenditure account and Balance sheet for 2007 from the Balance sheet and Receipts and payments account.

Balance sheet As on 31-12-2007

Liabilites	Amount Rs	Assets	Amount Rs
Capital Fund	13,448	Building	12,000
Subscriptions received		Outstanding subscriptions	152
in advance	240	Outstanding lockers rent	96
Out standing expenses	560	Cash	4000
loan	2,000		
	16,248		16,248

Receipts and Payment Account for the year ended 31-12-2007

		Rs			Rs
To Balance 1-12007		4,000	By Expenses	2006	480
				2007	800
To Subscriptions :	2006	80	By Land		1,600
	2007	840	By Interest		160
	2008	40	By Mic. expenses		800
To Entrance fees		320			
To Lockers rent		280	To Balance c/d		3,320
Misc. Income		1600			
		7,160			7,160

4. Guntur sports club started on 1-1-2007, Their Receipts and payment A/c for the year 2007 is given below.

Receipts	Rs	Payment	Rs
To Donations	50,000	By Buildings	40,000
To Entrance fees	4000	By Tournment expenses	900
To Tournament Fund	10,000	By Furniture	2,100
Revenue receipts		By Revenue Payments	

To Subscriptions (including Rs.100 for 2008)	3,200	By salaries	18,000
		By cricket expenses	1140
To rent	100	By Insurance	360
To other receipts	700	By gardener	600
To Cricket fees	400	By Investments	18,000
		By Balance c/d	3,500
	68,400		68,400

Additional Information :

1. Subscriptions receivable for the year 2007 Rs 300/-
2. Salaries un paid Rs 170/-
3. Entrance fees are to be capitalised
4. Insurance include 9 months premium for 2008.

4. From the following particulars prepare Income and Expenditure account

	Rs.	
Fees collected (Including Rs.24,000 on account of last year)	2,24,000	
Fees for the year outstanding	40,000	
Salary paid (including Rs.2,400 on account of last year)	19,200	
Salary outstanding	3,200	
Entertainment expenses	4,000	
Tournament expenses	8,000	
Meeting expenses	16,000	
Travelling & Conveyance	6,400	
Purchase of books	16,000	
Periodicals		8,000
Rents	9,600	
Postage, Telephone and Telegrams	13,600	
Printing and Stationery	4,000	
Donations received	6,400	

(Ans : Surplus Rs.1,56,800)

5. Following is the Receipt and Payments account of Visakapatnam cultural club for the year ended 31-12-2000.

Dr. Cr.

Receipts	Rs	Payments	Rs
To Donations	25,000	By Salaries	900
To Life membership	2,000	By Cricket	300

To Sports competition fund	5,000	By Tennis	270
To Subscription	1,600	By Inusrance	180
(including Rs.50 for 2001)		By Garden maintenance	85
To Locker rent	50	By Printing	15
To Interest on securities	200	By Telephone	125
To Cricket	150	By Investments	9,000
To Tennis	100	By Balance c/d	1,825
To Billiards	100		
	34,200		**34,200**

Subscriptions receivable for 2000 Rs.150, outstanding salaries Rs.100. Half of the donations are to be capitalised, accrued interest Rs.300, Prepaid insurance Rs.30.

Prepare Income and Expenditure Account for the year ended 31-12-2000.

(Ans : Surplus Rs.13,155)

6. The Receipts & Payments account of the Hyderabad Friends Club for the period ending 31st December, 2000 is given below.

Receipts	**Rs**	**Payments**	**Rs**
To Donates received	25,000	By Buildings	20,000
To Reserve fund (Being		By Furniture	1,050
life numbers fees received)	2,000	By Tournament Expenses	
quadrangular match fund	5,000	quadrangular matches	450
Revenue Receipts		Revenue payments	
To subscriptions (including		By salaries	900
Rs. 50 for 2001)	1,600	By Cricket	300
To Lockers rent	50	By Tennis	270
To interest on securities	50	By Insurance (Paid up	
To cricket	200	30th September 2001)	180
To sundries	25	By Gardening	85
To Tennis	175	By Printing	15
To Billiards	100	By Telephone	125
		By sundries	75
		By Investments (at cost)	9,000
		By Balance c/d	1,750
	34,200		34,200

Subscription fees outstanding for the year 2000 was Rs. 150. Salaries up paid for 2000 Rs, 85, From the particulars given above prepare an Income and Expenditure account of the club for the year ended 31st December, 2000 and the Balance Sheet as on that date.

(Ans : Excess of income Over Expenditure, Rs. 400, Balance Sheet Total Rs. 32,085)

7. Tarakarama Sports Club's Receipts and Payments amount for the year ending 31st Dec., 20000 is given here under.

Receipts	Rs	Payments	Rs
To Cash in hand	250	By Salary workmen	2,000
To Cash at Bank	2,250	By Grass cutting machine	1,000
To subscriptions	6,750	By Rent	450
To tournament fund	2,500	By Games expenditure	3,500
To Life members fees	1,500	By Tournament expenditure	1,000
To Entrance fees	250	By office expenditure & Postage	2,250
To Donation Pavilion	4,000	By Games equipment	1,500
To sale of glass	200	By Balance c/d	
		Cash in hand	750
		Cash at Bank	5,250
	17,700		17,700

Additional information.

1. Subscriptions receivable for 1999 Rs. 1,000 and for 2,000 Rs. 1,050

2. Games equipment in the beginning was Rs. 250 for 2001.

3. Provide depreciation at 10% on Gras cutting machine.

Prepare Income and Expenditure account for the year ending 31st Dec., 2000 and opening and closing Balance sheet.

(Ans : Excess of Expenditure Over Income Rs.2,550 Capital fund Rs. 4,500 Balance sheet Total Rs. 9,200)

8. Prepare the final a/c of Hyderabad Club from the particulars given below for the year ending 31-12-2000.

Receipts	Rs	Payments	Rs
To Balance b/d	1,200	By Salaries	6,500
To Subscriptions		By Rent	1,200
(including 400 for 2001)	6,400	By Printing & Stationery	180
To Interest on investment		By postage	50
(Investment cost Rs.40,000)	2,500	By Cycle purchase	800
To Bank interest	50	By Govt. Bands	1,000
To Sale furniture	500	By Balance c/d.	920
	10,650		10,650

Adjustments

Subscriptions received included Rs.200/-of 1999

Rent paid included Rs.100/- for Dec.,1999.

Subscriptions due for 2000 Rs. 300/-

Salaries payable Rs. 600/-

Cost of Furniture sold was Rs.640/-

(Ans : Excess of Income over Expenditure Rs. 80 Capital Fund Rs. 14,940 Balance Sheet Total Rs. 43,020)

9. From the following Receipts and Payments account and other information of City Club, prepare Income and Expenditure account as on 31-12-2000 and Balance Sheet as on that date.

Adjustments :

1. Subscriptions received include Rs. 1,200 - for the year 1999 and Rs.2,400/- for the year 2001.

2. Subscriptions due for the year 2000 - Rs.1,800/-

3. Printing charges payable for 2000 - Rs.240/-

4. Salaries payable for 2000 - Rs. 3,600/-

Receipts & Payment Account on 31-12-2000

Receipts	**Rs**	**Payments**	**Rs**
1.1.2000		By Salaries	39,000
To Balance of		By Rent	7,200
Cash 1800		By printing and stationary	1,080
Bank 5400		By postage	300
	7,200	By Purchase of a cycle	1,800
31-12-2000		By Purchase of Govt. Bonds	9,000
To Subscriptions	38,400	**31-12-2000**	
To interest on investments	15,000	By Balance C/D	
To Bank interest	300	Cash 180	
To sale of furniture	3,000	Bank 5,340	
(Cost of furniture			5,520
on 1-1-2000 Rs. 3,840)	63,900		63,900

(Ans: Excess of Expenditure over Income - Rs. 360, Capital Fund - Rs 12,240 Balance Sheet Total - Rs. 18,120)

10. From the under mentioned Receipts and Payment account for the year ending 31-12-2000 of French Recreation Club,prepare Income and Expenditure account and Balance Sheet as on that date.

Receipts and Payments Account
(For the year ended 31-12-2000)

Receipts	Rs	Payments	Rs
To Balance b/d (Bank)	25,000	By purchase of furniture (1-4-200)	5,000
To subscriptions		By salaries	2,000
1999 1,500		By Telephone expenses	300
2000 10,000		By Electricity charges	600
2001 500	12,000	By postage and stationery	150
To Donations	2,000	By Purchase of books	2,500
To Rent	300	By Entertainment expenses	900
To Interest on bank deposits	450	By Purchase of Govt. Bonds 5%	
To Entrance fee	1,000	(1-7-2000)	8,000
		By Miscellaneous expenses	600
		By Balance c/d :	
		Cash 300	
		Bank 20,400	20,700
	40,750		40,750

The following additional information is available :

1. Salaries outstanding Rs, 1,500.
2. Entertainment expenses outstanding Rs 500
3. Bank interest receivable Rs. 150
4. Subscriptions accrued Rs. 400
5. 50% of entrance fee is to be capitalised.
6. Furniture is to be depreciated at 10% (per annum).

(Ans : Excess of Income over Expenditure - Rs. 7,075 Capital Fund Rs. 26,500, Balance sheet Total Rs. 36,575)

11. The following is the Receipts and payments statement of the Secunderabad sports Club for the year ended 31st December, 2000

Receipts	Rs	Payments	Rs
To Balance 1-1-2000	2,400	By Secretary's salary	3,600
To Entrance fees	500	By Up-keeps of grounds (c)	2,100
To subscriptions (a)	8,700	By Wages of grounding (d)	2,400
To proceeds of		By found rent	150
Concerns	1,500	By Sundry repairs	175
To Interest on (b)		By Printing and postage	200
Investment	500	By Balance 31-12-2000	4,945
	13,600		13,600

a) This item included subscriptions outstanding brought over from previous year, Rs. 300

b) This item includes Rs. 150 in respect of interest accrued in the preceding period.

c) This item includes Rs. 400 applicable to the previous year.

d) This item includes Rs. 200 applicable to the previous year.

Other ledger balance at the commencement of the financial period were :

Capital fund Rs. 40,100 Income and Expenditure account Credit Balance brought forward Rs. 8,900, Club premises and Grounds (as per valuation) Rs. 31,000, Investments Rs. 10,000, Sports material Rs. 2,450, Furniture and Fixtures Rs. 4,000, Books - Rs. 300.

From the above particulars, prepare a Balance sheet at the commencement of the period, and income end Expenditure account for the period, and a Balance Sheet as the close of the period.

Entrance fees are to be capitalised. The outstanding labilities on 31st December, 2000 were wages Rs. 200 and Printing Rs. 100. Interest occurred and outstanding on investments was Rs 120. Depreciate Club premises by 2 per cent, Furniture by 5 per cent and sports Equipment by 331/3 percent.

(Ans : Excess of Income over Expenditure Rs. 428. Balance sheet total Rs. 50,228)

12. The receipts and payments account of the Hyderabad Athlete, Society, for the year ending 31st December, 2000 is given below. In the Society's ledger, the following balance are found on the date.

	Rs.
Capital account (Donations etc.)	30,000
Club House and grounds	18,000
Investments at cost	8,000
Furniture & fittings	4,500
Income & expenditure (Cr.)	2,500

Receipts and payment Account for the year ended 31st December, 2000

Receipts	**Rs**	**Payments**	**Rs**
To Balance 1-1-2000	2,085	By Upkeep of grounds	3,300
To subscriptions	7,200	By Secretary's salary (c)	2,400
To Entrance fees	320	By Wages of groundman (d)	2,800
To proceeds of		By ground rent	150
Lectures	3,500	By Sundry repairs	140
To Interest on		By Printing and postage	80
Investment	360	By Balance 31-12-2000	5,595
	13,465		13,465

a) This item includes Rs 400, in respect of subscriptions brought over from previous year.

b) This item included Rs. 90, by way of interest occurred in the previous year.

c) This included Rs.400 applicable to the previous ear.

d) This item included Rs. 175, which relates to the previous year.

Other adjustments are :

1) Entrance fees are to be capitalised.

2) Charge 10% depreciation on furniture and 2 percent of club house and grounds.

From these particulars, prepare the final accounts of the Society for the yea 2000.

(Ans Excess of Income over Expenditure Rs. 2,465, Balance Sheet Total Rs. 35,285.)

13. The following particulars related to Cucullate club.

Income and Expenditure Account

(For the year ended 31-12-2000)

Receipts	**Rs**	**Payments**	**Rs**
To Salaries	4,800	By Entrance fees	36,000
To subscriptions	6,300	By Subscriptions	42,300
To Advertising	5,400	By Rent	12,000
To Audit fees	900		
To Fire insurance	3,000		
To Depreciation	24,000		
To Excess of Income over Expenditure	45,900		
	90,300		90,300

Receipts and Payment Account

(For the year ended 31-12-2000)

Receipts	**Rs**	**Payments**	**Rs**
To Balance b/d	12,600	By Salaries	3,600
To Entrance fees	36,000	By Printing & Stationery	7,500
To Subscriptions		By Advertising	5,400
1999	1,800	By Fire Insurance	3,600
2000	40,500	By Investments	60,000
2001	1,200	By Balance c/d	22,500
To Rent received	10,500		
	1,02,600		1,02,600

The assets on 1-12000 included land and buildings Rs. 1,50,000, sports equipment Rs. 75,000, Furniture Rs. 12,000, Subscriptions in arrears on that date were Rs. 2,400, Subscriptions in arrears on 31-12-2000 amounted to Rs. 1,800.

Prepare Balance sheet as at 31-12-2000.

(Ans Capital fund the being Rs.2,52,000 B/s total Rs. 3,01,200)

14. From the following information given the books of a sports club, prepare the Balance sheet as on 31-12-2000.

Receipts and Payment Account for the year ended 31-12-2000.

Receipts	Rs	Payments	Rs
To Balance b/d	16,800	By Salaries	32,600
To Entrance fees	8,000	By Printing & Stationery	80,000
To Subscriptions		By Advertising	2,000
1999	2,400		7,200
2000	40,500	By printing & Stationery	60,000
2001	1,200	(including Rs.1,200	22,500
		of the previous year)	
		By Insurance Premium	4,800
		By Balance c/d	10,800
To Interest received	8,000		
	1,36,800		1,36,800

Income and Expenditure Account for the year ended 31-12-2000.

Receipts	Rs	Payments	Rs
To Salaries	33,600	By Subscriptions	1,02,000
To Advertising	2,000	By Entrance fees	8,000
To Printing & Stationery	6,000	By Interest received	8,000
To Audit fees	4,000		
To Insurance premium	4,000		
To Depreciation	24,000		
on sports - equipment	30,000		
Furniture	1,600		
To Excess of over			
Expenditure	45,900		
	1,18,000		1,18,000

Assets of the club on 1-1-2000 including Sports equipment Rs. 1,00,000, Ground and pavilion Rs. 1,60,000 and Furniture Rs. 16,000. Subscription in arrears on that date was Rs, 3,200 and subscription received in advance was Rs. 1,000.

(Ans : B/s Total Rs 3,37,800; Opening capital fund Rs 2,93,800)

15. Andhra Cricket club gives you the following information.

Income and Expenditure Account
for the year ended 31-12-2000.

Expenses	Amount Rs	Income		Amount Rs
To Remuneration	9,000	By Donation and		
To Salaries and wages	12,000	Subscription		51,000
To Rent	6,000	By Barroom receipts	12,000	

To Repairs	5,500	Less expenses	10,000	2,000
To Miscellaneous expenses	3,500	By Bank Interest		1,000
To Honoraum to secretary	9,000	By Hire of club hall		6,000
To Depreciation on equipment	2,500			
To Surplus	12,500			
	60,000			60,000

Balance Sheet as on 31-12-2000.

1999 Rs	Labilities	2000 Rs.	1999 Rs.	Assets	2000 Rs.
	Capital Fund as		12,500	Equipment	10,000
	On 31-12-99 24,000			Outstanding	
	Entrench fee 5,000		3,000	Subscription	4,000
24,000	Surplus 12,500	41,500	2,500	Cash in hand	2,000
	Subscription in		1,250	Cash at bank	5,000
2,000	advance	15,00	10,000	Fixed deposits	25,000
	Outstanding expenses				
750	Miscellaneous	500			
1,000	Salaries and wages	1,500			
	Honorarium to				
1,500	Secretary	1,000			
29,250		46,000	29,250		46,000

Prepare the Receipts and payments Account of the club for the year ended 31-12-2000.

(Donations subscriptions received Rs, 49,500, Salaries and wages paid Rs. 11,500, Misc. expenses paid Rs. 3,750, Honorarium to secretary paid on 9,500).

8.7 SUGGESTED READINGS :

Financial Accountancy	**:**	**Shukla Grewal**
Financial Accountancy	**:**	**Jain and Narang**
Financial Accountancy	**:**	**R.L. Gupta & V.K. Gupta**

Dr. Ch. Suravinda

Lesson: 9

Partnership Accounts I – Admission of a partner

9.0 Objective:

After going through the lesson you will be able to understand the following:

1. Definition and meaning of partnership.
2. Accounting procedure while a new partner joins the partnership.
3. Method of calculating goodwill in view of admission.

Structure:

9.1: Definition and meaning of Partnership

9.2: Accounts in Partnership

9.3: Admission in Partnership

9.4: Treatment of Goodwill

9.5: Revaluation of Assets and Liabilities

9.6: Illustrations

9.7: Try yourself

9.8: Summary

9.9: Glossary

9.10: Self Assessment Questions

9.1: Definition and meaning of Partnership:

According to Section 4 of Indian Partnership Act, Partnership is ***"the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".***

The above definition gives the following ***features*** to a partnership:

1. It is an association of two or more persons.
2. It has an agreement entered by all the partners concerned.
3. It deals with a business.
4. It can be carried on by all partners or any of them can act for them.
5. The partners share profits and losses as per the agreement.

9.2: Accounts in Partnership:

Partnership accounts do not present much difficulty unless there is an admission, retirement, death or dissolution. Profit and Loss Account is prepared in the usual way and the Balance Sheet is also made out in the usual manner. In this lesson we learn how to prepare accounts when a new partner enters the organization i.e. admission. The following four lessons deals with other areas of partnership accounts.

9.3: Admission in Partnership:

It is a usual thing that some new partners join the partnership often which is already in existence and the firm continues its operations as usual with the old and new partners together. When a new person is admitted as partner, the two main problems to be tackled are regarding a) treatment of goodwill and b) revaluation of assets and liabilities.

9.4: Treatment of Goodwill:

It is generally observed that a firm, which has been in existence for a number of years, is in a position to earn a higher amount of profits year after year in comparison to a new firm in spite of all other things remaining the same. This is because over a period of time a firm establishes its reputation on account of which not only the old customers continue to patronize the firm but they also bring new customers. This results in enabling an old established firm to earn excess profits as compared to a new firm. Goodwill has, therefore, been defined as, "the present value of a firm's anticipated excess earnings".

In the ongoing firm when a new partner is admitted, he automatically enjoys the benefits of the firm i.e. the goodwill. Therefore, generally the new partner needs to bring some extra amount towards this goodwill and the existing partners share this in their agreed ratio.

Depending upon the share of profits to be given to the new partner, either a sum of money will be paid by him to the old partners (through the firm or privately) or the old partners will be credited with their share of the goodwill. As said earlier, the new partner will take a share of profits which comes out of the shares of other partners. The old partners must be compensated for such a loss. The amount to be brought in by the new partner for goodwill is in addition to the amount to be brought in as capital.

The following are the various possibilities as regards goodwill;

1. Premium Method: Under this method, the new partner brings goodwill in cash which is left in the business or that cash is withdrawn by the old partners. Sometimes, new partner may pay the goodwill to the old partners privately.

Journal entries:

a) When the new partner brings goodwill in cash which is left in the business —

i) Cash/Bank A/C Dr

To Goodwill

ii) Goodwill A/C Dr

To Old partners Capitals

b) When goodwill brought in by new partner withdrawn by old partners ——

i) Cash/Bank A/C Dr

To Goodwill

ii) Goodwill A/C Dr

To Old partners Capitals

iii) Old partners Capitals A/C Dr

To Cash/Bank

c) When the goodwill is paid by the new partner to the old partners privately, No entry is required.

2. Revaluation Method: The new partners do not bring cash as goodwill but is raised in the books of the firm. The entry required is as follows:

Goodwill A/C Dr

To Old partners Capitals

The old partners Capital accounts are to be credited in their old profit sharing ratio. Goodwill thus created appears in the balance sheet.

3. Memorandum Revaluation Method: Under this method, goodwill is raised in the books and then is immediately written off. In the above case, goodwill is credited to the old partners in the old profit-sharing ratio. But when it is to be written off, the goodwill should be credited to all partners in the new profit sharing ratio.

When a new partner comes into the organization, the existing ratio of the old partners should be changed to accommodate him. And the partners who are losing their part of the share should get benefit in the form of goodwill. This is called as sacrificing ratio. For example, A and B, sharing in the ratio of 3:2 and admit C as partner and it is agreed that the new profit-sharing ratio is 2:2:1. It is obvious that B does not suffer at all on C's admission. He previously received 2/5ths of profits; he still receives 2/5ths of profits. It is A alone who has suffered and, therefore, any amount brought in as goodwill by C should be credited to A only. Thus, it is proper to credit goodwill brought in by a new partner to the old partners in the ratio in which they suffer on the admission of the new partner.

Goodwill to be inferred: Sometimes, the value of goodwill is not specifically given and has to be inferred from the arrangement of capital and profit-sharing ratio. Suppose, A's capital is Rs.5, 000 and B's capital is also Rs.5, 000 and they share profits equally. They admit C, as equal partner, on his bringing in Rs.8, 000 as capital. In this case, the point is that C's capital should only be one-half of the combined capitals of A and B. If C's capital is Rs.8, 000 the combined capitals of A and B should be Rs.16, 000. Since their present capital is Rs.10, 000, there must be goodwill of Rs.6000 to be shared equally by A and B.

9.5: Revaluation of Assets and Liabilities:

When a new partner is admitted, it is natural that he should not benefit any appreciation in the value of assets which has occurred or vice versa in the value of assets. Similar is the case with liabilities. Therefore, assets and liabilities are revalued and the old partners are debited or credited with the net loss or profit, as the case may be, in the ratio in which they have been sharing profits and losses. Partners may agree that the change in the value of assets and liabilities is to be adopted and figures changed accordingly or that the assets and liabilities should continue to appear in the books of the firm at the old figures.

1. When valued are altered in the books: In this case, a profit and loss adjustment account (or revaluation account0 is opened and the result is to be transferred to the capitals of the old partners in their profit sharing ratio.

a) For an increase in asset the following entry is required ——

Asset A/c Dr

To P & L Adj. A/C

b) For a reduction in asset——

P & L Adj. A/C Dr

To Asset A/C

c) For increase in liabilities——

P & L Adj. A/C Dr

To Liability

d) For a decrease in liabilities——

Liability A/C Dr

To P & L Adj. A/C

2. When values are not altered in the books: In this case, the increase in the amounts of assets and liabilities is entered in a Memorandum Adjustment or Revaluation Account but the corresponding entry is not made in the asset or liability accounts and the balance is transferred to old partners' capital accounts in the old ratio. Then, to complete double entry, the entries made in the Memorandum Adjustment Account are put down on the reverse side and the balance transferred to all partners, including the new one, in the new profit-sharing ratio.

9.6: Illustrations:

Illustration 1:

R and S are equal partners in a firm. They decided to admit T as a new partner and to readjust the Balance Sheet values for this purpose. The balance sheet of the firm as at 31st December, 2007 was as under.

Creditors		5,000	Machinery			5,000
Bills payable		2,000	Furniture			3,500
Capital:			Stock			3,000
R	7,500		Debtors	5,800		
S	5,000	12,500	Less: Reserve	300		5,500
			Cash			2,500
		19,500				19,500

The following adjustments were to be made before T's admission:

a) Rs.500 more to be provided for bad debts.

b) Furniture is to be valued at Rs.3, 000.

c) Value of machinery is to be appreciated by Rs.1, 000.

d) Investments worth Rs.600 (not included in Balance Sheet) are to be taken into account.

e) T brings Rs.5, 000 for capital and Rs.2, 000 for Goodwill. The amount of Goodwill is shared by R and S in their due proportions. Give journal entries and prepare the Balance Sheet of the firm after admission of T as a partner.

Solution:

Profit and Loss (Adj) A/C	Dr	1,000	
To Reserve for bad debts			500
To Furniture			500
(Being Assets value reduced)			

Machinery A/C	Dr	1,000	
Investments A/C	Dr	600	
To Profit and Loss (Adj) A/C			1,600
(Being Assets value raised)			
Profit and Loss (Adj) A/C	Dr	600	
To R's Capital A/C			300
To S's Capital A/C			300
(Being profit distributed to partners)			
Cash A/C	Dr	7,000	
To T's Capital A/C			5,000
To Goodwill			2,000
(Being Capital and Goodwill brought in by T)			
Goodwill A/C	Dr	2,000	
To R's Capital A/C			1,000
To S's Capital A/C			1,000
(Being Goodwill distributed between R and S)			

Balance Sheet of the New Firm

Liabilities			Assets		
Creditors		5,000	Furniture		3,000
Bills payable		2,000	Machinery		6,000
Capital:			Stock		3,000
R	8,800		Investments		600
S	6,300		Debtors	5,800	

T	5,000	20,100	Less: Reserve	800	5,000
			Cash		9,500
		27,100			**27,100**

Working Notes:

Profit and Loss Adj. Account

To Reserve for bad debts		500	By Machinery	1,000
To Furniture		500	By Investments	600
To R's Capital	300			
To S's Capital	300	600		
		1,600		**1,600**

Illustration 2:

Mukund and Makarand were partners in a firm sharing profits equally. Their business position as on 30th June 2007 was as follows:

Balance Sheet

Liabilities			Assets
Sundry Creditors	6,000	Cash in hand	150
Bank overdraft	1,500	Stock	3,600
Mukund capital	2,100	Sundry debtors	6,200
Makarand capital	1,600	Furniture	600
		Investments	650
	11,200		**11,200**

It is agreed to take Manohar into partnership and to make the following adjustments:

a) Bad debts to be written off for Rs.1, 600.

b) Value of the furniture to be reduced to Rs.400

c) Depreciate stock at 10%.

d) Write off 20% on investments.

e) Create goodwill for Rs.1, 000.

Manohar introduced Rs.1, 000 as capital for his 1/3 share. Other partners' capitals should be adjusted according to the new partner's capital.

Pass necessary journal entries and prepare the balance sheet of the new firm.

Solution:

Profit and Loss (Adj) A/C	Dr	2,290	
To Reserve for bad debts			1,600
To Furniture			200
To Stock			360
To Investments			130
(Being assets value reduced)			
Mukund Capital A/C	Dr	1,145	
Makaran Capital A/C	Dr	1,145	
To Profit and Loss (Adj) A/C			2,290
(Being profit transferred to capital accounts)			
Goodwill A/C	Dr	1,000	
To Mukund Capital			500
To Makarand Capital			500
(Being goodwill created)			
Cash A/C	Dr	1,000	
To Manohar Capital A/C			1,000

(Being capital brought in by Manohar)

Cash A/C	Dr	45	
To Makarand Capital			45
(Being the cash brought in)			
Mukund Capital A/C	Dr	455	
To Cash			455
(Being cash paid)			

Mukund Capital Account

To Profit & Loss A/C	1,145	By Balance B/D	2,100
To Cash	455	By Goodwill	500
To Balance C/D	1,000		
	2,600		**2,600**

Makarand Capital Account

To Profit & Loss A/C	1,145	By Balance B/D	1,600
To Balance C/D	1,000	By Goodwill	500
		By Cash	45
	2,145		**2,145**

Manohar Capital Account

		By Cash	1,000

Goodwill Account

To Mukund’s Capital	500	By balance C/D	1.000
To Makarand’s Capital	500		
	1,000		**1,000**

Cash Account

To Balance B/D	150	By Mukund's Capital	455
To Manohar's Capital	1,000	By Balance C/D	740
To Makarand's Capital	45		
	1,195		**1,195**
To Balance B/D	740		

Balance Sheet of the New firm

Liabilities			Assets		
Creditors		6,000	Cash		740
Overdraft		1,500	Stock		3,240
Capitals:					
Mukund	1,000		Debtors	6,200	
Makarand	1,000		Less: R.B.D	1,600	4,600
Manohar	1,000	3,000	Furniture		400
			Investments		520
			Goodwill		1,000
		10,500			**10,500**

Working notes:

Profit sharing ratio of old partners: 1:1

New partners share 1/3

Remaining	1-1/3 = 2/3
Mukund's share	2/3X1/2=1/3
Makaran's share	2/3X1/2=1/3

Manohar's Capital for his 1/3 share = 1,000

Mukund's Capital for his 1/3 share = 1,000

Makarand's Capital for his 1/3share = 1,000

Illustration 3:

Anup and Bhupal share profits in the proportion of three-fourths and one-fourths. The Balance Sheet on December 31, 2006 was as follows:

Sundry creditors	41,500	Cash at Bank	22,500
Anup's Capital	30,000	Bills receivable	3,000
Bhupal's Capital	16,000	Debtors	16,000
		Stock	20,000
		Fixtures	1,000
		Buildings	25,000
	87,000		87,500

On January 1, 2007 Chandrajit was admitted into partnership on the following terms:

a) That Chandrajit pays Rs.10, 000 as his capital for a fifth share.

b) That Chandrajit pays Rs.5, 000 for goodwill half of this sum is to be withdrawn by Anup and Bhupal.

c) That the capitals of Anup and Bhupal be adjusted on the basis of Chandrajit's capital by opening the necessary current accounts.

d) That Stock and Fixtures be reduced by 10% and a 5 % provision be created for doubtful debts on Debtors and Bills receivable.

e) That value of Buildings is appreciated by 20%.

f) That an item of Rs.650 included in creditors is not likely to be claimed and hence should be written back.

Solution:

Profit and Loss (Adj) Account

To Stock	2,000	By Buildings	5,000
To Fixtures	100	By Creditors	650

To Reserve for bad debts		800		
To Reserve on Bills		150		
To Anup's Capital	1,950			
To Bhupal's Capital	650	2,600		
		5,650		**5,650**

Anup Capital Account

To Cash	1,875	By Balance B/D	30,000
To Current A/C	3,825	By Profit & Loss A/C	1,950
To Balance C/D	30,000	By Goodwill	3,750
	35,700		**35,700**

Bhupal Capital Account

To Cash	625	By Balance B/D	16,000
To Current A/C	7,275	By Profit & Loss A/C	650
To Balance C/D	10,000	By Goodwill	1,250
	17,900		**17,900**

Chandrajit Capital Account

		By Cash	10,000

Anup Current Account

		By Capital	3,825

Bhupal Current Account

		By Capital	7,275

Cash Account

To Balance C/D	22,500	By Anup Capital	1,875
To Chandrajit capital	10,000	By Bhupal Capital	625
To Goodwill	5,000	By Balance C/D	35,000
	37,500		**37,500**

Balance Sheet of the firm as on 1-1-2007

Liabilities			Assets		
Creditors		40,850	Cash at Bank		35,000
Capitals:			Bills receivable		2,850
Anup	30,000		Debtors	16,000	
Bhupal	10,000		Less: RBD	800	15,200
Chandrajit	10,000	50,000	Stock		18,000
Current Accounts:			Fixtures		900
Anup	3,825		Buildings		30,000
Bhupal	7,275	11,100			
		1,01,950			**1,01,950**

Working notes:

Old partners' profit sharing ratio = ¾: ¼ : 1 share 10,000 Capital

New partner ratio = 1/5 (420) : 3 share 30,000 Capital

Remaining = 1-1/5 = 4/5

Anup new Ratio = 4/5 x ¾ = 12/20

Bhupal new Ratio = 4/5 x ¼ = 4/20

New profit sharing ratio = 3 (Anup) : 1 (Bhupal) : 1 (Chandrajit)

Illustration 4:

The balance sheet of Sridhar and Muralidhar as on 31st December 2007 is set out below. They share profits and losses in the ratio of 2:1.

Liabilities		Assets	
Sridhar's Capital	40,000	Freehold property	20,000
Muralidhar's Capital	30,000	Furniture	6,000
General Reserve	24,000	Stock	12,000
Creditors	16,000	Debtors	60,000
		Cash	12,000
	1, 10,000		**1, 10,000**

They agree to admit Purnachandra into the firm subject to the following terms and conditions:

a) Purnachandra will bring in Rs.21, 000 of which Rs.9, 000 will be treated as his share of goodwill to be retained in the business.

b) He will be entitles 1/4th share of the profits of the firm.

c) Fifty per cent of the general reserve is to remain as a reserve for bad and doubtful debts.

d) Depreciation is to be provided on furniture at 5%.

e) Stock is to be revalued at Rs.10, 500.

Show the journal entries giving effect to the above said arrangements (including cash transaction) and prepare the opening balance sheet of the new partnership.

Solution:

Profit & Loss (Adj) A/C	Dr	1,800	
To Furniture		300	
To Stock			1,500

(Being assets value reduced)

Sridhar capital A/C	Dr	1,200	
Muralidhar capital A/C	Dr	600	
To Profit & Loss (Adj) A/C			1,800
(Being loss distributed among partners)			
General Reserve A/C	Dr	12,000	
To Reserve for bad debts			12,000
(Being provision created from reserve)			
General Reserve A/C	Dr	12,000	
To Sridhar Capital			8,000
To Muralidhar Capital			4,000
(Being reserve distributed)			
Cash A/C	Dr	21,000	
To Purnachandra Capital			12,000
To Goodwill			9,000
(Being capital and goodwill brought in by Purnachandra)			
Goodwill A/C	Dr	9,000	
To Sridhar Capital			6,000
To Muralidhar Capital			3,000
(Being goodwill distributed)			

Balance sheet of the new firm

Liabilities		Assets	
Capitals:		Freehold premises	20,000
Sridhar	52,800	Furniture	5,700

Muralidhar	36,400		Stock		10,500
Purnachandra	12,000	1, 01,200	Debtors	60,000	
Creditors		16,000	Less: RBD	12,000	48,000
			Cash		33,000
		1, 17,200			**1, 17,200**

Working Notes;

Capital Accounts

	Sridhar	Muralidhar	Purna		Sridhar	Muralidhar	Purna
To P & L A/C	1,200	600	——	By Balance	40,000	30,000	—
To Balance C/D	52,800	36,400	12,000	By Cash			12,000
				By Gl. Reserve	8,000	4,000	——
				By Goodwill	6,000	3,000	——
	54,000	**37,000**	**12,000**		**54,000**	**37,000**	**12,000**

Illustration 5:

On 1st January 2007, A and B who were in partnership sharing 7/12 and 5/12 respectively, take in C giving him 1/6 share. A and B were to share future profits in the ratio of 13/24 and 7/24.

Over and above his capital, C brings in Rs. 96, 000 as his goodwill for the 1/6 share. The cash brought in by C as his capital and his goodwill is credited to one separate account in his personal name. On 31st December 2007, the Trial Balance of the firm stood as follows:

Machinery	6,00,000	A's Capital	3,36,000
Furniture	40,000	B's Capital	2,40,000
Stock	1,20,000	C's Capital	2,24,000
Debtors	2, 00,000	Creditors	48,000
A's drawings	32,000	Current year's profit	2,32,000
	10, 80,000		**10,80,000**

Interest on drawings is to be ignored but interest on capital accounts is to be allowed at 5% per annum after the necessary adjustments therein consequent one's admission. Prepare the Balance Sheet of the firm as on December 31, 2007.

Solution:

Working Notes:

Profit sharing ratio of A & B before C's admission = 7/12 : 5/12

Profit sharing ratio of A & B after C's admission = 13/24 : 7/24

Sacrificing ratio : A = 7/12- 13/24= 14-13/24 = 1/24

B = 5/12 – 7/24 = 10-7/24 = 3/24

= 1:3

The goodwill brought in by C (which is kept in an account opened in his personal name) is to be shared by A and B in their sacrificing ratio i.e. 1:3 respectively. This sharing is to be done immediately after C's admission. But it was not done at that time. Therefore, this is to be adjusted now, with retrospective effect.

1. C's Personal A/C	Dr	2,24,000	
To C's Capital			1,28,000
To A's Capital			24,000
To B's Capital			72,000

(Being Rs.96,000 goodwill shared by A and B and the balance transferred to C's capital)

Profit & Loss A/C for the year 2007

To Interest on Capital			
A: 3,60,000 x 5/100	18,000	By Balance	2,32,000
B: 3,12,000 x 5/100	15,600		
C: 1,28,000 x 5/100	6,400		
To Net Profit transferred to			
A's Capital 1,04,000			

B's Capital	56,000			
C's Capital	32,000	1,92,000		
		2,32,000		**2,32,000**

A's Capital Account

To Drawings	32,000	By Balance B/D	3,36,000
To Balance C/D	4,50,000	By C's personal A/C(goodwill)	24,000
		By Interest on capital	18,000
		By P & L A/C (profit)	1,04,000
	4,82,000		**4,82,000**

B's Account

To Drawings	52,000	By Balance B/D	2,40,000
To Balance C/D	3,31,600	By C's personal A/C(goodwill)	72,000
		By Interest on capital	15,600
		By P & L A/C (profit)	56,000
	3,83,000		3,83,000

C's Capital Account

To Drawings	8,000	By C's personal A/C (goodwill)	1,28,000
To Balance C/D	1,58,000	By Interest on capital	6,400
		By P & L A/C (profit)	32,000
	1,66,400		**1,66,400**

Balance Sheet of A, B and C as on 31-12-2007

Capital	A	4,50,000	Machinery	6,00,000
Capital	B	3,31,000	Furniture	40,000
Capital	C	1,58,400	Stock	1,20,000
Creditors		48,000	Cash	28,000
		9,88,000		**9,88,000**

Note:

1. Interest on capital in to be allowed on the amount which is remained after adjusting the goodwill into the capital accounts.

2. The sacrificing ratio is to be taken into account, when the goodwill is brought in by new partner in cash and also when the old ratio and new ratio is given.

Illustration 6:

A and B were partners in AB Coal Stores sharing profits equally. On 31st December, 2007, their balance sheet was as follows:

Liabilities			Assets	
Creditors		7,480	Furniture and fittings	1,200
Bills payable		8,520	Lorries	9,300
Capitals:			Horses and Carts	4,760
A	30,000		Debtors	35,000
B	26,000	56,000	Stock of Coal	7,700
			Cash at Bank	13,660
			Cash in hand	180
		72,000		**72,000**

On the above date they admitted C as new partner with the following adjustments:

1. A, B and C share future profits in 3:2:1 ratio.
2. As Capital C is bringing Rs.5, 600 debtors (provide 5% reserve), Rs.3, 000 goodwill and the remaining in cash. C's capital being Rs.10, 000.
3. The following adjustments were made in A and B balance sheet:
    a) Lorries value to be raised to Rs.10, 000.
    b) Provide reserve on debtors at 71/2%.
    c) Create goodwill for Rs.4, 450.
4. A's Capital should be equal to that of B.

Pass the necessary journal entries for the above adjustments and prepare cash account, capital accounts and the new balance sheet.

Solution:

Lorries A/C	Dr	700	
To P & L A/C			700
(Being the asset value appreciated)			
P & L Adj A/C	Dr	2,640	
To Reserve for bad debts A/C			2,640
(Being the reserve provided on debtors)			
A's Capital A/C	Dr	970	
B's Capital A/C	Dr	970	
To P & L Adj. A/C			1,940
(Being the loss shared to partners)			
Goodwill A/C	Dr	4,450	
To A's Capital			2,225
To B's Capital			2,225
(Being goodwill created)			
Debtors A/C	Dr	5,600	
Goodwill A/C	Dr	3,000	
Cash A/C (Balancing figure)	Dr	1,680	
To C's Capital A/C			10,000
To Reserve for doubtful debts			280
(Being the new partner brings various assets towards capital)			
A's Capital A/C	Dr	4,000	
To Cash A/C			4,000

(Being the excess capital paid to partner)

P & L Adj. Account

To Reserve for bad debts	2,640	By Lorries	700
		By A's Capital	970
		By B's Capital	970
	2,640		**2,640**

A's Capital Account

To P & L Adj. A/C	970	By Balance	30,000
To Cash A/C	4,000	By Goodwill	2,225
To Balance C/D	27,225		
	32,225		**32,225**

B's Capital Account

To P & L Adj. A/C	970	By Balance	26,000
To Balance C/D	27,255	By Goodwill	2,225
	28,225		**28,225**

C's Capital Account

		By Sundries	10,000

Cash Account

To Balance: Bank	13,660	By A's Capital	4,000
Cash	180	By Balance C/D	11,520
To C's Capital	1,680		
	15,520		**15,520**

Balance Sheet of A, B and C on 31-12-2007

Liabilities			Assets		
Capital	A	27,255	Furniture		1,200
Capital	B	27,255	Lorries (9,300+700)		10,000
Capital	C	10,000	Horses and Carts		4,760
Creditors		7,480	Debtors	35,200	
Bills payable		8,520		5,600	
				40,800	
			Less: RBD (2,640+280)	2,920	37,880
			Coal Stock		7,700
			Goodwill		7,450
			Cash		11,520
		80,510			**80,510**

Illustration 7:

The following was the balance sheet of A, B and C who were equal partners, on 1st June 2007.

Liabilities			Assets	
Bills payable		3,300	Cash	600
Creditors		6,000	Debtors	10,800
Capital Accounts:			Stock	11,400
A	16,800		Furniture	2,400
B	12,600		Building	19,500
C	6,000	35,400		
		44,700		**44,700**

They decided to take D into partnership and give him a fourth share in the parofits on the following terms:

1. That D should bring in Rs.9, 000 for goodwill and Rs.15,000 as capital.
2. That one-half of the goodwill shall be withdrawn by the old partners.
3. That stock and furniture be depreciated by 10 per cent.
4. That a provision of 5 per cent on debtors be created for doubtful debts.
5. That a liability for Rs.1, 050 be created against hills discounted.

6. That the value of the building having appreciated, the building should be valued of Rs.27, 000.
7. That the values of liabilities and assets other than cash are not being altered.

Prepare the necessary ledger accounts and the opening balance sheet of the firm as newly constituted.

Solution:

Working Notes;

Here in this problem, first the Assets and Liabilities were revalued and again after D's admission, it was asked no to alter the values of Assets and Liabilities. For this purpose, a separate account called "Memorandum P & L A/C" is to be prepared.

Memorandum P & L Adj. Account

To Stock		1,140	By Buildings		7,500
To Furniture		240			
To Reserve for bad debts		540			
To Liability on bills discounted		1,080			
To Capital A/Cs (profit):					
A	1,500				
B	1,500				
C	1,500	4,500			
		7,500			**7,500**
			By Sundry Assets (debited to this Account previously)		3,000
To Buildings		7,500	By Capital Accounts (Less)		
			A	1,125	
			B	1,125	
			C	1,125	4,500
		7,500			**7,500**

Goodwill Account

To A's Capital	3,000	By Cash	9,000
To B's Capital	3,000		
To C's Capital	3,000		
	9,000		**9,000**

A's Capital Account

To Cash	1,500	By Balance	16,800
To P & L Adj. A/C	1,125	By P & L Adj. A/C	1,500
To Balance C/D	18,675	By Goodwill	3,000
	21,300		**21,300**
		By Balance B/D	18,675

B's Capital Account

To Cash	1,500	By Balance	12,600
To P & L Adj. A/C	1,125	By P & L Adj. A/C	1,500
To Balance C/D	14,475	By Goodwill	3,000
	17,100		**17,100**
		By balance B/D	14,475

C's Capital Account

To Cash	1,500	By Balance	6,000
To P & L Adj. A/C	1,125	By P & L Adj. A/C	1,500
To Balance C/D	7,875	By Goodwill	3,000
	10,500		**10,500**
		By Balance B/D	7,875

D's Capital Account

To P & L Adj. A/C	1,125	By Cash	15,000
To Balance C/D	13,875		
	15,000		**15,000**
		By Balance B/D	13,875

Cash Account

To Balance	600	By Capital A/C:		
To D's Capital	15,000	A	1,500	
To Goodwill	9,000	B		1,500
		C		1,500
		By Balance C/D		20,100
	24,600			**24,600**
To Balance B/D	20,100			

Balance Sheet of A, B, C and D as on 1st June, 2007

Liabilities		Assets	
Bills payable	3,300	Cash	20,100

Creditors	6,000	Debtors	10,800
Capitals:		Stock	11,400
A	18,675	Furniture	2,400
B	14,475	Buildings	19,500
C	7,875		
D	13,875		
	64,200		**64,200**

Illustration 8:

Sudha and Aruna are partners in a firm sharing profits in the ratio of 2:1. The Balance Sheet of the firm on 31st December, 2007 was as follows:

Liabilities			Assets		
Creditors		4,200	Bank		3,012
Investments provision		1,200	Bills receivable		7,500
Workmen compensation fund		3,600	Debtors	12,000	
General reserve		6,300	Less: Provision	1,500	10,500
Capitals:			Stock		9,000
Sudha	18,000		Investments		15,000
Aruna	14,700	32,700	Goodwill		2,988
		48,000			48,000

On this date Prathima is admitted for 2/5th share in the profits of the firm. Following revaluations were made at the time of admission:

1. Accrued incomes not appearing in the books Rs.300
2. Market value of investments is Rs.13, 500.
3. Claim on account of compensation is estimated at Rs.450.
4. Provision for doubtful debts is required at Rs.1800.
5. X, an old customer, whose account was written off as bad, has promised to pay Rs.1, 050 in settlement of his full claim.

6. Sudha and Aruna have purchased machinery on hire-purchase system for Rs.9, 000 of which only Rs.300 are to be paid. Both machinery and unpaid liability did not appear in the Balance Sheet.

7. There was a Joint Life Policy on the lives of Sudha and Aruna for Rs.45, 000. Surrender value of the policy on the date of admission amounted Rs.7, 200. It was decided to record this as an asset of the new firm.

8. Prathima is required to bring in Rs.30, 000 as capital. Her share of Goodwill was calculated at Rs.7, 200.

You are required to make journal entries and prepare new Balance Sheet after the admission of Prathima.

Solution:

Accrued income A/C	Dr	300	
Workmen compensation fund A/C	Dr	3,150	
X's A/C(old customer)	Dr	1,050	
Machinery A/C	Dr	9,000	
Joint Life Policy A/C	Dr	7,200	
To P & L Adj. A/C			20,700
(Being assets and liabilities revalued)			
P & L Adj. A/C	Dr	900	
To Investment Provision A/C			300
To Reserve for doubtful debts			300
To Hire vendor (Machinery) A/C			300
(Being assets and liabilities revalued)			
P & L Adj. A/C	Dr	19,800	
To Sudha Capital A/C			13,200
To Aruna Capital A/C			6,600
(Being the profit on revaluation shared between partners)			
General Reserve A/C	Dr	6,300	
To Sudha Capital A/C			4,200
To Aruna Capital A/C			2,100
(Being the accumulated profit shared to partners)			
Goodwill A/C	Dr	15,012	
To Sudha Capital			10,008

To Aruna Capital 5,004

(Being the goodwill created)

Full value of goodwill 5/2 x 7,200 =18,000

Less: Already appearing 2,988

15,012

Cash A/C	Dr	30,000	
To Prathima's Capital A/C			30,000

(Being the new partner brings capital)

Balance Sheet of Sudha, Aruna and Prathima

Liabilities		Assets			
Creditors (including hire vendor)	4,500	Cash (3,012 + 30,000)			33,012
Investment provision	1,500	Bills receivable		7,500	
Workmen's compensation fund	450	Debtors	12,000		
Capitals:		X	1,050		
Sudha	45,408		13,050		
Aruna	28,404	Less: Provision	1,800		11,250
Prathima	30,000	Stock		9,000	
		Investments		15,000	
		Joint life policy		7,200	
		Machinery		9,000	
		Goodwill		18,000	
		Accrued incomes		300	
	1, 10,262			**1, 10,262**	

Capital Accounts

	Sudha	Aruna		Sudha	Aruna
			By Balance	18,000	14,700
			By P & L Adj. A/C	13,200	6,600
			By General reserve	4,200	2,100
To Balance C/D	45,408	28,404	By Goodwill	10,008	5,004
	45,408	**28,404**		**45,408**	**28,404**

Profit & Loss Adj. Account

To Sundry Assets & Liabilities	900	By Sundry Assets & Liabilities	20,700
To Capital Accounts:			
Sudha	13,200		
Aruna	6,600		
	20,700		**20,700**

Note: Liability as compensation fund is only Rs.450; the balance will be accumulated profit, to be shared by the partners.

9.7: Try yourself:

1. Sunil, Kapil and Rakesh trading in partnership and sharing profits and losses in the proportion of ½, 1/3 and 1/6 respectively agree to take Ajay into the partnership on the following terms;

a) Ajay should be given ¼ share and he should bring Rs.10, 000 as goodwill and Rs.1, 28,000 as capital.

b) A reserve for bad and doubtful debts should be created at 5%.

c) The value of Land and Building should be brought up to Rs.6, 20,000.

d) Stock should be taken at Rs.2, 61,000.

e) Machinery should be revalued at Rs.61, 600.

The following is the Balance Sheet of the firm of Sunil, Kapil and Rakesh on the eve of Ajay's admission.

Balance Sheet as on 31-12-2007

Sundry Creditors		38,000	Cash on hand	8,000
Partners' Capitals:			Debtors	2, 52,000
Sunil	5, 70,000		Stock	2, 90,000
Kapil	3, 20,000		Machinery	70,000
Rakesh	1, 60,000	10, 50,000	Land and Buildings	4 80,000
Reserve fund		12,000		
		11, 00,000		**11, 00,000**

The capitals of the old partners who continue to share in the same proportion in the new firm as before should be adjusted on the basis of the proportion of Ajay's capital to his share in the business, involving cash movements in or out, as the case may be.

Pass journal entries in the books of the new firm, keeping these arrangements in view and show the balance sheet of the newly constituted firm.

(Capital Accounts: Sunil- 1,92,000; Kapil – Rs.1,28,000; Rakesh – Rs.64,000; Ajay – Rs.1,28,000; Balance Sheet total – Rs.13,28,000)

2. A and B are partners in a firm sharing profits and losses as 5:3. The position of the firm as on 31st March 2007 is as follows:

Capital and Liabilities			Property and Assets	
Capital Accounts:			Plant and Machinery	40,000
A	30,000		Stock	30,000
B	20,000	50,000	Sundry Debtors	20,000
Sundry Creditors		15,000	Bills receivable	10,000
Bank overdraft		42,500	Cash at bank	7,500
		1, 07,500		**1,07,500**

C now joins them on condition that he will share 3/4th of the future profits, the balance of profits being shared by A and B as 5:3. He introduces Rs.40, 000 by way of capital in cash and pays off the overdraft. He also pays Rs.4, 000 by way of premium for goodwill of the business and this amount is to remain in business. The partners agree to depreciate plant by 10% and raise a reserve against Sundry Debtors by 5%.

You are asked to journalise the entries in the books of the firm and the resultant Balance Sheet. How will the partners share future profits?

(Capitals: A – Rs.29,375; B – Rs.19,625; C – Rs.82,500; Balance Sheet total Rs.1,46,500)

3. Shriram and Krishna are partners in a firm sharing profits and losses as Shriram 75% and Krishna 25% on 1st January, 2007; their position was as given below:

Liabilities			Assets	
Capital Accounts;			Plant	40,000
Shriram	50,000		Stock	10,000
Krishna	30,000	80,000	Debtors	30,000
Sundry Creditors		20,000	Cash at bank	20,000
		1,00,000		**1,00,000**

Nair is now to join the partnership. He agrees to pay the partners Rs.20,000 by way of goodwill and introduce one half of the combined capital of the two existing partners after depreciating plant and stock at 20% and 10% respectively and raising a reserve of 10% against Sundry Debtors. The new partner is to be allowed 1/4th share of the profits of the firm.

You are asked to record the above transactions in the books of the firm and give the resultant Balance Sheet of the new firm.

(New Capitals: Shriram – Rs.56, 000; Krishan – Rs.32,000; Nair – Rs.44,000; Total of Balance Sheet – Rs. 1,52,000)

4. The following is the Balance Sheet of Srinivas and Chandrasekhar as on 31st March 2007. Narayana is admitted as partner on that date when the position of Srinivas and Chandrasekhar was as under:

Liabilities		Assets	
Srinivas's Capital	3,000	Debtors	3,300
Chandrasekhar's Capital	2,400	Land and Buildings	2,400
Creditors	3,600	Plant and Machinery	3,000
Gerenal Reserve	4,800	Stock	3,600
Workmen's compensation fund	1,200	Cash and Bank Balances	2,700
	15,000		15,000

Srinivas and Chandrasekhar shared profits in the proportion of 3:2. The following terms of admission are agreed upon:

1. Revaluation of assets: Land and Buildings Rs.5, 400, Stock Rs.4, 800.
2. The liability on workmen's compensation fund is determined at Rs.600.
3. The new partner has to bring in as his share of goodwill Rs.3,000 in cash.
4. The new partner was to bring further cash as would make his capial equal to 20% of the combined capitals of partners Srinivas and Chandrasekhar after above revaluation and adjustments are carried out.
5. The future profit sharing proportions were as under: Srinivas – 2/5th; Chandrasekhar -2/5th; Narayana – 1/5th. Prepare the new Balance Sheet of the firm and the capital accounts of the partners.

(New Capitals: Srinivas- Rs.11, 760; Chandrasekhar –Rs.6, 240; Narayana –

Rs.3, 600; Total Balance Sheet – Rs.25, 800)

5. X, Y and Z were partners sharing Profits and Losses in the ratio of 3:2:1. On January 1st, 2007, they admitted A into partnership on the following terms:

Goodwill of the firm was valued at Rs.2, 70,000; A paid Rs.45, 000 to X, through the books, on account of goodwill. A paid in proportionate of capital. It was further agreed that investments are to be revalued at Rs.54, 000; plant should be reduced to Rs.87, 000. A sum of Rs.9, 000 included in creditors was to be written back as there was no viability to pay the amount. The Balance Sheet before A's admission was as follows:

Liabilities		Assets	
Creditors	2, 70,000	Cash at bank	1, 20,000
Capitals;		Debtors	1, 80,000
X	1, 80,000	Stock	1, 50,000
Y	1, 20,000	Investments at cost	90,000

Z	60,000	Furniture and Fittings	30,000
Reserve	45,000	Plant	1, 05,000
	6, 75,000		**6, 75,000**

The Profits for 2007 were Rs.1, 80,000 and drawings were Rs.45, 000 for X, Rs.36, 000 for Y, Rs.22, 500 for Z and Rs.18, 000 for A.

Journalise the entries to be made on A's admission, give the capital accounts and the resulting Balance Sheet.

(Current Accounts: X – Rs.15, 000; Y – Rs.24, 000; Z – Rs.7, 500; A – Rs.12, 000; balance sheet – Rs.6, 79,500)

9.8: Summary:

Partnership is a business carried on by one partner for all and all working together to share profits and bear losses. New partners may join the ongoing partnership which is called as admission of partnership. When a new partner admits into the firm, normally, he brings with him the capital and an agreed amount of goodwill. There are various ways of preparing accounts depending on different circumstances. Normally, in admission, a profit and loss adjustment account and a new balance sheet is to be prepared after adjusting the old partners capital accounts.

9.9: Glossary:

Partnership: It is 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.

Goodwill: It is the present value of a firm's anticipated excess earnings.

9.10: Self Assessment Questions:

1. Define partnership. What are the things to be remembered when a new partner comes in?

2. What is goodwill? How it is valued in case of admission of a new partner?

Dr.R.Jayaprakash Reddy.

Lesson: 10

Partnership Accounts II – Retirement or death of a partner

10.0 Objectives:

After going through this lesson you will be able to understand the following:

1. Treatment of goodwill and revaluation of assets and liabilities in case of retirement or death of a partner.
2. Purchase of retiring partner's share by the remaining partners.
3. Treatment of Joint Life policy.

Structure:

10.1: Retirement of a partner:

In the partnership, any of the partners may retire in accordance with agreement, or with the consent of the remaining partners or where the partnership is at will, by giving notice in writing to all other partners of his intention to retire. A retiring partner will not be liable for liabilities incurred by the firm after his retirement. However, he must give a public notice to that effect. Such a public notice is not necessary in case of a sleeping or dormant partner.

The problems to be dealt with on retirement of a partner are mainly similar to those arising on the admission of a partner. The main difference between admission of a partner and retirement of a partner is on the question of payment of the dues to the retiring partner. Treatment of goodwill and revaluation of assets and liabilities in retirement are as follows:

10.1.1: Goodwill:

Goodwill will be valued in the manner prescribed in the deed or by mutual understanding. One of the following cases may be adopted:

1. Goodwill may be raised in the books of the firm. Then the following entry is required.

Goodwill A/C Dr

To Partners' A/Cs (to all partners in the old profit sharing ratio)

2. Goodwill may be raised in the books of the firm and is written off. The following entries are required:

a) Goodwill A/C Dr

To Partners' A/Cs (to all partners in the old profit sharing ratio)

b) Partners' Capital A/Cs (Remaining partners and in the new profit sharing ratio) Dr

To Goodwill

3. Only the share of the retiring partner is brought into books. The entry is

Goodwill A/C Dr

To Retiring partner Capital A/c (his share level)

In this case, *it is advisable to write off the goodwill to the remaining partners in the ratio in which they gain on the retirement.* If goodwill appears in the books already, entries for raising goodwill should be made only for the difference.

10.1.2: Revaluation of Assets and Liabilities:

The method of dealing with revaluation of assets is exactly similar to that followed at the time of admission of a partner. The Profit and Loss Adjustment Account or Revaluation Account will be prepared and the balance transferred to all the partners, including the retiring one, in the old profit-sharing ratio. Assets and liabilities will then appear in the books at changed values. But if it is desired that assets and liabilities should continue to appear in the books at the old values, a Memorandum Revaluation Account will be prepared. Its balance will be transferred to all the partners in the old profit-sharing ratio and then the same amount will be put on the reverse side and transferred to the remaining partners in the new profit-sharing ratio.

10.1.3: Payment to Retiring Partner:

The amount due to the retiring partner will be paid as per terms of the partnership agreement or as otherwise mutually agreed. When the amount payable to the retiring partner is determined, it will be transferred to his loan account.

Then the journal entry will be:
Retiring Partner's Capital A/C Dr
To Retiring Partner's Loan A/C

In case the continuing partners agree to bring cash to pay off the retiring partner, the entries will be:
Bank A/C Dr
To Continuing Partners' Capitals A/Cs

(Being cash brought in by the partners in the agreed ratio to pay off the retiring partner)

Retiring Partner's Capital A/C Dr

To Bank

(Being cash paid to the retiring partner)

In case the continuing partners decide to pay the retiring partner in their individual capacity in their profit - sharing ratio, the entry will be:

Retiring Partner's Capital Loan A/C Dr

To Continuing Partners' Capital A/Cs

The amount due to the retiring partner may be agreed to be paid *in installments* with interest. In such case Loan account will be closed after the last installment is paid.

10.1.4: Purchase of retiring partner's share:

There may, sometimes, be an agreement that the retiring partner's share in the firm will be purchased by the remaining partners. If the agreement does not state the proportion in which the remaining partners will buy the share of the retiring partner, it will be in the profit-sharing ratio. In the case of purchase, the amount due to the retiring partner is ascertained in the usual manner and then the retiring partner's capital account is debited and the other partners' capital accounts credited in the profit-sharing ratio or the ratio agreed upon. The retiring partner's loan will not figure in the books of the firm and he will look to the partners in their individual capacities for the satisfaction of his claim.

10.2: Death of a Partner:

In the event of death of a partner, usually, the surviving partners carry on the business, purchasing the share of the deceased partner after determining the amount due to him and then treating it as a loan to the firm. The legal representatives or the executor of the deceased partner will be entitled to get from the firm the amounts due. It is ascertained adding deceased persons capital, share of goodwill, profit on revaluation and share out of the proceeds of a joint life insurance policy. Except this, the treatment in accounts is not different from that in case of retirement. After ascertaining the amount due to the deceased partner, the balance in his capital account should be transferred to an account opened in the name of his executor.

It should be noted that according to the Partnership Act, the executors would be entitled, at their choice, to interest at 6% p.a. on the amount due from the date of death to the date of payment or to that portion of profit which is earned by the firm with the help of the amount due to the deceased partner. This also applies to a retiring partner.

10.3: Joint Life Policy:

For funds to pay to the executor of a deceased partner, without upsetting the working capital of the firm, it is usual to take out a joint policy on the lives of the partners. The insurance company undertakes to pay a fixed sum of money when any of the partners dies. There are three ways to deal with this in the accounts:

1. All the premiums paid are treated as expenses and debited to Profit and Loss Account and, when a partner dies, the amount received from the insurance company is treated as a profit and credited to all partners in the profit-sharing ratio.
2. a) The premiums paid are debited to the Joint Life Policy account.

   b) Every year, an amount equal to the premium is debited to the Profit and Loss Account and credited to Joint Life Policy Reserve account.

   c) The Joint Life Policy account and Joint Life Policy Reserve account are mutually adjusted so as to leave a balance in each account equal to the surrender value of the policy.

   d) When death occurs of a partner, the amount received is credited to the Joint Life Policy account. The amount standing to the credit of the Joint Life Policy Reserve account is also transferred to it and then it is closed by transfer to the capital accounts of all partners.
3. The surrender value of the policy is considered as an asset and the excess of the amount paid over the surrender value as an expense. In this case, the premiums paid are debited to a Joint Life Policy account which is reduced to its surrender value by appropriate debit to the Profit and Loss account. The Joint Life Policy Account is an asset and will be shown in the Balance Sheet. When a partner dies, the amount received from the insurance company will be credited to the joint life Policy Account, the balance on this account being then transferred to the capital accounts of partners (including the deceased partner) in the profit-sharing ratio.

Illustrations:

Illustration 1:

A, B and C are partners, sharing profits equally. Their Balance Sheet at 31st December 2007 is as follows;

Liabilities		Assets		
Sundry Creditors	4,000	Cash at Bank		4,000
Capitals:		Bills receivable		3,000
A	12,000	Sundry debtors	20,000	
B	8,000	Less: RBD	1,000	19,000
C	7,500	Stock		18,000
Reserve	6,000	Fixtures		3,500
	47,500			**47,500**

B retires on the date and the following adjustments are to be made for the purpose:

a) Goodwill of the firm is valued at Rs.12, 000.

b) Fixtures to be depreciated by 5%.

c) Stock to be appreciated by 10%.

d) Reserve for bad debts to be increased by Rs.500.

Draw up the Profit and Loss Adjustment Account, Capital Accounts of the partners and the Opening Balance Sheet of the continuing partners.

Solution:

Profit and Loss Adj. Account

To Fixtures		175	By Stock account	1,800
To Reserve for bad debts		500		
To A's Capital	375			
To B's Capital	375			
To C's Capital	375	1,125		
		1,800		**1,800**

Goodwill Account

To A's Capital	4,000	By Balance C/D	12,000
To B's Capital	4,000		
To C's Capital	4,000		
	12,000		**12,000**
To Balance B/D	12,000		

Reserve Account

To A's Capital	2,000	By Balance B/D	6,000
To B's Capital	2,000		
To C's Capital	2,000		
	6,000		**6,000**

A's Capital Account

To Balance C/D	18,375	By Balance B/D	12,000
		By P & L Adj. A/C	375
		By Goodwill	4,000
		By Reserve	2,000
	18,375		**18,375**
		By Balance B/D	18,375

B's Capital Account

To Loan A/C	24,375	By Balance B/D	18,000
		By P & L Adj. A/C	375

		By Goodwill	4,000
		By Reserve	2,000
	24,375		**24,375**

C's Capital Account

To Balance C/D	13,875	By Balance B/D	7,500
		By P & L Adj. A/C	375
		By Goodwill	4,000
		By Reserve	2,000
	13,875		**13,875**
		By Balance B/D	13,875

B's Loan Account

		By Capital A/C	23,475

Balance Sheet of A and C as on 31-12-2007

Liabilities		Assets		
Creditors	4,000	Cash		4,000
Capitals:		Bills receivable		3,000
A	18,375	Debtors	20,000	
C	13,875	Less: RBD	1,500	18,500
B's Loan Account	24,375	Stock (18,000+1,800)		19,800
		Fixtures		3,325
		Goodwill		12,000
	60,625			**60,625**

Illustration 2:

Viswanath, Gavaskar and Sobers are in partnership sharing profits equally. Sobers retired on 31st March 2007. The Balance Sheet of the firm on 31st December 2006 stood as follows:

Balance Sheet

Liabilities		Assets	
Creditors	7,740	Cash in hand and bank	3,000
General Reserve	2,400	Debtors	6,000
Investment fluctuation	720	Stock	6,000
Reserve for doubtful debts	480	Investments (at cost)	3,000
Capitals:		Freehold property	24,000

Viswanath	18,000		Goodwill	11,340
Gavaskar	12,000			
Sobers	12,000	42,000		
		53,340		**53,340**

On the date of retirement it was found that: a) Freehold property e valued at Rs.34, 800.b) Investments be valued at Rs.2, 820. c) Debtors were all good. d) Stock is valued at Rs.5, 640. e) Goodwill is valued at on year's purchase of the average profit of the past five years. f) Sobers share of profit to the date of retirement be calculated on the basis of average profit of the preceding three years.

The books showed the profits of the last five years as follows: 2002 – Rs.6, 900; 2003 – Rs.8, 400; 2004 – Rs.5, 400; 2005 – Rs.4, 800; 2006 – Rs.6000.

You are required to pass journal entries, give capital account of Sobers, and prepare Balance Sheet of the remaining partners.

Solution:

Calculation of Goodwill:

Total profit of 5 years: 6,900+8,400+5,400+4,800+6,000=31,500

One year's average goodwill = 31,500/5 = 6,300

Goodwill already appearing in Balance Sheet	= 11,340
Less: Revalued amount	6,300
Decrease in the value of Goodwill	**5,040**

Sobers's share of profit to the date of retirement:

Date of Balance Sheet 31 December 2006

Date of retirement 31 March 2007 i.e. after 3 months.

Total of the preceding 3 years profit = 5,400+4,800+6,000 = 16,200

Average = 16,800/3 = 5,400

Profit for 3 months = 5,400/12x3 = 1,350

Sobers's share = 1,350x 1/3 = 450

Journal entries;

1. P & L Adj. A/C	Dr	5,400	
To Stock			360
To Goodwill			5,040
(Being the assets revalued)			
2. Freehold Property A/C	Dr	10,800	
RBD A/C	Dr	480	
Investment fluctuation fund A/C	Dr	540	

To P & L Adj. A/C			11,820

(Being two assets revalued)

3. P & L Adj. A/C	Dr	6,420		
To Viswanath's Capital			2,140	
To Gavaskar's Capital				2,140
To Sobers's Capital			2,140	

(Being the profit on revaluation distributed among the partners)

4. General Reserve A/C	Dr	2,400		
To Viswanath's Capital			800	
To Gavaskar's Capital				800
To Sobers's Capital			800	

(Being the accumulated profit distributed to the partners)

5. P & L Suspense A/C	Dr	450	
To Sobers's Capital			450

(Being the share of profit to the date of retirement (3 months)
Credited to partner)

6. Sobers's Capital A/C	Dr	15,390
To Sobers's Loan A/C		15,390

(Being the retiring partner's claim transferred to the loan account)

Sobers's Capital Account

To Loan A/C	15,390	By Balance	12,000
		By P & L Adj. A/C	2,140
		By General Reserve	800
		By P & L Suspense A/C (3 months profit)	450
	15,390		**15,390**

Balance Sheet of Viswanath and Gavaskar as on 31-3-2007

Liabilities		Assets		
Capitals:		Cash		3,000
Viswanath	20,940	Debtors		6,000
Gavaskar	14,940	Stock		5,640
Sobers Loan A/C	15,390	Investments		3,000
Creditors	7,740	Freehold Property	34,800	

Investment fluctuation fund	180	Goodwill	6,300
		P & L Suspense A/C	450
	59,190		**59,190**

Working notes:

Profit and Loss Adjustment Account

To Sundry Assets		5,400	By Sundry Assets	11,820
To Capital Accounts:				
Viswanath	2,140			
Gavaskar	2,140			
Sobers	2,140	6,420		
		11,820		**11,820**

Capital Account

	Viswanath	Gavaskar		Viswanath	Gavaskar
			By balance	18,000	12,000
			P & L Adj. A/C	2,140	2,140
			General Reserve	800	800
				20,740	**20,740**

Note:

As the Goodwill is already appearing in the Balance Sheet, no special treatment for Goodwill is necessary. It is enough to adjust in the P & L Adj. A/C, along with other assets.

Investments: Actual value as per Balance Sheet = 5,000

Less: Existing fund 1,200

Value as per Balance Sheet 3,800

i.e. there is an appreciation in the value by Rs.900. This appreciation is shown in another way by reducing the investment fluctuation fund.

Illustration 3:

P, Q and R are partners, sharing profits equally. Balance Sheet at 31st December 2007 is as follows:

Liabilities		Assets		
Sundry Creditors	5,000	Cash at Bank		3,000
Current Accounts;		R's Current A/C		2,500
P	2,000	Bills receivable		5,000
Q	3,000	Sundry debtors		20,000
Reserve Capitals:		Less: RBD	1,000	19,000

P	10,000	Stock	18,000
Q	15,000	Fixture	3,500
R	10,000		
	51,000		**51,000**

R retires on that date and the following adjustments are to be made for the purpose:

1. Goodwill is valued at Rs.12,000.
2. Fixtures to be depreciated by 5%.
3. Stock to be appreciated by 10%.
4. Bad debts provision to be increased by Rs.500.

Find out the amount due to R and transfer it to his loan account. Pass journal entries, open partners account and Profit and Loss Adjustment Account, and prepare the opening Balance Sheet of the continuing partners.

Solution:

Journal entries:

1. P & L Adj. A/C	Dr	675	
To Fixtures			175
To Reserve for bad debts			600
(Being Assets value reduced)			
2. Stock A/C	Dr	1,800	
To P & L Adj.A/C			1,800
(Being Asset value rose)			
3. P & L Adj. A/C	Dr	1,125	
To P's Current A/C			375
To Q's Current A/C			375
To R's Current A/C			375
(Being profit transferred to current accounts)			
4. Goodwill A/C	Dr	12,000	
To P's Current A/C			4,000
To Q's Current A/C			4,000
To R's Current A/C			4,000
(Being Goodwill created)			

5. Reserve A/C	Dr	6,000	
To P’s Current A/C			2,000
To Q’s Current A/C			2,000
To R’s Current A/C			2,000
(Being Reserve distributed)			
6. R’s Current A/C	Dr	3,875	
To R’s Capital A/C			3,875
(Being current account balance transferred to Capital Account)			
7. R’s Capital A/C	Dr	13,875	
To R’s Loan A/C			13,875
(Being Capital account balance transferred to Loan account)			

Profit and Loss Adjustment Account

To Fixtures	175	By Stock	1,800
To Reserve for bad debts	500		
To P’s Current A/C	375		
To Q’s Current A/C	375		
To R’s Current A/C	375		
	1,800		**1,800**

Goodwill Account

To P’s Current A/C	4,000
To Q’s Current A/C	4,000
To R’s Current A/C	4,000
	12,000

P’s Current Account

To Balance C/D	8,375	By Balanace B/D	2,000
		By P & L Adj. A/C	375
		By Goodwill	4,000
		By Reserve	2,000
	8,375		**8,375**

Q’s Current Account

To Balance C/D	9,375	By Balance B/D	3,000
		By P & L Adj. A/C	375

		By Goodwill	4,000
		By Reserve	2,000
	9,375		**9,375**

R's Current Account

To Balance C/D	2,500	By P & L Adj. A/C	375
To Capital A/C	3,875	By Goodwill	4,000
		By Reserve	2,000
	6,375		**6,375**

R's Capital Account

To Loan A/C	13,875	By Balance B/D	10,000
		By Current A/C	3,875
	13,875		**13,875**

R's Loan Account

To Balance C/D	13,875	By Capital A/C	13,875
	13,875		**13,875**
		By Balance B/D	13,875

Balance Sheet of P and Q

Liabilities			Assets		
Creditors		5,000	Bank Balance		3,000
R's Loan A/C		13,875	Bills receivable		5,000
Current Accounts:			Debtors	20,000	
P	8,375		Less: RBD	1,500	18,500
Q	9,375	17,750	Stock		19,800
Capital Accounts:			Fixtures		3,325
P	10,000		Goodwill		12,000
Q	15,000	25,000			
		61,625			**61,625**

Illustration 4:

The Balance Sheet of A, B and C who were sharing profits is proportion to their capitals stood as follows on December 31, 2007.

Liabilities				Assets	
Sundry Creditors		6,90,000	Cash at Bank		5,50,000
Capital Accounts:			Sundry Debtors 5,00,000		
A	20,00,000		Less : Provision	10,000	4,90,000
B	15,00,000		Stock		8,00,000
C	10,00,000	45,00,000	Plant and Machinery		8,50,000
			Land and Buildings		25,00,000
		51,90,000			**51,90,000**

B retired on the above date and the following was agreed upon:

1) That stock is depreciated by 6%.

2) That the provision for Doubtful debts be brought up to 5% on Debtors.

3) That the Land and Buildings be appreciated by 20%.

4) That a provision of Rs.7, 700 be made I respect of outstanding legal charges.

5) That the Goodwill of the entire firm be fixed at Rs.10,00,000 and B's share of it be adjusted into the amounts of A and C who are going to share future profits in the ratio 5:3.

6) That the assets and liabilities (except cash) were to appear in the balance sheet at their old figures.

7) That the entire capital of the firm as newly constituted be fixed at Rs.28,00,000 between A and C in the proportion of 5:3 (actual cash to be brought in or paid off, as the case may be).

Pass journal entries to give effect to above arrangements. Show the Balance Sheet after B's retirement. Also give a statement showing how much cash is brought in by or pay to the partners.

Solution:

Profit sharing ratio of A, B & C 4:3:2 i.e. 4/9; 3/9; 2/9

New profit sharing A & C = 5:3 = 5/8; 3/8

Gaining Ratio of A = 5/8 – 4/9 = 13/72

Gaining Ratio of C = 3/8-2/9 = 11/72

= 13:11

Goodwill share given to B, shall be charged to A & C in this ratio.

Total Capital of the firm after B's retirement = 28,00,000

A's Capital = 28,00,000 x 5/18 = 17,50,000

C's Capital = 28,00,000 x 3/8 = 10,50,000

Journal entries:

1. P & L Adj. A/C	Dr	1,40,000	
To Stock			48,000

To Reserve for bad debts			15,000
To Outstanding legal bills			77,000

(Being the assets revalued)

2. Land and Buildings A/C	Dr	5,00,000	
To P & L A/C			5,00,000

(Being the assets appreciated)

3. P & L A/C	Dr	3,60,000	
To A's Capital			1,60,000
To B's Capital			1,20,000
To C's Capital			80,000

(Being the profit on revaluation distributed to partners)

4. A's Capital A/C	Dr	1,95,000	
C's Capital A/C	Dr	1,65,000	
To B's Capital A/C			3,60,000

(Being the retiring partner's share of goodwill changed to continuing partners capitals in their gaining ratio i.e. 13:11)

5. B's Capital A/C	Dr	19,80,000	
To B's Loan A/C			19,80,000

(Being the retiring partner's claim transferred to his Loan A/C)

6. A's Capital A/C	Dr	2,25,000	
C's Capital A/C	Dr	1,35,000	
To P & L Adj. A/C			3,60,000

(Being Loss on revaluation distributed to A & c in their new ratio i.e.5:3; assuming that the value of assets and liabilities were reinstated)

7. Cash A/C	Dr	2,80,000	
To A's Capital			10,000
To C's Capital			2,70,000

(Being the shortage in Capital Accounts brought in by partners)

Memorandum P & L Adj. Account

To Stock		48,000	By Land & Buildings	5,00,000
To RBD		15,000		
To Outstanding legal bills		77,000		
To A's Capital	1,60,000			
To B's Capital	1,20,000			

To C's Capital	80,000	3,60,000			
		5,00,000			5,00,000
To Land & Buildings		5,00,000	By Sundry Assets&Liabilities		1,40,000
			By A's Capital	2,25,000	
			By B's Capital	1,35,000	3,60,000
		5,00,000			**5,00,000**

A's Capital Account

To B's Capital (goodwill)	1,95,000	By Balance	20,00,000
To P & L Adj. A/C	2,25,000	By P & L Adj.A/C	1,60,000
To Balance C/D	17,50,000	By Cash (brought in)	10,000
	21,70,000		**21,70,000**
		By Balance B/D	17,50,000

B's Capital Account

To Loan A/C	19,80,000	By Balance	15,00,000
		By P & L Adj. A/C	1,20,000
		By A's Capital A/C- Goodwill	1,95,000
		By C's Capital A/C – Goodwill	1,65,000
	19,80,000		**19,80,000**

C's Capital Account

To B's Capital – goodwill	1,65,000	By Balance	10,00,000
To P & L Adj. A/C	1,35,000	By P & L Adj. A/C	80,000
To Balance C/D	10,50,000	By Cash (brought in)	2,70,000
	13,50,000		**13,50,000**
		By Balance B/D	10,50,000

B's Loan Account

By Capital	19,80,000

Balance Sheet A & c as on 1-1-2007

Liabilities				Assets
Creditors	6,90,000	Cash	5,50,000+2,80,000	8,30,000
Capitals:		Debtors	5,00,000	
A	17,50,000	Less: Provision	10,000	4,90,000
C	10,50,000	Stock		8,00,000

B's Loan A/C	19,80,000	Plant	8,50,000
		Land and Buildings	25,00,000
	54,70,000		**54,70,000**

	A	C
Capitals of partners before the cash brought in	17,40,000	7,80,000
Cash to be brought in	10,000	2,70,000

Illustration 5:

Bedi and Prasanna were carrying on business, as equal partners. It was agreed that Bedi should retire from the firm on March 31, 2007, and that his son Chandra should join Prasanna from 1st April, 2007, and should be entitled to one third of the profits. The Balance Sheet on March 31, 2007 was as follows:

Bedi's Capital	23,800	Cash at bank	7,700
Prasanna's Capital	19,740	Sundry debtors	11,270
Sundry Liabilities	6,860	Furniture	9,940
		Buildings	14,490
		Goodwill	7,000
	50,400		**50,400**

On 31st March, 2007, goodwill was valued of Rs.15, 400 and Buildings at Rs.16, 800. It was agreed that enough money should be introduced to enable Bedi to be paid out and leave Rs.7, 000 cash by way of working capital. Prasanna and AChandra were to provide such sums as would make their capital proportionate to their share of profits. Bedi agreed to make a friendly loan to Chandra by transfer from his capital account of half the amount which Chandra had to provide.

Prasanna and Chandra paid in cash due from them on 1st April, 2007 and the amount due to Bedi was paid out on the same day.

Pass the necessary journal entries and prepare the Balance Sheet as on 1st April, 207.

Solution:

Balance Sheet (after paying off Bedi and after the admission of Chandra)

Liabilities		Assets	
Sundry Liabilities	6,860	Cash (as per revaluation)	7,000
(no change in revaluation)		Debtors(no change)	11,270
Combined Capital of Prasanna		Furniture (no change)	9,940
And Chandra (Bal. Fig)	53,550	Buidings (as per revaluation)	16,800
		Goodwill (as per revaluation)	15,400
	60,410		**60,410**

Total Capital of Prasanna Chandra after paying off Bedi		55,550	
Prasanna's share	2/3 = 53,550 x 2/3	35,700	
Chandra's share	1/3 = 53,550 x1/3		17,850
Less: Transfers from his father's A/C(Bedi's A/C)1/2			8,925
Cash to be brought in by Chandra			**8,925**

Journal Entries:

1. Goodwill A/C	Dr	2,310	
Buildings A/C	Dr	8,400	
To P & L Adj. A/C			10,710
(Being the assets appreciated)			
2. P & L Adj. A/C	Dr	10,710	
To Bedi's Capital			5,355
To Prasanna's Capital			5,355
(Being the profit on revaluation distributed to partners)			
3. Cash A/C	Dr	19,530	
To Prasanna's Capital			10,605
To Chandra's Capital			8,925
(Being shortage of capital brought in by Prasanna and the new partner brings half of his share of capital)			
4. Bedi's Capital A/C	Dr	29,155	
To Cash			20,230
To Chandra's Capital A/C			8,925
(Being retiring partner's claim settled and some account transferred to his son's capital (New partner) A/C)			

Balance Sheet of Prasanna and Chandra as on 1-4-2007

Liabilities			Assets	
Capitals:			Cash	7,000
Prasanna		35,700	Debtors	11,270
Chandra		17,850	Furniture	9,940
Sundry Liabilities		6,860	Buildings	16,800
			Goodwill	15,400
		60,410		**60,410**

Working Notes:

Bedi's Capital Account

To Cash	20,230	By Balance	23,800
To Chandra's Capital A/c	8,925	By P & L Adj. A/C	5,355
	29,155		**29,155**

Prasanna's Capital Account

		By Balance	19,740
		By P & L Adj. A/C	5,355
		By Cash	10,605
			35,700

Chandra's Capital Account

		By Cash	8,925
		By Bedi's Capital	8,925
			17,850

Prasanna's Capital in the new firm:	35,700
Less: Existing Capital after revaluation	25,095
Cash to be brought in	**10,605**

Cash Account

To Balance	7,700	By Bedi's Capital	20,230
To Prasanna's Capital	10,650	By Balanace C/D	7,000
To Chandra Capital	8,925	(working capital)	
	27,230		**27,230**
To Balance B/D	7,000		

Illustration 6:

A, B and C are partners sharing profits and losses in the proportion of 3:2:1 and their Balance Sheet of 31st December, 2007 was as follows:

Bills payable		7,560	Cash in hand	250
Creditors		12,300	Cash at bank	960
General Reserve		3,000	Bills receivable	3,300
Capitals:			Debtors	7,450
A	10,000		Stock	12,470
B	6,000		Investments	10,430
C	4,000	20,000	Building	8,000
		44,860		**42,860**

B died on February 28 2007 and according to partnership agreement his executor is entitled to be paid out as follows:

a) The capital to his credit at the time of his death and interest up to the time of his death at 6% per annum.

b) His appropriate share of general reserve.

c) His share of profit to the date of his death which is to be taken on the basis of preceding year's profit.

d)His share of goodwill which is calculated at two year's purchase of the average profit of the preceding three years.

The investments were sold for Rs.16,020 and B's executor was paid off. The profits in the three preceding years was 2004 – Rs.7,800; 2005 – Rs.9,000; 2006 – Rs.9,600.

Pass the journal entries and write the accounts of B.

Solution:

Journal entries:

1. Interest on capital A/C	Dr	60.00	
To B's Capital Account			60.00
(Being the interest for 2 months @ 6% due to B)			
2. General Reserve A/C	Dr	3,000	
To A's Capital			1,500
To B's Capital			1,000
To C's Capital			500
(Being the accumulated profits shared)			
3. P & L A/C	Dr	533.33	
To B's Capital			533.33
(Being the share of profit on the basis of preceding year's profit)			
4. Goodwill A/C	Dr	17,600	
To A's Capital			8,800.00
To B's Capital			5,866.67
To C's Capital			2,933.33
(Being the goodwill raised)			
(7,800+9,000+9,600=26,400/3x2=17,600)			
5. Cash A/C	Dr	16,020	
To Investment A/C			16,020
(Being the assets sold)			
6. B's Capital A/C	Dr	13,460	

To B's executor's A/C 13,460

(Being the claim transferred to executor's account)

7. Executor's Account Dr 13,460

To Cash 13,460

(Being cash paid to the executor)

B's Capital Account

To Executor's A/C	13,460.00	By Balance	6,000.00
		By Interest on capital (6,000x2/12x6/100)	
		By General Reserve (3,000 x 1/3)	1,000.00
		By P & L A/C (9,600x2/12x1/3)	533.33
		By Goodwill	5,866.67
	13,460.00		**13,460.00**

Illustration 7:

A, B and C carried on business in partnership, profits being divisible in 3:2:1. The balance sheet on 31st December 2006 showed their capitals as Rs.10, 400; Rs. 5,000 and Rs.3, 000 respectively. On 28th February 2007 A died. From the following particulars prepare an account for presentation to A's executor.

a) The firm issued the partners' lives severally A for Rs.9, 000, B for Rs.4, 800 and C for Rs.2,400. The premiums have been charged to the profit and loss account. The surrender value on 28th February 2007 was one fourth of the sum assured.

b) Capital carries interest at 5% per annum.

c) A's drawings from 1st January 2007 to the date of his death were Rs.1, 200.

d) A's share of profits for the portion of the current year in which he was alive was to be taken at the sum calculated on the average of the previous three completed years and goodwill was to be raised on the basis of two years' purchase of average profits of those three years.

The profits of the three previous completed years were Rs.9, 200; Rs.7, 400 and Rs.8, 600 respectively.

Show A's account. Take calculations to the nearest rupee.

Solution:

A's Capital Account

To Drawings	1,200	By Balance	10,400
		By Joint life policy	5,400
		By Interest on Capital(for 2 months)	87

		By P & L A/C(share of profit)	700
To A's Executor's A/C	23,787	By Goodwill	8,400
	24,987		**24,987**

A's Executor's Account

		By A's Capital A/C	24,987

Working Notes:

Joint Life Policy:	A	9,000 (full value as he leaves the firm)
	B (4,800 x ¼)	1,200
	C (2,400 x ¼)	600
		10,800

A's share = 10,800 x ½ = 5,400.

Interest on Capital = 10,400 x 5/100 x 2/12 = 87 (approx)

Share of profit = profit for the 3 preceding years =9,200+7,400+8,600=25,200

Average of one year = 25,200/3 = 8,400.

Profit for 2 months = 8,400 x 2/12 = 1,400

A's share = 1,400 x ½ =700

Goodwill: Two years' purchase of average profits of 3 years

Average profit = 8,400

2 years' purchase = 8,400x 2 = 16,800

Goodwill = 16,800

A's share = 16,800 x ½= 8,400.

Illustration 7:

S, J and N were partners sharing profits and losses in the ratio of 3:2:1 on 31st December 2007. Their balance sheet was as follows:

Creditors		8,000	Goodwill	6,000
General Reserve		9,000	Buildings	20,000
Capitals:			Patents	5,000
S	35,000		Machinery	15,000
J	20,000		Stock	8,000
N	15,000	70,000	Debtors	8,000
			Cash at Bank	25,000
		87,000		**87,000**

J died on 1st July 2007. The following terms and conditions were agreed upon between her executor and the remaining partners.

a) Goodwill was valued at 1 ½ years purchase price of past three years' profits which were as follows:

2004 16,000

2005 8,000

2006 12,000

b) Patents were valued at Rs.8, 000; buildings at Rs.25, 000; and machinery at Rs.24, 000.

c) Profit up to the date of death of J was to be taken on the basis of the average profits of the past three years.

d) Interest on capital at 5% per annum was to be charged.

e) Cash amounting to Rs.7, 500 was paid immediately and the balance due to the executor of the deceased was payable together with interest at 6% per annum in two equal yearly installments.

f) Reserve for bad and doubtful debts was to be provided for an amount of

Rs. 1,000.

g) J's drawings up to the date of his death were Rs.4, 000.

Draft the necessary journal entries to record the above transactions and prepare J's capital account as on the date of her death.

Solution:

Journal entries:

1. General Reserve A/C	Dr	3,000	
To J's Capital A/C			3,000
(Being J's share in the reserve transferred to his capital account)			
2. Goodwill A/C	Dr	12,000	
Patents A/C	Dr	3,000	
Buildings A/c	Dr	5,000	
Machinery A/C	Dr	9,000	
To P & L Adj. A/C			29,000
(Being Assets revalued)			
3. P & L Adj. A/C	Dr	1,000	
To Reserve for bad debts			1,000
(Being provision credited on debtors)			
4. P & L Adj. A/C	Dr	28,000	
To S's Capital			14,000

To J's Capital			9,333
To N's Capital		4,667	
(Being profit on revaluation distributed)			
5. Profit and Loss Suspense A/C	Dr	2,000	
To J's Capital A/C			2,000
(Being the share of profit of J for six months transferred to his account)			
6. Interest on Capital A/C	Dr	500	
To J's Capital A/C			500
(Being interest on Capital for six months transferred to his account)			
7. J's Capital A/C	Dr	30,833	
To Executor's A/C			30,833
(Being J's capital balance transferred to his Executor's account)			
8. Executor's A/C	Dr	7,500	
To Cash			7,500
(Being part payment made)			

J's Capital Account

To Drawings	4,000	By Balance B/D	20,000
To Executor's A/C	30,833	By Reserve	3,000
		By P & L Adj. A/C	9,333
		By P & L Suspense A/C	2,000
		By Interest on Capital	500
	34,833		**34,833**

Executor's Account

To Cash	7,500	By J's Capital A/C	30,833
To Balance C/D	23,333		
	30,333		**30,333**
		By Balance B/D	23,333

Working Notes:

Goodwill 1 ½ years purchase of the average profit of preceding 3 years

3 years profit = 16,000+8,000+12,000=36,000

1 year average = 36,000/3=12,000

11/2 years average = 12,000 x 1 ½ = 18,000

Less: Goodwill already in the balance sheet = 6,000

Increase in goodwill =12,000

Illustration 8:

A and B who share profit in the ratio of 3:2, took out a joint life policy on 1st May, 2000 for Rs.30, 000. The annual premium was Rs.1, 300. The surrender value of the policy was:

2000 – Nil; 2001 – Rs.400; 2002 – Rs.900; 2003 – Rs.1, 450.

B died on 15th September, 2003 and the amount of the policy was received on 31st December, 2003. The books are closed on December 31 each year.

Give journal entries if premium paid is written off to profit and loss account each year.

Solution:

Journal Entries:

May 1, 2000	Joint life policy A/C	Dr	1,300	
	To Cash			1,300
	(Being the 1st premium paid on Joint Policy)			
Dec 31,2000	P & L A/C	Dr	1,300	
	To Joint Policy Reserve A/C			1,300
	(Being the reserve created for Joint Policy)			
	Joint Life Policy Reserve A/C	Dr	1,300	
	To Joint Life Policy			1,300
	(Being the surrender value taken into account)			
May 1, 2001	Joint Life Policy A/c	Dr	1,300	
	To Cash			1,300
	(Being the 2nd premium paid)			
Dec 31, 2001	P & L A/C	Dr	1,300	
	To Joint Life Policy Reserve			1,300
	(Being the reserve created for Joint Life Policy)			
	Joint Life Policy Reserve A/C	Dr	900	
	To Joint Life Policy			900
	(Being the surrender value of Rs.400 taken into account)			
May 1, 2002	Joint Life Policy A/C	Dr	1,300	
	To Cash			1,300
	(Being 3rd premium paid)			
Dec 31, 2002	P & L A/C	Dr	1,300	
	To Joint Life Policy Reserve			1,300
	(Being the reserve created)			

	Joint Life Policy Reserve A/C	Dr	800	
	To Joint Life Policy			800
	(Being the surrender value Rs.900 taken into account)			
May 1.2003	Joint Life Policy A/C	Dr	1,300	
	To Cash			1,300
	(Being the 4th premium paid)			
Dec 31, 2003	Cash A/C	Dr	30,000	
	To Joint Policy			30,000
	(Being the policy surrendered due to the death of a partner and cash received)			
	Joint Life Policy Reserve A/C	Dr	900	
	To Joint Life Policy			900
	(Being the reserve cancelled)			
	Joint Life Policy A/C	Dr	28,700	
	To A's Capital			17,220
	To B's Capital			17,220
	(Being the policy amount distributed among the partners)			

Working Notes:

Joint Life Policy Account

1-5-00	To Cash		1,300	31-12-00	By Joint Life Policy Reserve	1,300
1-5-01	To Cash		1,300	31-12-01	By Joint Life Policy Reserve	900
					By Balance C/D	400
			1,300			**1,300**
1-1-02	To Balance B/D		400	31-12-02	By Joint Life Policy Reserve	800
1-5-02	To Cash		1,300		By Balance C/D	900
			1,700			**1,700**
1-1-03	To Balance B/D		900	31-12-03	By Cash	30,000
1-5-03	To Cash		1,300		By Joint Life Policy reserve	900
	To A's Capital	17,220				
	To B's Capital	11,480	28,700			
			30,900			**30,900**

Joint Life Policy Reserve Account

31-12-00	To Joint Life Policy	**1,300**	31-12-00	By P & L A/C	**1,300**
31-12-01	To Joint Life Policy	900	31-12-01	By P & L A/C	1,300

	To Balance C/D	400			
		1,300			**1,300**
31-12-02	To Joint Life Policy	800	1-1-02	By Balance B/D	400
	To Balanace C/D	900	31-12-02	By P & L A/C	1,300
		1,700			**1,700**
31-12-03	To Joint Life Policy	**900**	1—1-03	By Balance B/D	**900**

Illustration 9:

Shiv, Shankar and Shambu took a joint life policy on 10th January, 2000, to provide the necessary amount at the time a partner's death. The policy amount is

Rs.40, 000. On 10th January 2003 they paid Rs.1, 000 as last annual premium. Shiv died on 20th February 2003. The surrender value of the policy was as follows:

2000 - Nil: 2001 - 250; 2002 - 450;

After the death of Shiv, on 1st March the policy amount received. Pass the necessary journal entries regarding the policy for three years. Show the final adjustment after Shiv's death.

Partners share profits in 2:1 ratio and close the books every year on 31st December.

Solution:

Journal Entries:

10-1-00	Joint Life Policy A/C	Dr	1,000	
	To Cash			1,000
	(Being the first premium paid)			
31-12-00	P & L A/C	Dr	1,000	
	To Joint Life Policy Reserve			1,000
	(Being the premium transferred to P & L A/C and created reserve)			
	Joint Life Policy Reserve A/C	Dr	1,000	
	To Joint Life Policy A/C			1,000
	(Being the surrender value taken into account)			
10-1-01	Joint Life Policy A/C	Dr	1,000	
	To Cash			1,000
	(Being the second premium paid)			
31-12-01	P & L A/C	Dr	1,000	
	To Joint Life Policy Reserve A/C			1,000
	(Being the premium transferred to P & L A/C)			
	Joint Life Policy Reserve A/C	Dr	750	
	To Joint Life Policy			750
	(Being the surrender value taken into account)			

10-1-02	Joint Life Policy A/C	Dr	1,000	
	To Cash			1,000
	(Being the third premium paid)			
31-12-02	P & L A/C	Dr	1,000	
	To Joint Life Policy Reserve			1,000
	(Being the premium transferred to P & L A/C)			
	Joint Life Policy Reserve A/C	Dr	800	
	To Joint Life Policy			800
	(Being the surrender value taken into account)			
10-1-03	Joint Life Policy A/C	Dr	1,000	
	To Cash			1,000
	(Being fourth premium paid)			
1-3-2003	Cash A/C	Dr	40,000	
	To Joint Life Policy			40,000
	(Being the policy amount received)			
	Joint Life Policy A/C	Dr	3,000	
	To Shiv's Capital			9,750
	To Shankar's Capital			9,750
	To Shambu's Capital			9,750
	(Being the policy amount distributed to partners)			
	Joint Life Policy Reserve A/C	Dr	450	
	To Joint Life Policy			450
	(Being the reserve account written off)			

Joint Life Policy Account

10-1-00	To Cash	**1,000**	31-12-00	By Joint Life Policy Reserve	**1,000**
10-1-01	To Cash	1,000	31-12-01	By Joint Life Policy Reserve	750
				By Balance C/D	250
		1,000			**1,000**
1-1-02	To Balance B/D	250	31-12-02	By Joint Life Policy Reserve	800
	To Cash	1,000		By Balance C/D	450
		1,250			**1,250**
1-1-03	To Balance B/D	450	1-3-03	By Cash	40,000
10-1-03	To Cash	1,000		ByJoint Life Policy Reserve	450
	To Shiv's Capital	19,500			

	To Shankar's Capital	9,750			
	To Sambu's Capital	9,750			
		40,450			**40,450**

Joint Life Policy Reserve Account

31-12-00	To Joint Life Policy A/C	**1,000**	31-12-00	By P & L A/C	**1,000**
31-12-01	To Joint Life Policy A/C	750	31-12-01	By P & L A/C	1,000
	To Balance C/D	250			
		1,000			**1,000**
31-12-02	To Joint Life Policy A/C	800	1-1-02	By Balance B/D	250
	To Balance C/D	450	31-12-02	By P & L A/C	1,000
		1,250			**1,250**
1-3-03	To Joint Life Policy A/C	**450**	1-1-03	By Balance B/D	**450**

Try yourself:

1. A, B and c were carrying on business in partnership sharing profits and losses in the ratio of 3:2:1. On 31st December 2003, Balance Sheet of the firm stood as follows:

Liabilities				Assets
Sundry Creditors		13,590	Cash	5,900
Capital Accounts:			Debtors	8,000
A	15,000		Stock	11,690
B	10,000		Buildings	23,000
C	10,000	35,000		
		48,590		**48,590**

B retired on the above mentioned date on the following terms:

i) Buildings are to be appreciated by Rs.7, 000.

ii) Provision for bad debts is to be made @ 5% on debtors.

iii) Goodwill of the firm is to be valued at Rs.9, 000 and adjustment is this respect to be made without raising goodwill account.

iv) Rs.5, 000 is to be paid to B immediately and the balance due to him be treated as a loan carrying interest @ 6% per annum. Pass journal entries to record the above transactions and show the Balance Sheet of the firm as it would appear immediately after B's retirement.

(A's Capital: Rs.16, 050; C's Capital: Rs.10, 350; B's Loan A/C: Rs.10, 200)

2. The Balance Sheet of X,Y and Z who were sharing profits in the ratio of 4:3:2 respectively stood as follows on 31st December, 2007:

Liabilities				Assets
Sundry Creditors	4,140	Cash at Bank		3,300
Capital Accounts:		Sundry Debtors	3,045	

X	12,000		Less: Provision	105 2,940
Y	9,000		Stock	4,800
Z	6,000	27,000	Plant and Machinery	5,100
			Land and Buildings	15,000
		31,140		**31,140**

Y having given notice to retire from the firm, the following adjustments in the books of the firm were agreed upon:

1. That land and buildings are appreciated by 10%.
2. The provision for bad debts is no longer necessary.
3. That the stock is to be appreciated by 20%.
4. That adjustment is to be made in the accounts to rectify a mistake previously made whereby Y was credited in excess by Rs.810 while X and Y were debited in excess by Rs.420 and Rs.390 respectively.
5. That the goodwill of the firm is to fixed at Rs.5, 400 and Y's share of the same is to be adjusted to that of X and Z who are going to share in future profits in the ratio of 2:1.
6. That the entire capital of the firm, as newly constituted, will be readjusted by fringing in or paying of cash so that the future capital of X and Z is in the ratio of 2:1.

Pass journal entries and prepare the Balance Sheet of the new firm showing Y's balance as loan.

(New capitals of X Rs.12, 480; Z Rs.6, 240; Y's loan A/C Rs.10, 845; B/S total

Rs.33, 705)

3. Gupta, Badal and sinha are in partnership sharing profits and losses in the ratio of 2:2:1. Sinha retires on 31st December, 2007. The Balance Sheet of the firm on the date of retirement of Sinha is as follows:

Liabilities			Assets	
Creditors		2,300	Cash in hand	500
General Reserve		2,500	Cash at Bank	3,000
Capitals:			Debtors	6,000
Gupta	10,000		Stock	10,000
Badal	8,000		Buildings	8,000
Sinha	7,200	25,200	Furniture	2,000
Profit & Loss Account		500	Goodwill	1,000
		30,500		**30,500**

The following adjustments are to be made:

1. Buildings are to be revalued at Rs.10, 000.
2. Bad debts to be written off Rs.400.
3. Stock is to be revalued at Rs.9 000.

4. Furniture is to be revalued at Rs.1, 800.
5. The Goodwill of the firm is to be completely written off.
6. It was agreed to pay Rs.2, 000 only to the sundry creditors in full settlement of their dues.
7. The amount available at Bank is agreed to be paid to Sinha and the balance of the amount due to Sinha to be transferred to his loan account.

   You are required to prepare capital accounts of the partners, profit and loss adjustment account and balance sheet of the firm.

   (New Capitals: Gupta: Rs.11,080; Badal: Rs.9, 80; Sinha Loan A/C: Rs.4,740; Total of Balance Sheet: Rs.26,900)

4. Amit, Dharam and Rajesh were partners sharing profits and losses in the ratio of 5:3:2. They had taken out a joint life policy of the face value of Rs.24,000. On 31st December 2007 its surrender value was Rs.4,800 on this date the balance sheet of the firm stood as under:

Liabilities			Assets	
Sundry creditors		6,360	Fixed assets	30,000
Expenses outstanding		840	Stock	13,200
Reserve		3,600	Book debts	10,800
Capitals:			Cash at bank	2,400
Amit	24,000			
Dharam	12,000			
Rajesh	9,000	45,600		
		56,400		**56,400**

On this date Dharam decided to retire and for this purpose: i) goodwill was valued at Rs.18, 000; ii) fixed assets were valued at Rs.36, 000 and iii) stock was considered as worth Rs.12, 000.

Dharam to be paid through cash brought in by Amit and Rajesh in such a way as to make their capitals proportionate to their new profit sharing ratio which was Amit 3/5 and Rsjesh 2/5. Goodwill was to be passed through books without raising a goodwill account. The joint life policy was also not to appear in the balance sheet.

Record these matters in the journal of the firm and prepare the resultant balance sheet.

(New Capitals: Amit: Rs.32,400; Rajesh: Rs.21,600;Cash to Dharam: Rs.21,360; Total of Balance Sheet: Rs.61,200)

5. X, Y and Z were partners sharing profits in 6:4:3. The amount payable to the expired partner will be paid 40% in the first year, 40% in the second year and 20% in the third year. To ascertain the amount of an expired partner, the following items should be taken into account:

1. Share of profit should be calculated basing on the profits of the year in which the partner died.

2. Goodwill should be calculated basing on the two years' purchase of the average profits of the preceding three years profits plus the profits of the year in which the partner died up to the date of his death.

3. Interest should be calculated at 6% on capital.

X died on 1st January 2004. Business closes every year on 31st March. Profits of the preceding years were:

2000-01	42,000
2001-02	46,500
2002-03	48,000
2003-04	52,000

X Capital on 31st March 2003 was Rs.20, 000; X drawings from 31st March 2003 to 1st January 2004 were Rs.6, 200. Show X executor's account up to full payment.

(X executor's account (beginning balance): Rs.75, 750; Last installment Rs.16, 059 (including interest))

10.6: Summary:

This lesson dealt with the accounting procedure when a partner retires or dies in the firm. The retirement or death basically makes no difference as the existing partners have to pay his part. However, in certain aspects there are some differences. The retired partner's due is transferred to his loan account and will be paid later. The deceased partner's due is transferred to his executor's account and will be paid immediately or with interest. Treatment of goodwill and revaluation of assets and liabilities are almost same as in admission of partnership. Joint Life Policy helps the partnership firm when a person dies and it has three methods of accounting treatment.

10.7: Glossary:

Joint Life Policy: It is a policy taken on the lives of partners to meet the commitment when a partner dies.

10.8: Self Assessment Questions:

1. How goodwill is treated when a partner dies?
2. What are the accounting differences in retirement and death of a partner?
3. Explain the methods of Joint Life Policy treatment when a partner dies?

Dr.R.Jayaprakash Reddy.

Lesson 11

Partnership Accounts III: Amalgamation

11.0 Objective:

After going through the lesson you will be able to understand the following:

1. Meaning and purpose of amalgamation in partnership firms.
2. Method of accounting.

Structure:

11.1: Meaning of Amalgamation:

When two or more firms of similar nature merge, there come many economies. Because of this, often firms merge or amalgamate themselves. The partners in the old firm continue in the new firm. They reach an agreement regarding the revaluation of assets, future sharing of profits and other modalities. These require separate entries in the books of old partnership firms and new firm. After amalgamation, the firm will continue the operations and the old partnership firms ceased to exist. For example, A &B firm and C & D firms may amalgamate and become A, B, C & D firm. The partners in the old firms become partners of the new firm. Their old firms will be closed down after amalgamation.

11.2: Journal Entries:

The following journal entries are required in the books of old firms and new firm when amalgamation takes place:

Books of Old Firms

1. For Goodwill: The value of goodwill will be ascertained in case of each firm and the amount will be credited to their respective partners' capital accounts in their respective books.

Goodwill A/C Dr

To Partners' Capital A/C

3. Reserve and other undistributed profits: They will be credited to the partners of each of the firms in their respective books.

Reserves Dr

P & L A/C Dr

To Partners' Capital A/C

In case of losses the entry will be reversed.

3. Revaluation of assets and liabilities: A profit and loss adjustment account will be opened in each firm's books. The profit or loss will be credited or debited to their partners' capital accounts in the old profit sharing ratio.

i) For increase in the value of assets or decrease in the value of liabilities:

Assets/Liabilities Dr

To P & L Adj. A/C

ii) For decrease in the value of assets or increase in the value of liabilities:

P & L Adj. A/C Dr

To Assets/Liabilities

iii) For distribution of profits:

P & L Adj. A/C Dr

To partners' Capital A/Cs

In case of loss the entry will be reversed

4. For an asset taken over by a partner:

Partner's Capital A/C Dr

To Asset A/C

5. For a liability taken over by a partner:

Liability A/C Dr

To Partner's Capital A/C

6. For assets and liabilities taken over by the new firm:

New Firm Dr

Liabilities A/C Dr

To Assets A/C

7. Assets or Liabilities not taken over by the new firm will be either sold away or paid off and any profit or loss on such selling or payment will be transferred to partners' capital accounts in

their profit and loss sharing ratio. In case they are not disposed off, the will be transferred to partners' capital accounts in the ratio of their capitals.

8. Partners' capital accounts will be closed by transferring them to the new firm's account.

Partners' Capital A/Cs Dr

To New Firm A/C

Books of New Firm

1. For assets and liabilities taken over:

Assets taken over Dr

To Liabilities taken over

To Partners' Capital A/Cs

2. For any further contribution towards capital by the partners:

Bank A/C Dr

To Partners' Capital A/Cs

3. For any capital withdrawn by the partners:

Partners' Capital A/Cs Dr

To Bank

11.3: Illustrations:

Illustration 1:

X and Y are two sole traders, their Balance Sheets as on 1st January 2007 are given below:

Balance Sheet of X

Sundry creditors	8,000	Plant and Machinery	10,000
Capital Account	20,000	Stock in trade	5,000
		Sundry debtors	11,000
		Cash at bank	2,000
	28,000		28,000

Balance Sheet of Y

Sundry creditors	8,000	Plant and Machinery	10,000
Capital Account	20,000	Stock in trade	5,000
		Sundry debtors	11,000

	Cash at bank		2,000
	28,000		28000

They agree to amalgamate their business as on 1-1-2007. The following revaluations were to be made:

a) Plant and Machinery were to be reduced by 10%.

b) Stock in trade was to be reduced in case of X by 20% and in the case of Y 10%.

c) A reserve of 2 ½ % is to be made against Sundry debtors.

d) Each partner is to be credited with goodwill of Rs.5, 000.

You are required to give journal entries for recording the above transactions in the books of X and Y. Give also the amalgamated Balance Sheet of the partners as on 1-1-2007.

Solution:

Books of X

Journal Entries:

1. P & L Adj. A/C	Dr	2,275	
To Plant and Machinery			1,000
To Stock in trade			1,000
To Reserve for bad debts			275
(Being the assets value reduced)			
2. Capital A/C	Dr	2,275	
To P & L Adj. A/C			2,275
(Being loss transferred to capital)			
3. Goodwill A/C	Dr	5,000	
To Capital			5,000
(Being goodwill transferred to capital)			
4. Creditors A/C	Dr	8,000	
Reserve for bad debts A/C	Dr	275	
New firm A/C	Dr	22,725	
To Goodwill			5,000
To Plant and Machinery			9,000
To Stock in trade			4,000

To Debtors			11,000
To Bank			2,000
(Being various assets and liabilities transferred to the new firm)			
5. Capital A/C	Dr	22,725	
To New firm			22,725
(Being the capital account closed)			

Books of Y

Journal Entries:

1. P & L Adj. A/C	Dr	1,175	
To Plant and Machinery			1,000
To Stock in trade			500
To Reserve for bad debts			275
(Being assets value reduced)			
2. Capital A/C	Dr	1,775	
To P & L Adj. A/C			1,775
(Being loss transferred to capital)			
3. Goodwill A/C	Dr	5,000	
To Capital			5,000
(Being goodwill transferred to capital)			
4. Creditors A/C	Dr	8,000	
Reserve for bad debts A/C	Dr	275	
New firm A/C	Dr	23,225	
To Goodwill			5,000
To Plant and Machinery			9,000
To Stock in trade			4,500
To Debtors			11,000
To Bank			2,000
(Being various assets and liabilities transferred to the new firm)			
5. Capital A/C	Dr	23,225	

To New firm 23,225

(Being the capital account closed)

Balance Sheet of the New Firm

Liabilities			Assets		
Sundry Creditors		16,000	Goodwill		10,000
Capitals:			Plant and Machinery		18,000
X	22,725		Stock in trade		8,500
Y	23,,225	45,950	Debtors	22,000	
			Less: RBD	550	21,450
			Bank		4,000
		61,950			**61,950**

Illustration 2:

The following were the Balance Sheet of M/S A & B M/S C and D on December31, 2007.

Liabilities			Assets		
	A&B	C&D		A&B	C&D
Sundry Creditors	40,000	50,000	Cash at Back	11,200	13,400
Mrs.A's Loan	10,000		Stock	40,800	36,600
Capitals:			Sundry Debtors	30,000	40,000
A	80,000		Furniture	8,000	10,000
B	40,000		Premises	80,000	—
C		48,000	Investments	———	30,000
D		32,000			
	1, 70,000	**1, 30,000**		**1, 70,000**	**1,30,000**

The two firms decided to amalgamate their businesses as from 1st January, 2007. For this purpose it was agreed that Mrs.A's loan should be repaid and that the investments of M/C C and D be not taken over by the new firm. Goodwill of M/S A and B was fixed at Rs.16, 000 and that of M/S C and D at Rs.20, 000. Premises were revalued at Rs.1, 00,000 but the stock of M/S A and B was found over-valued by Rs.8, 000. The stock of M/S C and D was under valued by Rs.4, 000. A provision of 5% was created for bad debts of both the firms. The total capital of the new firm was to be Rs.80, 000 and the capital of each partner was to be in his profit-sharing ratio which was to be 3:2:3:2. Goodwill account in the new firm was to be written off.

Close the books of the two firms and pass opening entries of M/S A, B, C and D. Also give the Balance Sheet of the newly constituted firm.

Solution:

Books of M/S A and B

		Dr	Cr
1. Mrs A's Loan A/C	Dr	10,000	
To Cash			10,000
(Being the loan paid off before amalgamation)			
2. P & L Adj. A/C	Dr	9,500	
To Stock			8,000
To Reserve for bad debts			1,500
(Being the assets revalued)			
3. Premises A/C	Dr	20,000	
To P & L Adj. A/C			20,000
(Being the asset appreciated)			
4. P & L Adj. A/C	Dr	10,500	
To A's Capital			5,250
To B's Capital			5,250
(Being the profit on realization shared to partners)			
5. Goodwill A/C	Dr	16,000	
To A's Capital			8,000
To B's Capital			8,000
(Being the goodwill raised)			
6. M/S A, B, C and D A/C (New firm)	Dr	1,46,500	
Creditors A/C	Dr	40,000	
RBD A/C	Dr	1,500	
To Cash			1,200
To Stock			32,800
To Debtors			30,000
To Furniture			8,000
To Premises			10,000
To Goodwill			16,000
(Being the assets and liabilities transferred to new firm)			
7. A's Capital A/C	Dr	93,250	
B's Capital A/C	Dr	53,250	

To A,B,C and D (New firm)			1,46,500
(Being the capitals transferred to new firm)			

Books of C and D

1. P & L Adj. A/C	Dr	2,000	
To RBD			2,000
(Being the asset revalued)			
2. Stock A/C	Dr	4,000	
To P & L Adj.			4,000
(Being the asset revalued)			
3. P & L Adj. A/C	Dr	2,000	
To C's Capital			1,000
To D's Capital			1,000
(Being the profit on revaluation shared to partners)			
4. Goodwill A/C	Dr	20,000	
To C's Capital			10,000
To D's Capital			10,000
(Being the goodwill raised)			
5. C's Capital A/C	Dr	18,000	
D's Capital A/C	Dr	12,000	
To Investments			30,000
(Being the asset not taken over by the new firm shared to partners in their capital ratio)			
6. M/S A, B, C and D A/C	Dr	72,000	
Creditors A/C	Dr	50,000	
RBD A/C	Dr	2,000	
To Cash			13,400
To Stock			40,600
To Debtors			40,000
To Furniture			10,000
To Goodwill			20,000

(Being the assets and liabilities transferred to new firm)

7. C's Capital A/C	Dr	41,000	
D's Capital A/C	Dr	31,000	
To A, B, C and D A/C			72,000

(Being the capitals transferred)

Books of A, B, C and D

1. Cash A/C	Dr	14,600	
Stock A/C	Dr	73,400	
Debtors A/C	Dr	70,000	
Furniture A/C	Dr	18,000	
Premises A/C	Dr	1,00,000	
Goodwill A/C	Dr	36,000	
To Creditors			90,000
To RBD			3,500
To A'sCapital			93,250
To B's Capital			53,250
To C's Capital			41,000
To D's Capital			31,000

(Being the assets and liabilities of old firms acquired)

2. A's Capital A/C	Dr	10,800	
B's Capital A/C	Dr	7,200	
C's Capital A/C	Dr	10,800	
D's Capital A/C	Dr	7,200	
To Goodwill			36,000

(Being the goodwill written off)

3. Cash A/C	Dr	26,000	
To C's Capital			17,800
To D's Capital			8,200

(Being the cash brought in partners to make their capitals proportionate to the profit sharing ratio)

4. A's Capital A/C	Dr	34,450	
B's Capital A/C	Dr	14,050	
To A's Current A/C			34,450
To B's Current A/C			14,050

(Being the surplus amount in capitals transferred to current accounts, as there is no sufficient cash)

Balance Sheet of M/S A, B, C, and D as on 1-1-2007

Liabilities		Assets		
Capitals:		Cash		40,600
A	48,000	Stock		73,400
B	32,000	Debtors	70,000	
C	48,000	Less: RBD	3,500	66,500
D	32,000	Furniture		18,000
Current Accounts:		Premises		1,00,000
A	34,450			
B	14,050			
Creditors	90,000			
	2,98,500			**2,98,500**

Note: The assets and liabilities not taken over the new firm are to be transferred to capital accounts of respective partners in their capital ratio.

Capitals of Partners of the New Firm

	A	B	C	D
Capitals transferred Less goodwill	82,450	46,050	30,200	23,800
Less: Capitals to be in the new firm	48,000	32,000	48,000	32,000
Cash to be payable or to be brought in (-)	34,450	14,050	-17,800	– 8,200

Illustration 3:

Richard and Lloyd have been carrying on businesses as general merchants. They decided to amalgamate, and, henceforth, trade under the name of R&L on the following terms:

1. Each partner shall have a fixed capital of Rs.40, 000.
2. Richard's stock is to be brought in at Rs.12, 800 and Lloyd's at Rs.10, 800.

3. Provisions for Bad debts are to be increased to 6% on debtors.
4. Lloyd's furniture is not to be taken over while Richard's furniture is to be taken at Rs.1, 800.
5. Richard is to pay the loan from his son before amalgamation.
6. Any deficiency on the net assets brought in is to be paid into the firm's bankers while any excess is to be withdrawn.

Richard's Balance Sheet on 31-12-2007

Liabilities		Assets		
Creditors	4,800	Furniture and Fixtures		1,400
Loan from his son	2,400	Machinery		20,000
Capital	42,540	Stock in trade		13,600
		Debtors	11,000	
		Less: RBD	480	10,520
		Cash at Bank		4,220
	49,740			**49,740**

Lloyd's Balance Sheet on 31-12-2007

Liabilities		Assets		
Creditors	8,400	Furniture and fixtures		800
Capital	40,400	Machinery		22,000
		Stock in trade		11,200
		Debtors	12,100	
		Less: RBD	500	11,600
		Cash at Bank		3,200
	48,800			**48,800**

Give journal entries necessary to adjust each trader's books prior to amalgamation and the opening journal entries and the Balance Sheet of M/S R & L.

Solution:

Books of Richard

1. Loan from his son A/C	Dr	2,400	
To Cash			2,400

(Being the loan paid off)

2. Furniture A/C	Dr	400	
Capital A/C	Dr	580	
To Stock			800
To RBD (660-480)			180

(Being the assets revalued and loss debited to capital account)

Note: As there is one partner (Sole trader) the profit or loss arising out of revaluation can be credited or debited to his capital account directly. No need of Preparation of P & L Adj. Account.

3. M/S R & L A/C (New firm)	Dr	41,960	
Creditors A/C	Dr	4,800	
RBD A/C	Dr	600	
To Furniture			1,800
To Machinery			20,000
To Stock			12,820
To Debtors			11,000
To Cash			1,820

(Being the assets and liabilities transferred to new firm)

4. Capital A/C	Dr	41,960	
To M/S R & L (New firm)			41,960

(Being the capital transferred to new firm)

Books of Lloyd

1. Capital A/C	Dr	1,426	
To Furniture			800
To Stock			400
To RBD (726 – 500)			226

(Being the asset not taken over by the new firm, i.e. Furniture and loss on revaluation debited to capital Account)

2. M/S R & L A/C (New firm)	Dr	38,974	
Creditors A/C	Dr	8,400	
RBD A/C	Dr	726	
To Machinery			22,000
To Stock			10,800
To Debtors			12,100

To Cash			3,200
(Being the assets and liabilities transferred to new firm)			
3. Capital A/C	Dr	38,974	
To M/S R & L (New firm)			38,974
(Being the capital transferred to new firm)			

Books of M/S R & L (New Firm)

1. Furniture A/C	Dr	1,800	
Machinery A/C	Dr	42,000	
Stock A/C	Dr	23,600	
Debtors A/C	Dr	23,100	
Cash A/C	Dr	5,020	
To Creditors			13,200
To RBD			1,386
To Richard's Capital			41,960
To Lloyd's Capital			38,974
(Being the assets and liabilities of both firms acquired)			
2. Cash A/C	Dr	1,026	
To Lloyd's Capital			1,026
(Being the cash brought in partner to make his capital Rs.40, 000)			
3. Richard's Capital A/C	Dr	1,960	
To Cash			1,960
(Being the surplus capital paid to partner, to make his capital Rs.40, 000)			

Balance Sheet of M/S R & L as on 31-12-2007

Liabilities		Assets		
Capitals:		Furniture		1,800
Richard	40,000	Machinery		42,000
Lloyd	40,000	Stock		23,600
Creditors	13,200	Debtors	23,100	
		Less: RBD	1,386	21,714
		Cash (See note)		4,086
	93,200			**93,200**

Note:

Cash: Balance transferred	5,020
Add: Brought in by Lloyd	1,026
	6,046
Less: Paid to Richard	1,960
	4,086

Illustration 4:

R and S are partners sharing profits and losses equally in a business similar to that carried on by T. In order to avoid competition they decided to amalgamate the two businesses by taking over the assets and liabilities of T and admitting him into partnership with them as from 1st January, 2007. Their Balance Sheets as at 31st December, 2006 were as follows:

Liabilities		R&S	T	Assets		R&S	T
Sundry creditors		15,000	37,500	Cash		300	700
Bank overdraft		5,000	32,000	Debtors	35,000		
Bills payable		—	3,000	Less: Provision	1,500	33,500	25,000
Loan		—	10,500	Stock		21,200	26,300
Capital Accounts:				Investment		—	27,000
R	20,000			T's Capital (over drawn)		—	4,000
S	15,000	35,000	——				
		55,000	83,000			55,000	83,000

The new partnership is to be carried on as R, S and T and it was agreed among all the partners that the book debts of both the businesses should be provided with bad debts provisions at 10% and the stock to be reduced by 5% for the purpose of amalgamation and that the investments of T should be valued at Rs.35, 000 and that T was credited with a sum of Rs.5, 000 for goodwill. It was further agreed that in order to raise the total capital of the firm to Rs.60, 000, each partner shall introduce such sum as would make his capital in the new business equal to one third of the capital.

Give journal entries in the books of the new firm and show amalgamated Balance Sheet as at 1st January 2007.

Solution:

Books of the New Firm

1. Cash A/C	Dr	300

Debtors A/C	Dr	35,000		
Stock A/C (21,200-1,060)	Dr	20,140		
To Sundry Creditors			15,000	
To Bank Overdraft			5,000	
To RBD			3,500	
To R's Capital			18,470	
To S's Capital			13,470	

(Being the assets and liabilities of old firm acquired)

R's Capital 20,000 – 1,530 (loss on revaluation) :		18,470
S's Capital 15,000 – 1,530 (loss on revaluation):		13,470
Loss on Revaluation: RBD = 3,500 – 1,500	2,000	
Stock	1.060	
	3.060	

R's share 3,060/2 =1,530

S's share 3,060/2 =1,530

2. Cash A/C	Dr	700	
Debtors A/C	Dr	25,000	
Stock A/C (26,300 – 1,315)	Dr	24,985	
Investments A/C	Dr	35,000	
Goodwill A/C	Dr	5,000	
To RBD			2,500
To Sundry Creditors			37,500
To Bank overdraft			32,000
To Bills payable			3,000
To Loan			10,500
To T's Capital			5,185

(Being the assets and liabilities of old firm acquired)

T's Capital 4,000

Profit revaluation:

	Goodwill	5,000		
	Investment	8,000		
		13,000		
less: RBD 2,500				
Stock 1,315		3,815	9,185	
	Capital		**5,185**	
3. Cash A/C		Dr	22,875	
To R's Capital (20,000 – 18,470)				1,530
To S's Capital (20,000 – 13,470)				6,530
To T's Capital (20,000 – 5,135)				14,815

(Being the partners brings cash to make their capital Rs.20, 000 each)

Balance Sheet of R, S and T as on 1-1-2007

Liabilities			Assets
Capitals:		Cash (300+700+22,875)	23,875
R	20,000	Debtors 60,000	
S	20,000	Less: RBD10% 6,000	54,000
T	20,000	Stock (20,140 + 24,985)	45,125
Sundry Creditors	52,500	Investments	35,000
Bank overdraft	37,000	Goodwill	5,000
Loan	10,500		
Bills payable	3,000		
	1, 63,000		**1,63,000**

Illustration 5:

X &Co. having X and Y as equal partners decided to amalgamate with P& Co. having P and Q as equal partners on the following terms and conditions:

1. The new firm to take investments at 10% depreciation, land at Rs.80,000, premises at Rs.45,000, Machinery at Rs.9,000 and to take over only the trade liabilities of both the firms. The debtors are taken over at book values including reserve.

2. The new firm to pay Rs.12, 000 to each firm for goodwill.

3. Typewriters at the written off value of Rs.800, belonging to P & Co. and not appearing in the Balance Sheet was also not taken over by the new firm.

4. It was also agreed that the furniture belonging to both the firms be not taken over by the new firm.

5. All the four partners in the new firm to bring in Rs.1, 60,000 as capital in equal shares.

The following were the Balance Sheets of both the firms on the date of amalgamation.

Balance Sheets

Liabilities	X&Co.	Y&Co.	Assets	X&Co.	Y&Co.
Sundry Creditors	20,000	10,000	Cash at Bank	15,000	8,000
Bills payable	5,000	———	Investments	10,000	8,000
Bank Overdraft	2,000	10,000	Debtors 10,000		
X's Loan	6,000		Less:Provision 1,000	9,000	8,000
Capitals:			Furniture	12,000	6,000
X	35,000	—	Premises	30,000	———
Y	22,000	—	Land	————	50,000
P	——	36,000	Machinery	15,000	———
Q	——	20,000	Goodwill	9,000	——
General Reserve	8,000	3,000			
Investment fluctuation					
Fund	2,000	1,000			
	1, 00,000	**80,000**		**1, 00,000**	**80,000**

Pass journal entries in the books of both the firms and prepare a Balance Sheet of the new firm.

Solution:

Books of X&Co.

1. P& L Adj. A/C	Dr	6,000	
Investment fluctuation fund A/C		1,000	
To Machinery			6,000
To Investment			1,000

(Being the assets depreciated and decrease in investment value adjusted in investment reserve)

2. Premises A/C	Dr	15,000	
To P&L Adj.A/C			15,000

(Being the asset appreciated)

3. P&L Adj. A/C	Dr	9,000	
To X's Capital			4,500
To Y's Capital			4,500
(Being the profit on revaluation shared)			
4. General Reserve AC	Dr	8,000	
Investment fluctuation fund A/C	Dr	1,000	
To X's Capital			4,500
To Y's Capital			4,500
(Being the reserve and balance in investment fund shared to partners)			
5. Goodwill A/C	Dr	3,000	
To X's Capital			1,500
(Being the goodwill adjusted)			
6. Bank overdraft A/C	Dr	2,000	
X's Loan A/C	Dr	6,000	
To X's Capital			4,912
To Y's Capital			3,088
(Being the liabilities not taken over by the new firm transferred to capital accounts in their capital ratio i.e. 35:22)			
7. X's Capital A/C	Dr	7,368	
Y's Capital A/C	Dr	4,632	
To Furniture			12,000
(Being the asset not taken over debited to capital accounts)			
8. New Firm A/C	Dr	74,000	
Bills payable A/C	Dr	5,000	
Creditors A/C	Dr	20,000	
Reserve for bad debts A/C	Dr	1,000	
To Bank			15,000
To Investments			9,000
To Debtors			10,000

To Premises			45,000
To Machinery			9,000
To Goodwill			12,000

(Being the assets and liabilities transferred to new firm)

9. X's Capital A/C	Dr	43,044	
Y's Capital A/C	Dr	30,956	
To New Firm			74,000

(Being the capitals transferred to new firm)

Working Notes:

Goodwill value to be raised is Rs.12, 000 but already Rs.9, 000 is appearing in the Balance Sheet. The difference only can be adjusted.

Capital Accounts

	X	Y		X	Y
To Furniture	7,368	4,632	By Balance	35,000	22,000
To New Firm	43,044	30,956	By P&L Adj. A/C	4,500	4,500
			By Gel. Reserve &		
			Investment fund	4,500	4,500
			By Goodwill	1,500	1,500
			By Liabilities	4,912	4,912
	50,412	**35,588**		**50,412**	**35,558**

Books of P&Co.

1. Typewriter A/C	Dr	800	
Land A/C	Dr	30,000	
To P&L Adj. A/C			30,800

(Being asset revalued and unrecorded asset taken into the books)

2. Investment fluctuation fund A/C	Dr	800	
To Investments			800

(Being the asset revalued and difference adjusted out of reserve)

3. P&L Adj. A/C	Dr	30,800	
To P's Capital			15,400
To Q's Capital			15,400

(Being the profit on revaluation shared to partners)

4. General Reserve A/C	Dr	3,000	
Investment fluctuation fund A/C	Dr	200	
To P's Capital			1,600
To Q's Capital			1,600

(Being the reserve and balance in investment fund shared)

5. Goodwill A/C	Dr	12,000	
To P's Capital			6,000
To Q's Capital			6,000

(Being the goodwill created)

6. P's Capital A/C	Dr	4,371	
Q's Capital A/C	Dr	2,429	
To Furniture			6,000
To Typewriter			6,000

(Being the assets not taken over by the new firm debited to capital of partners in their capital sharing ratio of 9:5)

7. Bank overdraft A/C	Dr	10,000	
To P's Capital			6,429
To Q's Capital			3,571

(Being the liability not taken over credited to capitals)

8. Creditors A/C	Dr	10,000	
New Firm A/C	Dr	1,05,200	
To Bank			8,000
To Investments			7,200

To Debtors			8,000
To Land			80,000
To Goodwill			12,000
(Being the assets and liabilities transferred to new firm)			
9. P's Capital A/C	Dr	61,058	
Q's Capital A/C	Dr	44,142	
To New Firm			1,05,200
(Being the capitals transferred to new firm)			

Working Notes:

Capital Accounts

	P	Q		P	Q
To Furniture& Type Writer	4,371	2,429	By Balance	36,000	20,000
To New Firm	61,058	44,142	By P&L Adj.A/C	15,400	15,400
			By Gen. Reserve	1,600	1,600
			By Goodwill	6,000	6,000
			By Overdraft	6,429	3,571
	65,429	**46,571**		**65,429**	**46,571**

Books of New Firm

Balance Sheet of the New Firm

Liabilities		Assets			
Capitals:		Cash at Bank(see working notes)			3,800
X	40,000	Investments			16,200
Y	40,000	Debtors	18,000		
P	40,000	Less:Provision		1,000	17,000
Q	40,000	Machinery			9,000
Creditors	30,000	Premises			45,000
Bills payable	5,000	Land			80,000
		Goodwill			24,000
	1, 95,000				**1, 95,000**

Working Notes:

	X	Y	P	Q
Capitals transferred	43,044	30,956	61,058	44,142
Capitals in the new firm	40,000	40,000	40,000	40,000
Cash payable or to brought in	3,044	- 9,044	21,058	4,142

Cash at Bank:	Balance transferred		23,000
	Cash brought in by Y		9,044
			32,044
Less: Cash paid to X		3,044	
	P	21,054	
	Q	4,142	28,244
			3,800

Illustration 6:

The Balance Sheets of Sun and Moon and A and B as on 31st December 2007 were as follows:

	S&M	A&B		S&M	A&B
Captials:			Land & Workshops	50,000	60,000
Sun	50,000		Machinery& Tools	35,000	40,000
Moon	50,000		Furniture&Fixtures	15,000	17,500
A		50,000	Sundry Debtors	30,000	42,500
B		50,000	Stock	40,000	50,000
Creditors	75,000	50,000	Cash at Bank	1,500	5,000
Loan		50,000			
Outstanding expenses	10,000	15,000			
	1, 85,000	**2, 15,000**		**1, 85,000**	**2,15,000**

The two firms decided to amalgamate and form in S, M, A & B Co. with effect from 1st January 2007. Partners would share equally between themselves as they were doing prior to amalgamation and they agreed to the following revaluation of assets and liabilities:

	Sun & Moon	A & B
Land and Workshops	50,000	50,000
Machinery and Tools	35,000	40,000

Furniture and Fixtures	12,500		12,500	
Sundry debtors	27,500		35,000	
Stock	40,000		40,000	
Outstanding expenses		10,000		10,000

In addition to the above it was decided —

i) That the new firm would not take over the loan of A&B which is taken over by the two partners equally.

ii) That the goodwill of Sun & Moon and A&B was valued at Rs.50, 000 and Rs.25, 000 respectively in the first instance but for the purpose o the Balance Sheet of the new firm the combined goodwill could be valued at Rs.60,000.

iii) That the reconstructed capitals of partners should be Rs.70, 000 each, introducing cash if necessary.

You are required to show the profit and loss adj. accounts of amalgamating firms and partners capital accounts before and after amalgamation and the balance sheet of the new firm.

Solution:

Books of Sun and Moon

P & L Adjustment Account

To Furniture A/c	2,500	By Sun Capital A/C	2,500
To RBD	2,500	By Moon Capital A/C	2,500
	5,000		**5,000**

Sun Capital Account

To P&L Adj. A/C	2,500	By Balance	50,000
To New Firm	72,500	By Goodwill (1/2 of 50,000)	25,000
	75,000		**75,000**

Moon Capital Account

To P&L Adj. A/C	2,500	By Balance	50,000
To New Firm	72,500	By Goodwill (1/2 of 50,000)	25,000
	75,000		**75,000**

Books of A and B

P & L Adj. Account

To Land	14,000	By A's Capital	17,500

To Furniture	5,000	By B's Capital	17,500
To RBD	7,500		
To Stock	10,000		
To Outstanding expenses	2,500		
	35,000		**35,000**

A's Capital Account

To P & L	17,500	By Balance	50,000
To New Firm	70,000	By Goodwill	12,500
		By Loan (not taken over)	25,000
	87,500		**87,500**

B's Capital Account

To P & L Adj. A/C	17,500	By Balance	50,000
To New Firm	70,000	By Goodwill	12,500
		By Loan (not taken over)	25,000
	87,500		**87,500**

Books of New Firm

Balance Sheet of New Firm as on 1-1-2007

Liabilities			Assets		
Capitals:			Land and Workshops		1,00,000
Sun	70,000		Machinery		75,000
Moon	70,000		Furniture		25,000
A	70,000		Debtors	72,500	
B	70,000		Less: Provision	10, 000	62,500
Creditors	1,25,000		Stock		80,000
Outstanding expenses		27,500	Goodwill		60,000
			Cash (see working notes)		30,000
	4, 32,500				**4, 32,500**

Working Notes:

Goodwill transferred from old firm 50,000+25,000 75000

Less: Goodwill to be shown in the Balance Sheet	60,000			
Goodwill to be written off from Capital Accounts	15,000			
	Sun	Moon	A	B
Capital transferred to New Firm	72,500	72,500	70,000	70,000
Less: Goodwill share (15,000 x ¼)	3,750	3,750	3,750	3,750
	68,750	**68,750**	**66,250**	**66,250**
Cash to be brought in	1,250	1,250	3,750	3,750
Capital of the partners in the New Firm	**70,000**	**70,000**	**70,000**	**70,000**

Debtors:

Transferred from old firm	30,000 + 42,500	72,500
Less RBD transferred	2,500 + 7,500	10,000
		62,500

Cash Balance:

Balance transferred from old firms 15,000 + 5,000	20,000	
Add: Cash brought in by the partners		10,000
	30,000	

11.4: Try yourself:

1. A and B who are in partnership sharing profits and losses in the proportion of three-fifths and two-fifths respectively, decided to admit into partnership C who is trading alone in the same line. Their Balance Sheets on the 31st December, 2006 are as follows:

Liabilities	A & B	C	Assets	A & B	C
A's Capital Account	1, 05,000		Cash	20,000	10,000
B's Capital Account	70,000		Book debts	65,000	2,500
C's Capital Account		20,000	Machinery	35,000	—
Creditors	15,000	7,500	Stock	70,000	15,000
Reserve	10,000				
	2, 00,000	**7,500**		**2, 00,000**	**27,500**

It is decided that C should be given a quarter share in the new firm, A and B sharing the balance in the old proportion. It is also agreed that C's assets and liabilities were to be taken over as per his balance sheet, but the following adjustments were to be made in A and B's balance sheet:

a) Debtors to be written off by Rs.15, 000.

b) Stocks to be written off by Rs.15, 000.

c) Machinery to be written off by Rs.5, 000.

C also agrees to pay privately to A and B by way of goodwill quarter share of A and B's profits for the last two years which were 2005 – Rs.27, 000; 2006 –Rs.33, 000. It was also decided that the partners' capitals in the new business shall be in the same proportion as they share profits.

Draw up the new firm's Balance Sheet as at 1st January 2007 and state a) the total cost to C for his share in the business, b) how much A and B will each receive for goodwill.

(A's Capital: Rs.76, 500; B's Capital: Rs.51, 000; C's Capital: Rs.42, 500; Total of Balance Sheet Rs.1, 92,500; C pays Rs.9, 000 to A and Rs.6, 000 to B as goodwill)

2. Singh and Khan have each been carrying on business as general merchants. They decide to amalgamate, and, henceforth, trade under the name of Singh & Khan, on the following terms:

1) Each partner shall have fixed capital of Rs.10, 000.

2) Singh's stock is to be brought in at Rs.3, 200 and Khan's at Rs.2, 700.

3) Provisions for bad debts are to be increased to 6 per cent on the debtors.

4) Khan's furniture is not to be taken over while Singh's furniture is to be taken at Rs.450.

5) Singh is to pay the loan from his son before amalgamation.

6) Any deficiency on the net assets brought in it's to be paid into the firm's bankers while any excess is to be withdrawn.

The Balance Sheets of Singh and Khan as on 31st December, 2007.

Liabilities	Singh	Khan	Assets		Singh		Khan
Creditors	1,200	2,100	Furniture and Fixtures		350		200
Loan from his son	600	—	Machinery		5,000		5,500
Capital	10,635	10,100	Stock in trade		3,400		2,800
			Debtors	2,750		3,025	
			Less: Provision	120	2,630	125	2,900
			Cash at Bank		1,055		800
	12,435	**12,200**			**12,435**		**12,200**

Give journal entries necessary to adjust each trader's books prior to amalgamation and the opening balance sheet of Singh and Khan.

(Khan pays: Rs.257; Singh receives: Rs.1, 090; Total of Balance Sheet: Rs.23, 300)

3. Two partnership firms, carrying on business under the styles of Black & Co. and White & Co. respectively, decide to amalgamate into Grey & Co. with effect from 1st April, 2007. The Balance Sheets are as follows:

Liabilities	Black & Co.	White & Co.	Assets	Black & Co.	White & Co
B's Capital	19,000		Plant and Machinery	10,000	
X's Capital		10,000	Stock in trade	20,000	5,000
Y's Capital		2,000	Sundry debtors	10,000	10,000
Sundry Creditors	10, 000	28,000	A's Capital	4,000	
Bank overdraft	15,000		Cash in hand		6,000
			Cash at bank		9,000
			Goodwill		10,000
	44,000	**40,000**		**44,000**	**40,000**

The following further information is given:

i) Goodwill of Black & Co. is to be valued on the basis of 3 years' purchase of the average profits for 3 years in excess of 10% of the total assets of the firm, the total assets being taken as on 31st March 2007 and the profits for the three preceding years were:

2004-05 Rs.11, 000 (after a credit of Rs.3, 000 in respect of claims raised in 2002-03)

2005-06 Rs.6, 000

2006-07 Rs.12, 000 (after a debit of Rs.1, 000 for loss by theft)

ii) X brings in Rs.8, 750 and Y Rs.16, 750 as fresh capital into the new firm but otherwise they will be deemed to have contributed capitals in proportion to their share in profits, taking the capitals and A and B in total as the base.

iii) A and B will bring or take cash to make their capitals in the profit sharing ratio.

iv) Goodwill will not remain in the books of Grey & Co.

v) Black & Co owes Rs.5, 000 to White & Co.

vi) Stock of Black & Co. includes Rs.10, 000 worth goods purchased from White & Co. whose practice is to sell goods at a margin of 25%.

vii) The two pairs of partners as between themselves will share profits in the ratio of 3:5 but the old profit-sharing ratios amongst the partners will remain undisturbed.

viii) B will make a gift of Rs.5, 000 to A towards his capital.

Prepare journal entries for White & Co. and the Balance Sheet of Grey & Co.

(Total of the balance sheet: Rs.71, 500)

4. A and B carry on independent business in provisions and their positions as at 30th September, 2007 are reflected in the Balance Sheets given below:

Liabilities	A	B	Assets	A	B
Creditors	1, 10,000	47,000	Stock in trade	1, 70,000	98,000
Payable expense	750	2,000	Sundry debtors	89,000	37,000

Bills payable	12,500	——	Cash at Bank	13,000	7,500
Capital Account	1, 53,000	95,500	Cash in hand	987	234
			Furniture	2,750	1,766
			Investments	513	—
	2, 76,250	**1, 44,500**		**2, 76,250**	**1, 44,500**

Both of them want to form a partnership firm form 1 October, 2007 on the following understanding:

a) The capital of the partnership would be Rs. 3 lakhs which would be contributed by them in the ratio 2:1.

b) The assets of the individual businesses would be evaluated by C at which the contribution due by A and B.

c) C gave his valuation report as follows: Business of A: Stock in trade to be written down by 15% and a portion of Sundry debtors amounting to Rs.9, 000 estimated unrealizable not to be assumed by a firm; furniture to be valued at Rs.2, 000 and investments to be taken at market value of Rs.1, 000.

   Assets of B: Stocks to written up by 10% and sundry debtors to be admitted at 85% of their value; rest of the assets to be assumed at their book value.

d) The firm is not to assume any creditors other than the dues on account of purchases made.

Prepare the opening Balance Sheet of the firm.

(A introduces Rs.8, 513 and B withdraws Rs.1, 750; Balance Sheet: Rs.4, 58, 750)

11.5: Summary:

Two partnership firms amalgamate themselves to reap economies and to avoid unnecessary competition between them. The assets and liabilities of the firms are revalued and capital accounts of the partners are adjusted accordingly after preparing profit and loss adjustment account. Closing the old firms, new balance sheet of the new firm is prepared and new capital accounts are opened.

11.6: Glossary:

Amalgamation: Merging of two partnership firms into one single new firm is called amalgamation.

11.7: Self Assessment Questions:

1. How amalgamation takes place in partnership? And what is the procedure adopted while it is taking place?

Dr.R.Jayaprakash Reddy.

Lesson: 12

Partnership Accounts IV – Dissolution of a partnership firm

12.0 Objective:

After going through the lesson you will be able to understand the following:

1. Dissolution of partnership firm and partnership.
2. Modes of dissolution.
3. Accounting procedure for dissolution.
4. Selling a partnership firm to a company.

Structure:

12.1: Dissolution of Partnership firm – Introduction

12.2: Dissolution of Partnership and Partnership firm

12.3: Modes of dissolution of a Partnership Firm

12.4: Accounting Entries

12.5: Sale to a Company

12.6: Illustrations

12.7: Try yourself

12.8: Summary

12.9: Glossary

12.10: Self Assessment Questions

12.1: Dissolution of Partnership firm – Introduction:

In the foregoing lessons we have studied about partnership accounts relating to admission and retirement or death. In this lesson let us know about dissolution. Dissolution is nothing but closing down the business which is running at present. The existing partner ceased to do business and apart after taking their shares and thus the existing business with its present shape comes to an end. When there is a change in the partnership deed i.e. admission of a new partner or retirement or death of a partner, it is also a kind of dissolution. Closing the firm totally is no doubt dissolution. Selling a partnership firm to a company is also dissolution. Let us discuss all these aspects in this lesson.

12.2: Dissolution of Partnership and Partnership firm:

Any change in the relations of the partners is called *dissolution of partnership*. Thus, in all those cases where a partnership is reconstituted, there is dissolution of the partnership. For example, in case there is a partnership between X and Y, and a new partner Z is admitted, the partnership between X and Y comes to an end and a new partnership between X, Y and Z comes into existence. Hence, in dissolution of the partnership, the firm continues in a reconstituted form. Similarly, a retirement or death of a partner also leads to reconstitution of the partnership.

The dissolution of partnership among all the partners of a firm is called the *dissolution of the firm*. In this case, the business of the firm is closed down and its affairs are wound up. The assets are realized and the liabilities are paid off. The dissolution of a partnership may or may not result in the dissolution of a firm but the dissolution of a firm will necessarily result in the dissolution of the partnership.

12.3: Modes of dissolution of a Partnership Firm:

Partnership firm may be dissolved voluntarily or with the intervention of the court. Here in this lesson, we consider only voluntary dissolution. This dissolution may take place in any of the following ways:

1. **Dissolution by agreement:** A partnership firm comes into existence by mutual agreement and, therefore, it can be dissolved by the mutual consent of all the partners.

2. **Compulsory dissolution:** In the following cases a partnership firm will have to be compulsorily dissolved:

    a) by the adjudication of all the partners or of all the partners but one as insolvent, or

    b) by the business of firm becoming unlawful due to the happening of any such event.

3. **Dissolution on the happening of certain contingencies:** In the absence of any contract to the contrary, a firm will be dissolved on the happening of the following contingencies:

    a) on the expiry of the fixed period for which the firm was constituted,

    b) on the completion of the adventure or undertaking for the carrying out of which the firm was constituted.

    c) on the death of a partner; and

    d) on the adjudication of a partner as insolvent.

4. **Dissolution by notice:** When a partnership is at will, the firm may be dissolved by any partner giving a notice in writing to all the other partners of his intention to dissolve the firm. The firm will be taken to be dissolved from the date as specified in the notice, or if no date is mentioned from the date of the communication of the notice to the last of the partners.

In this lesson, only ***voluntary and mutual agreed dissolution*** related problems are discussed. At the time of dissolution, a realization account is prepared and all assets and liabilities are sold and paid off and the result of realization will be transferred to the capital accounts of the partners and finally, the partners' accounts are also be closed down. When partners take assets or responsibility of liabilities their capital accounts are adjusted accordingly.

12.4: Accounting Entries:

In the event of dissolution of a partnership firm, all its assets are sold away and liabilities paid off. A Realisation Account is opened in order to find out any profit or loss on realization of assets and making payment of liabilities.

Journal Entries:

1. For transfer of assets to Realisation Account:

Realisation A/C Dr

To Sundry Assets A/C

It is to be noted that when an asset is transferred to the Realisation Account, its corresponding provision or reserve appearing on the liabilities side of the balance sheet, will also be transferred to the Realisation Account. For example, Investments and Joint Life Insurance Policy appear on the assets side of the balance sheet while Investments Fluctuation Fund and Joint Life Insurance Policy Reserve appear on the liabilities side of the balance sheet. The accounting entries in the event of dissolution of the firm would be as follows:

a) Realisation A/C Dr

To Investments A/C

To Joint Life Insurance Policy A/C

b) Investments Fluctuation Fund A/C Dr

Joint Life Insurance Policy Reserve A/C Dr

To Realisation A/C

2. For transfer of liabilities to Realisation Account:

Liabilities A/C Dr

To Realisation A/C

All liabilities excluding partners' loans will be transferred at book values. Each liability should debit individually. This will close accounts of all liabilities transferred.

3. For Realisation of assets:

Cash/Bank A/C Dr

To Realisation A/C

4. For payment of liabilities:

Realisation A/C Dr

To Cash/Bank A/C

5. In case a partner takes an asset:

Partner's Capital A/C Dr

To Realisation A/C

6. In case a partner agrees to meet a liability:

Realisation A/C	Dr
To Partner's Capital A/C	

7. For expenses on Realisation:

Realisation A/C	Dr
To Cash/Bank	

8. For profit on Realisation:

Realisation A/C	Dr
To Partners' Capital A/Cs	

9. For paying off partner's loan:

Partner's Loan A/C	Dr
To Bank A/C	

10. For distribution of reserves, undistributed profits etc.

P & L A/C	Dr
Reserve A/C	Dr
To Partners' Capital A/Cs	

11. For cash brought in by a partner on account of his account showing a debit balance:

Cash/Bank A/C	Dr
To Partner's Capital A/C	

12. The credit balance in a partner's capital account will be paid off:

Partner's Capital A/C	Dr
To Cash/Bank A/C	

12.5: Sale to a Company:

Often, a partnership firm converts itself into a joint stock limited company or sells its business to an existing one. Broadly, the procedure already discussed above will be followed for closing the books of the firm. Realization Account will be opened and assets transferred to it, so also liabilities as per the agreement reached with the company. Whatever the company pays as purchase consideration will be credited to the Realisation Account. If expenses are incurred by the firm, the amount will be debited to Realisation Account. If the creditors are taken over by the company, no further treatment is necessary except transferring them to Realisation Account. But if the creditors are to be paid by the firm, the actual amount paid to them will be debited to liability account concerned; the difference between the book figure and the amount actually paid should be transferred to the Realisation Account. The profit or loss on realization will be transferred to the capital accounts in the profit-sharing ratio.

Usually, the company takes over all the assets including cash. Therefore, cash should also be transferred to Realisation Account. Otherwise, it will not be transferred. Normally, the company will discharge the amount due from it in the form of cash, debentures and shares. Separate accounts will be opened for debentures and shares received. Partners will divide the debentures and shares among themselves, in absence of an express agreement, *in the ratio of their final claims*, that is to say, in the ratio of capitals standing after the loss or profit on realization has been transferred. Further, since no fraction of a share or debenture can be issued, the nearest whole number being made in cash. If there is an agreement to divide the shares or debentures in a particular manner, the agreement should be followed.

It is to be noted that if there is some valueless assets in the books of the firm and if this has to be divided among the partners, it should be divided in the profit-sharing ratio so that any ultimate profit or loss may correspond to the ratio in which profits are shared.

12.6: Illustrations:

Illustration 1:

The Balance Sheet of a firm showed the following position as on 31st December, 2007.

Liabilities				Assets
Partners Capitals:			Buildings	40,000
D	25,000		Investments	10,000
E	20,000		Debtors	5,000
F	15,000	60,000	Bank Balance	15,000
Sundry Creditors		10,000		
		70,000		**70,000**

The partnership was dissolved on 31-12-2007. Creditors were paid at 5% discount. D agreed to take over buildings at Rs.45, 000, E took over investments at Rs, 26,000 and F took debtors at Rs.3, 000.

Show necessary accounts in the firm's books.

Solution:

Realisation Account

To Buildings		40,000	By Creditors	10,000
To Investments		10,000	By D's Capital – Buildings	45,000
To Debtors		5,000	E's Capital – Investments	26,000
To Cash – Creditors		9,500	F's Capital – Debtors	3,000
To D's Capital – profit	6,500			
To E's Capital – profit	6,500			

To F's Capital – profit 6,500	19,500		
	84,000		**84,000**

D's Capital Account

To Realisation A/C	45,000	By Balance B/D	25,000
		By Realisation A/C	6,500
		By Cash	13,500
	45,000		**45,000**

E's Capital Account

To Realisation A/C	26,000	By Balance B/D	20,000
		By Realisation A/C	6,500
	26,500		**26,500**

F's Capital Accounts

To Realisation A/C	3,000	By Balance B/D	15,000
To Cash	18,500	By Realisation A/C	6,500
	21,500		**21,500**

Cash Account

To Balance B/D	15,000	By Realisation A/C	9,500
To D's Capital	13,500	By E's Capital A/C	500
		By F's Capital A/C	18,500
	28,500		**28,500**

Illustration 2:

The following was the Balance Sheet of Raja and Sudhir as on 31st December, 2007.

Liabilities		Assets		
Sundry Creditors	38,000	Cash at Bank		11,500
Mrs. Raja's Loan	10,000	Stock in trade		6,000
Sudhir's Loan	15,000	Sundry Debtors	20,000	
Reserve Fund	5,000	Less: Provisions	1,000	19,000
Raja's Capital	10,000	Furniture & Fittings		4,000
Sudhir's Capital	8,000	Machinery and Plant		28,000

		Investments	10,000
		Profit and Loss Account	7,500
	86,000		**86,000**

The firm was dissolved on 31st December, 2007 and the following was the result:

a) Raja took over investments, at an agreed value of Rs.8, 000 and agreed to pay of the loan of Mrs. Raja.

b) The assets realized the following:

Stock	5,000	Machinery and Plant	25,500
Expenses	1,100	Furniture & Fittings	4,500
Debtors	18,000		

c) The Sundry Creditors were paid off less 2 ½ % discount. Raja and Sudhir shared profits and losses in the ratio of 3:2. Journalise the entries to be made on the dissolution and show Realisation Account, Cash Account, and Partners' Capital Accounts.

Solution:

Journal Entries:

1. Realisation A/C	Dr	68,000	
To Stock			6,000
To Debtors			20,000
To Furniture & Fixtures			4,000
To Machinery			28,000
To Investments			10,000
(Being assets transferred to Realisation account)			
2. Bad debts Reserve A/C	Dr	10,000	
Creditors A/C	Dr	38,000	
Mrs. Raja's loan A/C	Dr	10,000	
To Realisation A/C			49,000
(Being liabilities transferred to Realisation account)			
3. Raja's Capital A/C	Dr	8,000	
To Realisation A/C			8,000
(Being investments taken over by Raja)			

4. Realisation A/C	Dr	10,000	
To Raja's Capital A/C			10,000
(Being the risk of payment for liability of Mrs. Raja taken over by Raja)			
5. Cash A/C	Dr	53,000	
To Realisation A/C			53,000
(Being the assets realized)			
6. Realisation A/C	Dr	1,100	
To Cash			1,100
(Being realization expenses paid)			
7. Realisation A/C	Dr	37,050	
To Cash			37,050
(Being liabilities paid)			
8. Reserve Fund A/C	Dr	5,000	
To Raja Capital			3,000
To Sudhir Capital			2,000
(Being reserve fund distributed)			
9. Raja Capital A/C	Dr	4,500	
Sudhir Capital A/C	Dr	3,000	
To Profit and Loss A/C			7,500
(Being loss distributed)			
10. Sudhir Loan A/C	Dr	15,000	
To Cash			15,000
(Being Sudhir's loan paid)			

Realisatin Account

To Sundry Assets	68,000	By Sundry Liabilities	49,000
To Raja Capital	10,000	By Raja Capital	8,000
To Cash – expenses	1,100	By Cash – Assets	53,000
To Cash – liabilities	37,050	By Raja Capital – loss	3,690
		By Sudhir Capital – loss	2,460
	1,16,150		**1,16,150**

Raja Capital Account

To Profit and Loss A/C	4,500	By Balance B/D	10,000
To Realisation A/C	8,000	By Reserve fund	3,000
To Realisation A/C – loss	3,690	By Realisation	10,000
To Cash A/C	6,810		
	23,000		**23,000**

Sudhir Capital Account

To Profit and Loss A/C	3,000	By Balance B/D	8,000
To Realisation A/C – loss	2,460	By Reserve fund	2,000
To Cash	4,540		
	10,000		**10,000**

Cash Account

To Balance B/D	11,500	By Realisation A/C	1,100
To Realisation A/C	53,000	By Realisation A/C	37,050
		By Sudhir's Loan	15,000
		By Raja Capital	6,810
		By Sudhir Capital	4,540
	64,500		**64,500**

Illustration 3:

A, B and C commenced business on 1st January 2006, with capitals of Rs.50,000, Rs.40,000 and Rs.30,000. Profits and losses were shared in the ratio of 4:3:3 capitals carried interest at 5% per annum. During 2006, and 2007, they made profits of Rs.20, 000, and Rs.25, 000 (before allowing interest). Drawings of each partner were Rs.5, 000 per year.

On 31st December 2007, the firm was dissolved. Creditors on that date were Rs.12, 000. The assets realized Rs.1, 30,000 net. Give necessary accounts to close the books of the firm.

Solution:

Balance Sheet of the firm as on 31-12-2007

Liabilities			Assets	
Creditors		12,000	Sundry Assets	1, 47,000
Joint Capital (A, B & C)			(Bal. Fig)	
On 1-1-2006	1, 20,000			

Add: 2 years' profits	45,000		
	1, 65,000		
Less: 2 years' drawings	30,000	1, 35,000	
		1, 47,000	**1,47,000**

Which means Rs.1, 47,000 worth of assets was realized Rs.1, 30,000.

To ascertain the capital of each partner, capital accounts should be prepared for 2006 and 2007.

A's Capital Account

	To Drawings	5,000	1-1-2006	By Cash	50,000
31-12-2006	To Balance C/D	53,100	31-12-2006	By Interest	2,500
				By P & L A/C	5,600
		58,100			**58,100**
	To Drawings	5,000	1-1-2007	By Balance B/D	53,100
31-12-2007	To Realisation A/C	6,800	31-12-2007	By Interest	2,655
				By P & L A/C	7,500
		63,255			**63,255**

B's Capital Account

	To Drawings	5,000	1-1-2006	By Cash	40,000
31-12-2006	To Balance C/D	41,200	31-12-2006	By Interest	2,000
				By P & L A/C	4,200
		46,200			**46,200**
	To Drawings	5,000	1-1-2007	By Balance B/D	41,200
31-12-2007	To Realisation A/C	5,100	31-12-2007	By Interest	2,060
	To Cash	38,785		By P & L A/C	5,625
		48,885			**48,885**

C's Capital Account

	To Drawings	5,000	1-1-2006	By Cash	30,000
31-12-2006	To Balanace C/D	30,700	31-12-2006	By Interest	1,500
				By P & L A/C	4,200
		35,700			**35,700**

	To Drawings	5,000	1-1-2006	By Balance B/D	30,700
31-12-2007	To Realisation A/C	5,100	31-12-2007	By Interest	1,535
	To Cash	27,760		By P & L A/C	5,625
		37,860			**37,860**

Realisation Account

To Sundry Assets	1,47,000	By Creditors	12,000
		By Cash – Assets	1,30,000
To Cash – Creditors	12,000	By A's Capital	6,800
		By B's Capital	5,100
		By C's Capital	17,000
	1,59,000		**1,59,000**

Cash Account

To Realisation A/C - (Assets realized)	1,30,000	By Realisation A/C - (Creditors paid)	12,000
		By A's Capital	51,455
		By B's Capital	38,785
		By C's Capital	27,760
	1,30,000		**1,30,000**

Illustration 4:

A, B and C decided to dissolve their partnership on 30th June, 2007. Their Balance Sheet is as follows:

Liabilities		Assets	
Creditors	3,400	Cash at Bank	2,500
Capitals:		Debtors	6,200
A	12,000	Stock	3,700
B	9,000	Loose Tools	800
C	6,000	Plant and Machinery	6,000
		Freehold premises	10,000
	30,400		30,400

B and C agreed to form a new partnership to carry on the business and it is agreed that they shall acquire from the old firm the following assets at figures shown below:

Stock	4,000
Loose Tools	500
Motor Vehicles	2,500
Plant and Machinery	7,800
Freehold premises	8,400
Goodwill	6,000

The partnership agreement of A, B and C provide that trading profit and loss shall be divided in the ratio of 3:2:1 and that capital profits or losses shall be divided in proportion of their respective capitals.

Debtors realize Rs.5, 900 and discounts amounting to Rs.72 are secured on payments due to creditors.

Prepare the necessary accounts of A, B and C giving effect to these transaction and draw up the opening Balance Sheet of B and C bring the necessary cash to pay A in the ratio of 3:2.

Solution:

Realisation Account

To Debtors		6,200	By Creditors		3,400
To Stock		3,700	By B & C Joint Account:		
To Loose Tools		800	Stock	4,000	
To Motor Vehicles		1,200	Loose Tools	500	
To Plant and Machinery		6,000	Vehicles	2,500	
To Freehold Premises		10,000	Plant	7,800	
To Cash – Creditors (3,400-72)		3,328	Freehold	8,400	
To A's Capital	3,236		Goodwill	6,000	29,200
To B's Capital	2,424		By Cash – debtors		5,900
To C's Capital	1,612	7,272			
		38,500			**38,500**

The profit realized on Stock, Bills receivable, Bills payable and Creditors is revenue profit or trading profit.

The profit realized on other fixed assets is capital profit.

Profit on Stock	300
Profit on Creditors	72
	372
Loss on debtors	300
Trading profit or Revenue profit	72

A's Share 72 x ½ = 36

B's Share 72 x 1/3 = 24

C's Share 72 x 1/6 = 12

Total Profit on realization	7,272
Less: Trading Profit	72
Capital Profit	7,200

A's Share 7,200 x 4/9 =	3,200
B's Share 7,200 x 3/9 =	2,400
C's Share 7,200 x 2/9 =	1,600
Total Profit to A	3,200 + 36 = 3,236
Total Profit to B	2,400 + 24 = 2,424
Total Profit to C	1,600 + 12 = 1,612

B & C Joint Account

To Realisation A/C	29,200	By B's Capital A/C	17,523
		By C's Capital A/C	11,677
	29,200		**29,200**

Cash Account

To Balance	2,500	By Realisation – Creditors	3,328
To Realisation – Debtors	5,900	By A's Capital	15,236
To B's Capital	6,099		
To C's Capital	4,065		
	18,564		**18,564**

A's Capital Account

To Cash – payment	15,236	By Balance	12,000
		By Realisation	3,236
	15,236		**15,236**

B's Capital Account

To B & C Joint A/C	17,523	By Balance	9,000

		By Realisation	2,424
		By Cash	6,099
	17,523		**17,523**

C's Capital Account

To B & C Joint A/C	11,677	By Balance	6,000
		By Realisation	1,612
		By Cash	4,065
	11,677		**11,677**

Books of New Firm

Balance Sheet of B & C

Liabilities			Assets
Capitals:		Stock	4,000
B	17,523	Loose Tools	500
C	11,677	Motor Vehicles	2,500
		Plant and Machinery	7,800
		Freehold Premises	8,400
		Goodwill	6,000
	29,200		**29,200**

Working Notes:

Cash available as per Balance Sheet		2,500
Add: Realisation on Debtors	5,900	
	8,400	
Less: Payment to creditors	3,328	
Cash available to pay to A	5,072	
Cash required to pay to A	15,236	
Cash brought by B & C in the ratio of 3:2	10,164	

B = 10,164 x 3/5 = 6,099

C= 10,164 x 2/5 = 4,065

Illustration 5:

Rao, Gopi and Krishna are partners of a firm of Chartered Accountants having office at Nagpur, Pune and Goa, sharing profits and losses in the ratio of 5:3:2 respectively. The statement of affairs of the firm as at 31st March, 2007 is shown below:

Capital Accounts:		
Rao		1,50,000
Gopi		1,20,000
Krishna		60,000
Current Accounts:		
Rao		75,500
Gopi	25,750	
Krishna	11,150	
Accounts payable		49,150
Accounts receivable:		
Nagpur	1,20,000	
Pune	86,250	
Goa	98,750	
Goodwill	50,000	
Cash in hand	5,750	
Cash with bank	57,000	

On that date, Rao desires to retire from the firm and other two partners agree and it is decided that Gopi would take over the Nagpur and Pune offices and Krishna would take over the Goa office with respective assets and liabilities. You are given the following additional information:

a) Rao's share of goodwill is valued at Rs.1,50,000 and this would be brought by Gopi and Krishna in their profit sharing ratios.

b) Accounts payable include rent of the Goa office for the months of February and March 2007 at the monthly rate of Rs.2,500 and the balance represents outstanding expenses of Nagpur and Pune offices.

c) Cash in hand is to be utilized to pay Rao and other settlements to take place before 1st May, 2007.

d) Accounts receivable to be discounted by 2%.

Draw up the necessary accounts to give effect to the above and also the books of the firm.

Solution:

Realisation Account

To Accounts receivable A/C:		By Accounts payable	49,150
Nagpur	1,20,000	By Gopi's Capital A/C	2,02,125
Pune	86,250	(Assets taken)	
Goa	98,750	By Krishna's Capital A/C	96,775
To Gopi's Capital A/C	44,150	By Gopi's Capital A/C – loss	16,830
To Krishna 's Capital A/C	5,000	By Krishna's Capital A/C – loss	11,200
Goodwill	50,000	By Rao's Capital A/C – loss	28,050
	4, 04,150		**4, 04,150**

Rao's Capital Account

To Realisation A/c	28,050	By Balance	1,50,000
To Cash – payment	3,47,450	By Current A/C – transfer	75,500
		By Gopi's Capital – goodwill	90,000
		By Krishna's Capital – goodwill	60,000
	3,75,500		**3,75,500**

Gopi's Capital Account

To Current A/C – transfer	25,750	By Balaance	1,20,000
To Realisation – loss	16,830	By Realisation – liability	44,150
To Realisation – assets taken	2,02,125	By Cash – introduced	1,70,555
	3,34,705		**3,34,705**

Krishna's Capital Account

To Current A/C – transfer	11,150	By Balance	60,000
To Realisation – loss	11,220	By Realisation – liability	5,000
To Realisation – assets taken	96,775	By Cash – introduced	1,14,195
	1,79,145		**1,79,145**

Cash Account

To Balance : Bank	57,000	By Rao's Capital	3,47,450
Cash	5,750		

To Gopi's Capital	1,70,555		
To Krishna's Capital	1,14,145		
	3,47,450		**3,47,450**

Working Notes:

Assets taken over by partners:

	Gopi (Nagpur and Pune offices)	Krishna (Goa office)
Accounts receivable (1,20,000 + 86,250)	2,06,250	98,750
Less: 2% discount	4,125	1,975
Net value of Assets taken over (to be debited to Capitals and creditors to Realisation A/C)	2, 02,125	96,775

Liabilities:

Accounts payable	49,150
Less; 2 months rent of Goa office @ 2,500 per month	5,000
Liabilities of Nagpur and Pune offices	44,150

That is liabilities taken over by Gopi: Rs.44, 150 (to be credited capital and debited to Realisation Account0

Liabilities taken over by Krishna Rs.5, 000.

Goodwill: The balance appearing in the Trial Balance is to be transferred to Realisation account to write off it, and Rao's share of Goodwill is credited him and debited to Gopi and Krishna in their profit sharing ratio.

Cash: Gopi and Krishna brought cash as their capital accounts shown debit balance. The existing cash balance and the amount brought in by Gopi and Krishan is utilized to pay off Rao's claim.

Current Accounts: The balance in Current Accounts is transferred to respective sides of Capital Accounts and all the adjustments wee carried out through Capital Accounts.

Sale to a company:

Illustration 6:

The Balance Sheet of Young and Active sharing 5/8 and 3/8 respectively stood as follows, when they determined to sell of their business to a newly started Joint Stock Company:

Liabilities		Assets	
Young Capital	60,000	Machinery	32,000

Active Capital	36,000	Debtors	20,000
Reserve	8,000	Stock	64,000
Creditors	16,000	Cash	4,000
	1, 20,000		**1, 20,000**

The company takes over all the assets except cash for Rs.1, 20,000 of which Rs.80, 000 payable in shares of the company and Rs.40, 000 in cash. The expenses of realization amounted to Rs.720 and the creditors were paid off at 5% discount.

Pass journal entries and open realization, cash and capital accounts in the books of the firm.

Solution:

Journal Entries:

1. Realisation A/C	Dr	1,16,000	
To Machinery			32,000
To Debtors			20,000
To Stock			64,000
(Being assets transferred to realization account)			
2. Creditors A/C	Dr	16,000	
To Realisation			16,000
(Being creditors transferred to realization accounts)			
3. Company A/C	Dr	1,20,000	
To Realisation			1,20,000
(Being the assets sold)			
4. Cash A/C	Dr	40,000	
Shares A/C	Dr	80,000	
To Company			1,20,000
(Being the purchase consideration received)			
5. Realisation A/C	Dr	720	
To Cash			720
(Being expenses paid)			
6. Realisation A/C	Dr	15,200	

To Cash			15,200
(Being creditors paid with 5% discount)			
7. Reserve A/C	Dr	8,000	
To Young's Capital			5,000
To Active's Capital			3,000
(Being Reserve distributed)			
8. Realisation A/C	Dr	4,080	
To Young's Capital			2,550
To Active's Capital			1,530
(Being profit on realization distributed)			
9. Young's Capital A/C	Dr	50,000	
Active's Capital A/C	Dr	30,000	
To Shares			80,000
(Being shares distributed in the final capital ratio)			
10. Young's Capital A/C	Dr	17,550	
Active's Capital A/C	Dr	10,530	
To Cash			28,080
(Being final settlement made)			

Realisation Account

To Machinery		32,000	By Creditors	16,000
To Debtors		20,000	By Company	1,20,000
To Stock		64,000		
To Cash – expenses		720		
To Cash – creditors		15,200		
To Young's Capital	2,550			
To Active's Capital	1,530	4,080		
		1,36,000		**1,36,000**

Cash Account

To Balance B/D	4,000	By Realisation A/C	720

To Company A/C	40,000	By Realisation A/C		15,200
		By Young's Capital	7,500	
		By Active's Capital	10,530	28,080
	44,000			**44,000**

Shares Account

To Comapany A/C	80,000	By Young's Capital	50,000
		By Active Capital	30,000
	80,000		**80,000**

Young's Capital Account

To Shares	50,000	By Balance B/D	60,000
To Cash	17,550	By Realisation A/C	2,550
		By Reserve	5,000
	67,550		**67,550**

Active's Capital Account

To Shares	30,000	By Balanace B/D	36,000
To Cash	10,530	By Realisation A/C	1,530
		By Reserve	3,000
	40,530		**40,530**

Working Notes:

Final Capital Ratio: 67,550: 40,530

5: 3

Note: shares should be distributed first in the final capital ratio.

Illustration 7:

Ram and Shyam are in partnership sharing profits and losses in the ratio of two-thirds and one-thirds respectively. Their Balance Sheet as on 31st December 2007, on which date they agreed to convert their business into a limited company was as follows:

Balance Sheet

Liabilities		Assets	
Sundry Creditors	30,000	Cash	7,000
Mortgage on Freehold premises	10,000	Sundry Debtors	26,000

Capitals:				Stock	16,000
	Ram	20,000		Plant	5,000
	Shyam	10,000	30,000	Freehold premises	16,000
			70,000		70,000

The company takes over all the assets and liabilities with the exception of the mortgage loan purchase price being Rs.60, 000, payable as to Rs.12, 000 in cash, Rs.24, 000 in debentures and the balance in equity shares of the company.

Close the books of the firm after the above transactions have been carried out including the payment of mortgage. The partners agree to share the debentures and shares in proportion to their capitals.

Solution:

Purchase Consideration:

In the form of cash	12,000
In the form of debentures	24,000
In the form of equity shares	24,000
	60,000

Realisation Account

To Cash		7,000	By Creditors	30,000
To Debtors		26,000	By Company A/C	60,000
To Stock		16,000		
To Plant		5,000		
To Freehold premises		16,000		
To Ram's Capital	13,333			
To Shyam's Capital	6,667	20,000		
		90,000		**90,000**

Company Accounts

To realization A/C	60,000	By Cash	12,000
		By Debentures	24,000
		By Shares	24,000
	60,000		**60,000**

Mortgage Loan Account

To Cash	10,000	By Balance B/D	10,000
	10,000		**10,000**

Cash Account

To Company A/C	12,000	By Mortgage Loan	10,000
		By Ram's Capital	1,333
		By Shyam's Capital	667
	12,000		**12,000**

Debentures Account

To Company A/C	24,000	By Ram's Capital	16,000
		By Shyam's Capital	8,000
	24,000		**24,000**

Shares Account

To Company A/C	24,000	By Ram's Capital	16,000
		By Shyam's Capital	8,000
	24,000		**24,000**

Ram's Capital Account

To Debentures	16,000	By Balance B/D	20,000
To Shares	16,000	By Realisation A/C	13,333
To Cash	1,333		
	33,333		**33,333**

Shyam's Capital Account

To Debentures	8,000	By Balance B/D	10,000
To Shares	8,000	By Realisation A/C	6,667
To Cash	667		
	16,667		**16,667**

Illustration 8:

Rao and Reddy carry on business in partnership wished to dissolve the firm and sell off the business to a limited company on 31st December, 2006, when the firm's position was as under:

Sundry Creditors	21,250	Furniture	3,320
Rao's Capital	34,000	Stock	15,380
Reddy's Capital	17,000	Debtors	48,450
		Cash	5,100
	72,250		**72,250**

The arrangement with the limited company was as follows:

a) Furniture and stock were purchased at Balance Sheet values less 10%.

b) Goodwill of the firm was valued at Rs.10, 120.

c) The firm's debtors, cash and creditors were not to be taken over by the company, but the company agreed to collect the book debts and discharge the liabilities of the vendors as agent, for which services the company was to he paid 3% on all collections from the vendors' debtors and 2% on cash paid to Vendors' creditors.

d) The purchase price was to be discharged by the company in fully paid ordinary shares of Rs.100 each at a premium of Rs.10 per share.

The company received during the first two months after the purchase of business Rs.48, 000 from vendors' debtors in full satisfaction. The creditors were paid off less Rs.250 allowed by them as discount. The company paid the balance due to the vendors on March 1, 2007.

Ignore the question of interim distribution of cash write up the realization account, cash account and the capital accounts of the partners.

Solution:

Purchase Consideration:

Assets taken over:			
Furniture	3,320		
Less: 10%	332	2,988	
Stock	15,380		
Less: 10%	1,538	13,842	
Goodwill		10,120	
Purchase price			26,950

In the form of shares of Rs.110 each

Number of shares: 26,950/110 = 245

Cash collected by the company from debtor on behalf of the firm:	48,000
Less: Cash paid to creditors on behalf of the firm	21,000

			27,000
Cash due from the company			
Less: Commission 48,000 x 3/100		1,440	
21,000 x 2/100		420	1,860
Cash received from the company			25,140

Realisation Account

To Furniture	3,320	By Creditors	21,250
To Stock	15,380	By Company A/C	26,950
To Debtors	48,450	By Company A/C- cash due	25,140
To Rao's Capital 3,095			
To Reddy's Capital 3,095	6,190		
	73,340		**73,340**

Company Account

To Realisation A/C	26,950	By Shares – Company	26,950
To Realisation A/C	25,140	By Cash	25,140
	52,090		**52,090**

Shares Account

To Company A/C	26,950	By Rao's Capital	17,490
		By Reddy's Capital	9,460
	26,950		**26,950**

Cash Account

To Balance	5,100	By Rao's Capital	19,605
To Company A/C	25,140	By Reddy's Capital	10,635
	30,240		**30,240**

Rao's Capital Account

To Shares	17,490	By Balance B/D	34,000
To Cash	19,605	By Realisation A/C	3,095
	37,095		**37,095**

Reddy's Capital Account

To Shares	9,460	By Balance B/D	17,000
To Cash	10,635	By Realisation	3,095
	20,095		**20,095**

Note: Shares to be distributed first in the ratio of final claims of the partners =

37,095:20095 = 370: 201 (adjusted)

Shares to Rao = 245 x 371/572 = 17,490

Shares to Reddy = 245 x 201/572 = 9,460

The remaining claim to the partners should be paid in cash.

12.7: Try yourself:

1. Rahul and Kiran are partners sharing profits as 2:1. The position of the firm as on 31st December 2007 when they decided to dissolve the business was as follows:

Liabilities			Assets	
Sundry Creditors		15,000	Plant and Machinery	25,000
General Reserve		10,000	Furniture	4,000
Capital Accounts:			Stock	10,000
Rahul	22,000		Sundry Debtors	20,000
Kiran	22,000	44,000	Cash at Bank	10,000
		69,000		**69,000**

The realization shows the following result:

a) Rahul took over plant and machinery and furniture at book values less 10%.

b) Kiran took over the stock and goodwill at Rs.17, 500

c) Sundry debtors realized Rs.18, 500.

d) Sundry creditors wee settled at a discount of 5%.

Close the books of the firm.

(Rahul gets Rs.5, 134 and Kiran gets Rs.9, 116)

2. Lakshman, Mukund and Mohan sharing profits in the proportion of 3:2:1 agreed upon dissolution of their partnership on 31st December, 2007 on which date their Balance Sheet was as under:

Liabilities			Assets		
Capital Accounts:			Machinery		60,750
Lakshman	60,000		Stock in trade		11,325
Mukund	30,000	90,000	Investments		31,245
Mrs.Lakshman Loan		15,000	Joint Life Policy		21,000
Creditors		27,750	Debtors	13,950	
Life Policy Fund		21,000	Less: Provision	900	13,050
Investments fluctuation fund		9,000	Current Account – Mohan		17,250
			Cash at bank		8,130
		1, 62,750			**1,62,750**

The Life Policy is surrendered for Rs.18, 000. The investments are taken over by Lakshman for Rs.26, 250. Lakshman agrees to discharge his wife's loan. Mukund takes over all the stock at Rs.10, 500 and debtors amounting to Rs.7, 500 at Rs.6, 000. Machinery is sold for Rs.82, 500. The remaining debtors realize 50% of book value. The expenses of realization amount to Rs.900.

It is found that an investment not recorded in the books is worth Rs.3, 000. The same is taken over by one of the creditors at this value.

Show the necessary ledger accounts including the final accounts of the partners on completion of the disillusion of the firm.

(Realisation: Lakshma – Rs.21,353; Mukund – Rs.14,235; Mohan – Rs.7,117; Final settlement: Lakshman gets Rs.70,103; Mukund gets Rs.27,735; Mohan pays Rs.10,133)

3. P, Q and R carried on business in partnership. On 31st December, 2007, their balance sheet was as under:

Liabilities			Assets	
Sundry Creditors		40,500	Land and Buildings	36,000
P's Loan		54,000	Plant and Machinery	72,000
Capital Accounts:			Loose Plant and Tools	13,500
P	1, 08,000		Stock in trade	90,000
Q	90,000		Sundry debtors	1, 26,000
R	67,500	2, 65,500	Cash at Bank	22,500
		3, 60,000		**3, 60,000**

They decided to dissolve the firm as on 31st December, 2007. Q and R continued the business, agreeing to purchase P's share in the capital of the firm in the proportions in which they shared profits and losses. P agreed to allow his loan to remain in the business. Profits and losses are shared: P two-fifths, Q two- fifths, and R one-fifths. Q and R utilize the cash at bank to pay P and contribute the balance.

For the purpose of the dissolution, the following valuations were made:

Goodwill 45,000; Land and Buildings Rs.50,500; Plant and Machinery as in the Balance Sheet, subject to 10% depreciation; Loose plant and tools as in the Balance Sheet; Stock in trade Rs.81, 000; Sundry Debtors as in the Balance Sheet, subject to Rs.9, 900; Provision for bad debts and an allowance of 5% for discounts. The liability to sundry creditors is taken over by Q and R subject to a allowance of Rs.1, 800 for discounts.

Q and R continue to share profits and losses in the same proportion as before. Draw up the Realisation Account and other necessary accounts in the books of P, Q and R to close the books and opening Balance Sheet of M/S Q and R together with their opening entries.

(Realisation: P- Rs.7, 758; Q – Rs.7, 758; R – Rs.3, 879; P receives cash Rs.1, 15,758; New firm total of Balance Sheet Rs.3, 55,095)

4. X, Y and Z carry on business in partnership sharing profits and losses ½, 3/8 and 1/8 respectively. On 31st March, 2007, they agreed to sell their business to a limited company. Their position on that date was as follows:

Liabilities		Assets	
X Capital	40,000	Freehold property	36,000
Y Capital	30,000	Machinery	24,000
Z Capital	26,000	Book debts	30,000
Loan on Mortgage	8,000	Stock	26,000
Sundry Creditors	16,000	Cash	4,000
	1, 20,000		**1, 20,000**

The company took the following assets at the valuation shown below:

Freehold property	44,000	Machinery	22,000
Book debts	28,000	Stock	24,000
Goodwill	8,000		

The company also agreed to pay the creditors which were agreed at Rs.15, 400. The company paid Rs.67, 000 in fully paid shares of Rs.10 each and the balance in cash. The expenses amounted to Rs.1, 000.

You are required to prepare Realisation and other related accounts in the books of the firm with the calculation of purchase consideration)

(Realisation A/C: X – Rs.4, 800; Y – Rs.3, 600; Z – Rs.1, 200; Cash to X – Rs.16, 380; Y – Rs.12, 280; Z – Rs.9, 940; Purchase consideration: Rs.1,10,600;)

5. Rao, Raheman and Robert were partners in a partnership firm sharing profits in ½, 3/8, 1/8 ratio. On 31st December, 2007 they want to sell the firm to a newly established Joint Stock Company. Their position on the above date was as follows:

Liabilities			Assets	
Capitals:			Freehold Assets	18,000
Rao	20,000		Machinery	12,000
Raheman	15,000		Book debts	15,000
Robert	13,000	48,000	Stock	13,000
Sundry Creditors		12,000		
		60,000		**60,000**

Company took the following assets as under:

Freehold Assets Rs.26, 000; Machinery Rs. 10, 000; Book debts Rs.14, 000; Stock Rs.12, 000; Goodwill Rs.5, 000.

The purchase price of Freehold assets and machinery for Rs.36, 000 are to be paid in the form of equity shares, the purchase price of book debts, stock and goodwill are to be paid in cash. The partnership firm paid creditors with 3% discount. Expenses of Realisation amounted to Rs.1, 000.

Pass the necessary journal entries to close the books of the firm and prepare the necessary ledger accounts to show the result of dissolution and final settlement among the partners.

(Realisation A/C: Rao – Rs.4, 180; Raheman – Rs. 3, 135; Robert – Rs.1, 045; Rao receives – Rs.8, 750 and shares Rs.15, 430; Reheman receives Rs.6, 565 and shares Rs.11, 570; Robert receives Rs.5, 045 and shares Rs.9, 000; Purchase consideration: Rs.67, 000)

12. 8: Summary:

Partnership dissolves when the term of the partnership expires, or when the adventure completes, or when any of the partners die or retire or insolvent. In all these cases, the partnership firm may continue with the remaining partners. There is also a possibility of dissolution of partnership firm. When all the partners agree, or any of the partners become insolvent, or when business becomes illegal or when partnership has a will or when court orders; the partnership firm dissolves. In this lesson the accounting procedure when a firm dissolves voluntarily are discussed. Further, the method of accounts when a firm is sold to a joint stock company is also discussed.

12.9: Glossary:

Dissolution of partnership: Closure of the existing partnership relation among the partners is called dissolution of partnership. The expiry of the term of duration, the completion of the adventure, the death of a partner, the insolvency of a partner and the retirement of a partner lead to dissolution of partnership.

Dissolution of partnership firm: It is the closure of the existing partnership firm after clearing the assets and liabilities and closing down and settling the capital accounts of partners once for all.

Purchase Consideration: It is the value or compensation offered by the buying company to the partnership firm for taking the firm into its fold. The consideration consists of cash or cash with shares and debentures.

12.10: Self Assessment Questions:

1. Distinguish between dissolution of partnership and dissolution of partnership firm.
2. Mention the accounting procedure when a joint stock company purchases a partnership firm.

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Lesson: 13

Partnership Accounts: V – Insolvency

13.0 Objective:

After going through the lesson, you will be able to understand the following:

1. Accounting method when a partner becomes insolvent.
2. Garner vs. Murray case.
3. Accounting procedure when all partners become insolvent.
4. Piece meal method of distribution after realization of assets.

Structure:

13.1: Insolvency - Introduction

13.2: Garner vs. Murray Case

13.3: When all partners are insolvent

13.4: Gradual realization of assets and piecemeal distribution

13.5: Illustrations

13.6: Try yourself

13.7: Summary

13.8: Glossary

13.9: Questions

13.1: Insolvency - Introduction:

Whenever any partner in the partnership firm becomes insolvent, the firm dissolves and the burden of the insolvent partner should be borne by the solvent partners in their profit sharing ratio. As usual, a realization account needs to be prepared and the loss or profit that comes out of it should be transferred to the partners. The debit balance of the insolvent partner should be transferred to the debit side of the solvent partners in their respective profit sharing ratio and thus the accounts of all partners will be closed. This is a usual practice to be adopted. But after the case of Garner vs. Murray, the method of bearing the burden of insolvent partner had changed. In this lesson, we discuss the accounting procedure before and after this case and also the case when all partners become insolvent. Finally, the piece meal distribution method of the sale proceeds when a partnership firm dissolves is also discussed.

13.2: Garner vs. Murray Case:

When a partner becomes insolvent, he may not be in a position to pay the amount owed by him to the firm in full. The amount not so paid is a loss to the firm. This loss has to be borne by the solvent partners. Generally, they share in their profit sharing ratio. This was the procedure used to be adopted before Garner vs. Murray case. The Garner vs. Murray case gave a new look regarding sharing the loss of the insolvent partner. The case says the following points:

1. The solvent partners should bring in cash their share of loss on realization.
2. The loss on account of insolvency of a partner should then be borne by the solvent partners in the ratio of their capitals after bringing in cash such loss on realization.

   According to this case, the loss on account of insolvency of partner should be borne by the solvent partners in the ratio of their capitals standing in the balance sheet, just before the dissolution of the partnership firm.

   In this connection, the following points should be noted:

1. The term capitals here mean the real capitals of the partners and not the capitals as may be standing in the books of the partnership firm in the names of different partners. This distinction is particularly important when the partners are maintaining their capital accounts on fluctuating capital system. The true capitals in case of this system will be ascertained after making all adjustments regarding reserves, drawings, unrecorded assets on the date of the balance sheet, just before dissolution of the partnership firm.
2. In case a partner, though solvent has a debit balance in his capital account, just before the dissolution of the partnership firm, such a partner will not be required to bear the loss on account of insolvency of a partner.

13.3: When all partners are insolvent:

If all the partners are insolvent then the creditors cannot expect to be paid in full. All the cash available, together with whatever can be received from the private estates of all partners, will be paid to the creditors after the expenses of realization are met. The Realisation Account should be prepared in the usual course but creditors should not be transferred to this account nor will payment to creditors be debited to this amount. The loss on realization should be transferred to the capital accounts of partners in the profit-sharing ratio. The available cash should then be paid to the creditors. The amount remaining unpaid should be transferred to Deficiency Account to which account the balances of partners' capital accounts should be transferred. Thus, the books will be closed.

13.4: Gradual realization of assets and piecemeal distribution:

In the previous lessons, it is assumed that all assets have been realised on the date of dissolution and all liabilities have also been paid on that date. This assumption makes possible the ascertainment of profit or loss on realization immediately. However, in actual practice, this does not happen. The assets are sold gradually to realize the best price for them. Similarly, the liabilities are paid gradually depending upon amount realised from the sale of the assets. Thus, the final profit or loss on realization can be known only after the expiry of certain time when all assets are completely realised and all liabilities completely paid off.

After payment of all outside liabilities and partners loans, the capitals of the partners are returned. However, the amount payable to a partner on account of his capital cannot be ascertained, unless the total profit or loss on realization is known. This means that the partners should not be paid any amount till realization is complete. This may create financial problems for the partners, since on the one hand the partnership business is being dissolved and on the other the partners do not get any money from the firm to start a new business or to meet their expenses. Thus, the partners should not be required to wait till realization is complete. They should be paid as and when the firm has funds left with it after payment of all outside liabilities. This is called as piecemeal distribution of assets.

In dissolution, first of all the outside creditors have to be paid, then if surplus remains, any loans given by the partners over and above their capitals are paid and last of all the partners' capitals will be paid off. It is clear, therefore, that any cash in hand or cash collected should be distributed among creditors until all of them are paid off. It is to be remembered that sufficient funds for liabilities are to be kept in hand for future contingencies like for bills discounted expected to be dishonoured.

Basis of distribution: As we know well, the profit or loss cannot be adjusted in the capital accounts immediately. However, cash must be distributed in such a way that the amounts finally left unpaid (i.e. the loss to be borne by the partners) are in the ratio in which profits and losses are shared. The available cash cannot be distributed according to the profit sharing ratio (unless the capitals are themselves in the profit sharing ratio) because that will leave the balances unpaid out of proportion. The cash available cannot also be distributed in the ratio of capitals because, and then the partners will be forced to bear the final loss in the ratio of capitals which may be different from the profit sharing ratio.

13.5: Illustrations:

Illustration 1:

Partners A, B and C share profits in the ratio of 2:1:2 respectively on 31st March 2007. They decided to dissolve the partnership. The Balance Sheet as on that date is given below:

Liabilities		Assets	
Sundry Creditors	40,000	Balance in Bank	4,000
Capitals:		Other assets	3, 96,000
A	1, 60,000		
B	1, 60,000		
C	40,000		
	4, 00,000		**4, 00,000**

The assets realized Rs.2, 40, 000 only, and realization expenses were Rs.10, 000. C has been declared insolvent. C has no assets other than the capital stated above.

Show the capital accounts of the partners, before and after the decision of Garner vs. Murray.

Solution:

Realisation Account

To Other assets	3, 96,000	By Creditors			40,000
To Cash – expenses	10,000	By Cash			2, 40,000
To cash – creditors	40,000	By Realisation – loss:			
			A	66,400	
			B	33,200	
			C	66,400	1, 66,000
	4, 46,000				**4, 46,000**

Before Garner vs. Murray case:

A's Capital Account

To Realisation – loss	66,400	By Balance	1, 60,000
To C's Capital	17,600		
To Cash	76,000		
	1, 60,000		**1, 60,000**

B's Capital Account

To Realisation – loss	33,200	By Balance	1, 60,000
To C's Capital	8,800		
To Cash	1, 18,000		
	1, 60,000		**1, 60,000**

C's Capital Account

To Realisation – loss	66,400	By Balance		40,000
		By A's Capital	17,600	
		By B's Capital	8,800	26,400
		(Profit sharing ratio: 2:1)		
	66,400			**66,400**

Cash Account

To Balance	4,000	By Realisation- exps.& liabilities	50,000
To Realisation	2, 40,000	By A's Capital	76,000
		By B's Capital	1, 18,000
	2, 44,000		**2, 44,000**

After Garner vs. Murray case:

A's Capital Account

To Realisation A/C	66,400	By Balance	1, 60,000
To C's Capital	13,200	By Cash (nominal entry)	66,400
To Cash	1, 46,800		
	2, 26,400		**2, 26,400**

B's Capital Account

To Realisation A/C	33,200	By Balance	1, 60,000
To C's Capital	13,200	By Cash (nominal entry)	33,200
To Cash	1, 46,800		
	1, 93,200		**1, 93,200**

C's Capital Account

To Realisation A/C	66,400	By Balance		40,000
		By A's Capital	13,200	
		By B's Capital	13,200	26,400
	66,400			**66,400**

Cash Account

To Balance	4,000	By Realisation – Exps.&liabilities	50,000
To Realisation A/C	2, 40,000	By A's Capital	1, 46,800
To A's Capital (nominal)	66,400	By B's Capital	1, 46,800
To B's Capital (nominal)	33,200		
	3, 43,600	**3, 43,600**	

Real Payment:

A: 1, 46,800 – 66,400 = 80,400

B: 1, 46,800 – 33,200 = 1, 13,600

Note:

Before Garner vs. Murray case – the debit balance of insolvent partner is shared by solvent partners in their profit sharing ratio (2:1).

After the case – the debit balance of insolvent partner is to be shared by solvent partners in their final capital ratio (after writing the entry for bringing their share of realization less cash) (1:1).

Illustration 2:

The position of Rakesh, Rajeev and Ramesh on June 30, 2007 was as follows:

Sundry Creditors	25,000	Cash	10,000
Rakesh Loan Account	16,000	Sundry Assets	68,000
Rakesh Capital	25,600	Ramesh Capital	31,200
Rajeev Capital	14,400		
Profit and Loss A/C	28,000		
	1, 09,200		**1, 09,200**

Profits and losses are shared Rakesh 18/35; Rajeev 7/35. The firm is dissolved on the above date. Sundry assets realize Rs.56, 000. Sundry creditors are paid Rs.24, 000 in full settlement. Expenses amount to Rs.3, 200. Ramesh is insolvent.

Assume the capitals are not fixed. Close the books of the firm.

Solution:

Realisation Account

To Sundry Assets	68,000	By Creditors A/C		25,200
To Cash – expenses	3,200	By Cash – expenses		56,000
To Cash – creditors	24,000	By Rakesh Capital	7,200	
		By Rajeev Capital	2,800	
		By Ramesh Capital	4,000	14,000
	95,000			**95,000**

Rakesh Capital Account

To Realisation – loss	7,200	By Balance	25,600
To Ramesh Capital	18,133	By P & L A/C	14,400
To Cash	21,867	By Cash	7,200
	47,200		**47,200**

Rajeev Capital Account

To Realisation – loss	2,800	By Balance	14,400
To Ramesh Capital	9,067	By P & L A/C	5,600
To Cash	10,933	By Cash	2,800
	22,800		**22,800**

Ramesh Capital Account

To Balance	31,200	By P & L A/C	8,000

To Realisation – loss	4,000	By Rakesh Capital 18,133		
		ByRajeev Capital	9,067	27,200
		(Final Capital ratio)		
	35,200			**35,200**

Cash Account

To Balance	10,000	By Realisation – expenses	3,200
To Realisation – assets	56,000	By Realisation – creditors	24,000
To Rakesh Capital	7,200	By Rakesh Loan	16,000
To Rajeev Capital	2,800	By Rakesh Capital	21,867
		By Rajeev Capital	10,933
	76,000		76,000

Note: When a partner becomes insolvent, the formula in Garner vs. Murray case is to be applied. As per that formula – a) the realization loss is to be shared to all partners; b) the solvent partners should bring their share of realization less in cash; c) the debit balance in insolvent partner's capital account should be charged to solvent partners' capital account in their final capital ratio.

Illustration 3:

X, Y and Z were in partnership sharing profits and losses in the ratio of 1/5, 3/10 and ½. The following is their Balance Sheet as on 30th June 2007 when they decided to dissolve:

Liabilities			Assets
X Capital	3,000	Cash	1,000
Y Capital	4,000	Plant and Machinery	5,000
Z Capital	3,000	Sundry Debtors	20,000
Trade Creditors	12,000	Advance to X	2,000
Loan from Bank on book debts, plant etc.	14,000	Loss to date	8,000
	36,000		**36,000**

The assets realized Rs.20, 000. X has private estate which is valued at Rs.4, 000. Y is insolvent. From Z's estate a dividend of 50 paise in a rupee is received.

Show the Realisation Account and the accounts of the partners assuming that all entries relating to dissolution are passed through the Realisation Account.

Solution:

Realisation Account

To Plant	5,000	By Loan from Bank	14,000
To Sundry Debtors	20,000	By Creditors	12,000

To advance to X		2,000	By Cash – assets	20,000	
			Advance to X	2,000	22,000
			By X Capital	1,000	
To Cash – loan	14,000		By Y Capital	1,500	
- Creditors	12,000	26,000	By Z Capital	2,500	5,000
		53,000			**53,000**

Cash Account

To Balance	1,000	By Realisation – liabilities	26,000
To Realisation – assets	22,000		
To X Capital	1,250		
To Z Capital	1,750		
	26,000		**26,000**

X Capital Account

To Realisation – loss	1,000	By Balance	3,000
To P & L A/C	1,600	By Cash (Bal. Fig)	1,250
To Z Capital	750		
To Y Capital	900		
	4,250		**4,250**

Y Capital Account

To Realisation – loss	1,500	By Balance	4,000
To P & L A/C	2,400	By X Capital	900
To Z Capital	1,000		
	4,900		**4,900**

Z Capital Account

To Realisation – loss	2,500	By Balance		3,000
To P & L A/C	4,000	By Cash		1,750
		By X Capital	750	
		By Y Capital	1,000	1,750
	6,500			**6,500**

Note: First Z capital account was settled as his capital is showing a debit balance. It was transferred to capitals of X and Y in their capitals ratio 3:4. Then Y capital account debit balance was transferred to X capital Account. The necessary cash was then brought in by X.

Illustration 4:

The Balance Sheet of O, P, Q, and R showed the following position on dissolution.

Balance Sheet

Liabilities			Assets
Creditors	10,000	Cash at Bank	34,000
O's Capital	15,000	Q's Capital	10,000
P's Capital	10,000	R's Capital	3,000
Profit on Realisation	12,000		
	47,000		**47,000**

Show the final adjustments among the partners assuming that R is insolvent.

Solution:

Realisation Account

To O's Capital	3,000	By Balance B/D	12,000
To P's Capital	3,000		
To Q's Capital	3,000		
To R's Capital	3,000		
	12,000		**12,000**

Creditors' Account

To Cash	10,000	By Balance B/D	10,000
	10,000		**10,000**

O's Capital Account

To Cash	18,000	By Balance B/D	15,000
		By Realisation A/C	3,000
	18,000		**18,000**

P's Capital Account

To Cash	13,000	By Balance B/D	10,000
		By Realisation A/C	3,000
	13,000		**13,000**

Q's Capital Account

To Balance B/D	10,000	By Realisation A/C	3,000
		By Cash	7,000
	10,000		**10,000**

R's Capital Account

To Balance B/D	3,000	By Realisation A/C	3,000
	3,000		**3,000**

Cash Account

To Balance B/D	34,000	By Creditors A/C	10,000
To Q's Capital A/C	7,000	By O's Capital A/C	18,000
		By P's Capital A/C	13,000
	41,000		**41,000**

Illustration 5:

P, Q, R and S were partners sharing profits and losses in the ratio of 3:3:2:2.

Following was their Balance Sheet as on 30th June 2007.

Liabilities			Assets		
Sundry Creditors		15,500	Cash at bank		2,000
P's Loan		10,000	Sundry debtors	16,000	
Capital Accounts:			Less: Provision	500	15,500
P	20,000		Stock		10,000
Q	15,000	35,000	Furniture and fittings		4,000
			Trade marks		7,000
			Capital Accounts:		
			R	16,000	
			S	6,000	22,000
		60,500			**60,500**

On 30th June, 2007 the firm was dissolved and Q was appointed to realize the assets and pay off the liabilities. He was appointed to receive 5% commission on the amounts finally paid to other partners as capital. He was to bear the expenses of realization. The assets realized as followed.

Study debtors	11,000	Stock	8,000
Furniture and fittings	1,000	Trade marks	4,000

Creditors were paid off in full, in addition a contingent liability for bills receivable discounted materialized to the extent of Rs.2, 500. Also there was a joint life policy for Rs.30, 000. This was surrendered for Rs.3, 000. Expenses of realization amounted to Rs.500. R was insolvent but Rs.3, 700 were recovered from his estate.

Write up the necessary accounts to close the books of the firm.

Solution:

Realisation Account

To Debtors		16,000	By Reserve for bad debts		500
To Stock		10,000	By Creditors		15,500
To Furniture		4,000	By Cash – Debtors	11,000	
To Trade marks		7,000	Stock	8,000	
To Cash – Creditors	15,500		Furniture	1,000	
Discounted bill	2,500	18,000	Trademarks	4,000	
			Policy	3,000	27,000
			By Realisation – loss:		
			By P's Capital A/C	3,600	
			By Q's Capital A/C	3,600	
			By R's Capital A/C	2,400	
			By S's Capital A/C	2,400	12,000
		55,000			**55,000**

P's Loan Account

To Cash	10,000	By Balance B/D	10,000
	10,000		**10,000**

P's Capital Account

To Realisation A/C – loss	3,600	By Balance B/D	20,000
To R's Capital A/C	8,400	By Cash (nominal entry)	3,600
To Q's Capital – commission	381		
To Cash	11,219		
	23,000		**23,000**

Q's Capital Account

To Realisation A/C –loss	3,600	By Balance B/D	15,000
To R's Capital A/C	6,300	By Cash (nominal entry)	3,600
To Cash – expenses	500	By P's Capital – commission	381
To Cash	8,581	(8,000 x 5/105)	
	18,981		**18,981**

R's Capital Account

To Balance B/D	16,000	By Cash		3,700
To Realisation A/C –loss	2,400	By P's Capital	8,400	
		By R's Capital	6,300	14,700
	18,400			**18,400**

S's Capital Account

To Balance B/D	6,000	By Cash	8,400
To Realisation – loss	2,400		
	8,400		**8,400**

Cash Account

To Balance B/D	2,000	By Realisation – liabilities	18,000
To Realisation A/C	27,000	By P's Loan	10,000
To R's Capital A/C	3,700	By Q's Capital – expenses	500
To S's Capital A/C	8,400	By P's Capital (11,210 – 3,600)	11,219
To P's Capital (nominal entry)	3,600	By Q's Capital (8,581 – 3,600)	8,581
	48,300		**48,300**

Note: S's Capital account shows debit balance, but he is not insolvent. He brings in the necessary cash. R is insolvent. His debit balance charged to P and Q in their final capital ratio i.e. after writing the entry for bringing their loss of realization in cash. But really any partner, who is solvent, does not bring cash for the realization loss. A notional entry will be written for bringing cash. Therefore the actual amount payable to P comes to Rs.8, 000 (20,000-3,600+8,400). On this amount, the commission to Q is to be calculated. If calculation is made as 5/100 on 8, 000, P does not get Rs.8, 000. So calculation shall be 5/105 on 8, 000. The commission is to be chargeable to P as the realization account and other partners' capital accounts were already closed.

It is assumed that expenses of realization were paid first by the firm, and then they were charged to Q, who has to bear them.

Illustration 6:

A, B and C are partners in a business sharing profits equally. Their Balance Sheet at 31st March 2007 is as follows:

Liabilities			Assets		
Sundry Creditors		10,000	Furniture		2,100
Bills payable		2,000	Stock		15,400
Capital Accounts:			Sundry debtors	18,000	
A	12,000		Less: Provision	900	17,100

B	9,000		C's Current Account	5,000
C	1,000	22,000	Cash in hand	1,400
Current Accounts:				
A	2,000			
B	2,000	3,000		
		41,000		**41,000**

C is insolvent and his estate pays Rs.1, 800 to the firm. The partnership is consequently dissolved and sundry debtors, stock and furniture realize Rs.23, 600. Sundry creditors are settled at Rs.8, 000. You are required to prepare the necessary ledger accounts to close the books of the firm in accordance with the decision in Garner vs. Murray.

Solution:

Realisation Account

To Furniture		2,100	By Reserve for bad debts		900
To Stock		15,400	By Creditors		10,000
To Debtors		18,000	By Bills payable		2,000
To Cash – creditors	8,000		By Cash – assets realized		23,600
- bills payable	2,000	10,000	By A's Current A/C	3,000	
			By B's Current A/C	3,000	
			By C's Current A/C	3,000	9,000
		45,500			**45,500**

A's Current Account

To Realisation A/C	3,000	By Balance	2,000
To C's Capital A/c	2,400	By Reserve fund	1,000
(4/7th share of C's deficiency)		By Cash	3,000
To A's Capital A/C – transfer	600		
	6,000		**6,000**

B's Current Account

To Realisation A/C	3,000	By Balance	2,000
To C's Capital A/C(3/7th share)	1,800	By Reserve fund	1,000
To B's Capital – transfer	1,200		
	6,000		**6,000**

C's Current Account

To Balance	5,000	By Reserve fund	1,000
To Realisation A/C	3,000	By C's Capital A/C – transfer	7,000
	8,000		**8,000**

A's Capital Account

To Cash	12,600	By Balance	12,000
		By Current A/C	600
	12,600		**12,600**

B's Capital Account

To Cash	10,200	By Balance	9,000
		By Current A/C	1,200
	10,200		**10,200**

C's Capital Account

To Current A/C	7,000	By Balance	1,000
		By Cash – brought in	1,800
		By A's Current A/C (4/7th share)	2,400
		By B's Current A/C (3/7th share)	1,800
	7,000		**7,000**

Cash Account

To Balance	1,400	By Realisation – liabilities	10,000
To Realisation – assets	23,600	By A's Capital A/C	12,600
To A's Current A/C – loss brought in	3,000	By B's Capital A/C	10,200
To B's Current A/C – loss brought in	3,000		
To C's Capital A/C – loss brought in	1,800		
	32,800		**32,800**

Note: In the case of Garner vs. Murray, the solvent partners have to bring their share of realization loss in cash before sharing the deficiency caused by the insolvency of one of the partners. But when the partners have current accounts in addition to their capital accounts, they need not bring the loss in cash, as it makes no difference even if it is not brought in.

When there are current accounts the following procedure is to be followed:

1) Insolvent partner's current account balance is to be transferred to his capital account.
2) Debit balance of his capital account is to be charged to the current account of other solvent partners in their capital ratio.

3) Current account balances of solvent partners to be transferred to respective capital accounts and the final payment are to be made.

Insolvency of all Partners:

Illustration 7:

Kalyan and Krishna are equal partners. Their Balance Sheet stood as under:

Liabilities		Assets	
Kalyan's Capital	6,000	Plant and Machinery	13,750
Creditors	39,000	Furniture	5,000
		Debtors	5,000
		Stock	6,250
		Cash at bank	3,000
		Krishna's drawings	12,000
	45,000		**45,000**

The partnership was dissolved and the assets were realised as follows:

Stock Rs.3, 500; Furniture Rs.3, 000; Debtors Rs.5, 000; Machinery Rs.6, 000;

The cost of collecting and distributing the estate amounted to Rs.1, 500. Kalyan's private estate is not sufficient even to pay his private debts, whereas in Krishna's private estate there is a surplus of Rs.500.

Prepare Realisation account, cash account and profit and loss account and creditors' account showing dividend payable to creditors.

Solution:

Realisation Account

To Plant and Machinery	13,750	By Cash – Stock	3,500	
To Furniture	5,000	- Furniture	3,000	
To Debtors	5,000	- Machinery	6,000	
To Stock	6,250	- Debtors	5,000	17,500
To Cash – expenses	1,500	By Kalyan Capital A/C	7, 000	
		By Krishna Capital A/C	7, 000	14,000
	31,500			**31,500**

Creditors Account

To Cash A/C	19,500	By Balance	39,000
To Deficiency (or P & L A/C)	19,500		
	39,000		**39,000**

Cash Account

To Balance	3,000	By Realisation A/C	1,500
To Realisation A/C	17,500	By Creditors	19,500
To Krishna's Capital	500		
	21,000		**21,000**

Kalyan's Capital Account

To Realisation A/C	7,000	By Balance	6,000
		By Deficiency (or P & L A/C)	1,000
	7,000		**7,000**

Krishna's Capital Account

To Balance	12,000	By Cash	500
To Realisation A/C	7,000	By Deficicency (or P & L A/C)	18,500
	19,000		**19,000**

Deficiency Account (P & L A/C)

To Kalyan's Capital A/C	1,000	By Creditors A/C	19,500
To Krishna's Capital A/C	18,500		
	19,500		**19,500**

Note: When all partners became insolvent, the creditors need not be transferred to realization account. In such case the realization account shall be utilized only for the assets and expenses.

Illustration 8:

Below is the Balance Sheet of A, B and C as on December 31, 2007.

Liabilities				Assets
Sundry creditors		40,000	Cash	1,000
A's Loan		10,000	Stock	24,000
Capital Accounts:			Debtors	20,000
A	5,000		Furniture	3,000
B	3,000	8,000	C's Capital overdrawn	10,000
		58,000		**58,000**

Due to the inability to pay the creditors, the firm is dissolved. B and C cannot pay anything. A can contribute only Rs.1, 500 from his private estate. Stock realises Rs.15, 000. Debtors realize Rs.16, 000 and furniture is sold for Rs.1, 000. Expenses amounted to Rs.3, 000. Prepare accounts to close the books of the firm.

Solution:

Realisation Account

To Stock	24,000	By Cash – assets	32,000
To Debtors	20,000	By A's Capital – loss	6,000
To Furniture	3,000	By B's Capital – loss	6,000
To Cash – expenses	3,000	By C's Capital – loss	6,000
	50,000		**50,000**

Creditors Accounts

To Cash	31,500	By Balance B/D	40,000
To Deficiency A/C	8,500		
	40,000		**40,000**

A's Loan Account

To Deficiency A/C	10,000	By Balance B/D	10,000
	10,000		10,000

A's Capital Account

To Realisation A/C – loss	6,000	By Balance B/D	5,000
To Deficiency A/C	500	By Cash	1,500
	6,500		**6,500**

B's Capital Account

To Realisation A/C - loss	6,000	By Balance B/D	3,000
		By Deficiency A/C	3,000
	6,000		**6,000**

C's Capital Account

To Balance B/D	10,000	By Deficiency A/C	16,000
To Realisation A/C – loss	6,000		
	16,000		**16,000**

Cash Account

To Balance B/D	1,000	By Realisation A/C	3,000
To Realisation A/C	32,000	By Creditors A/C	31,500
To A's Capital A/C	1,500		
	34,500		**34,500**

Deficiency Account

To B's Capital A/C	3,000	By Creditors A/C	8,500
To C's Capital A/C	16,000	By A's Loan A/C	10,000
		By A's Capital A/C	500
	19,000		**19,000**

Note: When all partners become insolvent, the firm becomes unable to pay the creditors in full. In such cases the creditors should not be transferred to Realisation account. As the creditors are not satisfied fully the question of payment of A's loan does not arise and that loan shall be transferable to Deficiency account.

Gradual or Piecemeal Distribution:

Illustration 9:

Moon, Light and Shade were partners sharing profits in the ratio 4:3:1. They want to dissolve the firm from the following Balance Sheet as on 31st March 2007.

Balance Sheet 31-12-2007

Liabilities				Assets
Creditors		2,625	Sundry Assets	18,500
Bank Overdraft		875		
Capital Accounts:				
Moon	7,000			
Light	3,000			
Shade	5,000	15,000		
		18,500		**18,500**

Capital should be repaid whenever the assets realised. Firm's assets realised as follows:

May	2,000
July	1,500
September	2,500
October	4,000
December	6,500

No additional amount was realised.

From the above Balance Sheet and other information prepare the statement showing the interim distribution of cash.

Solution:

Statement showing the distribution of cash

Particulars	Creditors	O D	Moon	Light	Shade
Balances	2,625	875	7,000	3,000	5,000
Less: Receipts in May (3:1)	1,500	500	—	—	—
	1,125	375	7,000	3,000	5,000
Less: Receipts in July (3:1)	1,125	375	—	—	—
	—	—	7,000	3,000	5,000
Less: Receipts in September	—	—	—	—	2,500
	—	—	7,000	3,000	2,500
Less: Receipts in October	—	—	—	—	750
	—	—	7,000	3,000	1,750
Remaining (4,000-750) to Moon & Shade in 4:1 ratio	—	—	2,600	—	650
	—	—	4,400	3,000	1,100
Less: Receipts in December (500 in 6,500 to Moon and Shade in 4:1ratio)	—	—	400	—	100
	—	—	4,000	3,000	1,000
Remaining 6,000 in 4:3:1 ratio	—	—	3,000	2,250	750
Partners' share in loss (4:3:1)	—	—	1,000	750	250

Note: The liabilities are to be payable first. Creditors and overdraft were in the ratio of 3:1. Until they are discharged completely the cash available is to be distributed between creditors and overdraft in the ratio of 3:1. The amount available in the first two installments is sufficient to discharge the liabilities.

The cash realised in the subsequent installments is to be distributed to the partners so as to bring their capitals in to their profit sharing ratio. It will enable the partners to suffer the loss on realization (which can be known only at the end of last installment) in their profit sharing ratio.

Working Notes:

Total book value of assets		18,500
Less: Assets realised in installments		16,500
Loss on Realisation		2,000
Moon's share	2,000 x 4/8	1,000
Light's share	2,000 x 3/8	750

Shade's share	2,000 x 1/8	250

Cash Account

May	To Realisation A/C	2,000	May	By Creditors	1,500
July	To Realisation A/C	1,500		By Overdraft	500
Sept.	To Realisation A/C	2,500	July	By Creditors	1,125
Oct	To Realisation A/C	4,000		By Overdraft	375
Dec	To Realisation A/C	6,500	Sept.	By Shade Capital	2,500
			October	By Moon Capital	2,600
				By Shade Capital	1,400
			Dec.	By Moon Capital	3,400
				By Light Capital	2,250
				By Shade Capital	850
		16,500			**16,500**

Moon's Capital Account

Oct.	To Cash	2,600	By Balance B/D	7,000
Dec.	To Cash	3,400		
	To Realisation A/C	1,000		
		7,000		**7,000**

Light's Capital Account

Dec.	To Cash	2,250	By Balance B/D	3,000
	To Realisation A/C	750		
		3,000		**3,000**

Shade's Capital Account

Sep.	To Cash	2,500	By Balance B/D	5,000
Oct.	To Cash	1,400		
Dec.	To Cash	850		
	To Realisation A/C	250		
		5,000		**5,000**

Creditors's Account

May	To Cash	1,500	By Balance B/D	2,625
July	To Cash	1,125		
		2,625		**2,625**

Overdraft Account

May	To Cash	500	By Balance B/D	875
July	To Cash	375		
		875		**875**

13.6: Try yourself:

1. A, B and C were equal partners. On 31st December, 2007, their position was as follows:

A's Capital	2,000	Cash	1,500
B's Capital	600	C's Capital	200
		Loss on Realisation	900
	2,600		**2,600**

C is insolvent and can pay nothing. Close the books of the firm ignoring the decision in Garner vs. Murray.

(A gets Rs.1, 450 and B gets Rs.50)

2. The following is the balance sheet of a firm as on 31st December 2007, when D has become insolvent:

Balance Sheet as on 31st December, 2007

Liabilities		Assets	
Sundry Creditors	10,000	Sundry Assets	50,000
General Reserve	10,000	C's Capital A/C	10,000
A's Capital A/C	30,000	D's Capital A/C	10,000
B's Capital A/C	20,000		
	70,000		**70,000**

The assets realised Rs.40, 000. Creditors are paid in full. Partners share profits and losses equally. You are required to close the books of the firm applying Garner vs. Murray rule.

(D's deficiency Rs.7,500; A's share Rs.4, 432 and B's share Rs.3,068; Finally A gets Rs.26, 590 and B gets Rs.18, 410)

3. A, B and C were partners in a firm. They shared profits and losses in 40%, 30%, and 30% respectively. The firm was dissolved and B was appointed to realize assets and distribute the proceeds. B is to receive 5% commission on the amounts realized from sale of assets and to bear all expenses of realization. The Balance Sheet on the date of dissolution was as under:

Liabilities		Assets		
Creditors	17,700	Cash		450
A's Capital	9,000	Debtors	13,650	

B's Capital	6,000	Less: Provision	750	12,900
		Stock		18,000
		C's Capital overdrawn		1,350
	32,700			**32,700**

Debtors realized Rs.10, 500; stock Rs.13, 500; goodwill Rs.600. Creditors were paid Rs.17, 250 in full settlement. In addition, outstanding creditors Rs.150 and expenses Rs.180 paid by B. A and B agreed to receive Rs.900 in full settlement from C.

Show the Realisation Account, Cash Account and Capital Accounts of the partners.

(Loss on Realisation: A- Rs.2,892; B- Rs.2,169; C- Rs.2,169; A gets Rs.7,428 and B gets Rs. Rs.6,003)

4. Ram and Shyam were in equal partnership. Their Balance Sheet stood as under on 31st December, 2007 when the firm was dissolved.

Creditors	3,200	Machinery and Plant	1,200
Ram's Capital	400	Furniture	300
		Debtors	500
		Stock	400
		Cash	180
		Shyam's drawings	1,020
	3,600		**3,600**

The assets realised as under:

Machinery	600	Furniture	100
Debtors	400	Stock	300

The expenses of realization amounted to Rs.140. Ram's private estate is not sufficient even to pay his private debts, whereas in Shyam's private estate there is a surplus of Rs.140 only.

Give accounts to close the books of the firm.

(Profit on Realisation: Ram – Rs.240; Shyam – Rs.240; Deficiency Rs.1, 450)

5. A, B and C carried on business as partners, sharing profits and losses in the ratio of 3:4:5. They decided to dissolve the partnership as on 1st July, 2007 and agreed that the sale of the assets should not be forced but should be made gradually. As the realization was not likely to be completed for over a year and as the partners wished the receipts from sales to be dealt with as and when received, you are asked to prepare a scheme for the equitable distribution of such receipts.

The following was the Balance Sheet of the firm at the date of dissolution:

Liabilities		Assets	
Creditors	10,000	Sundry Assets	36,000

B's Loan Account		2,000	
Capital Accounts:			
A	12,000		
B	8,000		
C	4,000	24,000	
		36,000	**36,000**

The net amounts realised from the gradual sale of assets were as follows:

1st Installment	5,000
2nd Installment	10,000
3rd Installment	5,100
4th Installment	6,300
5th Installment	5,700

Draw up a detailed statement showing the distribution of each installment received and the final settlement.

(In II installment A gets Rs.3,000; In III installment A gets Rs.3,900 and B Rs.1,200; In IV installment A gets Rs.2,700; B Rs.3,600; In V installment A gets Rs.1,425; B Rs.1,900 and C Rs.2,375)

13. 7: Summary:

Insolvency of a partner, Insolvency of all partners and distribution of the proceeds among the partners are discussed in this lesson at length along with their accounting procedures. Garner vs. Murray case and method of distribution of loss among the solvent partners and final settlement are also discussed with suitable accounting problems. Finally, in this lesson, the piecemeal method of distribution of proceeds of assets among partners is discussed.

13.8: Glossary:

Garner vs. Murray case: Under this case - first, the solvent partners should bring in cash equal to their share of the loss on realisation and second – the loss due to the insolvency of a partner should be divided among the other partners in the ratio of capitals then standing.

13.9: Self Assessment Questions:

1. Explain the peculiarities of Garner vs. Murray case with an illustration.

2. Explain the procedure of accounting and distribution of proceeds of assets among the partners and creditors under piecemeal distribution.

Dr. R.Jayaprakash Reddy.

Lesson - 14

BRANCH ACCOUNTING - I

BRANCHES NOT KEEPING FULL SYSTEM OF ACCOUNTING/ DEPENDENT BRANCHES

OBJECTIVES:

The objective of this lesson is

1. To understand the purpose of branch accounting

2. To Know the salient features of dependent branches.

3. To follow the accounting treatment under debtors system and stock and debtors system.

STRUCTURE:

14.1 Introduction

14.2 Objectives of Branch Accounting

14.3 Types of Branches

14.4 Branch not keeping full system of accounting

14.5 System of accounting for branch

14.6 Debtors system

i) Cost price method

ii) Invoice price method

14.7 Final account system

14.8 Stock and Debtors system

a) Goods charged to branch at cost price

b) Goods charged to branch at seeling price

14.9 Distinction between wholesale and Retail profit.

14.10 Summary

14.11 Self Assessment Questions

14.12 Exercises

14.13 Refrence Books

14.1 INTRODUCTION:

In order to increase the sales, the business houses are required to market their products over a large territory and to have an effective and efficient retailing, a business is split into certain branches or departments. The various divisions of the business are located under the same roof, they are known as departments. If the various divisions are located in different places of the same city or in different cities of the same country or in different countries, these are known as branches.

14.2 OBJECTIVES OF BRANCH ACCOUNTING :

A proper accouting system is to be adopted for recording business transactions in case of a business having different branches. The main object of keeping branch accounts is dependent on the nature of the business and specific need of a particular branch.

The objectives of Branch Accounting are as followss :

i. To Know the profit or loss of each branch seperately.

ii. To ascertain the financial position of each branch on a particular date.

iii. To know the cash and goods requirements of the various branches.

iv. To evaluate the progress and performance of each branch.

v. To calculate commission for payment to the manager if based on profits of branch.

vi. To know the profitability of each branch and type of business for expansion of the business.

vii. To give correct suggestions for the improvement in the working of the various branches.

14.3 TYPES OF BRANCHES :

Branches can be broadly classified into two categories for the purpose of recording the business transactions in the books of branch accounts.

1. Branch not keeping full system of accounting / Dependent brnaches.

2. Branch keeping full system of accounting / Independent branches.

   i. Home Branches

   ii. Foreign Branches

14.4 BRANCHES NOT KEEPING FULL SYSTEM OF ACCOUNTING / DEPENDENT BRANCHES :

Branches not keeping full system of accounting are also known as dependent branches. The dependent branch does not maintain its own set of books. All the records have to be maintained by the Head office.

The following are the main features of such branches :

1. All purchases are made by the Head Office. The branches sell only those goods which are received from Head office. Some times the branches may be allowed to make purchases from the local markets.
2. Goods are supplied by the Head office to such branches either at cost price or at invoice price.
3. All expenses of the branch such as rent, salary of staff, advertisement etc are directly paid by the Head office.
4. Petty expenses are paid by the branch manager out of petty cash book balance. Petty cash book is maintained at the branch either as simple cash book or on imprest system.
5. The amount received from cash sales or cash received from the debtors is either remitted to the head office daily or deposited in the account of head office in some local bank.
6. The branch manager is normally expected to sell the goods for cash only but he may be authorised to sell goods on credit in certain cases.

The branches with the above features do not keep proper set of books of accounts. In order to supply the requisite accounting information to the head office, each branch keeps some memorandum records such as the stock register, the cash book and petty cash book. If the branch is authorised to make credit sales, a sales Day book and a Debtors ledger will also be required to be maintained.

14.5 SYSTEM OF ACCOUNTING FOR BRANCH :

Branches of the above type do not keep proper accounts, but accounts are maintained only in the Head office books. The system of accounting for branch to be adopted by the Head Office depends on the size of the branch and the degree of control to be exercised, the nature and volume of branch transactions. Keeping in view of the above factors the head office may keep the accounts of the Branch according to any of the following methods.

1. Debtors system
2. Final account system
3. Stock and Debtors system
4. Whole sale Branch system.

14.6 DEBTORS SYSTEM :

This system is adopted when branch is small in size. Under this system head office opens an account for each branch. This account is known as " Branch account ". Branch account is a nominal account. It serves the same purpose as the profit & loss account. In other words, This account is prepared to know the profit made by the branch. The goods supplied by the Head office to branch may be either at cost price or at invoice price (cost plus profit).

Th following are the Journal entries which are passed in the books of Head Office to record branch transactions.

1. When goods are sent to Branch

    Branch A/C Dr

    To goods sent to

    branch A/C

2. For goods returned by the Branch to Head office

    Goods sent to branch A/C Dr

    To Branch A/C

3. For transfering the goods to another branch

    Goods sent to branch A/C Dr

    To Branch A/C

4. For expenses at the branch met by the Head office.

    Branch A/C Dr

    To Bank A/C

5. For remittances received from the branch

    Bank A/C Dr

    To Branch A/C

6. For transfer of balance in goods sent to branch account

    Goods sent to branch A/C Dr

    To purchases / Trading A/C

7. For closing the balance of assets

    Branch Assets A/C Dr

    To Branch A/C

8. For beginning balances of assets (next year)

    Branch A/C Dr

    To Branch Assets A/C

9. For closing balances of liabilities

   Branch A/C Dr

   To Branch A/C

10. For opening balances of liabilities (next year)

    Branch liabilities A/C Dr

    To Branch A/C

11. For branch profit

    Branch A/C Dr

    To General profit & loss A/C

12. For branch loss

    General profit & loss A/C Dr

    To branch A/C

The Branch account will appear as follows :

Branch Account

(IN HEAD OFFICE BOOKS)

To opening Balances	By Branch liabilities A/C (opeining balances)
Branch cas in hand	By Bank (remittances)
Branch at stock (at cost)	Cash sales
Branch Furniture	Cash received from debtors
Branch Prepaid insurance etc.	By closing balances
To goods sent to Branch A/C	Petty cash
To Bank (expenses paid by H.O)	Stock
To Branch liabilities A/C	Detors
(Closing balances)	Furniture
To General profit & loss A/C (profit)	Prepaid expenses
	By General profit & loss A/C (loss)

1. Branch account shows opening and closing balances of assets and liabilities.
2. Branch account does not show credit sales, sales returns, discounts allowed, allowences bad debts depreciation on fixed assets.

3. Goods in transit will be shown either on both sides of the branch a/c or will be ignored totally.
4. The branch a/c debited with the opening balance of petty cash and the amount sent by the Head Office and credited with the closing balance of petty cash. Petty expenses are automatically charged to branch a/c
5. If the branch has purchased any fixed asset then the branch a/c will be credited by the Head office and the remittance from the branch will be reduced by the amount.
6. If the branch has sold any fixed asset for cash it will increase the remittance and reduce the value of asset at the end.

Cost Price Method .

Illustration 1 :

Messers naveen brothers are having their head office at Delhi and Branch at Bombay. The following are the transactions of the Head office with Branch for the Year ended 31st March 2007.

	Rs.
Sotck at Branch as on 1-4-2006	30,000
Debtors at the Branch as on 1-4-2006	16,000
Petty cash as on 1-4-2006	500
Goods supplied to the Branch	1,50,000
Remittances from Branch:	
Cash sales	10,000
Realisation of debtors	1,57,000
Amount sent to Branch :	
Salary	7,400
Rent	2,400
Petty cash	3,000
Stock at Branch as on 31-3-2007	23,000
Sundry debtors at the branch as on 31-3-2007	50,000
Petty cash as on 31-3-2007	750

Show the Branch Account in the books of Head office.

In Naveen Brothers Books

Bombay Branch Account

		Rs.		**Rs.**
To Balance b/d			By Bank Remittances	
stock at Branch		30,000	Cash saler	10,000
Branch debtors		16,000	Debtors	1,57,000
Petty cas		500		1,67,000
To goods sent to branch A/C		1,50,000	By Balances	
To bank (expenses)			stock at Branch	23,000
Salary	7400		Branch debtors	50,000
Rent	2400		Petty cas	750
petty cash	3000	12,800		
To General profit & loss A/C		31,450		
		2,40,750		2,40,750

Ilustration 2 :

From the following particulars relating to kanpur branch for the year ending 31st March 2007, prepare branch account in the Head Office Books.

		Rs.
Balances as on 1-4-2006		
Stock at the Branch		30,000
Debtors at the Branch		60,000
Petty cash at the Branch		600
Goods sent to Branch during the year		5,04,000
Remittances from the Branch		
For cash sales	1,20,000	
Received from debtors	4,20,000	5,40,000
Goods returned by the Branch		4,000
Credit sales during 2006-07		4,56,000

Cheques sent to Branch during the year :

For salaries	18,000	
For Rent & Taxes	3,000	
For petty cash	2,200	23,200
Balances as on 31-3-2007		
Stock at the Branch		50,000
Petty cash		400
Debtors		96,000

In the Books of Head office

Kanpur Branch Account for the Year ended 31-3-2007

		Rs.			Rs.
			By cash :		
To Branch stock		30,000	Cash saler	1,20,000	
To Branch Debtors		60,000	Received from		
To Branch petty cash		600	debtors	4,20,000	5,40,000
To goods sent to			By Branch stock A/C		50,000
Branch A/C	5,04,000		By Branch debtors A/C		96,000
Less returns to H.O.	4,000	5,00,000			
To Bank (expenses)			By Branch petty cash		400
Salaries	18,000				
Rent & taxes	3,000				
Petty cash	2,200	23,200			
To General profit &					
Loss A/C		72,600			
		6,86,400			6,86,400

llustration 3 :

Shriram solvents co., Bangalore opened a branch at Hyderabad on Ist April 2006. The following information is available in respect of the branch for the year 2006 -07.

	Rs.
Goods sent to the branch	37,500
Cash sales at the branch	25,000
Credit sales at the branch	30,000
Salaries of the branch staff paid by the Head office	7,500
Office expenses of the branch paid by the Head office	6,000
Cash remittances to branch towards petty cash	3,000
Petty cash at branch on 31-3-2007	250
Stock at the branch on 31-3-2007	13,500
Debtors at the branch on 31-3-2007	2,500

Prepare branch A/C to show the profit /loss from the branch for the year

In the Books of Shriram solvent co Bangalore

Hyderabad Branch Account

		Rs.			Rs.
			By Bank (Remittances)		
To Branch sent to Branch A/C		37,500	Cash saler	25,000	
To Branch expenses			cash collected		
Salaries	7,500		form customers	27,500	52,500
office expenses	6,000	13,500	By Balances at the end 31-3-07		
To cash remitted to			Stock		13,500
Branch towards petty cash		3,000	Debtors		2,500
To profit transfened to General			Petty cash		250
Loss A/C		14,750			
		68,750			68,750

Branch Debtors Account

	Rs.		Rs.
To sales - credit	30,000	By cash (balancing figure)	27,500
		By Balance C/d	2,500
	30,000		30,000

Note :

1. Cash collected from customers Rs. 27500 is missing figure in this question. This can be found out by preparing branch debtors account.
2. Credit sales do not appear in the branch account. It is taken only to Branch debtors account.

lustration 4 :

From the following particulars relating to Delhi branch for the year ending December 31,2007 prepare Branch account in the books of Head office.

	Rs.
Stock at the branch on Jan 1, 2007	20,000
Branch Debtors on Jan 1, 2007	8,000
Branch Debtors on Dec 31, 2007	9,800
Petty cash at branch on Jan 1, 2007	1,000
Furniture at Branch on Jan 1, 2007	4,000
Prepaid Fire insurance on Jan 1, 2007	300
Salaries outstanding at branch on Jan 1, 2007	200
Goods sent to branch during the year	1,60,000
Cash sales during the year	2,60,000
Credit sales during the year	80,000
Cash received from debtors	70,000
Cash paid by the branch debtors direct to Head office	4,000
Discount allowed to debtors	200

Cash sent to branch for expenses :

Rent 4000		
Salaries 4800		
Petty cash 2000		
Insurance up to		
March 31st 2008 1200		12,000
Goods returned by the branch		2,000
Goods returned by the debtors		4,000
Stock on December 31		10,000
Petty expenses by the branch		1,700

Provide depreciation on furniture 10% P.A.

Goods costing Rs. 2400 were destroyed on account of fire and a sum of Rs. 2000 was received from the Insurance company.

In the Books of Head Office

Delhi Branch Account

		Rs.				**Rs.**
To stock		20,000	By salaries out standing			200
To debtors		8,000	By Bank Remittances			
To petty cash		1,000	Cash sales		2,60,000	
To Furniture		4,000	Cash received			
To prepaid insurance		300	from debtors		70,000	
To goods sent to branch account		1,60,000	cash paid debtors			
To Bank (expenses			detors direct to H.O		4,000	
Rent	4,000		Received from			
Salaries	4,800		Insurace company		2,000	3,36,000
petty cash	2,000		By good sent to branch			
Insurance	1,200	12,000	(returned to goods by the			
			branch to H.O)			2,000

To General profit & loss account	1,57,900	By stock	10,000
		By petty cash	1,300
		By Debtors	9,800
		By Furniture	3,600
		By prepaid insurance (1/4xRs1200)	300
	3,63,200		3,63,200

Working Notes :

Calcution of petty cash at the end :

Opening balance	1000
Add cash received from H.O.	2000
Total cash with the branch	3000
Less spent by the branch	1700
Closing balance	1300

Invoice price method :

The goods may be sent to the branch by the Head office either at cost price or at a price higher than the cost price i.e. invoice price. Invoice price means cost plus some percentage of profit. The branch manager is required to sell the goods at invoice price only. Generally goods are marked on invoice price to maintain secrecy and to have effective control on stock.

Adjustments in Head office Books :

The branch records are not in any way affected due to invocing of goods at cost plus profit. But inorder to calculated the profit or loss made by the branch, some accounting adjustments are required in the books of Head office.

1. For adjustment of excess price of the opening stock at branch

   stock reserve A/C Dr

   To Branch A/C

2. For adjustment of excess price of goods sent to branch less returns to Head office

   Goods sent to Branch A/C Dr

   To Branch A/C

3. For adjustment of excess price of the closing stock of unsold goods at branch

   Branch A/C Dr

   To stock reserve A/C

Calculation of Mark - up or Load :

For calculating the excess price the following procedure is adopted :

1. When percentage of profit is given on cost, and goods are sent at invoice price.

Example : Suppose the goods are invoiced at cost plus 25%

Let us assume :

Cost is Rs. 100

Pofit is Rs. 25 $\left(100x\frac{25}{100}\right)$

Then selling price = 100+ 25 = 125

The ratio of profit to selling price is 25/125

Then take 1/5 of the invoice price is the excess price or loading.

2. When percentage of profit is given on selling price and cost price is given.

Percentage profit is 25 % on selling price

Assume selling price is Rs. 100

percentage of profit.

25% on selling price Rs. 25

Cost is Rs. 75 (100- 25)

So the percentage on cost will be 33 $\frac{1}{3}$% or $\frac{1}{3}$ of cost i.e $\frac{25}{75}$

3. If the percentages are given on cost or on selling prices the same amounts are given, then take same percentage of profit on cost or on selling price.

Illustration 5 :

A Head office in Meerut has a branch in Kanpur to which goods are invoiced by the Head office at cost plus 25%. All cash received by the branch is daily remitted to Head office. From the following particulars show how the Branch account will appear in the H.O. books. Entries are to be made at invoice price.

		Rs.
Stock on Jan 1, 2007		62,500
Debtors on Jan 1, 2007		60,000
Goods supplied by the H.O(at Invoice price)		2,00,000
Cash sales		80,000
Cash received from customers		1,47,500
Goods returned to the Head office (at Invoice price)		12,000
Cheques received from the H.O.		
Wages and salaries	55,000	
Rent, Rates & Taxes	15,000	
Sundry expenses	2,550	72,550
Stock on 31-12-2007 (at invoice price)		75,000
Debtors on 31-12-2007		1,12,500
Liability for petty expenses		550

In the Books of Head Office

Branch Account

		Rs.			Rs.
To Branch stock A/C		62,500	By Bank (Remittances)		
To Branch Debtors A/C		60,000	Cash sales	80,000	
To goods sent to			Cash from		
Branch	20,00,000		debtors	1,47,500	2,27,500
Less returns to H.O.	12,000	1,88,000	By Branch stock A/C		75,000
To Bank A/C			By Branch Debtors A/C		1,12,500
wages & salaries	55,000		By stock reserve A/C		
Rent Rates & taxes	15,000		$62,500 \times \frac{25}{125}$		12,500
Sundry expenses	2,550	72,550			

To stock reserve A/C $75{,}000 \times \frac{25}{125}$	15,000	By goods sent to $18{,}800 \times \frac{25}{125}$	37,600
To liability for petty expenses	550		
To General profity loss A/C	66,500		
	4,65,100		4,65,100

Note :

Percentage of profit on cost 25%

Assume

Cost = Rs. 100

Profit = Rs. 25

Selling price = Rs. 125

Profit percentage is given on cost. But invoice price is given in the problem. So percentage of profit on invoice price is 25/125 or 1/5 x 100 = 20 %.

Illustration 6 :

Sun shine co has an olde established branch at kolkata. Goods are invoiced to the branch at 20% profit on invoice price, the branch having been instructed to send all cash daily to hte Head office. All expenses are paid by the Head office except petty expenses which are met by the Branch manager. From the following particulars you are required to prepare branch account in the books of Head office.

	Rs.
Stock on Jan 1, 2007 (invoice price)	30,000
Sundry Debtors on Jan 1, 2007	18,000
Cash in Hand on Jan , 1, 2007	800
Office furniture on Jan, 1, 2007	2,400
Goods supplied by the Head office (Inovice price)	1,60,000
Goods returned to Head office	2,000
Goods returned by Debtors	960
Debtors at the end	16,440
Cash sales	1,00,000
Credit sales	60,000
Discount allowed	600

Expenses paid by Head office		
Rent	2,400	
Salary	4,800	
stationery and Printing	600	7,800
Petty expenses paid by Branch manager		560
Stock on 31-2-2007 (Invoice price)		28,000

Provide depreciation on furniture @ 10% P.A.

In the Books of Sunshine co

Branch Account

		Rs.			**Rs.**
To Branch stock A/C		30,000	By Bank (Remittances)		
To Branch Debtors A/C		18,000	Cash sales	1,00,000	
To Branch cash in hand		800	Cash from		
To Branch office furniture		2,400	debtors	60,000	1,60,000
To Goods sent to			By Branch stock		28,000
Branch A/C	1,60,000		By Branch Debtors		16,440
Less return to H.O.	2,000	1,58,000	By Branch Furniture		2,160
To Bank (expenses)			By Stock reserve 30,000 x $\frac{20}{100}$		6,000
Rent	2,400		By Goods sent to Branch A/C		
Salary	4,800		1,58,000 x $\frac{20}{100}$		31,600
Stationery & printing	600	7,800	By cash in hand (800-560)		240
To stock Reserve 28,000 x $\frac{20}{100}$			5,600		
To General profit & loss A/C					
(profit)		21,840			
		2,44,440			2,44,440

Working Notes :

Calculation of cash received from Debtors

Debtors Account

	Rs.		Rs.
To Branch b/d	18,000	By sales returns A/C	960
To sales (credit) A/C	60,000	By cash (Balancing figure)	60,000
		By Discount	600
		By Balance C/D	16,440
	78,000		78,000

Illustration 7 :

Messers ABC co has a branch at madras goods are invoiced from Head office at cost plus 33 1/3 %. Find out profit at the branch according to Debtors system.

Opening Balances :		
Debtors		12,000
Petty cash		1,200
Furniture		2,400
Stock (I.P)		10,000

Cash sent by Head office for petty expenses Rs. 2500. Branch expenses and lossess.

Frieght & Advetisement		6,000
Bad debts		100
Depreciation on furniture		100
Petty expenses		2,000
Sales :		
Cash	60,000	
Credit	40,000	1,00,000
Goods returned by Debtors		1,000
Goods returned by Branch to Head office		2,000
Cash received from Debtors		20,000

Stock at the end (I.P)	8,000
Goods invoiced by Head office during the year	1,02,000

In the Books of ABC co

Branch Account

		Rs.			Rs.
To Branch Debtors A/C		12,000	By Bank (Remittances)		
To Branch petty cash		1,200	Cash sales	60,000	
To Branch furniture		2,400	Cash received from		
To Branch stock		10,000	debtors	20,000	80,000
To Goods sent to			By Branch stock A/C		8,000
Branch A/C	1,02,000		By Branch Debtors		30,900
Less return to H.O.	2,000	1,00,000	By Branch Furniture		2,300
To Bank A/C (Cash sent)		2,500	By Branch petty cash		
To Bank A/C			(1200 + 2500 - 2000)		1,700
Freight & Advertisement		6,000	By stock reserve (1,00,000 x $\frac{1}{4}$)		2500
To Stock reserve A/C (8000 x $\frac{1}{4}$)		2,000	By goods sent to Branch A/C		
To General profit & loss A/C		12,800	1,00,000 x $\frac{1}{4}$		25,000
		1,47,900			1,47,900

Working Notes :

Calculation of Debtors at the end

Debtors Account

	Rs.		Rs.
To Branch b/d	12,000	By bad debts	100
To credit sales A/C	40,000	By sales returns	1,000
		By cash	20,000
		By Balance C/D (bal fig)	30,900
	52,000		52,000

Illustration 8 :

Royal brothers & Co of Bombay has a branch at Madras. Goods are sent by the Head office at invoice price which is at profit of 20% on invoice price. All expenses are paid by the Head office. From the following paritculars prepare branch account in the Head office books when goods are shown at invoice price.

Opening Balances :		
Stock at invoice prices		11,000
Petty cash		100
Goods sent to branch at invoice price		20,000
Expenses made by head office :		
	Rent	600
	Wages	200
	Salary etc.	900
Remittances made to head office		
	Cash sales	2,650
Cash collected from Debtors		21,000
Goods returned by Branch at invoice price		300
Credit sales		22,800
Balance at the end		
	Stock at invoice price	13,000
	Debtors at the end	2,000
	Petty cash (including Miscellaneous income Rs 25 not remitted)	125
Bad debts		300
Goods returned by customers		700

Calculation of Debtors at the end

Debtors Account

	Rs.		Rs.
To Branch b/d (bal fig)	1,700	By bad debts	300
To sales credit	22,800	By allowences	500
		By sales returns	700
		By cash	21,000
		By Balance C/D	2,000
	24,500		24,500

In the Books of Royal Brothers & Co.

Madras Branch Account

		Rs.			Rs.
To Branch stock A/C		11,000	By Bank (Remittances)		
To Branch Debtors A/C		1,700	Cash sales	2,650	
To Branch petty cash A/C		100	Cash from		
To Goods sent to			debtors	21,000	23,650
Branch A/C	20,000		By Branch stock A/C		13,000
Less return to H.O.	300	19,700	By Branch Debtors A/C		2,000
To Bank			By Branch petty cash A/C		100
Rent	600		By stock reserve A/C		
Wages	200		$11000 \times \frac{20}{100}$		2,200
Salary	900	1,700	By Goods sent to Branch A/C		
To stock reserve $(13000 \times \frac{20}{100})$		2,600	$(19700 \times \frac{20}{100})$		3,940
To general profity & loss A/C		8,095	By Miscellaneous Income		25
		44,895			44,895

14. 7 FINAL ACCOUNT SYSTEM :

According to this system the profit or loss made by the branch is determined by preparing Branch Trading and profit & loss account at cost price. It should be carefully noted that all expenses whether paid by the head office or by the branch are debited to the Trading & profit & loss account prepared for the branch. The profit & loss as disclosed by this account is exactly same as that of the branch account prepared according to Debtors system. The Branch trading and profit & loss A/C is only a memorandum account not forming part of the full accounting system. If the branch trading & profit and loss account, then such a branch account will be treated as a personal account. Then branch account will show a debit balance which will be equal to net worth or net assets available at branch at the end of the accounting period.

Illustration 9 :

A Bombay merchant has a branch at Madras to which he charges but the goods at cost plus 25%. The madras Branch keeps its own sales ledger and remits all cash received to the Head office every day. All expenses are paid from teh Head office. The Transactions for the Branch during the year 2007 were as follows :

Stock 1-1-2007	22,000
Debtors 1-1-2007	200
Petty cash 1-1-2007	200
Cash sales	5,300
Credit sales	47,900
Goods sent to Branch at I.P	40,000
Collections on ledger accounts	42,000
Goods returned to H.O at I.P	600
Bad debts	600
Allowences to customers	500
Returns Inwards	1,000
Cheques sent to Branch	
Rent	1,200
Wages	400
Salary and other expenses	1,800
Stock (31-12-2007) at I.P	26,000
Debtors (31-12-2007) at I.P	4,000

Petty cash (31-12-2007) including miscellaneous income Rs. 50 not remitted	250

Prepare Branch Trading and profit & loss account and Branch account for the year ending 31-12-2007

Branch Trading and Profit & Loss account for the year ending 31-12-2007

		Rs.			**Rs.**
To opening stock (2200 -4400)		17,600	By sales		
To goods sent to Branch A/C			Cash	5,300	
(40,000 - 8,000)	32,000		Credit	47,900	
				53,200	
Less returns (600 -120)	480	31,520	Less returns	1,000	52,200
To wages		400	By closing stock (26000-5200)		20,800
To Gross profit C/D		22,480			
		73,000			73,000
To bad debts		600	By gross profit b/d		22,480
To allowences		500	By Accrued income		50
To Rent		1,200			
To salaries & other expenses		1,800			
To Net profit		19,430			
		22,530			22,530

Branch Account (personal)

		Rs.		**Rs.**
To opening balance			By remittances (5300 +42000)	47,300
Stock		17,600	By Balance C/D	
Debtors		200	(20800 + 4000+250)	25,050
Petty cash		200		
To Goods sent to Branch	32,000			
Less returns	480	31,520		
To bank expenses		3,400		
To profit		19,430		
		72,350		72,350

14.8 STOCK AND DEBTORS SYSTEM :

There is yet another method of calculating profit and loss of a branch which is known as stock and Debtors system or Analytical Method. According to this system instead of opening one branch account, separate accounts are opened for various transactions at branch. According to this system a separate ledger for each branch will have to be maintained at head office for keeping accounts. Such as Branch stock, Branch Debtors, goods sent to Branch, Branch expenses, and Branch Assets etc. The Branch cash or petty cash account may sometime be required to be maintained if the branch is permitted to use the available cash for making certain payments. Preparation branch stock account will however, vary from branch to branch depending upon the method charging out the goods sent to branch.

A) Goods charged to Branch at Cost price :

In this the following accounts are prepared in the books of the head office -

1. **Branch stock Account :** This account is similar to that of the Branch trading account. This account is debited with opening stock at branch, goods sent to branch and the goods returned to the branch by customers. This account is credited with cash sales, credit sales made by the branch, the goods returned by branch to head office and closing stock at branch. The balance of this account represents gross profit or gross loss and the same is transferred to branch profit & loss A/C.
2. **Goods sent to Branch Account :** This account maintained in the books of the head office is credited with goods sent to branch and is debited with goods returned to branch. At the end of the year the balance of this account is transferred to purchases or trading account.
3. **Branch Debtors account :** This is prepared when the branch sells goods on credit and for ascertaining the balance of debtors at branch.
4. **Branch petty cash account :** This account is debited with the balance of petty cash and cash sent to the branch by the H.O. and is credited with all petty cash expenses incurred by the branch. The balance is petty cash available in hand.
5. **Branch profit & loss account :** The gross profit or loss from Branch stock account is transfered to this account. The branch expenses and loss are debited to this account and incomes are credited to this account. The balance of this account is net profit or loss for the year.
6. **Branch cash Account :** This account is maintained for recording all cash transactions relating to the branch.

   The following journal entries will be required for preparation ofbranch accounts according to Stock & Debtors system in the books of H.O.

1. For goods sent to branch

   Branch stock A/C Dr

   To Goods sent to branch A/C

2. For goods returned by branch

Goods sent to branch A/C Dr

To Branch stock A/C

3. For cash sales at branch remitted to H.O.

Branch cash A/C Dr

To Branch stock A/C

4. For credit sales at branch

Branch Debtors A/C Dr

To Branch stock A/C

5. Returns from customers

Branch stock A/C Dr

To Branch Debtors A/C

6. Bad debts & Discount etc allowed.

Branch Expenses A/C Dr

To Branch Debtors A/C

7. Cash received from branch debtors remitted to H.O.

Branch Cash A/C Dr

To Branch Debtors A/C

8. Shortage of goods in branch stock

Branch P&L A/C Dr

To Branch stock A/C

9. Surplus of goods in branch stock

Branch Stock A/C Dr

To Branch P&L A/C

10. Expenses paid by head office

Branch Expenses A/C Dr

To cash A/C

11. Transfer of branch expenses to branch P&L A/C

    Branch P&L A/C Dr

    To Branch stock A/C

12. For goods in transit

    Goods in transit A/C Dr

    To Branch stock A/C

13. For goods lost in transit being abnormal loss

    Branch P&L A/C Dr

    Insurance claim receivable A/C

    (if any claim is admitted)

    To Branch stock A/C

14. For transfer of branch gross profit

    Branch Stock A/C Dr

    To Branch P&L A/C\

15. Transfer of branch net profit

    Branch P&L A/C Dr

    To General P&L A/C

Illustration 10 :

XY Ltd. invoices goods to their various branches at cost and the branches sell on credit as well as for cash. From the following details relating to Baroda Branch, prepare necessary accounts in the books of head office.

	Rs.
Stock on 1st Jan 2007	30,000
Stock on 31st Dec 2007	28,000
Debtors on 1st Jan 2007	50,000
Debtors on 31st Dec 2007	70,000
Cash at Branch on 1St Jan 2007	1,000
Cash sent to branch	3,000
Goods sent to branch	1,00,000

Goods returned by the branch	1,000
Cash sales	64,000
Credit sales	1,16,000
Allowances to customers	600
Returns from customers	1,200
Bad debts written off	1,000
Discount allowed to customers	4,000
Remittance from branch	1,40,000
Rent & Tax	3,000
Wages & Salaries	10,000
General trade charges	3,000
Normal loss of goods due to wastage	2,000
Abnormal loss of goods due to pilferage	4,000

In the Books of Head Office

Branch Stock Account

	Rs.		**Rs.**
2007		2007	
Jan1 To Balance b/d	30,000	Dec 31 By cash A/C	64,000
Dec31 To goods sent		Dec 31 By Branch Debtors A/C	1,16,000
to branchA/C	1,00,000	Dec 31 By goods sent to	
To Branch Debtors	1,200	to branch A/C	1,000
To Branch P& L A/C (gross profit)	81,800	By Branch P&L A/C (pilferage0	4,000
		By Balance C/D	28,000
	1,13,000		1,13,000

Goods Sent To Branch Account

	Rs.		**Rs.**
2007		2007	
Dec31 To Balance stock	1,000	Dec 31 By Branch stock	1,00,000
Dec31 To Purchases A/c b/f	99,000		
	1,00,000		1,00,000

Branch Debtors Account

	Rs.			Rs.
2007		2007		
Jan 1 To Balance b/d	50,000	Dec 31 By Branch cash b/f		89,200
Dec31 To Branch stock	1,16,000	By Branch expenses		
		Allowences	600	
		Discount	4,000	
		Bad debts	1,000	5,600
		Branch stock		1,200
		Balance c/d		70,000
	1,66,000			1,66,000

Branch Cash Account

	Rs.			Rs.
2007		2007		
Jan 1 To Balance b/d	1,000	Dec 31 By Branch expenses		
Dec31 To General cash A/C	3,000	Rent & Taxes	3,000	
To Branch stock A/C	64,000	Wages & salaries	10,000	
To Branch debtors A/C	89,200	General Trade		
		charges	3,000	16,000
		Dec 31By General cash A/C		1,40,000
		Dec 31 By Balance C/d		1,200
	1,57,200			1,57,200

Branch Expenses Account

		Rs.		Rs.
2007			2007	
Dec 31 By Branch expenses			Dec 31 By Branch P&L A/C	21,600
Rent & Taxes	3,000			
Wages & salaries	10,000			
General Trade				
charges	3,000	16,000		
Dec 31 Branch debtors A/C		5,600		
		21,600		21,600

Branch profit and Loss Account

	Rs.		Rs.
2007		2007	
Dec31 By Branch expenses		Dec 31 By Branch stock A/C	
Allowences	600	(Gross profit)	81,800
Discount	4,000		
Bad debts	1,000		
Rent & Taxes	3,000		
Wages & salaries	10,000		
General Trade charges	3,000		
Branch stock	4,000		
(cost of goods pilfered)			
To net profit transferred to General			
P& L A/C	56,200		
	81,800		81,800

Illustration 11 :

A Head office in Delhi has a branch at Bombay where goods are invoiced at cost price from the following particulars, prepare the necessary ledger accounts in the book of H.O.

			Rs.
Stock on 1-1-2007			10,000
Debtors on 1-1-2007			8,750
Petty cash at Branch on 1-1-2007			1,250
Goods sent to branch			50,000
Cash sales			18,750
Cash received from Debtors			37,500
Goods returned to H.O.			2,500
Bad debts			625
Discount & allowences			1,875
Goods returned by customers			5,000
Expenses of branch			
	Salaries	10,000	
	Rent & Taxes	1,250	
	Petty expenses	1,500	12,750
Stock as on 31-12-2007			15,000
Debtors on 31-12-2007			12,500
Petty cash at branch at 31-12-07			1,000

In the Book of Head Office

Branch stock Account

	Rs.		Rs.
To balance b/d	10,000	By Bank A/C	18,750
To goods sent to Branch A/C	50,000	By Branch Debtors A/C	48,750
To Branch Debtors A/C	5,000	By goods sent to branch A/C	2,500
To Branch P&L A/C	20,000	By Balance C/D	15,000
	85,000		85,000

Branch Debtors Account

	Rs.		Rs.
To Balance b/d	14,000	By Bank A/c	60,000
To Branch stock A/C	78,000	By Branch stock A/C	8,000
		By Branch Expenses A/C	
		Bad debts	1,000
		Discount	3,000
		By Balance C/D	20,000
	92,000		92,000

Goods Sent to Branch Account

	Rs.		Rs.
To Branch stock A/C	4,000	By Branch stock A/C	8,000
To Purchases A/C	76,000		
	80,000		80,000

Branch Expenses Account

	Rs.		Rs.
To Branch Debtors A/c		By Branch P&L A/C	24,800
Bad debts	1,000		
Discount	3,000		
To bank A/c			
Salaries	16,000		
Rent & Taxes	2,000		
To Branch petty cash A/C			
Petty expenses	2,800		
	24,800		24,800

Branch Petty Cash Account

	Rs.		Rs.
To Balance b/d	2,000	By Branch expenses A/c	2,800
To bank A/c	2,400	By Balance C/d	1,600
	4,400		4,400

B) Goods charged to Branch at Selling price :

The stock & debtors system, as discussed above is particularly consideredd very useful and appropriate where goods are invoiced to the branch at selling price. A brief description of various accounts opened in the books of the head office is given below.

1. **Branch stock Account :** In this account the entries are made at invoice price. The balanace of this account after posting all the relevant entries should be equal to the stock in hand available at branch, unless there is any surplus or shortage. The profit or the load included in such surplus or shortage should be transfened to the branch adjustment account while the cost of such surplus or shortage should be adjusted to the branch profit & loss account.

2. **Branch Adjustment Account :** This account is prepared for ascertaining the gross profit of the branch. This is done by eliminating the loading. The gross profit or loss transfened to the Branch profit & loss account.

3. **Branch profit & loss Account :** This account is prepared to ascertain the net profit or loss at the branch. The branch expenses, shortage of stock at cost value and losses stock etc are debited to the account. This account is further credited with incomes and gains, if any at branch and cost value of surplus in branch stock etc. The balance of this account represents net profit or loss made at the branch during the accounting period which is transferred to general profit & loss A/C

4. **Stock Reserve / Suspense Account :** This account is prepared to adjust the loads included in the value of opening and closing stock at the branch.

A Part from the above other accounts which are required to be prepared are branch expenses account, Branch Debtors account, Branch Cash account, and Branch assets account etc.

1. When goods are sent to branch

Branch stock A/C Dr

To goods sent to Branch A/C

Reverse entry will be pass for goods returned to H.O.

2. When sales are made by the branch for cash sales.

Cash A/C Dr

To Branch stock A/C

For credit sales

Branch Debtors A/C Dr

To Branch stock A/C

3. When cash is received from Debtors

Cash A/C Dr

To Branch Debtors A/C

4. For discount allowed, allowences and bad debts

Branch Expenses A/C Dr

To Branch Debtors A/C

5. When goods are returned by branch debtors

Branch stock A/C Dr

To Branch Debtors A/C

6. When goods are returned by branch debtors direct to head office.

Goods sent to Branch A/C Dr

Branch Adjustment A/C Dr

To Branch Debtors A/C

7. For normal loss of stock

Branch Adjustment A/C Dr (Invoice price)

To Branch stock A/C

8. For abnormal loss, waste, or leakage or shortage of stock

Branch Adjustment A/C Dr

Branch P&L A/C Dr

To Branch stock A/C

Note: Reverse entry for surplus in stock

9. When goods are transferred from one branch to another branch

Transferor Branch

Goods sent to Branch A/C (cost) Dr

Branch Adjustment A/C (loading) Dr

To Branch stock A/C (invoice)

Transfere Branch

Branch Stock A/C (invoice) Dr

To goods sent to Branch A/C (cost)

To Branch Adjustment A/C (loading)

10. For apparent profit over the invoice price

Branch stock A/C Dr

To Branch Adjustment A/C

11. For Branch expenses paid in cash

Branch expenses A/C Dr

To cash A/C

12. For closing branch expenses account (excluding cash in hand at the end) to branch P&L account

    Branch P&L A/C Dr

    (with recurring expenses)

    To Branch expenses A/C

13. For adjustment of excess price of the opening stock

    Stock reserve A/C Dr

    To Branch adjustment A/C

14. For adjustment of excess price of the closing stock

    Branch Adjustment A/C Dr

    To stock Reserve A/C

15. For adjustment of excess price of goods sent to branch

    Goods sent to branch A/C Dr

    To Branch adjustment A/C

16. For insurance claim recoverable

    Insurance claim A/C Dr

    To Branch P&L A/C

17. For transfer of balance of Branch Adjustment A/C (i.e gross profit)

    Branch Adjustment A/C Dr

    To Branch P&L A/C

    For gross loss reverse entry

18. For transfer of profit or loss to general profit and loss account

    a) If profit

    Branch P&L A/C Dr

    To General P&L A/C

    b) If loss

    General P& L A/C Dr

    To Branch P&L A/C

19. For closing the goods sent to branch account

    Goods sent to branch A/C Dr

    To purchases or Trading A/C

Illustration 12 :

Messers Sunil trader, Madras opened a branch at Bangalore on 1-7-2006. The goods were sent by the head office to the branch invoiced at selling price of the branch which was 125% of the cost price of the Head office.

The following are the particulars relating to the transactions of Bangalore branch.

		Rs.
Goods sent to Branch (at cost to H.O)		1,40,400
Sales : Cash		62,500
Credit		87,500
Cash collected from Debtors		78,000
Discount allowed		2,000
Spoiled cloth in bales written off at invoice price		250
Goods returned by debtors to branch		2,500
Cash sent to Branch for :		
Salaries	1,500	
Freight outward other expenses	5,500	
including godown rent	3,000	10,000
Stock on 30 June 2007 at invoice price		27,750

Ascertain the profit or loss for the Bangalore Branch for the year endeed 30-06-07 by preparing accounts under stock and Debtors system.

Branch Stock Account

	Rs.		Rs.
To goods sent to branch account		By cash A/C (sales)	62,500
(140400+35100)	1,75,500	By Branch Debtors A/C	
To branch Debtors A/C Returns	2,500	(credit sales)	87,500
		By Branch Adjustment Account	
		(Loading of abnormal loss)	50
		By Branch P&L A/C (cost of AL)	200
		By Balance C/D	27,750
	1,78,000		1,78,000

Goods Sent to Branch Account

	Rs.		Rs.
To Branch Adjustment Account		By Branch stock Account	1,75,500
(20% of Rs. 175500)	35,100		
To purchases account	1,40,400		
	1,75,500		1,75,500

Branch Debtors Account

	Rs.		Rs.
To Branch stock account	87,500	By cash account	78,000
		By Branch stock Account	
		(sales returns)	2,500
		By Branch expenses account	
		Discount allowed	2,000
		BY Balance c/d	5,000
	87,500		87,500

Branch Expenses Account

	Rs.		Rs.
To cash account		By Branch P&L account	12,000
Salaries	1,500		
Freight outward	5,500		
Other expenses	3,000		
To Branch debtors account			
(discount)	2,000		
	12,000		12,000

Branch P&L Account

	Rs.		Rs.
To branch expenses account	12,000	By Branch Adjustment A/C	29,500
To branch stock A/C			
(cost of spoilage)	200		
To Net profit	17,300		
	29,500		29,500

Illustration 13 :

Crown Industries, Bombay has a branch at Madras to which goods are invoiced at cost+25%. The Branch makes the sales both for cash and on credit. Branch expenses are paid direct from Head Office and the branch remits all cash to Head office.

From teh following details, prepare the necesary ledger accounts in Head Office books to calculate branch profits as per the stock and debtors syste.

	Rs.
Goods received from Head office at I.P	60,000
Returns to Head office at I.P	1,200
Branch stock on 1-1-2007 at I.P	6,000
Cash sales	20,000
Credit sales	36,000
Branch Debtors on 1-1-2007	7,200
Cash collected from debtors	32,000
Discount allowed to debtors	600
Bad debts in the year	400
Goods returned by debtors to branch	800
Rent, Rates, Taxes at branch	1,800
Branch office expenses	600
Branch stock at I.P on 31 - 12-07	12,000

The difference in Branch stock account is to be treated as surplus.

Branch Stock Account

In the Books of Bombay

		Rs.			Rs.
To Balance b/d		6,000	By cash A/C		20,000
To goods sent to			By branch Debtors A/C		36,000
branch A/C	60,000		By balance C/d		12,000
Less returns	1,200	58,800			
To Branch Debtors A/C					
(sales returns)		800			
To Branch Adjustment A/C					
(Loading of surplus)		480			
To Branch P&L					
(Cost of surplus)		1,920			
		68,000			68,000

Branch Debtors Account

		Rs.			Rs.
To balance b/d		7,200	By cash A/c		32,000
To branch stock A/C			By Branch expenses A/C		
(credit sales)		36,000	Discount	600	
			Bad debts	400	1,000
			By Branch stock A/C		
			(sales returns)		800
			By Balance C/d		9,400
		43,200			43,200

Branch Expenses Account

	Rs.		Rs.
To cash A/C	2,400	By Branch P&L A/C	3,400
To Branch Debtors A/C	1,000		
	3,400		3,400

Branch Adjustment Account

	Rs.		Rs.
To stock reserve A/C	2,400	By stock reserve A/c	1,200
To Branch P&L A/C		By goods sent to	
(Gross profit)	11,040	Branch A/C	11,760
		By Branch stock A/C	480
	13,440		13,440

Branch Profit And Loss A/C

	Rs.		Rs.
To Branch expenses A/C	3,400	By Branch Adjustment A/C	11,000
To General P&L A/C		By Branch stock A/c	1,920
(Net profit)	9,560		
	12,960		12,960

14.9 DISTINCTION BETWEEN WHOLE SALE AND RETAIL PROFIT AT BRANCH :

Sometimes head office also sells goods at retail or list price besides sending the goods to brances at wholesales prices. The difference between the retail price and wholesale price will be the profit made by the branch. Suppose if an article costs to head office Rs. 100 and it is supplied to the branches at Rs. 160 at wholesale price but both head office and branches sell goods at Rs.200 then profit made by the branch will be Rs. 40 (i.e. Rs 200 - Rs. 160) and not Rs. 100 (Rs.200 - Rs. 100)

Illustration 14 :

A Head office sends goods to its branch at 20% less than the list price. Goods are sold to customers at cost plus 100% From the following particulars as certain the profit made at the Head office and branch on the wholesale basis :

	Head office Rs.	Branch Rs.
Opening stock at cost		
(at whole sale price in case of Branch)	20,000	16,000
Purchases	1,00,000	–
Goods sent to Branch (whole sale price)	48,000	–
Sales	85,000	40,000
Sundry expenses	7,000	4,000

If cost Price = Rs 100

List price = Rs 200

Whole sale price = Rs 160

Branch Expenses Account

	H.O Rs.	Branch Rs.		H.O Rs.	Branch Rs.
To opening stock	20,000	16,000	By sales	85,000	40,000
To Purchases	1,00,000	–	By goods sent to branch A/C	48,000	–
To goods from H.O.	–	48,000			
To gross profit C/d	60,500	8,000	By closing stock	47,500	32,000
	1,20,500	72,000		1,20,500	72,000

To sundry expenses	7,000	4,000	By gross profit b/d	60,500	8,000
To stock reserve			By stock reserve		
againt closing			againt closing		
Branch stock			Branch stock		
$\frac{60}{160}$ x 32,000)	12,000		(16000 x $\frac{60}{160}$)	6,000	
To Net profit	47,500	4,000			
	66,500	8,000		66,500	8,000

Calculation of closing stock

	Head office Cost	**Branch Wholesale price**
Opening stock at cost		
(whole sale price in case of Branch)	20,000	16,000
Purchases at cost	1,00,000	–
Goods sent to Branch (whole sale price)		48,000
	1,20,000	64,000
Less cost of goods sent to branch		
(Rs 48,000 x $\frac{60}{160}$)	30,000	–
	90,000	64,000
Less cost of sales to out siders		
whole sale price in case in branch		
100/200 of Rs. 85,000	42,500	
160/200 of Rs. 40,000		32,000
	47,500	32,000

14.10 SUMMARY :

Branches are opened by a business enterprise to increase the range of operations of the business over a wider area. The main office, known as head office controls the branches scattered over near or distant places. Branches may be dependent branches or independent branches. Dependent branches may sell the goods merely for cash or for credit also. The proceeds are sent or remitted directly to the head office either daily or at periodical intervals. An accounts is usually opened with a local bank where sale proceeds are deposited by the branch. The branch manager is provided with a small amount of cash on the imprest system for meeting day to day petty items of expenses. In case of credit sales the debtors accounts are also kept by the branch.

Profit or loss is ascertained by the head office in the case of dependent branches by preparing barnch account (under debtors system) and by preparing Branch adjustment account, under stock and debtors system. Other accounts prepared under stock and debtors system are Branch stock account, Branch debtors account and Branch expenses account.

14.11 SELF ASSESSMENT QUESTIONS :

1. What do you mean by branch accounting ? What is its purpose ?
2. Describe the salient features of system of branches not keeping full system of accounting.
3. What are the essential features of branch account under
   a. Debtors system, and
   b. stock and Debtors system
4. Distinguish between wholesale and retail branches. What are the special accounting features ?
5. Explain the accounting procedure for branch on the basis of Debtors system and Final Account system.

14.12 EXERCISES :

1. India Traders, Bombay opened a branch at baroda on Ist January 2007. The following information is available in respect of the branch for the year 2007.

	Rs.
Goods sent to branch	75,000
Cash sales at the branch	50,000
Credit sales at the branch	60,000
Salaries of the branch staff paid by head office	15,000

Office expenses of the branch	
paid by the head office	12,000
Cash remittance to branch	
towards pety cash	6,000
Petty cash at branch on 31-12-2007	500
Debtors at branch on 31-12-07	27,000
Cash received from Debtors	55,000

Prepare Branch Account to show profit / Loss from the branch for the year 2007.

[Profit. Rs. 29,500]

2. From the following particulars relating to patna branch for the year ending December31, 2007 prepare branch account in the books of head office.

		Rs.
Balances on 1-1-2007		
Stock at branch		20,000
Branch debtors		7,000
Petty cash at branch		750
Furniture at branch		6,000
Prepaid fire insurance		575
Salaries out standing at branch		1,050
Discount allowed to debtors		550
Cash sent to branch in expenses		
Rent	6,000	
Salaries	2,700	
Petty cash	2,000	
Annual insurance upto March 31, 2007	800	11,500
Goods sent to branch during the year		1,40,000
Cash sales during the year		1,65,000
Credit sales during the year		91,500
Cash received from debtors		67,500

Cash paid by the branch debtors		
direct to Head office		11,000
Goods returned by the branch		2,000
Goods returned by debtors		3,500
Stock on December 31		19,000
Petty expenses by the branch		1,425
Provide depreciation on furniture at 10% P.A.		

(Profit Rs. 1,02,600, Debtors at the end 15,950 ; Petty cash closing balance Rs. 1,325)

3. Moonshine Co. Delhi has a branch at Kolkata. It invoices goods to the branch at selling price which is cost plus 33 1/3 %. From the following particulars prepare branch account, Branch Debtors account and goods sent to Branch Account in the books of Moonshine Co.

		Rs.
Stock on Ist January 2007 at invoice price		15,000
Debtors on Ist January 2007		11,400
Goods invoiced to branch during		
the year at invoice price		67,000
Sales at branch		
cash	31,000	
credit	37,400	68,400
Cash received from debtors		40,000
Discount allowed to customers		300
Bad debts written off		250
Cheques sent to branch		
salaries	5,000	
Sundry expenses	1,700	6,700
Stock on 31st Dec 2007 (invoice price		13,400

[Profit 9700 ; Debtors at the end 8,250]

4. From the details given below relating to pune branch for the year ending March 31,2007. Prepare pune Branch account and Branch debtors account in the books of Head office. Show your working clearly. Goods are invoiced to give a profit of 20% of selling price.

	Rs.
Stock on 1-4-2006	5,000
Debtors on 1-4-2006	2,000
Furniture on 1-4-2006	1,000
Petty cash on 1-4-2006	200
Insurance prepaid on 1-4-2006	50
Salaries due on 1-4-2006	1,000
Goods sent to branch	40,000
Cash sales	55,000
Total sales	70,000
Cash received from debtors	16,000
Goods returned by the branch	500
Goods returned by the debtors	200
Cash sent to the branch for	
Rent	3,600
Salaries	10,200
Petty cash	600
Insurance (up to June 2007)	400
Petty cash expenses incurred by the branch	500
Depreciate furniture by 20% stock on 31-3-2007	3,000

[Profit 22,750]

5. A trader has its branch at Madras to which the goods are invoiced at cost plus 20% prepare Branch A/C in H.O books from the following :

	Rs.
Opening stock at branch	24,000
Cash sales at branch	17,500
Credit sales	41,000
Collections from Debtors	37,900
Goods received from H.O.	30,000
Branch Expenses :	
Paid by H.O	3,000
Paid by Branch	6,000
Expenses unpaid	1,400
Closing stock at Branch	18,000
Closing balance of debtors	9,160
Goods in transit from H.O.	3,600

[Profit 18,100]

6. A Head office in Bombay has a branch in Ahmedabad to which goods are invoiced by the head office at cost price plus 25% . All cash received by the branch is remitted to head office. All expenses are paid from Bombay, from the following particulars, show how the branch account will appear in the books of the head office.

		Rs.
Stock on I st July 2006 (at invoice price)		12,500
Debtors on Ist July 2006		12,000
Goods invoiced from Bombay		40,000
Remittances to Bombay		
Cash sales	16,000	
Cash received from Debtors	29,500	45,000
Goods returned to the head office		2,400

Cheques received from Bombay :

Wages and salaries	11,000	
Rent , rates etc.	3,000	
Sundry expenses	500	14,500
Stock on June 30,2007 (invoice price)		15,000
Debtors on June 30,2007		22,500
Liablility for petty expenses		420

[Profit Rs. 13,000]

7. Samata Co. of Hyderabad has a branch at Vijayawada. Goods are invoiced to branch at cost plus 20%. The expenses of the branch are paid from H.O. From the information supplied by the branch, prepare trading and P&L A/C of the branch for the year ending 31-3-2007 and slow the account of the Branch as it would appear in the books of the Head office.

	Rs.
Opening stock (invoice price)	24,000
Closing stock (invoice price)	18,000
Credit sales	41,000
Cash sales	17,500
Receipt from Debtors	35,000
Sundry debtors on 31 - 3- 07	8,500
Goods received from H.O.	34,000
Goods in transit from H.O as on 31-3-07	3,500
Expenses paid by the H.O. for the branch	10,000

[G.P. Rs. 25,167 ; N.P. 15,167 ; Branch A/C Balance Rs. 23,500 ; Debtors at the beginning Rs.2500]

Stock and Debtors system :

8. X has a retail branch at Allahabad. Goods are sent by the H.O. to the Branch marked at selling price which cost plus 25%. All the expenses of the Branch are paid by H.O. All cash collected by the is deposited to the credit of H.O.

   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 the Head Office.

	Rs.
Debtors on 1-1-2007	12,000
Debtors on 31-12-2007	14,000
Inventory with the Branch at invoice price	
On 1 -1 -2007	16,000
On 31-1-2007	17,000
Cash sales during the year	60,000
Total amount deposited in the H.O.	
Account during the Year	1,27,000
Return of goods to H.O at invoice price	5,000
Salaries paid	6,000
Rent paid	4,000
Discount allowed to customers	2,000
Bad debts written off	1,000
Spoilage	2,000

[G.P. 26,400 ; N.P. 11,800]

9. Record the following transactions concerning the Delhi Branch for the year ended Decemeber 31,2007 in the head office books. The head office uses the stock and Debtors system for recording transactions with and at he branch :

	Rs.
Stock at Branch 1-1-07	20,000
Debtors at Branch 1-1-07	9,000
Goods sent to the branch during the year	1,10,000
Cash sales at the Branch	30,000

Debtors at the end	10,900
Cash remitted to the Branch for expenses	8,000
Cash collected from debtors	57,000
Discount allowed to them	1,100
Stock at Branch (31 - 12-07)	38,000
Petty cash at Branch at the end of the year	100

The Branch remits all the cash collected to the head office and has instructions to sell the goods at the invoice price i.e cost plus 25%. The opening and closing stocks and goods sent to the Branch are all at invoice price.

[G.P. Rs. 18,000 ; N.P. Rs. 7,400 ; Credit Sales Rs. 60,000 ; Shortage of goods Rs. 2,000]

10. X Y Ltd. Calculta started a branch in Bombay on Ist April 2006 to which goods were sent at 20 % above cost. The branch makes both credit and cash sales. Branch expenses are met from Branch cash and balance money remitted to H.O. The branch does not maintain double entry book of account and necessary accounts relating to branch are maintained in H.O.

Following further details are given for the year ended on 31st March 2007

	Rs.
Cost of goods sent to Branch	50,000
Goods received by Branch till	
31 st March 2007 at invoice price	54,000
Credit sale for the year	48,000
Debtors as on 31st march 2007	20,800
Bad debts and discount written off	200
Cash remitted to H.O.	43,000
Cash is hand at Branch on 31st March 2007	2,000
Cash remitted by H.O. to Branch during the year	3,000
Cash stock at the Branch at invoice price	6,000
Expenses incurred at Branch	12,000

Show the necessary ledger A/Cs the books of the Head office (under stock and debtors system) and profit and loss of the Branch for the year ended on 31st March 2007.

[G.P. Rs. 36,000. N.P. Rs. 23,800 ; Cash received from debtors Rs. 27,000 and from sales Rs.27,000]

14.13 REFERENCE BOOKS :

1. Finanical Accountancy - S.P. Jain & K.L. Narang

2. Finanical Accountancy - R.L. Gupta & V.K. Gupta

3. An Introduction to Accountancy - S.N. Maheswari & S.K. Maheswari

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Lesson - 15

BRANCH ACCOUNTING - II

INDEPENDENT BRANCHES / BRANCHES KEEPING FULL SYSTEM OF ACCOUNTING

OBJECTIVES:

The objective of this lesson is to know the system of accounting when head office maintains independent branches how reconciliation is made in various transachions between the H.O and branches.

STRUCTURE:

15.1 INTRODUCTION:

Branches keeping full system of accunting or independent branches are those brances which maintain its own set of books. These branches also purchase goods from the market besides getting the goods from the head office. They can also supply goods to the head office, pay expenses from the cash realised and deposit cash in their own account. In other words, these branches operate as an independent unit for all practical purposes but their only link with the head office is that they are owned by the head office and what ever their profit or loss will be that belongs to the head office.

15.2 CHARACTERSTICS :

The Characterstics of the accounting system of an Independent branch can be summarised below :

1. Independent branch keeps a complete set of its books. It may also purchase goods from outside parties. It maintains its own bank account. It may remit money from time to time to the Head office as per the Head office instructions.
2. It prepares its own trial balance and Final accounts and sends their copies to the Head office for their incorporation in the Head office books.
3. It maintains a Head office account in its books. This is of the nature of a personal account. All transactions relating to the Head office are recorded in this account. The Head office also maintains a Branch account in its books.

15.3 ACCOUNTING TREATMENT :

i. **Purchase of fixed assets :** Generally the branch fixed assets are maintained in the books of Head office. When an asset is purchased the following entries are passed.

		H.O books	**Branch books**
a.	If the payment is made by the branch	Branch fixed assets A/C Dr To branch A/C	Head office A/C Dr To Branch A/C
b.	If the payment is made by the Head Office	Branch fixed assets A/C Dr To branch A/C	No Entry

ii. **Depreciation of fixed assets :**

H.O books	**Branch books**
Branch Account Dr	P& L A/C
To branch fixed Assets A/C	To Head office A/C

iii. **Head office Expenses :**

H.O books	**Branch books**
Branch Account	P& L A/C
To P& L A/C	To Head office A/C

15.4 RECONCILIATION ENTRIES :

The balance shown by the Branch account in the Head office books may not tally with the balance as shown by the Head office Account in the Branch books. The reasons for the difference and accounting entries required are :

Goods in transit :

The entry for reconciling the difference for this reason may either be passed in the Head office books or the Branch books but not in both of them.

In the Head office Books

Goods in Transit A/C Dr

To Branch Account

In Branch Books :

Goods in Transit A/C Dr

To Head office A/C

Cash in transit :

The entry for reconciliation of the difference on this account may either be passed by the Head office or the Branch but not in both of them, as follows :

In the Books of the Head office

Cash in Transit Account Dr

To Branch Account

In the Books of the Branch :

Cash in Transit Account Dr

To Head office A/C

Note : Cash in transit or goods in transit will be shown as an asset in the balance sheet.

15.5 INTER - BRANCH TRANSACITONS :

If the head office has many branches and there is a possibility that some branch may supply goods or send cahs to the other branch. Such transactions among the branches are called inter branch transactions. For example if goods are supplied by calculta branch to Delhi branch and the head office is at Bombay, then the following journal entries will be passed in the book of head office and branches.

	Bombay Books	Calculta books	Delhi books
i.	Delhi Branch A/C Dr	Head office A/C Dr	Goods received from other
	To calculta	To Goods supplied to other	Branch A/C Dr
	branch A/C	branch A/C	To head office A/C

ii. Cash paid by branch of behalf of H.O

H.O books	Branch books
Purchase A/C Dr	H.O A/C Dr
To branch A/C	To Cash A/C

iii. Cash collected by branch of behalf of H.O

H.O books	Branch books
Branch A/C Dr	Cash A/C Dr
To calls in Arrears	To H.O A/C

If a bill is drawn by one branch on another branch. If a bill is drawn by Agra Branch on Bombay Branch and the H.O is at Delhi then the following entries will be passed in the books of H.O and branches :

	H.O Books	Agra Branch	Bombay Branch
i.	Agra Branch A/C Dr	B/R A/C Dr	H.O A/C Dr
	To B/P A/C	To H.O A/C	To B/ P A/C
	B/R A/C Dr		
	To Bombay Branch A/C		

15.6 INTCORPORATION OF BRANCH TRIAL BALANCE IN HEAD OFFICE BOOKS :

Head office and its various branches are under one organisation and it is, therefore necessary that head office should prepare only one combined balance sheet for the benefit of the shareholders and the outsiders. For this purpose, the head office is required to incorporate the branch trial balance in its books. The following are the two methods for incorporation of trial balance.

15.7 FIRST METHOD :

Under this method branch trading and profit & loss account is prepared to incorporate all revenue items. Assets, liabilites and profit are also incorpurated through branch account in order to prepare the consolidated balance sheet. The following entries are passed :

1. For incorporating items which are shown on the Debit side of the Trading Account.

   Branch Trading Account Dr

   To Branch Account

2. For incorporating the items shown on the credit side of the Trading Account.

   Branch Account Dr

   To Branch Trading Account

3. For transferring of Gross profit to Branch Profit & Loss A/C

   Branch Trading Account Dr

   To Branch Profit & Loss A/C

4. For incorporating the items appearing on the Debit side of the Branch P&L A/C

   Branch P&L A/C Dr

   To Branch Account

5. For incorporating the items which appear on the credit side of the P& L Account.

   Branch Account Dr

   To Branch P&L A/C

6. For transferring the Net profit / Loss to General profit & Loss A/C.

If profit		If loss	
Branch P& L A/C	Dr	General P& L A/C	Dr
To General P& L	A/C	To Branch P& L	A/C

7. For incorporating of Branch Assets (after adjustments)

   Branch Assets (individually) A/C Dr

   To Branch A/C

8. For incorporating of Branch Liabilities (after adjustments)

   Branch Account Dr

   To Branch liabilities (individually) A/C

As a result of these incorporation entries, the Branch Account in the Head office wil be completely closed.

In the beginning of the next year, the various assets and liabilities will be transferred back to the Branch by means of the following entries.

1. For Transfer of Assets

   Branch Account Dr

   To Branch Assets account (individually)

2. For transfer of Liabilites

   Branch Liabilities (Individually) A/C Dr

   To Branch A/C

Illustration 1 :

Give Journal entries for incorporation of Agra Branch Accounts in the Head office and show the Branch Account in the Head office books after incorporating there in the assets and liabilities.

The Trial Balance as on 31st December 2007 is as under :

Particulars	**Dr**	**Cr**
	Rs.	**Rs.**
Manufacturing expenses	11,000	
Salaries	11,000	
Wages	44,000	
Cash in hand	2,200	
Purchases	88,000	
Goods received from H.O	16,500	
Rent	4,400	
General expenses	5,500	
Sales		1,65,000
Purchase Returns		1,100
Opening stock	33,000	
Discount earned		1,100
Debtors	16,500	
Creditors		5,500
H.O Account		59,400
	2,32,100	2,32,100

Closing stock at Branch Rs. 33,000 Depreciation is to be provided on Branch Mahcinery of 55000 @ 20 percent and Branch Furniture of Rs. 3300 @ 15 percent Rent out standing Rs 550.

Solution :

HEAD OFFICE BOOKS

JOURNAL

Date	Particulars	Dr Rs.	Cr Rs.
Dec31 2007	Agra Branch A/C Dr	11495	
	To Branch Machinery A/C		11000
	To Branch Furniture A/C		495
	(Being the depreciation on Branch fixed Assets charged to Branch)		
Dec31	Agra Trading A/C Dr	191400	
	To Agra Branch A/C		191400
	(Being the total of the following items in Branch trial		
	Balance debited to		
	Branch trading Account -		

	Rs.
Stock	33000
Purchases	86900
Less returns	89900
Wages	44000
Manufacturing expenses	11000
Goods received from H.O	16500

Dec31	Agra Branch A/C Dr	198000	
	To Agra Trading A/C		198000
	(Being the total of the following items at Branch credited to Branch Trading A/C Rs. Sales 165000 Branch Stock 33000 198000		
Dec31	Agra Trading A/C Dr	6600	
	To Agra P&L A/C		6600
	(Being the transfer of gross profit)		
Dec31	Agra Profit & Loss A/C Dr	32945	
	To Agra Branch A/C		32945
	(The total of the following expenses at Branch debited to branch profit & Loss A/C Rs. Rent 4950 Salaries 11000 General expenses 5500 Depreciation 11495 32945		
Dec31	Agra Branch A/C Dr	1100	
	To Agra P&L A/C		1100
	(Being the discount earned at agra credited to Branch profit & Loss A/C		

Dec31	General P & L A/C Dr	25245	
	To Branch A/C		25245
	P & L A/C		
	(Being the loss transfered to profit & loss A/C of the Head office)		
Dec31	Agra Debtors A/C Dr	16500	
	Agra Cash A/C Dr	2200	
	Agra Stock A/C Dr	3300	
	To Agra Branch A/C		51700
	(Being the transfer of various assets at Branch to H.O)		
Dec31	Agra Branch A/C Dr	6050	
	To Branch creditors A/C		5500
	To Branch expenses out standing A/C		550
	(Being the transfer of liabilities at Branch to Head office books)		

IN HEAD OFFICE BOOKS

Agra Branch Account

	Rs.		Rs.
Dec 312007		Dec 312007	
To Balance b/d	59400	By Agra Trading A/C	191400
To Branch Assets	11495	By Agra profit & Loss A/C (expenses	32945
To Agra trading Account	198000	By Sundry Assets	51700
To Agra profit & Loss A/C	1100		
To sundry Liabilities	6050		
	276045		276045

14.8 SECOND METHOD :

Undet this method branch trading and profit & loss account is prepared as a memorandum account and entry for transferring the net profit or loss is passed in the books of head office. No entries are passed for incorporating branch assets and Liabilities in the books of the head office with the result that branch account in the books of head office will show balance equal to net worth i.e. (total assets - total liabilites).

Illustration 2 :

A merchant opens a new branch in Bomboy which trandes independently of the Head office. The transactions of the Branch for the year ended 31-3-2007 are as under.

The Trial Balance as on 31st December 2007 is as under :

		Rs.
Goods supplied by Head office		25000
Purchases from out siders		
Credit	16000	
Cash	4000	20000
Sales		
Credit	16000	
Cash	4000	35000
Cash received from customers		31000
Cash paid to creditors		15000
Expenses paid by Branch		9000
Furniture purchased by Branch on credit		4000
Cash received from Head office initially		4000
Remitted to Head office		12000

Prepare Branch trading and profit & Loss Account and the Branch Account in the Head office Books after incorporation of the Branch trial balance taking the following into consideration.

a. The accounts of the Branch fixed Assets are maintained in H.O. Books.

b. Write off Depreciation on furniture at 5 % per annum.

c. A remittance of Rs. 2000 from the Branch to Head office is in transit.

d. The Branch closing stock is valued at Rs. 14000.

IN THE BOOKS OF H.O.

Bombay Branch Trading and Profit & Loss Account for the year ending 31-3-2007

		Rs.			Rs.
To goods supplied by Head office		25000	By sales		
			Cash	5000	
			Credit	30000	35000
To Purchases :					
Credit	16000				
Cash	4000	20000	By closing stock		14000
To Gross profit C/d		4000			
		49000			49000
To expenses		9000	By Gross profit b/d		4000
To Depreciation on			By Net loss transferred		
furniture		200	to general P & L A/C		5200
		9200			9200

Bombay Branch A/C

	Rs.			Rs.
To cash	4000	By furniture		4000
To Goods sent to Branch	25000	By Remittances	12000	
To Branch furniture	200	Less in tranit	2000	10000
		By General P&L A/C		5200
		By Balance C/D		10000
		(16000 - 6000)		
	29200			29200

Note : Sundry Assets

Closing stock	14000
Cash in transit	2000
Cash in hand	----
(400+5000+3100-15000-900-4000-12000)	16000

Sundry Liabilities

S. Cr 16000 - 15000	1000
Creditors for furniture	4000
Advance from debtors	1000
(3100-30000)	6000

Sundry Assets - Sundry liabilites = 16, 000 - 6000 = Rs 10,000

Illustration 3 :

A Madras Head office has an independent branch at Ahmedabad. From the following particulars, give journal entries to close the books of Ahmedabad branch. Show the Madras Head office Account in the branch books.

Ahmedabad Branch
Trial Balance
as on 31st Dec 2007

	Rs.		Rs.
Stock on 1 Jan	8200	Creditors	2700
Purchases	12800	Sales	34950
Wages	6550	Head office	14000
Manufacturing expenses	3400	Discount	150
Rent	1700	Purchase Returns	300
Salaries	5500		
Debtors	4000		
General expenses	2000		
Goods received from H.O	7200		
Cash at bank	750		
	52100		52100

a. Closing stock at branch Rs. 14350

b. The branch fixed assets maintained at H.O books were Machinery Rs 25000, Furniture Rs. 1000 and depreciation to be allowed at 10 percent on Machinery and 15 percent on furniture.

c. Rent due Rs. 150

d. A remittance of Rs. 4000 made by branch on 28th December 2007 was received by the Head Office on 4th january 2008.

IN THE BOOKS OF AHMEDABAD BRANCH

JOURNAL

Date	Particulars	L.F.	Dr Rs.	Cr Rs.
2007 Dec31	Remittance in Tranit A/C Dr		4000	
	To Madras H.O. Account			4000
	(Being the amount remitted on 28-12-07 to Madras H.O but credited them on 4-1-08)			
2007 Dec31	Depreciation Account Dr		2670	
	To Madras H.O. Account			2670
	(Being depreciation on Branch fixed assets maintained at Head office Books)			
2007 Dec31	Rent Dr		150	
	To outstanding Rent			150
	(Being the rent outstanding)			
2007 Dec31	Madras Head office account Dr		51,150	
	To Opening stock			8200
	To Purchases			12800
	To Wages			6550
	To Manufacturing expenses			3400
	To Rent			1850
	To Salaries			5500

	To General expenses			2000
	To goods received from madras Head office			7200
	To Depreciation			2650
	(Being the transfer of revesue items to Head office account)			
2007 Dec31	Sales account	Dr	34950	
	Discount Account	Dr	150	
	Purchase Returns	Dr	300	
	Closing Stock	Dr	14350	
	To Madras H.O Account			49750
	(Being the transfer of credit balances of revenue items to Head office account)			
2007 Dec31	Madras Head office account	Dr	23100	
	To closing stock			14350
	To Debtors			4000
	To cash at Bank			750
	To Remittance in transit			4000
	(Being the transfer assets to Head office A/C)			
2007 Dec31	Creditors Account	Dr	2700	
	Out standing Rent	Dr	150	
	To Madras H.O. Account			2850
	(Being the transfer of liabilities of Madras Head office account)			

Madras Head office Account

	Rs.		Rs.
2007 Dec 31		2007 Dec 31	
To Sundry Revenues	50150	By Balance b/d	14000
To Sundry Assets	23100	By Remittance in transit	4000
		By depreciation Account	2650
		By Sundry Revenues	49750
		By sundry liabilities	2850
	73,250		73,250

15.9 SUMMARY :

An Independent branch operates quite independently of its head office. It buys its own goods and sells the same at price fixed by itself . It may some supplies from the head office abo. Cash is deposited in its own account and expenses are met by it only. The head office reconciles the trial balance of the branch in its bllks after passing the necessary journal entries. Proper adjustments are made in head office and branch accounts for transit items-goods in transit and cash in transit; depreciation, inter branch transactions, expenses of head office chargeable to branches.

15.10 SELF ASSESSMENT QUESTIONS :

1. Journalise the following transactions in the head office books when branches are keeping full system of accounting -
   a. Depreciation on branch fixed assets when their accounts are maintained in head office books.
   b. Goods in transit.
2. How will you incorporate branch assets and liabilites in the head office books in case of an independent branch ?
3. Explain ' goods in transit ' and ' cash in transit ' .
4. What do you mean by independent system of branch accounting ?

15.11 EXERCISES :

1. The following balances are extracted from the books of the branch.

	Rs.
Stock on 1st Jan 2007	39000
Head office (Credit)	42000
Sundry debtor	15000
Purchases	34500
Goods received from H.O.	42500
Returns to H.O.	2000
Sales	96000
Sundry creditors	6000
Wages	8000
Salaries	2500
Carriage & Freight	1200
Rent, Rates etc	1200
Office expenses	300
Cash in hand	350
Cash at Bank	1450
Stock on 31st Decemeber 2007	42600

The Head office sent goods worth Rs. 7500 to the Branch on 30th December 2007, but the branch received the same on 7th Jan 2008. The Branch remitted to Head office Rs.4500 on 27th Dec. 2007 but the money was received by Head office on 2nd Jan.2008. The Branch Account in the Head office books showed a debit balance of Rs. 54000 on 31st Decemeber 2007. Branch plant and Machinery Account appeared in the Head office books at Rs. 24,000 on 31st Decemeber 2007 which was to be depreciated by 5percent.

Make the necessary Journal entries in the books of the Head office and the Branch for reconciling their account. Give also the Journal entries to incorporate branch trial balance in the Head office books.

[G. P. Rs. 15,400 ; N.P Rs. 10,200]

2. The following is the trial balance of theerut Branch as on 31st december 2007 -

	Dr Rs.	Cr Rs.
Delhi Head office	3240	
Stock 1st Jan. 2007	6000	
Purchases	97800	
Goods received from Head office	19000	
Sales		138000
Goods supplied to H.O.		6000
Salaries	4500	
Debtors	3700	
Creditors		1850
Rent	1960	
Sundry office expenses	1470	
Cash at bank	1780	
Furniture	6000	
Depreciation on Furniture	400	
	145850	145850

Stock at branch on 31st Dec. 2007 was valued at Rs. 7700.

Meerut Branch accounting the head office books

On 31st Dec. 2007 stood at Rs. 460 (debit balance)

On 28th Dec. 2007 the head office forwarded. goods of the value of Rs. 3700 to the branch where they were received on 3rd Jan. 2008.

i . Prepare Trading & Proit and loss account of Meerut Branch for the year ended 31st December 2007 and its Balancesheet on that date.

ii. Pass Journal entries in the books of the Head office to incorporate the above mentioned trial balance, and

iii. Show meerut Branch Account as it would be closed in head office's ledger.

[i. G. P Rs, 28900, N. P Rs. 20570, B/s Total 19180

ii. Total of Meerut Branch Rs. 154010]

3. A firm in Bangalore has a branch at salem. On March 31st 2007 the trial balance of salem branch stook as follows :

	Rs.	**Rs.**
Sales less returns		898000
Creditors		15000
Head office account		305000
Office furniture	38000	
Book debts	225700	
Goods from H.O.	602000	
Stock on 1.4.2006	160000	
Salaries, rent etc	124000	
Cash in hand and at Bank	68300	
	1218000	1218000

Closing stock was valued on 31.3.2007 at Rs. 132000. Give incorporation entries for incorporating the branch trial balance in head office books. Open branch account in the head office books.

4. From the following information show : (a) the journal entries to incorporate the trial balance of the branch in the head office book, and (b) the branch current account after incorporation of the branch data. Pune branch trial balance as at 31st March 2007 is as under :

	Rs.		**Rs.**
Purchases	173500	Sales	382000
Goods from H.O	81000	H.O Current Account	75600
Selling expenses	42600	Creditors	23400
Administration expenses	20400		
Sundry expenses	13800		
Petty cash	500		
cash at bank	12500		
Debtors	64000		
Stock 1st April 2006	72700		
	481000		481000

Stock on hand at the branch on March 31, 2007 was Rs 82,000 Pune branch current account in the head office books showed a balance of Rs. 84400 while the goods sent to pune branch account showed a balance of Rs. 89,800 by the closing date. A provition for doubtful debts is to be raised, calculated at 1 1/2 % of debtors accounts.

5. The delhi branch of National Industries Ltd., sent the following trial balance to the head office as on 31st December 2007

	Rs.		Rs.
Sundry debtors	12000	Sundry creditors	8600
Cash in hand	6250	Goods returned to head office	2250
Furniture	1900	Sales	112500
Stock 1-1-2007	2250	Head office account	10250
Goods from Head office	34000		
Purchases	66450		
Wages & salaries	5500		
Trade expenses	5250		
	133600		133600

The stock on 31st Dec. 2007 was Rs 5200. Pass the necessary Journal entries to incorporate the above figures in the head office books and show the branch account and the branch trading and profit and loss account.

[G.P Rs. 11750 ; N. P Rs. 6500]

15.12 REFERENCE BOOKS :

1. Finanical Accountancy - S.P. Jain & K.L. Narang

2. Finanical Accountancy - R.L. Gupta & V.K. Gupta

3. An Introduction to Accountancy - S.N. Maheswari & S.K. Maheswari

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Lesson 16

Departmental Accounts:

16.0 Objective:

After going through the lesson you will be able to understand the following:

1. Meaning and purpose of departmental accounts
2. Method of preparation of departmental accounts
3. Interdepartmental transfers and solving problems

Structure:

16.1: Departmental accounts – Meaning and Purpose:

A business orgnisation may have many departments producing different types of products or services. For example, one department may be producing plastic goods; the other may be producing metal goods and the like. To know the profit and loss of each department, it is better if separate trading and profit and loss accounts are prepared by the end of each accounting period. These are called as departmental accounts. The following are the purposes of these accounts:

1. Departmental accounts help in comparing the performance of one department to the other.
2. They are also helpful in formulating policies and programmes relating to the expansion and growth of the business. New profitable lines of production or trading can be taken up while the existing lines of production or trading which are giving a loss can be closed down.
3. They also help the management to appraise the performance of the employees of different departments based on the results.

16.2: Maintenance of columnar subsidiary books:

The preparation of Departmental Trading and Profit and Loss Account requires maintenance of proper subsidiary books having appropriate columns for different departments. For example, if a business has three departments A, B, and C, the subsidiary books such as Purchases Book, Purchases Returns Book, Sales Book, and Sales Returns Books etc. should have separate columns for each of the departments. Cash Book may also have columns for recording cash sales of each of the departments separately in case the volume of cash sales is quite large. The specimen of a purchases Book having columns for different departments is given below:

Purchases Book

Date	Particulars	L.F	Deptt. A	Deptt. B	Deptt. C	Deptt. D

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

16.3: Allocation of Expenses:

In order to ascertain the profit or loss made by each department, it is necessary that each department is charged with a proper share of the various business expenses. They should be allotted to respective departments on certain basis. The following bases may be adopted for allocation of such expenses:

1. *Expenses incurred specifically for a particular department* should be directly charged to that department. For example, salaries of a particular department should be charged to that department.
2. *Some expenses can be apportioned precisely*. For example, it is possible to find out the amount spent on lighting in each department by means of separate metres or on the basis of number of point. This would be the basis of allocation.
3. *Most of the expenses, however, cannot be allocated precisely.* The treatment of such expenses can be as follows:
   a) Expenses that clearly depend upon sales, such as selling commission, bad debts, discount on sales, carriage outward, should be apportioned on the basis of sales. Sometimes such expenses are allocated on the basis of number of units sold. But this is not the usual practice. Sales should include transfers to other departments.
   b) Expenses on buildings and premises should be allocated according to area occupied having regard to any special advantage enjoyed by a department. For instance, a department housed in the front portion should bear correspondingly higher charge than others. Sometimes the departments housed in upper storeys are made to bear proportionately less charges. The expenses will include rent and rates, insurance on buildings, repairs, etc.
   c) Lighting, heating, etc., should be allocated on the basis of number of points unless metred separately. If number of points is not available, allocation can be made on the basis of area.
   d) Depreciation for each machine should be calculated separately and charged to departments accordingly. In the absence of any other indication, it may be allocated in the ratio of sales or wages.

e) Power, unless metred separately, should be allocated according to horsepower of machinery installed, adjusted for any difference in running hours.

f) Insurance premium should be charged according to the value of the subject matter insured. Insurance on goods should be allocated on the basis of average stocks lying in each department. Workmen's compensation insurance should be apportioned on the basis of wages paid.

g) Labour welfare expenses should be allocated on the basis of number of workers in each department.

h) Advertising is usually allocated on the basis of sales but should rather be allocated according to space devoted to each department because the amounts spent on advertisement is not dependent on sales usually.

4. *Expenses, which cannot be allocated in a reasonable manner* like debenture interest, general manager's salary, share transfer office expenses etc., should not be allocated, as nothing will be gained by an arbitrary allocation. Profits revealed by various departments should be brought down in one account and these unallocatable expenses should be debited there. Non-departmental profits should also be credited in this account. Alternatively, the expenses and non-departmental profits can be allocated equally.

16.4: Interdepartmental transfers:

Transfer of goods or services may take place from one department to another. While preparing the Departmental Trading and Profit and Loss Account, the department receiving the goods or services should be debited with the value of the goods or services so supplied and department providing such goods or services should be credited with the same amount.

The transfer of goods 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 the transfer price itself. However, if the goods transferred by one department to another at a profit still remain unsold with the transferee department, an appropriate reserve for unrealized profit will have to be created by means of the following journal entry.

General Profit & Loss Account Dr

To Stock Reserve

In case the transferee department has also some stock in the beginning of the accounting year, including some unrealized profit, against which stock reserve was created last year such reserve will also be transferred to the General Profit & Loss Account by means of the following journal entry.

Stock Reserve Account Dr

To General Profit & Loss Account

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

16.5: Illustrations:

1. From the following Trial Balance, prepare Departmental Trading and Profit & Loss Account for the year ending 31st December, 2007 and a balance sheet as on that date.

Trial Balance as on 31 -12 – 2007

	Dr	Cr
Capital		30,000
General Reserve		20,000
Stock as on 1-1-2007:		
Dept. A	29,500	
Dept. A	26,000	
Purchases:		
Dept. A	50,000	
Dept. B	30,000	
Wages:		
Dept. A	12,000	
Dept. B	10,000	
Carriage and Freight	800	
Salaries	20,000	
Traveling expenses	1,500	
Rates and Taxes	6,000	
Insurance	10,500	
Sales:		
Dept. A		1, 20,000
Dept. A		80,000
Sundry debtors and Sundry creditors	12,500	7,500
Bills receivable and Bills payable	2,500	2,000
Freehold premises	14,000	
Manager's salary	5,000	
Printing and Stationery	500	
Discount	1,000	
Advertisement	3,500	
Plant and Machinery	15,500	
Furniture and Fixture	500	

Fuel and Water	1,750	
Incidental expenses	450	
Cash in hand	1,200	
Cash at bank	4,800	
	2, 59,500	**2, 59,000**

The following additional information is also provided:

Stock on 31st December 2007: Dept. A – Rs. 20,000; Dept. B- Rs.15, 000

Provided 5% Reserved for doubtful debts;

Outstanding wages Dept. A – Rs.600; Dept. B – Rs.400;

Outstanding salaries Rs.4, 000; Rates and Taxes prepaid Rs.1, 500;

Depreciate plant and machinery at 10%.

All allocated expenses are to be apportioned on the basis of turnover.

Solution:

Departmental Trading and Profit & Loss Account

for the year ending 31st December, 2007

Dr Cr

	Dept.A	Dept B		Dept.A	Dept. B
To Opening Stock	29,500	26,000	By Sales	1, 20,000	80,000
To Purchases	50,000	30,000	By Closing stock	20,000	15,000
To Wages& outstg.	12,000	10,400			
To Carriage freight					
(Purchase ratio 5:3)	500	300			
To Fuel and Water					
(Turnover ratio)	1,050	700			
To Gross profit C/D	46,350	27,600			
	1, 40,000	**95,000**		**1, 40,000**	**95,000**
To Salaries&outstdg.			By Gross profit B/D	46,350	27,600
(24,000 in 3:2 ratio)	14,000	9,600			
To Traveling exps.					
(3:2)	900	600			
To Rates and taxes					
(Less prepaid0	2,700	1,800			
To Insurance (3:2)	6,300	4,200			

To Manager's salary (3:2)	3,000	2,000			
To Printing Stationery (3:2)	300	200			
To Discount (3:2)	600	400			
To Advertisement (3:2)	2,100	1,400			
To Other expenses (3:2)	270	180			
To Reserve for doubtful Debts (3:2)	375	250			
To Depreciation (3:2)	930	620			
To Net profit	14,475	6,350			
	46,350	**27,600**		**46,350**	**27,600**

Balance Sheet as on 31-12-2007

Liabilities				Assets		
Capital	30,000			Debtors	12,500	
Add: Net profit	14,475			Less: B D	625	11,875
	6,350	50,825				
General Reserve		20,000		Bills Receivable		2,500
Creditors		7,500		Premises		14,000
Bills Payable		2,000		Plant & Machinery	15,500	
Wages outstanding				Less: Depreciation	1,500	13,950
Dept. A	600			Furniture		500
Dept. B	400		1,000	Cash in hand		1,200
Outstanding Salaries		4,000		Cash at bank		
				Dept. A	20,000	
				Dept. B	15,000	35,000
				Prepaid rates and taxes		1,500
		85,325				**85,325**

2. Anurag Ltd. Has 3 departments. From the following details, prepare trading and P & L Account in columnar form.

	Dept. A	Dept. B	Dept. C
Stock on 1-1-2007	17,820	5,600	1,250
Stock on 31-12-2007	19,360	4,710	3,160
Outside sales	1, 11,740	56,130	48,510
Wages	27,400	13,280	9,150
Purchases from outside	40,410	15,370	12,560
Salaries	9,450	5,720	4,163
Interdepartmental transfers:			
From A to B	9,040		
From A to C	4,820		
From B to A	11,260		
From B to C	2,110		
From C to A	3,480		
Insurance	2,100		
Managerial salaries	12,000		
Rent and Taxes	14,600		
Traveling expenses	8,700		
Postage and telegrams	1,100		
Depreciation	7,400		
Advertising expenses	4,500		
Bad debts:			
Dept. A	2,760		
Dept. B	1,430		
Dept. C	2,240		
Petty expenses	5,300		
Printing and stationery	2,600		

All expenses which are not given specifically are to be apparitional on the following basis: Dept. A – 50%; Dept. B – 30%; Dept. C – 20%;

Solution:

Working Notes;

Inter Departmental Transfers

Sales:		Purchases:	
Dept. A to B	9,040	Dept. A from B	11,260

To C	4,820	from C	3,480
	13,860		**14,740**
Dept. B to A	11,260	Dept. B from A	**9,040**
B to C	2,190		
	13,450		
Dept. C to A	**3,480**	Dept. C from A	4,820
		From B	2,190
			7,050

Departmental Trading and P & L A/C for the year ended ———

	A	B	C		A	B	C
To Opening stock	17,820	5,600	1,250	By Sales	1, 11,740	56,130	48,510
To Purchases	40,410	15,370	12,560	By Transfers	13,860	13,450	3,480
To Transfers	14,740	9,040	7,010	By Closing stock	19,360	4,710	3,160
To Wages	27,400	13,280	9,150				
To Gross Profit	44,590	31,000	25,180				
	1, 44,960	**74,290**	**55,150**		**1, 44,960**	**74,290**	**55,150**
To Salaries	9,450	5,720	4,100	By Gross profit	44,590	31,000	25,180
To Mgrl.salaries	6,000	3,600	2,400				
To Rent & taxes	7,300	4,380	2,920				
To Trav. Exps.	4,350	2,610	1,740				
To Postage & Tel.	500	330	220				
To Depreciation	3,700	2,220	1,480				
To Advertising	2,250	1,350	900				
To Bad debts	2,766	1,430	2,240				
To Petty expenses	2,650	1,590	1,060				
To Prtg. & Stnry.	1,300	780	520				
To Insurance	1,050	630	420				
To Net Profit	3,230	6,360	7,120				
	44,590	**31,000**	**25,180**		**44,590**	**31,000**	**25,180**

Note: Expenses debited to P & L A/C were apportioned in the ratio 5:3:2.

3. The standing and profit and loss account of Ratio and Gramophone equipment Co. for the six months ended 31st March 2007 is presented to you in the following form:

Dr		Cr	
Purchases:		Sales:	
Radios (A)	1,40,000	Radios (A)	1,50,000
Gramophones (B)	90,600	Gramaphones (B)	1,00,000
Spare parts for servicing (C)	64,400	Receipts from servicing	
Salaries and wages	48,000	and repair jobs (C)	25,000
Rent	10,800	Stock on 31-3-2007:	
		Radios (A)	60,100
		Gramophones (B)	20,300
		Spare parts for	
		Servicing (C)	44,600
	4, 00,000		**4, 00,000**

Prepare Departmental Accounts for each for the three Departments A, B and C mentioned above after taking into consideration the following information:

i) Radios and Gramophones are sold at the show room; servicing and repairs are carried out at the workshop.

ii) Salaries and wages comprises as follows:

Show room ¾

Workshop ¼

It was decided to allocate the show room salaries and wages in the ratio 1:2 between the departments A and B.

iii) The workshop rent is Rs.500 per month. The rent of the showroom is to be divided equally between Departments and A and B.

iv) Sundry expenses are to be allocated on the basis of the turnover of each department.

Solution:

Department Trading and P & L A/c for the half year ending 31st March 2007

	A	B	C		A	B	C
To Purchases	1, 40,700	90,600	64,400	By Sales	1, 50,000	1, 00,000	25,000
To Gross profit	69,400	29,700	5,200	By Clo.stock	60,100	20,300	44,600
	2, 10,100	**1, 20,300**	**69,600**		**2, 10,100**	**1, 20,300**	**69,600**
To Salaries	12,000	24,000	12,000	By Gross Profit B/D	69,400	29,700	5,200

To Rent	3,900	3,900	3,000	By Net loss	——	2,200	10,800
To Sundry exps.	6,000	4,000	1,000				
To Net profit	47,500						
	69,400	**31,900**	**16,000**		**69,400**	**31,900**	**16,000**

Working Notes:

Salaries and Wages 48,000

Of which for showroom 3/4th 36,000

Workshop (C) 1/4th 12,000

Showroom consisting of Depts. A and B. Therefore, Rs.36, 000 is to be divided in the ratio of 1:2 to A and B (given)

A: 36,000X1/3 = 12,000

B: 36,000X1/3 = 24,000

C: 48,000X1/4 = 12,000

Rent: Workshop rent (C) Rs.500 per month

For six months 6x500 = 3,000

Balance of Rs. 7,900 equally between A & B

i.e 7,900X1/2= 3,900 = A

i.e 7,900 X1/2= 3,900 = B

Sundry Expenses: Turnover Ratio (Sales Ratio)

= 1, 50,000: 1, 00,000: 25,000

6 : 4 : 1

4. From the under mentioned information and instructions, prepare the Departmental Trading and Profit and Loss Account in columnar form of the three departments of the Outfitting Ltd.

Particulars	Tailoring	Ladies Wear	Outfitting
Stock on 1-1-2007	41,280	33,975	93,721
Stock on 31-12-2007	32,840	43,828	81,626
Purchases during the year	2, 10,342	75,296	1, 39,109
Purchase returns	14,382	5,629	1,823
Sales during the year	4, 00,173	1, 54,085	3, 62,189
Sales returns	——	3,253	11,217
Wages	72,823	30,084	24,613

Goods were transferred from one department to another at cost price as follows:

a) Tailoring to Ladies Wear Rs.389 and to Outfitting Rs.6, 679.

b) Ladies Wear to Tailoring Rs.5, 315.

c) Outfitting to Tailoring Rs.4, 271 and to Ladies Wear Rs.5, 801.

Apportion the following expenses equally:

Stationery Rs.921; Postage Rs.663; General Charges Rs.39; 627, Insurance Rs.1, 785; and Depreciation Rs.5, 460.

Allocate the following further expenditure as you think best and append notes stating the basis for each item: Establishment Rs.63, 395, Bad debts Rs.19, 823, Advertising Rs.7, 293 and Income-tax Rs.11, 028.

Rent and taxes Rs.45, 437 is to be split up to proportion to space occupied i.e. Tailoring 4, Ladies wear 2, Outfitting 3, other space 2.

Apportionment is to be adjusted to the nearest rupee.

Solution:

Trading and Profit and Loss A/C of Outfitting Ltd

For the year ending 31st December 2007

Dr Cr

	Tailoring	Ladies Ware	Out fitting		Tailoring	Ladies ware	Out fitting
To Opening Stock	41,280	33,975	93,721	By Sales	4,00,173	1,50,000	3,50,972
To Purchases	1,95,000	70,667	37,286	less retrns.			
Less returns				By Inter detl.			
To Inter deptl.tranfrs.	9,586	6,190	6,679	transfers.	7,068	5,315	10,072
To Wages	73,823	30,084	24,613	By Clo.stock	32,840	43,828	81,626
To Gross profit C/D	1,20,432	50,059	1,80,371				
	4,40,081	**1,99,975**	**4,42,670**		**4,40,081**	**1,99,975**	**4,42,670**
To Stationery	307	307	307	By Gross			
To Postage	221	221	221	Profit	1,20,432	59,059	1,80,371
To General expenses	13,209	13,209	13,209				
To Insurance	595	595	595				
To Depreciation	1,820	1,820	1,820				
To Est. Expenses	36,226	15,094	12,075				
To Bad debts	8,810	3,305	7,708				
To Advertisements	3,241	1,216	2,836				

To Income tax	6,683	3,342	1,003			
To Rent	20,194	10,097	15,146			
To Net profit	29,126	9,853	1,25,451			
	1,20,432	**59,059**	**1,80,371**	**1,20,432**	**59,059**	**1,80,371**

Working Notes:

Establishment expenses, apportioned in wages ratio =

72:30:24 or 12:5:4

Bad debts, Advertisement expenses apportioned in sales ratio (adjusted)=

400:150:350 or 8:3:7

Income tax apportioned in Gross Profit ratio (adjusted) =

120:60:18 or 20:10:3

Rent apportioned in the given ratio: 4:2:3

Inter Departmental Transfers

Purchases		Sales	
Tailoring Dept:		**Tailoring Dept:**	
From Ladies wear	5,315	from Ladies wear	389
From Outfitting	4,271	From outfitting	6,679
	9,586		**7,068**
Ladies wear:		**Ladies wear:**	
From Tailoring	389	From tailoring	5,315
From Outfitting	5,801		
	6,190		
Outfitting:		**Outfitting:**	
From Tailoring	6,679	from Tailoring	4,271
		From Ladies wear	5,801
			10,072

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

Department A 1,000 units

Department B 2,000 units at a total cost Rs.1, 00,000

Department C 2,400 units

Stock on 1st January was:

Department A- 120 units; Department B- 80 units; Department C- 152 units;

The sales were:

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

The rate of gross profit is the same in each case. Prepare Departmental Trading Account.

Solution:

Working Notes:

Selling price of units purchased in each department: (Not actual sales)

Dept. A = 1,000X20	= 20,000
Dept. B= 2,000X25	= 45,000
Dept. C=2,400X25	= 60,000
Selling price of units Purchased	=1,25,000
Less: Purchase price	1,00,000
Total Gross Profit	**25,000**

Rate of Gross Profit o Sales 25,000/1,25,000X1000 = 20%

Calculation of purchase price in each Dept.

	A	B	C
Selling price per unit	20	22.50	25
Less: Profit 25% on selling price	4	4.50	5
Purchase price per unit	16	18.00	20

Actual purchases in each Dept:

A = 1,000 X 10 = 16,000

B = 2,000X 18 = 36,000

C = 2,400 X 20 = 48,000

Total Purchases **1,00,000**

Value of opening stock (at cost):

A = 120 X 16 = 1,920

B = 80 X 18 = 1,440

C = 152 X 20 = 3,040

Closing stock and its valuation (at cost)

Opening stock + Purchases – Sales (in units)

A = 120 + 1,000 – 1,020 = 100 units X16 = 1,600

B = 80 + 2,000 – 1,920 = 160 units X 18 = 2,880

C = 152 + 2,400 – 2,496 = 56 units X 20 = 1,120

Departmental Trading Account for the year ending ——

Dr							Cr
	A	B	C		A	B	C
To Opening stock	1,920	1,440	3,040	By Sales	20,400	43,200	62,400
To Purchases	16,000	36,000	48,000	By Clo. Stock	1,600	2,880	1,120
To Gross profit	4,080	8,640	12,000				
	22,000	**46,080**	**63,520**		**22,000**	**46,080**	**63,520**

16.6: Try yourself:

1. The Directors of Departmental Store Ltd., wish to ascertain approximately the net profits of A, B, and C departments separately for the quarter ended March 31, 2007. It is found impracticable actually to take stock on that date but an adequate system of departmental accounting is in use and the normal rates of gross profit for the departments concerned are 40%, 30% and 20% on turnover respectively. Indirect expenses are to be charged in proportion to departmental turnover.

Following are the figures for each department:

	A	B	C
Stock on 1-1-2007	30,000	35,000	15,000
Purchases to March 31, 2007	35,000	37,500	23,500
Sales to March 31, 2007	60,000	50,000	30,000
Direct expenses	10,100	7,250	3,550

Total indirect expenses for the period (including those relating to other departments) were Rs.21, 000 and total sales of Rs.4, 20,000.

Prepare a statement showing gross profit after making reserve for stock at 10% in respect of each department.

(Net profits: Dept. A – Rs.17, 090; Dept. B – 8,025; Dept. C- 2,695)

2. X Ltd. had two departments, Cloth and the Rreadymade clothes. The clothes were made by the firm itself out of cloth supplied by the cloth department at its usual selling price. From the following figures prepare departmental trading and profit and loss accounts for the year 2007.

	Cloth Department	Readymade clothes
Opening stock 1-1-2007	90,000	15,000
Purchases	6, 00,000	4,500
Sales	6, 60,000	1,35,000
Transfer to Readymade clothes	90,000	———
Expenses – Manufacturing		18,000
Selling	12,000	1,800
Stock on 31st December, 2007	1,20,000	18,000

The stock in the readymade clothes department may be considered as consisting of 75% cloth and 25% other expenses. The cloth department earned gross profit at the rate of 15% in 2006. General expenses of the firm as a whole came to Rs.33, 000.

(Net Profit- Clothes – Rs.1, 68,000; Readymade clothes – Rs. 23,700; Total Net profit Rs.1, 57,148)

3. Sundaram Brothers are leading paper merchants and book sellers. Their wholesale business is in paper and their retail show room conducts business in stationery, books and magazines.

The following balances are extracted from their books as at the end of their financial year 31st March 2007:

Capital	3, 00,000
Stock (1-4-2006)	
Paper	2, 00,000
Stationery	50,000
Books	1, 00,000
Magazines	25,000
Purchases:	
Paper	8, 00,000
Stationery	3, 00,000
Books	3, 50,000
Magazines	3, 00,000
Sales:	
Paper	10, 00,000
Stationery	3, 60,000
Books	4, 20,000
Magazines	4, 20,000

Rent	60,000
Lighting	24,000
Showroom maintenance	18,000
Showroom fittings	1, 80,000
Sundry Debtors (for paper)	1, 00,000
Sundry Creditors	1, 50,000
Salaries:	
Showroom staff	36,000
Wholesale business staff	12,000
Showroom cashier	12,000
General office salaries	11,000
General office expenses	44,000
Cash and bank balances	8,000

You are requested by the firm to prepare their Departmental Trading and Profit and Loss Account for the financial year under reference with the help of the following additional information:

i) Closing stock at the end of the year in the various departments was:

Paper: Rs. 1, 80,000; Stationery: Rs. 40,000; Books; Rs.1, 20,000; Magazines: Rs.30,000.

ii) Rent and lighting are for premises taken on lease, General office accommodation is negligible. Wholesale department uses 1,500 sq.feet. The balance of 1,500 sq.feet is occupied by the showroom with equal division among stationery, books, and magazines.

iii) Showroom fittings are to be depreciated by 10% p.a.

(Net profits: Paper Rs.1, 01,000; Stationery Rs.600; Books Rs.36, 700; Magazines

Rs.71, 700).

4. Complex Ltd. has three departments A, B & C. The following information is provided:

	A	B	C
Opening Stock	3,000	4,000	6,000
Consumption of direct materials	8,000	12,000	—
Wages	5,000	10,000	—
Closing stock	4,000	14,000	8,000
Sales	——	——	34,000

Stocks of each department are valued at cost to the department concerned. Stocks of A department are transferred to B at a margin of 50% above departmental cost. Stocks of B department are transferred to C department at a margin of 10% above departmental cost.

Other expenses were;

Salaries	Rs.2, 000
Printing & Stationery	Rs.1, 000
Rent	Rs.6, 000
Interest paid	Rs.4, 000
Depreciation	Rs.3, 000

Allocate expenses in the ratio of departmental gross profits. Opening figures of reserves for unrealized profits on Departmental Stocks were:

Department B – Rs.1, 000

Department C – Rs.2, 000

Prepare Departmental Trading and Profit and Loss Account.

(Net Loss Dept. A- Rs.2,000; Dept. B – Rs.1,000; Dept. C – Rs.1,000; Total Net loss after adjustment for stock reserves Rs.4,918)

16.7: Summary:

When a firm consists of two or more departments and runs with separate type of products, to know the profit or loss of each department, generally departmental accounts are prepared. These types of accounts help in comparing performance of different departments and take proper steps in correcting the low performance any department. Interdepartmental transfers are an important aspect in departmental accounts. The transfer of goods 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 the transfer price itself.

16.8: Glossary:

Interdepartmental transfers: These are the transfers of goods or services of different departments of the same firm.

16.9: Self Assessment Questions:

1. Why departmental accounts are necessary?
2. How interdepartmental expenses are dealt with? What are various bases? Give with examples.

Dr.R.Jayaprakash Reddy.

Lesson - 17

COMPANY ACCOUNTS - FUNDAMENTALS

OBJECTIVES:

After going through this lesson the student can know what is a company ? What are its features ? Different kinds of companies. Formation of company and Allotment of shares.

STRUCTURE:

17.1 INTRODUCTION:

To overcome to limitations of 1) inadequacy of funds and 2) Unlimited liability which exists in sole proprietorship concerns and partnership firms, a company type of organisation has been grown. In India, Joint Stock companies are governed by provisions of the companies Act 1956.

17.2 MEANING :

A Company is a voluntary association of persons, with capital divided into shares, formed to carry out a particular purpose in common. It is an artificial person created by law to achieve the object for which it is formed.

The companies Act defines a company as “A company formed and registered under this Act or an existing company” An “existing company” means a company formed and registered under any of the former companies Act.

17.3. CHARACTERISTICS OF A COMPANY :

Following are the essential characteristics of a company -

1. Voluntary association :

It is a voluntary association of persons for attaining a common goal, usually of economic.

2. Separate legal entity :

A company is a artifical person created by law which enjoys a separate legal entity i.e. it is distinct from its members. It can hold and deal with any type of property. It can enter into contracts. It can sue and can be sued by others on its own name.

3. Perpectual existence:

A company has a perpectual existence. The existence of a company can be terminated only by law. The shareholder can transfer their shares freely. Thus, members may come and go. but the company can go on forever. Even, If all the shareholders die on a single day also, it cannot affect the existence of the company.

4. Common seal :

A company being an artificial person cannot enter into contracts with third parties on its own. The Board of directors act as agents to the company. All these acts of the company are authorised by its “common seal “. The common seal is the official signature of the company. A document not bearing the common seal of the company will not be binding on the company.

5. Limited liability :

The liability of the members of a company is generally limited to the extent of the unpaid value of the share held by them.

6. Transferability of Shares :

The shares of a joint stock company are freely transferable, except private companies.

17.4. KINDS OF COMPANIES:

From the point of view of the formation, ownership and liabilities the companies can be classified as follows :

From the point of view of formation, the companies are of three kinds :

1. Chartered companies :

Those companies which are incorporated by the chartered of a king or queen are known as char-tered companies Ex: East India company.

2. Statutory Companies:

A company formed by a special Act passed either by the central or state legislature is called a statutory company. Such companies are governed by their respective acts. Ex: Reserve Bank of India. State Bank of India. L.I.C. of India etc.

3. Registered Companies:

Companies formed by registration under the companies Act of 1956 are known as Registered Companies. The working of such companies is regulated by the provisions of the companies Act. From the view point ownership the companies are of four kinds.

From the viewpoint ownership the companies are of Four kinds.

1.Government Companies :

A company of which not less than 51 percent of the paid up share capital is held by the central Government or by the State Government or by any two or more of them together shall be a government company.

Foreign Companies: A company which is incorporated outside India but which has a place of business in India, is termed as a foreign company.

2. Private company:

A Private Company is one which by its Articles of Association :

a) restrict the right of the members to transfer shares.

b) Limits the number of members to fifty excluding past and present employees of the company who are the members of the company.

c) Prohibits any invitation to the public the subscribe for its shares or debentures.

A private limited company may, however, be registered with only two members. It is required to add the words ‘Private Limited’ at the end of its name.

3. Public Company:

Public Company means a company which is not a private company. In other words a company, the articles of association of which does not contain the requisite restrictions to make it a private limited company, is called a public company. However, a public company is under no legal binding to invite public to subscribe to its share or debentures. A public company need minimum seven persons for its registration.

From the point of view of liability there are three kinds of companies:

1. Limited Companies:

In case of such companies, the liability of each member is limited to the extent of face value of shares held by him. Suppose A takes a share of Rs. 100, he remains liable to the extent of that amount. As soon as that amount is paid, he is no more liable.

2. Limited by guarantee :

The liability of the member of such a company is limited to the amount he has undertaken to contrib-ute to the assets of the company in the event of its wound up. This guaranteed amount is limited by fixed sum which is specified in the memorandum. Chambers of commerce, trade associations and sports clubs are usually guarantee concerns. The object of such companies is not to make profit and distribute dividend.

3. Unlimited Companies:

A company not having any limit on the liability of its members is an unlimited company. It may or may not have share capital. Members are held liable for the deficiency of assets to the liabilities of the company in proportion to their interests in the company. Liability in such a case may extend to the personal property of the shareholders. Unlimited companies, though permitted by the companies Act, are not popular in our country.

17.5. DISTINCTION BETWEEN PRIVATE AND PUBLIC COMPANIES :

Following are the main points of distinction between a private and a public company.

Private Company	Public Company
1. The minimum number of members to form is two.	1. The minimum number of members to form is seven.
2. The maximum number is restricted to 50.	2. No maximum limit.
3. It cannot invite public to subscribe its shares or debentures.	3. It can invite public to subscribe its shares or debentures by issue of prospectus.
4. It can commence business after receiving incorporation certificate.	4. Until it receives the certificate of commencement of business it cannot start bussiness.
5. It has to observe less legal formalities when compared to public limited company.	5. A public limited company has to observe a large number of legal formalities.
6. The share cannot be transferred freely in the market.	6. The shares of a public company are freely transferable.
7. A private Company which is not a subsidiary of a public company should have at least two directors. A private company being subsidiary of a public company should have maximum three directors.	7. It should have at least three directors.

8. There are no legal restrictions on remuneration of directors.	8. Total managerial remuneration in a public company cannot exceed 11 % of the net Profits, and in the case of inadequacy of profits an amount up to Rs.50,000 can be paid.
9. Directors can borrow from the company without the approval of central Government.	9. They must get the approval of the central government.
10. It need not hold a statutory meeting nor file a statutory report.	10. It must hold the statutory meeting and must file statutory report with the Registrar.
11. It cannot issue share warrants..	11. It can issue share warrants.
12. It must have the words Private Limited in its name.	12. It must have only the word limited as the last word in its name.
13. It can issue deferred shares even with disproportionate voting rights.	13. Since 1956. No public company can issue deferred shares.
14. Written consent of directors to act as such need not be filed with the registrar.	14. Written consent of directors to act as such must be filed with the registrar.
15. No qualification shares are prescribed for directors.	15. Directors must take up qualification shares.
16. A single resolution is enough to appoint at the new directors.	16. Separate resolutions must be passed to elect each directors.
17. There is no minimum subscription clause to be satisfied before the allotment of shares.	17. Only after securing minimum subscription allotment of shares can be made,
18. It need not keep the index of its members.	18. It must maintain the Index of its members.
19. Directors need not retire by rotation.	19. Directors are subject to retirement by rotation.
20. There is no need to file a prospectus or a statement in liew of prospectus.	20. Prospectus or the statement in liew of prospectus should be filed with the Registrar before allotment of shares.
21. Special privileges can be enjoyed by a private company.	21. A public company enjoys no such privileges.
22. Quorum required for a meeting is two.	22. Quorum required in this case is five.
23. A director can vote on a contract in which he is interested.	23. They are not allowed.

17.6. FORMATION OF COMPANY:

A company may be formed either to take over an existing business or to carry on a new business. Whatever may be the objective the procedure for the formation of a company, from the time the idea of forming a company is first conceived till the company is actually formed and commences business, may be divided into three principal stages:

1. Promotion
2. Incorporation
3. Commencement of Business

Each of these stages are explained below:

6.1. Promotion:

The stage of conceiving an idea and its working up is termed as promotion. The person involved in this task is termed as promoter. The promoter may work up the idea with the help of his own resources, influence, if necessary, take the help of technical experts to find out the economic and technical feasibility of the project that he has in his mind.

6.2. Incorporation:

It is the incorporation which brings a company into existence as a separate corporate entity. The promoter has to take the following preliminary steps in this connection. He has to prepare certain documents and filed with the registrar of the Joint Stock companies of the state in which the registered office of the company is to be situated.

6.2.1 Memorandum of Association : Memorandum of Association is the main document of the company, which defines its constitution and objects with which the company is formed. It may rightly be termed as the charter or the constitution of the company since it governs the relationship of the company with outside world.

The Memorandum of Association must have the following clauses.

a) **Name clause** : The clause contains the name of the company. A company can have any name of its choice subject to the following two restrictions.

i) The name should not be similar with the name of the existing company,

ii) The name should not be undesirable.

The last word of the name must be ‘limited’ in the case of public companies and ‘Private limited’ in the case of Private limited companies.

b) **Situation clause** :This clause contains the name of the state in which registered office of the company is to be situated.

c) **Objects clause**: The clause explains the objectives for which the company has been formed. The clause should state separately;

i) Main objects and

ii) The objects incidental to the main objects

iii) Other objects

d) **Liability clause**: The clause defines the liability of the members of the company. In case of a company limited by shares the memorandum must state that the liability of the members is limited to the extent of unpaid portion of the shares held by him. Incase of a company limited by guarantee, it should state the amount which each member undertakes to contribute to the assets of the company in the event of its winding up.

e) **Capital clause**: The clause states the amount of share capital with which the company is to be registered and its division into shares of a fixed amount.

f) **Association clause** : It is stated here that the persons putting their signatures to the memorandum are desirous of forming themselves into an association in pursuance of the memorandum of Association. The memorandum should be signed by seven or more persons in case of a public company and two or more in the case of a private company.

6.2.2. Articles of Association : Articles of Association contains the regulations and by-laws for governing the internal affairs of the company. They may be described as the internal regulations of the company governing its management. The Articles of Association of a company usually deal with the following matters:

1) The exclusion, total or partial, of Table A.
2) Adoption or execution of preliminary contracts.
3) Definition of important terms and phases.
4) Share capital and rights attached to different classes of shares.
5) Procedure as to making of calls and forfeiture of shares.
6) Appointment of managerial personnel eg: directors, managing directors etc. their rotation, powers, including borrowings and duties.
7) **Rules as to**: transfer and transmission of shares, issue of share warrants, general meeting, common seal of the company dividend, reserves and capitalisation of profits, accounts and audit, alteration of share capital, lien on shares, remuneration of managerial personal, issue of redeemable preference shares, paying commissions, paying interest out of capital, winding up of the company.

6.3. Prospectus :

Prospectus is a document inviting deposits from public or offers public to subscribe for the shares or debentures of a body corporate. Public company can only issue the prospectus. A prospectus must contain the matter specified in the schedule II to the companies Act. These matters relate to the objectives of the company, past history and future prospectus, managerial personnel, material contracts, amount of minimum subscription etc. Neither any material information should be omitted not it should be false and misleading otherwise the persons responsible for the issue of the prospectus i .e. the directors, promoters etc, can be made liable for the loss suffered by the shareholders.

6.4. Fixation of the underwriters, brokers, solicitors, auditors etc.

The promoter should file these documents with required fees to the Registrar of companies.

6.4.1 Certificate of incorporation : On receipt of the above documents and the requisite fees, the Registrar will examine them and if satisfied with them issue a certificate of incorporation. The certificate contains the name of the company, the date of its issue and the signatures of the Registrar with his seal. The date mentioned in the certificate will be taken, as the date of birth of the company.

6.5. Commencement of Business :

A private company can commence business soon after its incorporation but a public company has to obtain another certificate for this purpose, which is known as certificate for "Commencement of business". This certificate is issued by the Registrar on company filing the following documents.

1. A copy of the prospectus.
2. A statutory declaration duly verified by any one of the directors or the secretary of the company that the directors have taken the qualifying shares and the minimum subscription required by law have been received from the public.

17.7. ALLOTMENT OF SHARES :

Prospectus issued by a company is only an invitation to the general public to apply for the company's shares. Application for shares is the offer from the people to purchase shares. The communication of acceptance of this offer by an allotment order or notice gives rise to a valid contract between both the parties - the company and the shareholder.

Allotment of shares is usually done by a resolution of the board of directors. In case of over subscription, the directors follow the basis given by the stock exchange a public company offering shares or debentures to the public for subscription can proceed with allotment of shares only after complying with following requirements.

1. The amount fixed as minimums subscription must have been subscribed for.
2. A sum equal to at lest 5 per cent of the nominal value of shares must have been received in cash by the company as application money.
3. All money received from applicants for shares should be kept deposited in a scheduled bank till the company obtains the certificate for commencement of business.
4. In case a company has not issued a prospectus, a statement in Liew of prospectus must be filed with the Registrar at least three days before allotment of shares
5. No allotment can be made before the beginning of the 5 th day after the date on which the prospectus has been issued.

17.8. SUMMARY :

A company is a voluntary association of persons, with capital divided into shares, formed to carry out a particular purpose in common. It is an artificial person created by law. It has a common seal on its name. From the view point of formation, ownership and liabilities companies can be classified into different categories. For incorporation of a Joint stock company certain documents have to be submitted with the Registrar of company's such as Memorandum of Association, Articles of Association, prospectus etc. After verifying and satisfied himself the Registrar issue a certificate of incorporation. After satisfying the legal obligations a company can allot shares the shareholders.

17.9. MODEL QUESTIONS :

1. Define a company and state its essential characteristics.
2. Explain the documents that have to be filed with the Registrar of companies for getting a company incorporated.
3. What is allotment of shares? Explain the statutory restrictions imposed on allotment of shares.

17.10 REFERENCE BOOKS :

1. Advanced Accountancy - M. C. Shukla & T.S. Grawal

2. Advanced Accountancy - R.L. Gupta & M. Radha - Swami

3. Advanced Accountancy - S.P. Jain & K.L. Narang

4. Advanced Accountancy - Dr. S.N. Maheswari

5. Advanced Accountancy - S.P. Jain & K.L. Narang

6. Advanced Accountancy - K.R. Pall.

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Lesson - 18

COMPANY ACCOUNTS

SHARE CAPITAL - ISSUE

OBJECTIVES:

After going through this lesson the student can know what is share capital ? How is its division ? and how the joint stock companies issue shares to public and their accounting treatment.

STRUCTURE:

18.1 INTRODUCTION:

The sum total of the nominal value of shares of a company is called as its share capital. The capital of the company can be divided into different units with definite value called shares. Holders of these shares are called shareholders or members of the company.

18.2 TYPES OF SHARES :

There are two types of shares which a company may issue i.e.

1. Preference shares, 2. Equity shares.

2.1 Preference shares :

Shares which enjoy the preferential rights as to dividend and repayment of capital in the event of winding up of the company over the equity shares are called preference shares. The holder of preference shares will get a fixed rate of dividend, preference shares may be :

a) **Cumulative Preference shares :** If the company does not earn adequate profit in any year, dividends on preference shares may not be paid for that year. But if the preference shares are cumulative such unpaid dividends are treated as arrears and can be carried forward to subsequent years. Such unpaid dividends on these shares go on accumulating and become payable out of the profits of the company, in subsequent years. Only after such arrears have been paid off, any dividend can be paid to the holder of equity shares.

b) **Non - Cumulative Preference shares :** The holders of non - Cumulative preference shares no doubt will get a preferential right in getting a fixed dividend before it is distributed to equity shareholders and as regards payment of capital is concerned. The fixed dividend is to be paid only out of the divisible profits. But if in any particular year there is no profit as to distribute it cannot be carry forward.

c) **Redeemable Preference shares :** Capital raised by issuing shares is not to be repaid to the shareholders but capital raised through the issue of redeemable preference shares is to be paid back by the company to such shareholders after the expiry of a stipulated period.

d) **Participating or Non Participating Perference Shares :** The preference shares which are entitled to a share in the surplus profit of the company in addition to the fixed rate of preference dividend are known as participating preference shares. Thus participating preference shareholders obtain return on their capital in two forms. 1)fixed dividend 2) share in excess of profits: Those preference shares which donot carry the right of shares in excess profits are known as non-participating preference shares.

2.2 Equity shares :

Equity shares will get dividend and repayment of capital after meeting the claims of preference shareholders. There will be no fixed rate of dividend to be paid to the equity share holders and this rate may vary from year to year. This rate of dividend is determined by directors. In case of large profits, it may evern be more than the rate attached to preference shares and such shareholders may go without any dividend if no profit is made.

18.3 DIVISION OF SHARE CAPITAL :

The main divisions of share capital are as follows :-

1. Nominal or Registered or Authorised Capital :

The amount of capital with which the company intends to be registered is called registered capital. It is the maximum amount which the company is authorised to raise by way of public subscription. There is no legal limit on the extent of the amount of authorised capital.

2. Issued Capital :

That part of the authorised capital which is offered to the public for subscription is called issued capital.

3. Subscribed capital :

That part of the issued capital for which applications are received from the public is called the subscribed capital.

4. Called up capital :

The amount on the shares which is actually demanded by the company to be paid is known as called up capital.

5. Paid up capital :

The part of the called up capital which is offered and is actually paid by the members is known as paid up capital. The sum which is still to be paid is known as calls in arrears.

6. Reserve capital :

A company may determine by a special resolution that any portion of its share capital which has not been already called up shall not be capable of being called up except in the event of winding up of the company. Such type of share capital is known as reserve capital. A note regarding reserve capital is shown in the Balance sheet.

Terms of issue of shares :

The terms on which shares are to be issued by the company are given in the prospectus. The issue price of the shares can be received in one instalment or it can be spread over different instalments. The amount when received in different instalments may be paid on application, allotment or in different calls. The amount which is received on application is called the application money, the amount which becomes due on allotment is called allotment money. Rest of the amount may be called in different calls according to the requirements and needs of the company.

18.4 SHARES ISSUED FOR CONSIDERATION OTHER THAN CASH ACCOUNTING ENTRIES :

Shares may be issued by a joint stock company for two different considerations -

1. For consideration other than cash.
2. For cash.

A company may purchase a running business and pay to the vendors the purchase consideration in the form of shares. The accounting entries will be as follows -

1. Sundry Assets Account Dr

(Dr. each Asset individually)

To Sundry Liabilities

(Cr. each liability individually)

To Vendor's Account

(Being Purchase of assets and liabilities as per agreement dated.....)

2. Vendors Account Dr

To share capital Account

(Being payment to the vendors)

If the shares have been allotted to any person or firm from whom the company has purchased any asset, the following entries will be passed :

Assets Account Dr

To share capital Account

(Being .... Shares allotted in consideration of purchase of an asset for the company)

Illustration 1 :

A company purchased a running business from m/s P.K.R Brothers for a sum of Rs. 3,00,000 payable as to Rs. 2,40,000 in fully paid shares of Rs. 10 each and balance in cash. The assets and liabilities consisted of the following :

	Rs.
Plant and Machinery	80,000
Buildings	80,000
Sundry Debtors	60,000
Stock	80,000
Cash	60,000
Sundry Creditors	40,000

You are required to pass the necessary journal entries in the company's books.

Solution :

			Dr.	Cr
Plant and Machinery	A/c	Dr	80,000	
Buildings	A/c	Dr	80,000	
Sundry Debtors	A/c	Dr	60,000	
Stock	A/c	Dr	80,000	
Cash	A/c	Dr	60,000	
	To Sundry Creditors			40,000
	To P.K. R. Brothers			3,00,000
	To Capital Reserve			20,000
(Being assets and liabilities taken over)				
M/s P.K. R. Brothers A/C		Dr	3,00,000	
To Share Capital				2,40,000
To Bank				60,000
(Being payment to M/s P.K.R. Brothers)				

18.5 SHARES ISSUED FOR CASH - ACCOUNTING ENTRIES :

Companies generally issue shares for cash. The procedure involved is as follows :

1. On receipt of application money

Bank Accont Dr

To Share Application A/C

(Being application money received)

2. On allotment of shares all application money on allotted shares is transferred to share capital account by passing the following entry :

Share Application Account Dr

To Share capital Account

(Being the application money transferred to share capital Account)

3. To those applicants who could not be allotted any share their application money will be returned. For this the following entry will be passed :

   Share Application Account Dr

   To Bank Account

   (Being the application money of shares not allotted returned)

4. On the allotment of share's, the allotment money becomes due to the company, for this the company will pass the following entry :

   Share Allotment Account Dr

   To Share capital account

   (Being the allotment money due on ....shares)

5. On receipt of allotment money, the entry is :

   Bank A/c Dr

   To Share allotment A/C

   (Being the receipt of allotment money)

6. On making the first call due from shareholders the entry is :

   Share first call Account Dr

   To Share capital account

   (Being the first call money, due on .... Shares)

7. On receipt of the first call money the entry is :

   Bank Account Dr

   To Share first call Account

   (Being share first call money .... shares received)

   Similar entries will be passed for second and third calls.

Illustration 2 :

On Ist January 2008, a company offers 16,000 shares of Rs. 10 each. Applications are received for full. Money payble is all follows :

On Application	Rs. 3 Per share
On Allotment	Rs. 2 Per share
On 1st call	Rs. 3 Per share
On First call	Rs. 2 Per share

The shares were duly allotted, calls made and money realised, you are required to pass the necessary journal entries.

Solution :

JOURNAL

Date	Particulars	Dr Amount Rs.	Cr Amount Rs.
1-1-2008	Bank A/C Dr	48,000	
	To share Application A/C		48,000
	(Being Application money received on 16,000 shares @ Rs. 3. Per share)		
	Share Application A/C Dr	48,000	
	To share Capital A/C		48,000
	(Being Application money transferred to share capital account)		
	Share Allotment A/C Dr	32,000	
	To share Capital A/C		32,000
	(Being money due for allotment on 16000 shares @ Rs. 2 per share)		
	Bank A/C Dr	32,000	
	To share Allotment A/C		32,000
	(Being money received on allotment)		
	Share 1st call A/C Dr	48,000	
	To share Capital A/C		48,000
	(Being money due for 1st call on 16000 shares @ Rs. 3 per share)		
	Bank A/C Dr	48,000	
	To share 1st call		48,000
	(Being money received on 1st call)		
	Share Final Call A/C Dr	32,000	

	To share Capital A/C		32,000
	(Being money due on final call)		
	Bank A/C Dr	32,000	
	To share Final call A/C		32,000
	(Being money received on final call)		

18.6 WHEN BOTH PREFERENCE AND EQUITY SHARES ARE ISSUED :

When a company issues both preference and equity shares then it is desirable that the entries for application money, allotment money and calls money should be separately passed for each type of share capital. The word Equity or preference must be used in all the circumstances.

Illustration 3 :

A company was registered with an authorised capital consisting of 40,000 9% preference shares of Rs. 100 each, payable Rs.25 per share on application, Rs. 25 per share on allotment and Rs. 50 per share on first and final call. and 6,00,000 Equity shares of Rs. 10 each; payable Rs.2.50per share on application, Rs. 2.50 per share on allotment and Rs. 5 per share on first and final call. Applications were received for the whole of the preference and Equity shares. All the money due on the shares was paid. Make the necessary entries and the Balance sheet of the company :

Solution :

JOURNAL ENTIRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
1-1-2008	Bank A/C Dr		10,00,000	
	To pref. share Application A/C			10,00,000
	(Being pref. share application money received on 40,000 shares @ Rs. 25. Per share)			
	Bank A/C Dr		15,00,000	
	To Equity share application A/C			15,00,000
	(Being Equity share application money received on 6,00,000 shares @ Rs. 2.50 per share)			

	Pref. Share appliction A/C Dr		10,00,000	
	To pref. share Capital A/C			10,00,000
	(Being pref. share application money transferred to pre. share capital A/C)			
	Equity share application A/C Dr		15,00,000	
	To Equity share capital A/C			15,00,000
	(Being equity share applictaion money transferred to equity share capital account)			
	Pref. Share Allotment A/C Dr		10,00,000	
	To pref share Capital A/C			10,00,000
	(Being pref. share allotment money due on 20,000 shares @ Rs. 25 per share as per the resolution of the Board of Directors)			
	Equity share Allotment A/C Dr		15,00,000	
	To Equity share capital A/C.			15,00,000
	(Being Equity share allotment money due on 6,00,000 shares @ Rs. 2.50 per share as per the resolution of the Board of Director)			
	Bank A/C Dr		10,00,000	
	To pref. share Allotment A/C			10,00,000
	(Being pref. share Allotment money received on 40,000 shares @ Rs. 25 per share)			
	Bank A/C Dr		15,00,000	
	To Equity share allotment A/C			15,00,000
	(Being Equity share Allotment money received on 6,00,000 shares @ Rs. 2.50 per share)			

	Pref. Share 1st & Final call A/C Dr		20,00,000	
	To pref. share capital A/C			20,00,000
	(Being pref. share 1st & Final call money due on 40,000 shares @ Rs. 50 per share)			
	Equity share 1st & Final call A/C Dr		30,00,000	
	To Equityshare capital A/C			30,00,000
	(Being Equity share 1st & Final call money due on 6,00,000 shares @ Rs.5.per share)			
	Bank A/C Dr		20,00,000	
	To pref. share 1st & Final call			20,00,000
	(Being pref. share 1st & Final call money received on 40,000 shares @ Rs. 50 per share)			
	Bank A/C Dr		30,00,000	
	To Equity share 1st & Final call			30,00,000
	money received			

Balance Sheet .... co.

as on ....

Liabilities	Rs.	Assets	Rs.
Authorised capital :		Cash at Bank	1,00,00,000
40,000, 9% pref. shares of Rs. 100 each	40,00,000		
6,00,000 Equityshares of Rs. 10 each	60,00,000		
Issued and subscribed & Paid up capital :			
40,000, 9% pref. shares of Rs. 100 each	40,00,000		
6,00,000 Equity shares of Rs. 10 each	60,00,000		
	1,00,00,000		1,00,00,000

18.7. UNDER SUBSCRIPTION :

Sometimes a company may not receive applications for the total shares issued to the public. Then it is called under subscription.

Illustration 4 :

X ltd invited applications for 1,00,000 shares of Rs. 10 each payable as follows :

In application Rs. 3; on Allotment Rs. 4 and first and final call Rs. 3. 80,000 Applications were received from the public and all of these were accepted. All money due was received.

Pass necessary entries in the Journal of company. Also show how these transactions would appear in Balance sheet of the company.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Bank A/C Dr		2,40,000	
	To pref. share Application A/C			2,40,000
	(Being application money on 80,000 shares @ Rs. 3 per share received)			
	share Application A/C Dr		2,40,000	
	To share A/C			2,40,000
	(Being share application money transferred to share capital)			
	Share Allotment A/C Dr		3,20,000	
	To share Capital A/C			3,20,000
	(Being allotment money on 80,000 shares @ Rs. 4 per share due)			
	Bank A/C Dr		3,20,000	
	To share allotment A/C			3,20,000
	(Being allotment money received)			

	Share First & Final call A/C Dr		2,40,000	
	To pref. share Capital A/C			2,40,000
	(Being first & Final call amount on 80,000 shares @ Rs. 3. per share due)			
	Bank A/C Dr		2,40,000	
	To share First & Final call A/C.			2,40,000
	(Being First & Final call amount on 80,000 shares @ Rs. 3. per share received)			

Balance Sheet .... co.

As on ....

Liabilities	Rs.	Assets	Rs.
Authorised capital :		Cash at Bank	8,00,000
1,00,000 Equity shares of Rs. 10 each	10,00,000		
Issued capital :			
1,00,000 Equity shares of Rs. 10 each	10,00,000		
subscribed & Paid up capital :			
80,000 Equity shares of Rs. 10 each			
	8,00,000		8,00,000

18.8. OVER SUBSCRIPTION :

Sometimes a company may receive more applications than the issued capital to the public which is known as over subscription. Because of over subscription, the company may not allot all the shares for which applications have been received. Then the allotment is made on pro - rata basis. For example, if the company offered 20,000 shares but applications for 40,000 shares were received by the company. The directors sent letters of regret to applicants of 10,000 shares and applicants of 30,000 shares were allotted the 20,000 shares on pro-rata basis. In such a case, application money of 10,000 shares (excess received) will be adjusted either on allotment and on calls.

Illustration 5 :

A company issued Rs. 10,00,000 capital divided into Rs. 10 per share, payable as under:

On Application Re. 1 per share; on allotment Rs. 4 per share and on Final call Rs. 5 per share.

Over payments on application were to be applied towards sums due on allotment. Where no allotment was made, application money was to be returned in full. The issue was over subscribed. Applicants for 1,20,000 shares were allotted 1,00,000 shares and applicants for 30,000 shares were sent letters of regret. All money due on allotment and final call was duly received. Make the necessary entries in company's books.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Bank A/C Dr		1,50,000	
	To share Application A/C			1,50,000
	(Being Application money on 1,50,000 shares received)			
	Share Application A/C Dr		1,00,000	
	To share captial A/C			1,00,000
	(Being share application money on 1,00,000 shares transferred to share capital account.)			
	Share Application A/C Dr		30,000	
	To Bank Account			30,000
	(Being regreted Application money on 30,000 shares returned)			
	Share Allotment A/C Dr		4,00,000	
	To share capital A/C			4,00,000
	(Being Allotment money due)			

		Bank Account Dr Share Application A/C Dr		3,80,000 20,000	
		To share Allotment A/C			4,00,000
		(Being Allotment money received and excess amount in Application Account adjusted)			
		Share First & Final call A/C Dr		5,00,000	
		To share capital A/C.			5,00,000
		(Being share First & Final call due)			
		Bank A/C Dr		5,00,000	
		To share First & Final call A/C.			5,00,000
		(Being share First & Final call received)			

18.9. ISSUE OF SHARES AT PREMIUM :

A company may issue shares at a premium, i.e. at a value greater than its face value. Premium so received shall be credited to a separate account called securities premium account.

Section 78 of the companies Act, 1956 gives the purposes for which securities premium account may be applied by the company.

These are :

1. For the issue of fully paid bonus shares to the members of the company;
2. For writing off priliminary expenses of the company.
3. For writing off the expenses of , or the commission paid or discount allowed, on any issue of shares or debentures of the company; and
4. For providing premium payable on the redemption of any redeemable preference shares or debentures of the company.

Journal Entries :

a. If the premium is paid with application money, the following entries will be passed :

1. Bank Account Dr

To share Application A/C.

(Being share application money along with premium received)

2. Share Application Account Dr

To share capital A/C

To securities premium A/C.

(Share application money transferred to share capital A/C and securities premium A/C)

b. If the securities premium is received along with the allotment money, then the following entries will be passed :

1. Share Allotment Account Dr

To share capital A/C

To Securities premium A/C

(Being the allotment money and securities premium money due on .... shares)

2. Bank Account Dr

To Share Allotment Account.

(Being the receipt of allotment along with share premium account)

Illustration 6 :

A company offers 20,000 of shares of Rs 10 each to the public for subscription at Rs. 12 per share. Money is payable as follows :

Rs. 3. on application

Rs. 4. on allotment (including Re. 1 as premium)

Rs. 5. on call (including Re.1 as premium)

Applications are received for 30,000 shares. No allotment is made to applicants for 6,000 shares and their application money is refunded. Rest are allotted shares on a pro rata basis. All allotees pay the money due on shares as and when called up.

Pass the necessary journal entries and show how the items will appear in the company's balance sheet.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Bank A/C Dr		90,000	
	To share Application A/C			90,000
	(Being the application money received on 30,000 shares @ Rs. 3 per share)			
	Share Application A/C Dr		90,000	
	To share capital A/C			60,000
	To Bank A/C			18,000
	To Share Allotment A/C			12,000
	(Being application money transferred to share capital on 20,000 shares application money on 6,000 shares refunded and rest transferred to allotment)			
	Share Allotment A/C Dr		80,000	
	To share Capital A/C			60,000
	To Share premium A/C			20,000
	(Being money due on allotment on 20,000 shares @ Rs 4 per share including Re. 1. as share premium)			
	Bank Account Dr		68,000	
	To share allotment A/C			68,000
	(Being money received on allotment)			

	Share First & Final call A/C Dr		1,00,000	
	To share Capital A/C			80,000
	To share premium A/C			20,000
	(Being money due on call @ Rs. 5. per share)			
	Bank A/C Dr		1,00,000	
	To share first & Final call			1,00,000
	(Being money received on call)			

.... co Ltd.

Balance Sheet as on ....

Liabilities	Rs	Assets	Rs.
Share capital :		Current Assets :	
Authorised ...... shares of Rs. each	--------	Bank balance	2,40,000
Issued and subscribed capital :			
20,000 shares of Rs. 10 each fully paid	2,00,000		
Reserves and surplus :			
share premium	40,000		
	2,40,000		2,40,000

18.10. ISSUE OF SHARES AT DISCOUNT :

According to section 79 of the companies Act a company can issue shares at a discount i.e; Value less than the face value subject to the following conditions :

1. The issue of shares at a discount is authorised by a resolution passed by the company in general meeting and sanctioned by the central government.
2. The resolution must specify the maximum rate of discount which should not exceed 10 per cent of the nominal value of shares or such higher percentage as the central government may permit.
3. One year must have been elapsed since the date at which the company was allowed to commence business.

4. Issue must take place within two months after the date of the sanction by the court or within such extended time as the court may allow.
5. Every prospectus relating to the issue of shares and every balance sheet after the issue of shares contain particulars of the discount allowed and so much of the discount as has not been written off.

The following journal entry is passed on the issue of the shares at a discount at the time of allotment:

Share Allotment Account Dr

Discount on the issue of

shares Account Dr

To share capital Account

Discount on the issue of shares will be shown under miscellaneous head on the assets side of the balance sheet till it is completely written off from the profit and loss Account. Generally such discount is spread over some period say five years and the amount written off each year is debited to profit and loss account and the amount not yet written off is shown on the assets side of the Balance sheet.

Illustration 7 :

Z Ltd. invited applications for 2,00,000 shares of Rs. 10 each at a discount of 6% payable as follows :

On Application Rs. 2.50, on Allotment Rs. 3.40 and on First and Final call Rs. 3.50.

The applications received were for 1,80,000 shares and all of these were accepted. All money due was received.

Pass necessary entries in the Journal of company. Also show how these transactions would appear in Balance sheet of the company.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Bank A/C Dr		4,50,000	
	To share Application A/C			4,50,000
	(Being share Application money on 1,80,000 shares @ Rs. 2.50 per share received)			

	Share Application A/C Dr		4,50,000	
	To share capital A/C			4,50,000
	(Being share Application money on 1,80,000 shares @ Rs. 2.50 per share transferred to share capital)			
	Share allotment A/C Dr		6,12,000	
	Discount on issue of shares A/C Dr		108,000	
	To share capital A/C			7,20,000
	(Being share Allotment money due on 1,80,000 sahre @ Rs. 3.40 per share and discount @ Re. 0.60 per share)			
	Bank A/C Dr		6,12,000	
	To share Allotment A/C			6,12,000
	(Being share Allotment money received on 1,80,000 shares @ Rs. 3.40 Per share)			
	Share First & Final call A/C Dr		6,30,000	
	To share Capital A/C			6,30,000
	(Being share First & Final call money due on 1,80,000 shares @ Rs. 3.50 per share as per the resolution of the Board of Directors)			
	Bank A/C Dr		6,30,000	
	To share First & Final call A/C.			6,30,000
	(Being share First & Final call money received on 1,80,000 shares @ Rs. 3.50 per share)			

Balance sheet of Z Ltd. Co., as on ....

Liabilities	Rs.	Assets	Rs.
Issued capital :		Cash at Bank	16,92,000
2,00,000 shares @ Rs. 10 per share	20,00,000	Discount on issue	
subscribed & Paid up capital :		of shares	1,08,000
1,80,000 shares @ Rs. 10 per share	18,00,000		
	18,00,000		18,00,000

18.11. CALLS IN ARREARS AND CALLS IN ADVANCE :

If any amount has been called by the company either as allotment or call money and a shareholder has not paid that money, this is known as calls in arrears. On such arrears, the company can charge interest @ 5 % if there is a provision in the Articles of Association for the period for which such amount remained in arrear from the shareholders.

Similarly, if any call has been made, while paying that call, some shareholder, has paid the amount of the rest of calls also, then such amount will be called as calls in advance and will be credited to a separate account known as calls in advance account by passing the following entry.

Bank Account Dr

To callls in Advance A/C.

Calls in Advance Account is shown on the liabilities side of the Balance sheet separately from the paid up capital, generally interest is paid on such calls according to the provisions of the Articles of Association but such rate should not exceed 6% per annum.

Illustration 8 :

On 1 st March, 2008 sony Ltd. , makes an issue of 40,000 equity shares of Rs. 10 each payable as follows :

On application Rs. 2. on allotment Rs. 3. and on first and final call Rs. 6. (Three months after allotment)

Applications were received for 52,000 shares and Directors made allotment in full to the applicants demanding ten or more shares and returned money to the applicants for 12,000 shares. One shareholder who was allotted 80 shares paid first and final call with allotment money and another share holder allotted 120 shares did not pay allotment money on his shares, but which he paid with the first and final call. Directors have decided to charge and allow interest, as the case may be, on calls in arrears and calls in advance respectively according to the provisions of Table A. Give the necessary journal entries in the books of the company.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
2008 March 1	Bank Account Dr		1,04,000	
	To share Application Account			1,04,000
	(For Application money received on 52,000 shares @ Rs. 2 Per share)			
2008 March 1	Share Application A/C Dr		1,04,000	
	To share capital A/C			80,000
	To Bank A/C			24,000
	(For application money of 40,000 shares transferred to share capital account and application money of 12,000 shares refunded)			
2008 March 1	Share allotment A/C Dr		1,20,000	
	To shares capital A/C			80,000
	To securities premium A/C			40,000
	(For allotment money and securities premium due on 40,000 shares @ Rs.2. and Re.1. per share respectively as per resolution of the Board of Directors dated........)			
2008 March 1	Bank Account Dr		1,20,120	
	To share Allotment A/C			1,19,640
	To calls in Advance Account			480
	(For the receipt of allotment money @ Rs. 3 on 39,880 shares and advance call money on 80 shares @ Rs. 6. each)			

2008 June 1		Share First & Final call A/C Dr		2,40,000	
		To share Capital A/C			2,40,000
		(For the amount due in respect of first and final call on 40,000 shares @ Rs.6 per share)			
		Bank Account Dr		2,39,880	
		To share First & Final call A/C.			2,39,520
		To share Allotment Account			360
		(For the amount received on account of first and final call on 39,880 shares @ Rs. 6 and calls in arrears of allotment)			
		Calls in Advance A/C Dr		480	
		To share First & Final call A/C.			480
		(Adjustment of calls in advance against the first and final call)			
		Interest on calls in advance A/C Dr		7.20	
		To Bank			7.20
		(Interest Paid on calls in advance on Rs. 480 for 3 months @ 6% p.a.)			
		Bank Account Dr		4.50	
		To Interest on calls in Arrears A/C			4.50
		(Receipt of interest on calls in arrears on Rs. 360 for 3 months @ 5 % p.a.)			

18.12. SUMMARY :

The capital of the company is divided into different units with definite value called shares. Holders of these shares are called shareholders. There are two types of shares. 1. Preferential shares ; 2. Equity shares. The terms on which shares are to be issued by the company are given in the prospectus. Joint stock companies may issue shares for two different considerations. 1.For consideration other than cash.; 2. For cash shares may be over subscribed or undersubscribed. A company may issue shares at a premium ; i.e. at a value greater than its face value. Similarly a company can issue shares at a discount i.e, value less than the face value.

18.13. MODEL QUESTIONS :

1. Give the main divisions of share capital of a company.
2. What is a share ? Discuss the types of shares which a company can issue.
3. What do you understand by issue of shares at par, at a premium and at discount?
4. Distinguish between calls in advance and calls in arrears.
5. Give the journal entries for issue of shares from application money to final call.

18.14 EXERCISES :

1. Vimal co. Ltd. issued 80,000 shares of Rs. 10 each at a premium of Rs. 2. Payable as follows :

   On application Rs. 2

   On allotment Rs. 5 (Including premium)

   On 1st Call Rs. 2 and

   On final Call Rs. 3

Applications were received for 60,000 shares and allotment was made in full.

The first call was made and the amount due there on was received

2. A & Co. Ltd. invited applications for 10,000 shares of Rs. 100 each at a discount of 5% payable as follows :

   On application Rs. 25

   On allotment Rs. 34 and

   On first and final Call Rs. 36 (on call).

   The applications received were for 9,000 shares and all these applications were accepted All the money due were received.

3. A company issued 30,000 fully paid up shares of Rs. 100 each for purchase of following assets and liabilities from mohan brothers.

	Rs.
Land and Buildings	12,00,000
Plant	7,00,000
Stock in trade	9,00,000
Sundry Creditors	2,00,000

   You are required to pass the necessary journal entries

4. A company was registered with a share capital of Rs 1,00,000 divided into 5000 6 percent preference shares of Rs. 10 each. Out of these shares 1,000 preference shares and 1,000 equity shares were issued as fully paid to the vendors for purchase of property. The balance of the shares were offered to the public for subscription. The money was payable as follows on both the classes of shares :

   Rs. 3 on Application

   Rs. 2 on Allotment

   Rs. 3 on First call

   Rs. 2 on second and final call

   Applications were received for 6,000 equity shares and 5,000 preference shares. Allotment was made on prorata basis. All the calls were made and the amount due received. Pass necessary journal entries to record the above transcations.

5. Z Ltd. offered for public subscription Rs. 10, 000/- equity shares of Rs. 10/- each at a premium of Rs. 2. per share payable as follows -

   On application Rs. 2. per share

   On allotment Rs. 5 (Including premium)

   On first Call Rs. 3 and

   On final call Rs. 2

   Applications were received for 12,000 shares. All the applications were considered the excess application money is adjusted for allotment. Mr. Y to whom 500 shares were allotted fail to pay final call money.

   Prepare cash book, share capital account and balance sheet of the company.

6. A limited company issued a prospectus inviting applications for 2,000 shares of Rs.10 each at a premuim of Rs. 2 per share payable as follows :

   On Application Rs. 2

   On Allotment Rs. 5 (including premuim)

   On First call Rs. 3

   On second and final call Rs. 2

   Applications were received for 3,000 shares and allotments made pro-rata to the applicants for 2,400 shares, the remaining applications being refused. Money overpaid on applications was employed on account of sums due on allotment. All the calls were made and the amount due was received. Pass necessary journal entries to record the above transcations.

7. A company was registered with a share capital of Rs. 1,00,000 divided into 10,000 shares of Rs. 10 each. Out of these shares 2,000 shares of Rs. 10 each were issued, at a premium of Rs. 2 per share, fully paid to the vendors as consideration for purchase of Buildings, plant and machinery.

   5,000 shares were offered to the public for subscription at Rs. 12 per share. The money was payable as follows :

   On Application Rs. 3 per share

   On Allotment Rs. 4 per share (including premuim)

   On First call Rs. 2 per share (3 months after allotment)

   On Final call Rs. 3 per share (3 months after first call)

   Application were received for 8,000 shares. No allotment was made to applicants for 2,000 shares. Rest were allotted shares on a pro - rata basis. All calls were duly made and received.

   The company adopts Table A as its articles. You are required to pass the journal entries and prepare the company balance sheet.

   (Hint : Allow 6 percent p.a. as int0erest on call in advance and charge 5 percent interest on call on arrears)

8. A limited company issued a prospectus inviting applications for 2,000 shares of Rs.10 each at a premuim of Rs. 2 per share payable as follows :

   On Application Rs. 2

   On Allotment Rs. 5 (including premuim)

   On First call Rs. 3

   On Final call Rs. 2

   Applications were recived for 3,000 shares and allotment made pro-rata to the applicants of 2,400 shares. Money overpaid on applications was employed on account of sums due on allotment.

   Rajesh to whom 40 shares were allotted failed to pay allotment money. Manoj the holder of 60 shares failed to pay the two calls.

   Show Journal and cash book entries.

9. A limited company issued a prospectus inviting applications for 2,000 shares of Rs.10 each at a premuim of Rs. 2 per share payable as follows :

   On Application Rs. 2

   On Allotment Rs. 5 (including premuim)

   On First call Rs. 3 and On second call Rs. 2

Applications were received for 3,000 shares allotments made pro-rata to the applicants for 2,400 shares, the remaining applications being refused. Money overpaid on applications was employed on account of sums due on allotments. All calls were made and the amount due was received. Pass neccessary journal entries to record the above transcation.

10. Super max Ltd., invited applications for 10,000 of its equity shares of Rs. 10/- each payable on application Rs. 5 /-, on allotment Rs. 3/- and on call Rs. 2/-

    Applications were received for 15000 shares. The company allotted as follows - :

For 2000 shares applications	Full
For 12000 shares applications	8000
For 1000 shares applications	Nil

    Surplus money received on application will be adjusted towards allotment. A holder of 200 shares who was alloted on prorata basis, failed to pay allotment and call money.

    Give journal entries in the Books of the company and show the Balance sheet.

11. Blue moon company limited issued 50,000 share of Rs. 10/- each payable as under Rs.2/- on application Rs. 2.50 on allotment Rs. 3 on 1st call and Rs. 2.50 on Final call.

    The public applied for 90,000 shares. The allotment was made as follows on 1st August 1985.

To the applicants of 45,000 shares	Full
To the applicants of 20,000 shares	25%
To the remaining applicants	Nil

    The First call was made on 1st November 2008 and final call on 1st February 2009. According to the terms of issue, the surplus application money would be kept by the company against the money due on allotment and against subsequent calls. One share holder to whom 5,000 shares were allotted, paid on allotment the full amount due on shares. The interest @ 5 % P.A. on calls in advance was paid on 1st Feb 2009.

    Given cash book and Journal entries in the books of the company, assuming that all money were duly received. Also prepare calls in advance account.

12. A limited company was formed with anominal capital of Rs. 6,00,000 in shares of Rs.100 each 3,000 of which were issued payable as to

    Rs.10 on application,

    Rs. 15 on allotment,

    Rs. 25 three months after allotment and the balance to be called up when necssary. All the money were received except on call by one shareholder holding 200 shares. Another shareholder holding 150 shares paid the full amount on his holding. Make the cashbook and journal entries to record these transcations. Also show how the share capital appears in the Balance sheet of the company.

13. Harini company Ltd. issued 40,000 equity shares of Rs. 10 each, payable at

    Rs.2 on application,

    Rs. 4. on allotment and

    Rs. 4. on first and final call

    All the amount payable on allotment was duly received except in one case where the share holders failed to pay the amount due on allotment on his 100 share and another shareholder paid the shares in full at allotment on his 50 shares. The company was registered with 50,000 equity shares of Rs. 10 each. Pass necessary journal entries and prepare the Balance sheet of the company

14. Yellow limited offered for subscription 3,000 12% preference shares of Rs. 100 each at a premuim of 20% on 1st January 2008. The amount was payable as follows -

    On Application Rs. 20

    On allotment Rs. 40 (including premium - due on 1st Feb)

    On First call Rs. 30 due on 1st march

    On Second call Rs. 30 due on 1st may

    All the shares were subscribed by the public and subscription list was closed on 25th January, 2008. Money due on allotment and calls payable 15 days after the due dates.. All the amounts were duly received in times except the second call on 200 shares.

    Prepare journal and cash book in the books of the company and show them in the Balance sheet.

18.15 REFERENCE BOOKS :

1. Advanced Accountancy - M. C. Shukla & T.S. Grawal

2. Advanced Accountancy - R.L. Gupta & M. Radha - Swami

3. Advanced Accountancy - S.P. Jain & K.L. Narang

4. Advanced Accountancy - Dr. S.N. Maheswari

5. Financial Accounting - S.P. Jain & K.L. Narang

6. Advanced Accounting - K.R. Pall.

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Lesson - 19

FORFEITURE OF SHARES

OBJECTIVES:

After going through this lesson the student can know what is forfeiture of share ? and How these shares are re- issued and what is the accounting treatment ?

STRUCTURE:

19.1 INTRODUCTION:

When a shareholder fails to pay calls, the company, if empowered by its articles, may forfeit the shares. If a shareholder has not paid any call on the day fixed for payment there of and fails to pay it even after his attention is drawn to it by the secretary by registered notice, the Board of Directors pass a resolution to the effect that such shares be forfeited. Shares once forfeited become the property of the company and may be sold on such terms as directors think fit, upon forfeiture, the original shareholder ceases to be a member and his name must be removed from the register of members.

19.2 JOURNAL ENTRIES :

The following entry is passed at the time of forfeiture of shares.

Share capital Account Dr (with called amount)

To unpaid calls A/C (The amount not paid)

To Discount on issue of shares

To share forfeited A/C (with the amount already received)

On forfeiture, share capital account has been debited as it reduces the share capital and calls due but not received will be credited in order to cancel their debit balance standing in the books. Discount on the issue of shares will be cancelled like share capital on forfeiture of shares.

Premium received on the original issue of shares cannot be cancelled on the forfeiture of shares as once the premium is received it cannot be cancelled. But if securities premium is not received on the issue of shares, then it will be cancelled by debiting the securities premium account with the forfeiture entry.

Shares forfeited account balance will be shown on the liabilities side of the Balance sheet till all shares are reissued.

Illustration 1 :

A limited company has an authorised capital of Rs. 5,00,000 in Rs. 10 shares of these 8,000 shares were issued as fully paid in payment of building purchased and 16,000 shares were subscribed for by the public, and during the first year Rs. 5 per share was called payable Rs.2 on application, Rs. 1 on allotment Re.1 on first call and Re. 1 on second call. The amounts received in respect of these shares were as follows :

On 12,000 shares the full amount called

On 2,500 shares Rs. 4 per share

On 1,000 shares Rs. 3 per share

On 500 shares Rs. 2 per share

The Directors forfeited the shares on which less than Rs. 4 had been paid.

You are required to show journal entries in the books of the company, and to set out the capital as it should appear in the company's Balance sheet at the end of the first year.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Buliding Account Dr		80,000	
	To share capital A/C			80,000
	(Being issue of 8,000 fully paid shares of Rs. 10 each for the purchase of building)			

	Bank Account Dr		32,000	
	To share Application A/C			32,000
	(Being application money transferred to share captial account on allotment of shares)			
	Share Application Account Dr		32,000	
	To share Capital A/C			32,000
	(Being application money transferred to share capital account on allotment of shares)			
	Share Allotment Account Dr		16,000	
	To share captial Account			16,000
	(Being allotment money due on 16,000 shares @ Re. 1)			
	Bank Account Dr		15,500	
	To share Allotment A/C.			15,500
	(Being allotment money received on 15,500 shares @ Re. 1 per share)			

19.3 SURRENDER OF SHARES :

After the allotment of shares sometimes a shareholder is not able to pay the further calls and return his shares to the company for cancellation. Such voluntary return of shares to the company by the shareholder himself is called surrender of shares. Surrender of shares has no separate accounting treatment but it will be like that of forfeiture of shares. The same entires will be passed in case of surrender of Shares.

19.4 REISSUE OF FORFEITED SHARES :

Forfeited shares may be reissued by the company directors for any amount but if such shares are issued at a discount then the amount of discount should not exceed the actual amount received on forfeited shares.

Accounting entries :

Bank A/C Dr (with the amount received)

Forfeited shares A/C Dr (with the discount allowed)

To share capital A/C (with face value)

For example, if a company forfeits 200 shares of Rs. 10 each on which Rs. 600 had been received, the company can allow a maximum discount of Rs. 600 on these shares. In case these shares are reissued for Rs. 1800 fully paid, the following journal entry will be passed.

Bank A/C	Dr	1,800
Share forfeited A/C	Dr	200
To share capital A/C		2,000

(Being reissue of shares)

The balance standing to the credit of forfeited shares Account, is a capital profit and, therefore it will be transferred to capital reserve. The journal entry will be

Share forfeited A/C Dr

To capital Reserve A/C

(Being Profit on reissue of forfeited shares transferred to capital reserve)

4.1 Reissue of forfeited shares originally issued at discount :

In case the forfeited shares were originally issued at discount, the maximum permissible reissue discount is, the sum received on forfeited shares and original discount.

For example, if a share of Rs. 10 was originally issued at a discount Re.1 is forfeited, and the amount received on it was Rs 2, the maximum discount on reissue of such a forfeited share can be Rs. 3 (i.e original discount Re.1 + Amount received Rs. 2) . The journal entry will be as follows in case the share is issued for Rs. 7 per share, fully paid up.

Bank A/C	Dr	7
Discount on issue of shares A/C	Dr	1
Forfeited shares A/C	Dr	2
To share capital A/C		10

4.2 Re-issue of forfeited shares originally issued at Premium :

It is not necessary that if the shares were originally issued at premium, their reissue after forfeiture should also be at premium or the premium should be at the same rate.

Illustration 2 :

A company forfeits 200 shares of Rs. 10 each, originally issued at a premium of Rs. 2 per share. The shareholder paid Rs. 4 per share on application but did not pay the allotment money of Rs. 4 per share (including premium) and call of Rs. 4 per share. The shares are subsequently reissued at Rs. 11 per share fully paid up.

Pass journal entries for forfeiture and re-issue of forfeited shares.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Share capital A/C Dr		2000	
	Share premium A/C Dr		400	
	To share Allotment A/C			800
	To share call A/C			800
	To share forfeited A/C			800
	(Being forfeiture of 200 shares on account of non-payment of allotment and call money)			
	Bank A/C Dr		2,200	
	To share capital A/C			2000
	To share premium A/C			200
	(Being reissue of forfeited shares)			
	Shares forfeited A/C Dr		800	
	To Capital Reserve A/C			800
	(Being transfer of profit on shares forfeited to capital reserve)			

19.5 PARTIAL RE-ISSUE OF FORFEITED SHARES :

When all forfeited shares are not issued i.e, only a part of such shares is issued, it is desirable to spread the amount of shares forfeited account on all such forfeited shares and of the amount relating to that part of forfeited shares which has been reissued, discount on reissue of shares should be deducted from such amount and the balance is transferred to captial reserve being capital profit. The amount relating to that part of shares forfeited account which has not been reissued should be shown on the liabilities side of Balance sheet as shares Forfeited Account.

Illustration 3 :

A company invited the public to subscribe for 20,000 Equity shares of Rs.100 each at a premium of Rs. 10 per share payable on allotment. Payments were to be made as follows :

On Application	Rs. 20
On Allotment	Rs. 40
On First call	Rs. 30
On Final call	Rs. 20

Application were received for 26,000 shares. Applications for 4,000 shares were rejected and allotment was made proportionately to the remaining applicants. Both the calls were made and all the money were received except the final call on 600 shares.

Solution :

JOURNAL

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Share First call Account Dr		16,000	
	To share capital A/C			16,000
	(Being the amount due on first call on 16,000 shares @ Rs. 1. Per share)			
	Bank Account Dr		14,500	
	To share first call A/C			14,500
	(Being amount received on account of first call on 14,500 shares @ Re. 1. per share)			

	Share second call Account Dr		16,000	
	To share Capital A/C			16,000
	(Being the amount due on second call on 16,000 shares @ Rs. 1 per share)			
	Bank Account Dr		12,000	
	To share second call A/C			12,000
	(Being amount received on account of second call on 12000 shares @ Re.1 per share)			
	Share capital account Dr		7,500	
	To share allotment A/C			500
	To share first call A/C			1,500
	To share second call A/C			1,500
	To share forfeited A/C			4,000
	(Being forfeiture of 1500 shares on which less than Rs. 4. had been paid)			

Capital as it will appear in the balance sheet

Capital and Liabilities		
Authorised Capital :		
50,000 shares of Rs. 10 each		5,00,000
Issued and subscribed capital :		
8,000 shares of Rs. 10 each issued as fully paid up for the purchase of building		80,000
14,500 shares of Rs. 10 each Rs.5 per share called up	72,500	
less calls in Arreas (second call on 2,500 shares @ Re. 1)	2,500	
	70,000	
Add share forfeited Account	4,000	74,000
		1,54,000

Which are forfeited after due notice. Later 400 of the forfeited shares were issued as fully paid at Rs. 85 per share. Pass journal entries.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Bank A/C Dr		5,20,000	
	To Equity share Application A/C			5,20,000
	(Application money received for 26,000 shares @ Rs. 20 per share)			
	Equity share application A/C Dr		5,20,000	
	To Equity share capital A/C			4,00,000
	To bank A/C			80,000
	To share allotment A/C			40,000
	(Application money of 20,000 shares transferred to share capital A/C and balance returned to applicants and used for share allotment account)			
	Equity share allotment A/C Dr		8,00,000	
	To Equity share Capital A/C			6,00,000
	To securities premium A/C			2,00,000
	(Allotment money due on 20,000 shares)			
	Bank A/C Dr		7,60,000	
	To Equity share allotment A/C			7,60,000
	(Receipt of amount due on allotment)			

	Equity share first call A/C Dr		6,00,000	
	To Equity share capital A/C			6,00,000
	(Amount of first call due)			
	Bank A/C Dr		6,00,000	
	To Equity share first call A/C			6,00,000
	(Receipt of amount due on first call)			
	Equity share second call and final call A/C	Dr	4,00,000	
	To Equity share capital A/C			4,00,000
	(Amount due on second & final call)			
	Bank A/C Dr		3,88,000	
	To Equity share second & final call A/C			3,88,000
	(Receipt of amount due on second & final call except on 600 shares)			
	Equity share capital A/C Dr		60,000	
	To Equity share second & final call A/C			12,000
	To share forfeited A/C			48,000
	(600 shares forfeited)			
	Bank A/C Dr Shares forfeited A/C Dr		34,000 6,000	
	To Equity share capital A/C			40,000
	(Reissue of 400 shares @ Rs. 85 per share)			
	Shares forfeited A/C Dr		26,000	
	To capital reserve A/C (Proportional balance relating to 400 shares out of shares forfeited A/C transferred to capital reserve)			26,000

Working Notes :

1. On 600 Forfeited shares, the total amount forfeited is Rs. 48,000

   For 400 shares the amount will be

   $\frac{400}{600}$ X Rs. 48,000 = Rs. 32,000.

   Out of this Rs. 6,000 is allowed as discount on the reissue of shares and the balance of Rs. 26,000 is transferred to Capital Reserve.

2. Rs. 16,000 i.e, that is the amount relating to 200 shares which are not reissued will be shown on the liabilities side of the Balance sheet as shares Forfeited A/C and added to the paid up capital.

19.6. PRO - RATA ALLOTMENT AND FORFEITURE OF SHARES :

It has already been discussed that in case of companies of repute, there is possibility of over - subscription. Some applications are rejected altogether and others are allotted on pro - rata basis. When shares allotted on pro - rata basis are forfeited, the problem arises about the amount to be forfeited. In such cases, the following procedure is adopted.

1. Calculate the total number of shares applied for on the basis of alloted shares.
2. Calculate the total amount received on application by multiplying the number of shares applied with application money.
3. Deduct the amount due on application on alloted shares and calculate balance, i.e; money received in advance and to be adjusted on allotment.
4. Calculate the amount due on allotment on such shares and deduct the amount already received as advance on application. This gives the amount in arrear on allotment and credited to share allotment account at the time of forfeiture of shares.

Illustration 4 :

A company offered for public subscription 20,000 shares of Rs. 10 each at Rs. 11 per share. Money was payable as follows :

Rs. 3 on application

Rs. 4 on allotment

Rs. 4 on first and final call.

Applications were received for 24,000 shares and the directors made pro-rata allotment.

a) an applicant for 240 shares, could not pay the allotment and call moneys.

b) a holder of 400 shares, failed to pay the call. All these shares were later on forfeited.

Out of the forfeited shares, 300 shares (the whole of A's shares being included) were issued at Rs. 9 per share.

Pass the journal entries for recording the above transactions.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Bank A/C Dr		72,000	
	To share Application A/C			72,000
	(Being application money received on 24,000 shares @ Rs. 3 per share)			
	Share Application A/C Dr		72,000	
	To share capital A/C			60,000
	To share Allotment A/C			12,000
	(Being transfer of application money to share capital account on 20,000 shares and the balance to allotment account)			
	Share Allotment A/C Dr		80,000	
	To share capital A/C			60,000
	To share premium A/C			20,000
	(Being money due on allotment @ Rs.4 per share on 20,000 shares including Re. 1 on account of share premium)			
	Bank A/C Dr		67,320	
	To share allotment A/C			67,320
	(Being money received on share allotment)			

		Share call A/C Dr		80,000	
		To share Capital A/C			80,000
		(Being money due on call on 20,000 shares @ Rs. 4 per share)			
		Bank A/C Dr		77,600	
		To share call A/C.			77,600
		(Being call money received on 19,400 shares)			
		Share capital A/C Dr Share premium A/C Dr		6,000 200	
		To share allotment A/C.			680
		To share first & final call A/C.			2,400
		To share forfeited A/C.			3,120
		(Being forfeiture of 600 shares)			
		Bank A/C Dr Shares forfeited A/C Dr		2,700 300	
		To share capital A/C.			3,000
		(Being reissue of 300 forfeited shares)			
		Share Forfeited A/C Dr		1,020	
		To Capital Reserve A/C.			1,020
		(Being profit on forfeiture and reissue of 150 forfeited shares transferred)			

Working Notes :

1. Calculation of amount received on allotment :

		Rs
Total money due		80,000
Less Amount not paid by an applicant for 240 shares who was allotted only 200 shares	Rs. 800	
Less Extra money paid with application 40x3	120	680
		79,320
Less Amount received with application		12,000
		67,320

2. Share premium has been debited only with Rs. 200 relating to A's shares. The premium money has not been received on these shares.

   In case of B, the premium has been received, the share premium account has not been debited with the amount of premium on these 400 shares though they have been forfeited.

3. Share forfeited account represents the money received on forfeited shares excluding share premium. This can be verified as follows :

	Rs.
A has paid @ Rs. 3 per share on an application for 240 shares	720
B has paid @ Rs. 6 per share on 400 shares	2,400
Total amount received.	3,120

4. Amount received from A on shares forfeited (200 in all which has been reissued) — 720

Amount received from A on shares forfeited (200 in all which has been reissued)	720
Amount received from B on shares forfeited (100 shares which have been reissued)	600
Total amount received on 300 shares which have been forfeited and reissued.	1320
less : loss on reissue	300
	1020

19.7. SUMMARY :

When a shareholder fails to pay calls, the company can forfeit these shares, if empowered by its articles. Shares once forfeited become the property of the company and may be sold upon forfeiture, the original shareholder ceases to be a member and his name must be removed from the register of members. Sometimes if a shareholder is not able to pay the futher calls and return his shares to the company for cancellation, it is called surrender of shares. Forfeited shares may be reissued by the company but if such shares are issued at a discount then the amount of discount should not exceed the actual amount received on forfeited shares. After reissued the balance in share forfeited is a capital profit and transferred to capital reserve account.

19.8. MODEL QUESTIONS :

1. What is meant by forfeiture of shares ?
2. Discuss the provisions of Indian companies act relating to share premium.
3. What are the conditions for reissue of shares at discount ?

19.9 EXERCISES :

1. Super max Ltd. invited applications for 20,000 of its Equity shares of Rs. 10/- each payable on application Rs. 5/- on allotment Rs.3/- and on call Rs. 2/-

   Application were received for 15000 shares. The company allotted as follows :

For 4,000 shares applications	Full
For 24,000 shares applications	8,000
For 2,000 shares applications	Nil

   Surplus money received on application will be adjusted towards allotment. A holder of 400 shares who was alloted on proratabasis, failed to pay allotment and call money.

   Give Journal entries in the Books of the company and show the Balance sheet.

2. A limited company issued a prospectus inviting applications for 4,000 shares of Rs. 10 each at a premium of Rs. 2 per share payable as follows -

   On Application Rs. 2

   On Allotment Rs. 5 (including premuim)

   On First call Rs. 3 and

   On Final call Rs. 2

   Applications were received for 6,000 shares and allotment made pro-rata to the applicants of 4,800 shares. Money overpaid on applications was employed on account of sums due on allotment.

Sunil to whom 80 shares were allotted failed to pay allotment money and on his subsequent failure to pay the first call his shares were forfeited. Sridhar the holder of 120 shares failed to pay the two calls and his shares were forfeited after the second call. Of the forfeited shares 160 shares were sold to kishore as fully paid for Rs. 9 per share, the whole of sunil's shares being included.

Show journal and cash book entries.

3. Riddhima Co. Ltd. issued 1,60,000 shares of Rs. 10 each at a premium of Rs. 2 payable as follows :

On Application Rs. 2

On Allotment Rs. 5 (including premuim)

On First call Rs. 2 and

On Final call Rs. 3

Applications were received for 1,20,000 shares and allotment was made in full.

The first call was made and the amount due there on was received except the amount on 4,000 shares. These 4,000 shares were forfeited and reissued at Rs. 7 each. Pass journal entries and prepare Balance sheet.

4. A limited company issued a prospectus inviting applications for 6,000 shares of Rs. 10 each at premium of Rs. 2 per share payable as follows :

On Application Rs. 2

On Allotment Rs. 5 (including premuim)

On First call Rs. 3 and

On second call Rs. 2

Applications were received for 9,000 shares and allotments made pro-rata to the applicants for 7,200 shares, the remaining applications being refused. Money overpaid on application was employed on account of sums due on allotment.

X to whom 120 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay the first call, his shares were forfeited. Y. the holder of 180 shares failed to pay the two calls, and his shares were forfeited after the second call had been made of the shares forfeited, 240 shares were sold to Z, credited as fully paid, for Rs. 9 per share, the whole of the X's shares being included.

Show journal and cash book entries and the Balance sheet.

5. Z & Co. Ltd. invited applications for 20,000 shares of Rs. 100 each at a discount of 5% payable as follows :

   On application Rs. 25

   On allotment Rs. 34 and

   On first & final Call Rs. 36 (on call)

   The applications received were for 18,000 shares and all these applications were accepted. All the money due were received except the first and final call on 400 shares which were forfeited. Of these 200 shares were reissued @ Rs. 90/- as fully paid. You are required to pass journal entries in the books of Z Ltd. and prepare cash book, and the Balance sheet.

6. Reddy Ltd. issued 1,00,000 equity shares of Rs. 100 each at a premium of Rs. 10 per share payable as follows :

   On Application Rs. 20

   On Allotment Rs. 40 (including premuim)

   On First call Rs. 30

   On second call Rs. 20

   A member holding 2,000 shares failed to pay II call money and in consequence the shares were forefeited. At a later data 1000 of these shares were reissued as fully paid for a consideration of Rs. 80 per share write up ledger accounts.

7. Give the journal entries for the following -

   X Ltd, forfeited 30 shares of Rs 10/- each, on which they called up Rs. 7 each, on which Mr. X had paid application and allotment money of Rs. 5 per share, in total. Out of those forfeited shares 20 shares were reissued to sagar as fully paid up for Rs. 6 share

8. Give Journal entries for the forfeiture and reissue of shares in the following cases :

   a) S Ltd. forfeited 10 shares of Rs. 10 each issued at 10 percent premium to Gopalam (Rs 9 (called up) on which he did not pay allotment (including premium) of Rs.3 and first call of Rs 2. out of these, 6 shares were reissued to Madhu as fully paid up for Rs. 8 per share. and one share to karthik as fully paid up for Rs. 12 and two share to Romeo as fully paid up for Rs. 6. at different intervals of time.

   b) On 1may 2008 the directors of limited company forfeited 400 shares of Rs. 20 each, Rs. 15 per share called up, on which Rs. 10 per share has been paid by A, the amount of the first call of Rs. 5 per share being unpaid. Ten days latter, the directors re- issued the forteited shares of B credited as Rs 15 per share paid up. For payment of Rs 10 per share.

9. On 1 April 2008, excel Ltd. offered 2,00,000 equity shares of Rs. 10 each for public subscription Rs. 4,80,000 was received along with the applications at the rate of Rs. 2 per share on 1st july 2008, the company allotted the shares proportionately among all the applicants simultaneously making an allotment call of Rs. 2 per share.

   By 10 July 2008 all share holders, except an allottee of 1000 shares had paid the balance due on allotment. These shares were forfeited on 10 september 2008 the company made another call of Rs 2 per share on 30 september 2008 and by 10 october 2008 the amounts were received.

   pass journal entries (including cash/ bank transcations) to record the above in the books of excel Ltd.

10. A ltd. Company issued 4,000 shares of Rs. 10 each at a premium of Rs. 2 per share payable as follows :

    On Application Rs. 2

    On Allotment Rs. 5 (including premuim)

    On First call Rs. 3

    On second and final call Rs. 2

    Applications were received for 6,000 shares. Applications for 1200 shares were altogether rejected and to the applicants of 4,800 shares, allotment was made prorata. Money overpaid on application was adjusted on allotment.

    Ram, to whom 160 shares were allotted, failed to pay the allotment money and on his subsequent failure to pay first call, his shares were forfeited show journal entries.

11. A Co. ltd. offered to the public 40,000 equity shares of Rs. 100 each at a premium of Rs.10 per share. The payment was to be as follows :

    On Application Rs. 20

    On Allotment Rs. 40 (including premuim)

    On First call Rs. 25

    On second and final call Rs. 25

    Applicantions were received for 10,000 shares. Applications for 20,000 shares were rejected. Applicants for 30,000 shares were allotted 20,000 shares and remaining applications were accepted in full. The directors made both the calls. One shareholder holding 500 shares failed to pay the two calls and as a consequence his shares were forfeited. 400 of these shares were reissued as fully paid at Rs. 80 per share expenses of issue came to Rs. 10,000.

    Prepare cash book, the journal and the Balance sheet on the basis of information given above.

12. Wye Ltd. was formed with an authorised capital of 4,00,000 eqvity shares of Rs. 10 each. On 1st july 2008 2,00,000 shares were issued as fully paid to the vendors for properties purchased.

On the same day the company offered 1,60,000 shares to the public. The issue was fully subscribed. The amount on these shares was payable as follows :

On Application Rs. 2.50 per share

On Allotment Rs. 2.50 per share

On First call Rs. 2.50 per share (due on 1st September)

On second call Rs. 2.50 per share (due on 1st December)

On the shares subscribed for by the public there had been paid on 30 June 2008 the following -

On 1,20,000 shares	the full amount called
On 36,000 shares	Rs 7.50 per share
On 1000 shares	Rs 5.00 per share
On 3000 shares	Rs 2.50 per share

On 30 June 2008 the directors forfeited the shares on which less than Rs. 7.50 had been paid.The calls in arrears on 36,000 shares were collected on 31st July 2008 together with the necessary interest. The forfeited shares were reissued on the same date at price of Rs. 8 per share You are required to pass the necessary journal and cashbook entries and show how the various items will appear in the company's Balance sheet as on 31 December 2008.

19.10 REFERENCE BOOKS :

1. Advanced Accountancy - M. C. Shukla & T.S. Grawal

2. Advanced Accountancy - R.L. Gupta & M. Radha - Swami

3. Advanced Accountancy - S.P. Jain & K.L. Narang

4. Advanced Accountancy - Dr. S.N. Maheswari

5. Financial Accounting - S.P. Jain & K.L. Narang

6. Advanced Accounting - K.R. Pall.

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Lesson - 20

DEBENTURES

OBJECTIVES:

After going through this lesson the student can know what are debentures? What are the differences between debentures and shares ? classification of debentures and their issue.

STRUCTURE:

20.1 INTRODUCTION:

Companies require money from time to time for its extension and development. To raise funds without increasing its share capital, the company may invite the public, to lend money for a fixed period at a declared rate of interest. These are known as debentures. Debenture is an instrument in writing given by a company acknowledging the liability for the total amount received as a result of issue of debentures and agreeing thereby to pay the money raised after the expiry of the stipulated period at a certain rate of interest per annum.

20.2 DEFINITION :

A debenture may be defined as a certificate issued by a company under its seal acknowledging a debt due by it to it's holder.

The most essential characteristic of a debenture is the admission or record of indebtedness.

20.3 DISTINCTION BETWEEN SHARE AND DEBENTURE :

	SHARE		DEBENTURE
1.	Shares are a part of the capital of the company	1.	Debentures constitute loan to the company
2.	Shareholders are owners of the company	2.	Debenture holders are creditors of the company
3.	Shareholder enjoys the voting right, and right to attend general meetings	3.	These rights are not available to the debenture holders.
4.	No fixed payment on shares	4.	Fixed interest is paid on debentures
5.	Shareholders are the last persons to receive money at the time of insolvency or winding up.	5.	Debenture holders have priority over shareholder for payment of principal amount.
6.	Shares have no charge on the assets of the company	6.	Debentures usually have a charge on the assets of the company.
7.	Dividends on shares are paid only when the company has earned profits.	7.	Interest on debentures is payable whether there are profits or not.
8.	Dividend on shares can never be paid out of capital	8.	Interest on debentures is a debt and may be paid even out of capital.
9.	No fixed dividend, it fluctuates from year to year	9.	Debentures carry a fixed rate of interest.
10.	Shareholder can exercise control over the management of the company	10.	Debenture holders are not in a position to exercise any control on the affairs of the company.
11.	Shares cannot be purchased or redeemed by the company.	11.	Debentures can be purchased and redeemed by the company.

20.4 CLASSIFICATION OF DEBENTURES :

A company may issue various kinds of debentures with different rights as given below -

4.1 From the point of view of security :

From security point of view debentures may be naked or mortgage debentures.

a. **Naked debentures :** Naked debentures are those which do not carry any charge on the assets of the company. The holders of such debentures are not given any security as to the payment of interest and repayment of capital.

b. **Mortgage debentures :** Debentures which are secured by a mortgage or charge on the whole or a part of the assets of the company are known as mortgage debentures.

4.2. From the point of view of Redemption :

Form this point of view the debentures may be Redeemable or irredeemable debentures.

4.2.1 Redeemable debentures :

Redeemable debentures provide for the payment of the principal amount on the expiry of a certain period. Redeemable debentures can be reissued even after they have been redeemed until they have been cancelled.

4.2.2. Irredeemable debentures :

In the case of irredeemable or perpectual debentures the company does not give any undertaking of repaying the money borrowed by issuing debentures. Company may repay debentures at any time it may choose to do so, but the creditors cannot compel the company to repay them at any certain time. They shall, however, be repaid when the company goes into liquidation or makes a default in the payment of interest.

4.3. From the point of view of Transferability :

From this view point debentures may be Bearer or Registered debentures.

4.3.1 Registered debentures :

Registered debentures are made out in the name of a particular person, who is registered as a debenture - holder in the books of the company. The names of the debenture-holders are recorded in the companie's register of debenture holders. They are transferable in the same way as shares or in accordance with the conditions endorsed on their back.

4.3.2 Bearer debentures :

Bearer debentures are treated as negotiable instruments and are transferable by delivery alone. The name of the holders of such debentures are not required to be registered in the register of debenture holders.

4.4. From priority point of view :

From this point of view the debentures may be first or second debentures.

4.4.1 First Debentures :

First debentures are those debentures which are paid first before any payment is made to another type of debentures.

4.4.2 Second Debentures :

Second debentures are those debentures which are paid after making the payment of first debentures.

4.5. From convertion point of view :

From this point of view debentures may be convertible or non - convertible.

4.5.1. Convertible Debentures :

Convertible debentures given an option to debenture holders to convert then into equity or preference shares at a stated rate of exchange after a certain period.

4.5.2. Non - convertible Debentures :

Non - convertible debentures are not convertible into equity or preference shares afterwards.

20.5 ISSUE OF DEBENTURES :

The entries for issue of debentures are made on the same pattern as for issue of shares. The topic issue of debentures can be studied from different angles which are given below :

5.1. From consideration point of view :

From this point of view, debenture can be issued either for consideration in cash or for consideration other than cash or as colleteral security. The accounting treatment is discussed as under :

5.1.1. For consideration in cash :

Debentures can be issued for consideration in cash either at par or at discount or at premium. The journal entry will be :

Bank Account Dr

Discount on issue of shares A/C Dr (If issued at discount)

To Debentures A/C

To Debenture premium A/C (If issued at premium)

5.1.2. For consideration other than cash :

When debentures are issued to the vendors in lieu of purchase consideration, that is known as issue of debentures for consideration other than cash. The journal entry will be :

i. For purchase of assets

Asset A/C Dr

To vendor A/C.

ii. For issuing debentures for payment of purchase consideration .

Vendor A/C Dr

To Debentures A/C

5.1.3. As colleteral security :

When debentures are issued as subsidiary or secondary security in addition to the principal security against a loan or a bank overdraft. Such an issue of debentures is known as issue of debentures as collateral security. The basic objective of such an issue is that if the company does not repay the loan and the interest and the main security is not sufficient, the bank will be entitled to sell the debentures in the market or the bank may keep the debentures with it. If the company repays the loan, the bank will return the debentures issued as collateral security to the company. Debentures issued as collateral security can be dealt in two ways -

First Method : No entry need to be passed in the books of the company when debentures are issued as a collateral security. The fact of such an issue of debentures must be clearly mentioned in the Balance sheet by way of a note under the loan and debenture.

Second Method : The following journal entry can be passed for issue of debentures as collateral security.

Debenture suspense A/C Dr

To Debentures A/C

As and when the loan is paid, the entry passed above is reversed. In this method entries in the balance sheet will be shown as under :

Debentures and loan from bank will be shown on the liabilities side where as Debenture suspense account will be shown on the assets side of the Balance sheet.

5.2. From price point of view :

From this point of view the debentures can be issued either at par or at discount or at premium. When the amount collected on debentures issued is equal to the face value as issue of a debenture of Rs. 100 for Rs. 100, it is said to be issued at par. When the amount collected is more than the face value of debenture as issue of debenture of Rs. 100 at Rs. 105, it is said to be issued at premium. Debentures is said to be issued at a discount when the amount collected is less than the face value as issue of Rs. 100 debenture for Rs. 95.

The entries will be as under :

1. When debentures are issued at par :

Bank A/C Dr

To Debentures A/C

2. When debentures are issued at premium

Bank A/C Dr

To Debentures A/C

To Debenture premium A/C

3. When debentures are issued at discount .

Bank Account Dr

Debenture Discount A/C Dr

To Debentures A/C.

Illustration 1 :

Give journal entries in the books of a company

Company purchased assets of Rs. 35,00,000 and took over the liabilities of Rs. 3,00,000. It agreed to pay the purchase price, Rs. 33,00,000 by issuing debentures of Rs. 100 each at a premium of 10%

Solution :

JOURNAL

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Sundry Assets A/C Dr		35,00,000	
	Good will A/C (Bal. fig) Dr		1,00,000	
	To liabilities A/C			3,00,000
	To vendor A/C			33,00,000
	(Being the purchase of assets and liabilities)			

	Vendor A/C Dr		33,00,000	
	To Debentures A/C			30,00,000
	To premium on issue of Debentures A/C			3,00,000
	(Being issue of debentures at a premium of 10%)			

Illustration 2 :

A ltd. took over assets of Rs. 28,00,000 and liabilities of Rs. 2,00,000 of B ltd. for a sum of Rs. 27,00,000. Pass the necessary journal entries if the purchase consideration is satisfied by A ltd. in the form of 6% percent debentures of Rs. 100 each.

a. issue at par

b. issued at a discount of 10%

c. issued at a premium of 35 percent.

Solution :

JOURNAL

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Sundry Assets A/C Dr		28,00,000	
	Good will A/C Dr (Rs.27,00,000 - Rs. 26,00,000)		1,00,000	
	To sundry liabilities A/C			2,00,000
	To B Ltd			27,00,000
	(Being assets and liabilities of A ltd taken over)			
a.	B Ltd. A/C Dr		27,00,000	
	To 6 % Debentures A/C			27,00,000
	(Being issue of debentures at par)			

b.	B Ltd. A/C Dr		27,00,000	
	Discount on issue of Debentures A/C Dr		3,00,000	
	To 6 % Debentures A/C			30,00,000
	(Being issue of debentures at 10% discount)			
c.	B Ltd. A/C Dr		27,00,000	
	To 6 % Debentures A/C Dr			20,00,000
	To premium on issue of debentures A/C			7,00,000
	(Being issue of 20,000 debentures at a premium of 35%)			

Ilustration 3 :

In April 2008 sardar Ltd. offered for subscription of 10,000 7% percent debentures of Rs.1,000 each at the issue price of Rs. 94% payable Rs. 50 per debenture on application, Rs. 500 on allotment and the balance on 1st Aug, 2008. Interest was payable half yearly on 30th september and 31st march. The first coupon, payable on 30th sep. 2008, being for 2 percent. The issue was fully taken up.

Journalise the transactions.

Solution :

JOURNAL OF A LTD.

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
2008 Apr	Bank A/C Dr		5,00,000	
	To 7% Debenture Application A/C			5,00,000
	(Being application money received on 10,000 debentures @ Rs. 50 each)			
	7% Debenture Application A/C Dr		5,00,000	
	To 7 % Debentures A/C			5,00,000
	(Being transfer of application money to 7% Debentures Account)			

	7% Debenture Allotment A/C Dr		50,00,000	
	Discount on issue of Deb. A/C Dr		6,00,000	
	To 7 % debentures A/C			56,00,000
	(Being money due on allotment)			
	Bank A/C Dr		50,00,000	
	To 7 % Debenture allotment A/C			50,00,000
	(Receipt of allotment money)			
Aug1	7% Debenture First & Final call A/C Dr		39,00,000	
	To 7 % debentures A/C			39,00,000
	(Being first and final call due on 10,000 debentures @ Rs. 390 per debenture)			
	Bank A/C Dr		39,00,000	
	To 7 % Debenture First & Final call A/C			39,00,000
	(Being receipt of first & final call money)			
Sep1	Debenture Interest A/C Dr		2,00,000	
	To bank A/C			2,00,000
	(Interest paid on debentures @ 2% on Rs. 1,00,00,000)			
Mar 31	Debenture Interest A/C Dr		3,50,000	
	To Bank A/C			3,50,000
	(Payment of debenture interest for half year ended 31st Dec. 2008)			
Mar 31	Profit and loss A/C Dr		5,50,000	
	To Debenture Interest A/C			5,50,000
	(Being transfer of debenture interest to profit & loss account)			

The money was received on debentures on different dates. Instead of calculating interest on different amounts received on different dates, the question provides for a flat rate of 2 percent on the entire amount for the first six months.

5.3. From the redemption point of view :

When debentures are issued with certain conditions at which redemption can be made, there are five cases which are given as follows :

a. Issued at par, repayable at par.

b. Issued at premium, repayable at par.

c. Issued at discount , repayable at par

d. Issued at par, repayable at premium

e. Issued at discount , repayable at premium

The journal entries to be passed at the time of issue and redemption of debentures in the five cases are as follows :

a. When debentures are issued at par and repayable at par :

i. On issue of Debentures :

Bank A/C Dr

To Debentures A/C

ii. On Redemption of debentures :

Debentures A/C Dr

To Bank A/C

b. When debentures are issued at premium and repayable at par :

i. On issue of debentures, the entry will be :

Bank A/C Dr

To Debentures A/C

To premium on the issue of Debentures A/C

ii. On Redemption of debentures :

Debentures A/C Dr

To Bank A/C

c. When debentures are issued at discount and repayable at par :

i. On issue of debentures :

Bank A/C Dr

Discount on issue of Debentures A/C Dr

To debentures A/C

ii. On redemption of debentures :

Debentures A/C Dr

To Bank A/C

d. When debentures are issued at par and repayable at premium :

i. On issue of debentures :

Bank A/C Dr

Loss on issue of Debentures A/C Dr

To debentures A/C

To premium on redemption of debentures A/C

ii. On redemption of debentures :

Debentures A/C Dr

Premium on the redemption of debentures A/C Dr

To Bank A/C

e. When debentures are issued at a discount but repayable at a premium :

i. On issue of debentures :

Bank A/C Dr

Loss on issue of Debentures A/C Dr

(For discount & premium on redemption)

To debentures A/C

To premium on redemption of debentures A/C

ii. On redemption of debentures :

Debentures A/C Dr

Premium on the redemption of debentures A/C Dr

To Bank A/C

Loss on issue of Debentures and Discount of issue of Debentures are capital losses and will be shown on the assets side of the Balance sheet under the head Miscellaneous expenditure until these are written off. These accounts are to be written off either against profit and loss account or securities premium account.

Premium on debentures account is a capital profit and is shown on the liabilities side under the head reserve and surplus.

Illustration 4 :

Journalise the following transactions at the time of issue of debentures :

a) Debentures issued at Rs. 95, repayable at Rs. 100

b) Debentures issued at Rs. 95, repayable at Rs. 105

c) Debentures issued at Rs. 100, repayable at Rs. 100

d) Debentures issued at Rs. 105, repayable at Rs. 100

The face value of debenture is Rs. 100.

Pass the journal entries for recording the above transactions.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	At the time of issue			
a.	Bank A/C Dr		95	
	Discount on issue of debentures A/C Dr		5	
	To debentures A/C			100
	(For issue of Debentures of Rs. 100 at 95 at a discount of 5%)			
b.	Bank A/C Dr		95	
	Loss on issue of debentures A/C Dr		5	
	To debentures A/C			100
	To premium on redenption of debentures A/C			5
	(For issue of debentures of Rs. 100 at a discount of 5% and repayable at premium of 5%)			

c.		Bank A/C Dr		100	
		Loss on issue of debentures A/C Dr		5	
		To debentures A/C			100
		To premium on redemption of debentures A/C			5
		(For issue of debentures of Rs. 100 repayable at premium of 5%)			
d.		Bank A/C Dr		105	
		To Debenture A/C			100
		To premium on issue of debentures A/C			5
		(For issue of debentures of Rs. 100 at premium of 5% and repayable at par)			

20.7. SUMMARY :

To raise funds without increasing share capital, sometimes the companies issue debentures to the public. Debentures are long term loans also known as loan capital. From the point of view of security debentures may be naked or Mortgage. From the point of view of redemption, debentures may be Redeemable or irredeemable debentures. From the point of view of transferability debentures may be bearer or Registered debentures. From the priority point of view debentures may be first or second debentures. From convertion point of view debentures may be convertible or non - convertible.

Issue of debentures can be studied from different angles i.e

1.From consideration point of view

2. From price point of view

3. From the redemption point of view

20.8 . MODEL QUESTIONS :

1. What do you understand by a debenture ? Describe briefly the different types of debentures.
2. Distinguish between a debenture and a share
3. Give different considerations for which debentures may be issued.

20.9 EXERCISES :

1. A limited company issued 2000 debenture bonds of Rs. 100 each at a permium of 10 percent repayable at par at the end of the 10th year. The debenture Bonds were payable 25 percent on application 35 percent on allotment (including the premium) and the balance on first and final call. All the moneys were received by the company in due course.

   You are asked to journalise the above transcations in the books of the company.

2. A limited company issued Rs. 2,00,000 debentures, which were issued as follows :

	Rs
1. To sundry persons for cash at 90 percent	1,00,000 nominal
2. To a creditor for Rs. 20,000 capital expenditure in satisfaction as collateral security	50,000 nominal
3. To bankers as collateral security	50,000 nominal

The issue (1) and (2) are redeemable at the end of 10 years at par. How should the debentures be dealt with in preparation of the balance sheet of the company ?

3. Anil Ltd. issued Rs. 2,00,000 10 percent debentures on 1st january, 2008 at discount of 5 percent repayable in annual drawings of Rs. 50,000 commencing from 31st December following. The company's year ends on 31st December.

   Journalise the above transcations for four years ending 31st December, 2011 assuming the company decided to write off debenture discount account during the life of the debentures.

4. A company issues Rs. 3,00,000 10 percent debentures on 1st April, 2008 at a discount of 5 percent repayable in annual drawing of Rs. 75,000 each on 31st march every year. Calculate the amount of discount to be written off each year. The financial year of the company ends on 31st December each year.

5. a) A limited co. issued 4,000 10 % debentures of Rs. 100 each at Rs. 95 on 1-1-08. As per the terms of issue, debentures are to be redeemed at the end of 5 years.

   b) A company purchases assets of Rs. 5,20,000 and liabilities of Rs. 1,00,000 for a sum of Rs. 4,00,000. The purchase consideration is satisfied by the issue of 9% debentures of Rs. 100 each at par. journalise.

   c) A company issued 40,000 10 % debentures of Rs. 100 each at a discount of 5% repayable after 10 years at a premium of 5 % pass necessary journal entries.

6. XYZ Ltd. issued at par Rs. 60 lakhs, 15% non - convertible debentures of Rs. 1,000 each, payable 20% on application, 20% on allotment, 30 % on first call and the balance after three months from the date of first call. Except the allotment money on 400

debentures and call money on 600 debentures which were in arrears the debenture money was duly received. The company also received Rs. 14,000 towards interest on late payment of final call money on certain debentures.

Pass Journal entries to reflect the above transcations.

7. A company purchased assets of the book value of Rs. 99,000 from another firm. It was agreed that the purchase consideration be paid by issuing 11% Debuntures of Rs. 100 each. Assume debentures have been issued

   i) at par

   ii) at discount of 10% and

   iii) at a premium of 10% .

   Pass necessary journal entries.

8. Make journal entries for the following transcations :

   X ltd purchased plant and machiney for Rs. 2,00,000 payable as to Rs. 65,000 in cash and the balance by an issue of 16% debentures of Rs. 1,000 each at a discount of 10percent.

9. Kamala. Ltd. Purchased building for Rs. 2,20,000. Half the payment was made in cash and the remaining half by issue of 12% debentures at a premium of 10% pass the necessary journal entries.

10. A company took a loan of Rs. 10,00,000 from Canara Bank and issued 15% debentures of Rs. 15,00,000 of Rs. 100 each as a collateral security. Explain how will you deal with the issue of debentures in the books of the company.

11. Raju Ltd. acrquired assets of Rs. 2,50,000 and took over liabilities amounting to Rs.25,000 at an agreed value of Rs 2,00,000 of Rani Ltd. issued 9% Debentures at a discount of 20% in full satisfaction of the purchase price. Show the entries in the books of Raju Ltd.

12. On 1st march 2008, a limited company allotted 100, 13% debentures of Rs, 1000 each, at a discount of 5 percent, payable Rs. 500 on application, Rs. 150 on allotment, Rs.150 on 1st June and balance a month later. All money were duly received

    Give journal and cash book (Bank column) entries to record these transcations.

13. The quest company Ltd. took over assets of Rs. 3,50,000 and liabilities of Rs. 30,000 of Rajesh company for the purchase consideration of Rs. 3,30,000. The quest company Ltd. paid the purchase consideration by issuing debentures of Rs. 100 each at 10% premium. Give journal entries in the books of the quest company Ltd.

14. Give journal entries

    A limited company bought a building for Rs.9,00,000 and the consideration was paid by issuing debentures at a discount of 10%.

15. Rani industries Ltd. issued 1,000 12% debentures of Rs. 100 each, at a premium of Rs.10 per debenture payable as follows :

On application	Rs. 25
On allotment	Rs. 45 (including premium)
On call	Rs. 40

    The debentures were fully subscribed and the money was duly received.

    Pass the necessary cash book and journal entries in the books of the company.

20.10 REFERENCE BOOKS :

1. Advanced Accountancy - M. C. Shukla & T.S. Grawal
2. Advanced Accountancy - R.L. Gupta & M. Radha - Swami
3. Advanced Accountancy - S.P. Jain & K.L. Narang
4. Advanced Accountancy - Dr. S.N. Maheswari
5. Financial Accounting - S.P. Jain & K.L. Narang
6. Advanced Accounting - K.R. Pall.

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Lesson - 21

FINAL ACCOUNTS OF COMPANIES

OBJECTIVES:

After going through this lesson the student can know how the final accounts of the companies prepared ? What are the legal provisions regarding final accounts of companies.

STRUCTURE:

21.1 INTRODUCTION:

There is no statutory obligation upon sole proprietorship or partnership firm to prepare final accounts, but companies have a statutory obligation to prepare final accounts required by sec. 210 of the companies Act. A joint stock company must confirm to certain legal provisions as given in the companies Act, 1956 in respect of forms and contents of the final accounts.

21.2 PREPARATION AND PRESENTATION OF THE FINAL ACCOUNTS:

Sections 210 and 211 of the companies Act govern the preparation of final accounts of a company. Important provisions are as follows :

1. At every annual general meeting of the company, the Board of Directors of the company shall lay before the company :

   a) The balance sheet as at the end of the accounting period, and

   b) a profit and loss account for the period.

2. The profit and loss account and the balance sheet of a company must give a true and fair view of the state of affairs of the company. The balance sheet should be in the form as given in part I of schedule VI. The profit and loss account should comply with the requirements of part II of schedule VI to the companies Act.

21.3 FORM AND CONTENTS OF PROFIT & LOSS ACCOUNT :

The following special points should be kept in mind while preparing the profit and loss account of a company.

1. In case of companies, it is not necessary to split the profit and loss account into three sections Viz, trading account, profit and loss account and profit and loss appropriation account. The profit and loss account may be prepared under the following two headings

   i) profit and loss account

   ii) profit and loss appropriation account.

2. Items which are of abnormal nature, Viz. loss on account of fire, profit or loss on sale of machinery, penalty imposed by the government etc, should be disclosed separately and not mixed up with any other item.

3. Any adjustment which related to previous years should preferably shown in the profit and loss appropriation account.

4. In case of companies certain tax adjustments are required such as :

   a. Tax deducted at source : A company is required to deduct tax from any amount paid by it by way of interest, dividends, salaries to its employees. The following journal entry is passed :

   Interest on Debentures / Salaries A/C Dr

   To Bank A/C

   To Tax Deducted at source A/C

   The profit and loss account is debited with the gross amount of salaries or interest. The tax deducted is shown on the liabilities side of the balance sheet till it is finally paid by the company to the government.

b. Advance payment of tax : The following entry is passed when tax is paid in advance.

Tax paid in Advance Account Dr

To Bank Account

c. Provision for taxation : A company makes provision for taxation in respect of profit made during a particular accounting year. It is shown in the profit and loss Appropriation account as it is an appropriation of profit. However, it has become customary these days to show it in the profit and loss account.

The following entry is made :

profit & loss Account Dr

To provision for taxation

Provision for taxation appears as a liability till assessment in respect of that year is finalised.

Illustration 1 :

The following are the extracts from the trial balance of a company on 31. December 2008:

	Dr Rs	Cr Rs
Provision for taxation		20,000
Advance Tax paid for 2007	16,000	
Advance Tax paid for 2008	20,000	
Tax deducted at source 2008	2,000	
Provision for tax 2007		4,000
Profit & loss Account Balance 2007		40,000

Assessment for the year 2007 was finalised during the year 2008. The final total tax liability for that year was fixed at Rs. 24,000. The net profit earned by the company during 2008 before tax amounts to Rs. 60,000. The company is in 50 percent tax bracket.

You are required to pass the necessary journal entries and show how the various items will appear in the company's final accounts.

Solution :

JOURNAL ENTRIES

Date	Particulars	L.f	Dr Amount Rs.	Cr Amount Rs.
	Profit and loss Appropriation A/C Dr		4,000	
	To provision for Taxation (2007) A/C			4,000
	(Extra provision made for 2007)			
	Provision for Taxation (2007) A/C Dr		24,000	
	To Advance Tax (2007) A/C			16,000
	To Tax payable (2007) A/C			8,000
	(Advance tax paid for 2007 adjusted against provision for tax for 2007)			
	Profit and loss Account Dr		30,000	
	To provision for Taxation Account			30,000
	(Provision for tax made for 2008)			

Profit and loss account
for the year ending 31st Dec. 2008

Particulars	Rs.	Particulars	Rs.
To provision for Taxation	30,000	By net profit before Tax	60,000
To Net profit after Tax	30,000		
	60,000		60,000

Profit and loss Appropriation account
for the year ending 31st Dec. 2008

Particulars	Rs.	Particulars	Rs.
To provision for Taxation 2007	4,000	By Balance b/d	40,000
To Balance of profit taken to B/s	66,000	By Net profit after tax for 2008	30,000
	70,000		70,000

Balance sheet
as on 31st Dec. 2008

Liabilities	Rs.	Assets	Rs.
Reserves & Surplus :		**Loans and Advances :**	
Profit & loss Account	66,000	Advance Tax paid 2008	20,000
Current liabilities and provisions :			
Provision for taxation 2008	30,000	Tax deducted at source (2008)	2,000
Tax deducted at source 2008	4,000		
Tax payable 2007	8,000		

5. **Dividends :** The term dividend refers to that part of the profits of a company which is distributed among its shareholders. It may be of two types :

   i. Interim Dividend : It is the dividend declared by the directors during the course of the accounting year in respect of the same accounting year.

   ii. Final Dividend : It is the dividend declared by the shareholders at " The annual general meeting of the company which is recommended by the Board of Directors. On declaration of dividend a company is required to deposit the amount of dividend payable in a separate Dividend Bank Account.

The following are the accounting entries in respect of dividends :

Final Dividend :

1. On recommendation :

   Profit & loss Appropriation A/C Dr

   To proposed Dividend A/C

2. On declaration of dividend :

   Profit Dividend A/C Dr

   To Dividend payable A/C

   To Income Tax / Tax deducted at source A/C.

3. On opening a separate bank account :

   Dividend Bank A/C Dr

   To Bank A/C

   (with the net amount payable as dividend)

4. On payment of dividend :

Dividend payable A/C Dr

To Dividend Bank A/C

5. On payment to tax deducted at source :

Income Tax/ Tax Deducted at source A/C Dr

To Bank A/C

Interim Dividend :

On declaration of Interim dividend :

Interim Dividend Account Dr

To Interim dividend payable A/C

To Income Tax/ Tax deducted at source A/C

Other entries are same as explained above in case of final dividend.

At the end of the accounting year the amount of interim dividend will be transferred to profit and loss appropriation account by means of the following entry.

Profit & loss appropriation A/C Dr

To Interim Dividend A/C

6. Transfer to reserves. The entry will be :

Profit & loss Appropriation A/C Dr

To general / Specific Reserve A/C

21.4 FEATURES OF PROFIT & LOSS APPROPRIATION A/C OF COMPANIES :

The profit and loss appropriation section of the profit and loss account shows the appropriation of profit and is popularly known as " below the line " It is prepared as follows :

Particulars	Rs.	Particulars	Rs.
To Transfer to reserve		By Last year's Balance b/d	
To Income tax for previous year year not provided for		By Net profit for the year b/d	
To Interim Dividend		By Amount with drawn form general Reserve or any other Reserve.	
To corporate dividend Tax		By provision such as Income Tax	
To surplus carried to Balance sheet		By provision No longer required.	

Dividend paid or declared are subject to corporate dividend tax @ 10% w.e.f from 1st june 1997.

Illustration 2 :

Pratima Ltd. carried forward balance of Rs. 2,05,000 in the profit and loss account for the year ended on 31st March 2008. During the year 2008 - 09 it made a profit of Rs. 5,24,000 before charging depreciation and manager's commission. Depreciation for the year 2008 - 09 amounted to Rs. 84,000 and a commission of 5% on net profit before charging such commission was to be paid to the manager. It is decided that following decisions be carried out.

a. Transfer Rs. 1,25,000 to the General Reserve

b. Tansfer Rs. 50,000 to the Dividend Equalisation Reserve.

c. Pay the year's dividend on Rs 5,00,000, 11% cumulative preference shares.

d. Pay 20% dividend on Rs. 6,00,000 Equity share capital.

e. Pay Rs. 7,700 dividend on tax - free pref. shares (tax rate is 23 %)

f. Transfer Rs. 75,000 to Debenture Redemption Fund.

Prepare the profit and loss appropriation account showing the above appropriations.

Solution :

Profit and loss account of pratima Ltd.
for the year ending 31st March. 2009

Particulars	Rs.	Particulars	Rs.
To Depreciation	84,000	By profit for the year	5,24,000
To Managers commission			
(5% of Rs. 5,24,000 - Rs 84,000	22,000		
To Net profit C/d	4,18,000		
	5,24,000		5,24,000

Profit and loss Appropriation account of Pratima Ltd.
for the year ending 31st March. 2009

Particulars	Rs.	Particulars	Rs.
To General reserve	1,25,000	By Balance b/d (Last year bal.)	2,05,000
To Dividend Equalisation Reserve A/C	50,000	By Net profit as per profit & loss A/c	4,18,000
To proposed preference share dividend A/c	55,000		
To tax free proposed preference dividend A/c $(7700 \times \frac{100}{77})$	10,000		
To proposed Equity dividend	1,20,000		
To tax on dividend @ 10%	12,000		
To debenture Redemption fund account	75,000		
To surplus carried to Balance sheet	1,76,000		
	6,23,000		6,23,000

21.5 FORM AND CONTENTS OF BALANCE SHEET :

Section 210 of the companies Act requries that at every annual general meeting of the shareholder, the Board of Directors of the company shall lay before the company a balance sheet as at the end of each trading period. It is laid down in section 211 (1) that every Balance sheet of a company shall be prepared in the form given in part of the schedule VI of the companies act, 1956. The objective of prescribing the form for the balance sheet in schedule VI is to make sure that balance sheet exhibits a true and fair view of the state of affairs of the company.

The Balance sheet of a company shall be either in a horizontal form or a vertical form.

SCHEDVLE VI - PART I
(Sec 211)
A. Horizontal Form

Balance Sheet of .... as on ....

Figures For the Previous year Rs.	Liabilities	Figures For the Current year Rs.	Figures For the Previous year Rs.	Assest	Figures For the Current year Rs.
	Share Capital Authorised .... shares of Rs...... each **Issued :** (Distinguishing between the various classes of captial and stating the particulars specified below, in respect of each class).... shares of Rs...... each. **Subscribed :** (Distinguishing between the various classes of capital and stating the particulars specified below in respect of each class)..... .... shares of Rs.......... each .... Rs. .... called up. (of the above shares ...... shares are allotted as fully paid up pursuant to a contract without payments being received in cash).			**Fixed assets :** Distinguishing as far as possible between expenditure upon : a. good will b. land c. buildings d. leaseholds e. railway sidings f. plant and machinery g. furniture and fittings h. development of property i. patents, trade marks and designs j. live stock, and k. vehicles etc. (Under each head the original cost and the additions there to and deductions there from during the year, and the total depreciations written off or provided up to the end of the	

	(of the above shares......... shares are allotted as fully paid up by way of bonus shares). (Specify the source from which bonus shares are issued. e.g : Capitalisation of profits or reserves or from shares premium account) **Less : Calls Unpaid :** i By Directors ii By others Add : Forfeited shares : (amount originally paid up) (any capital profit on reissue of forfeited shares should be transferred to capital reserve). **Notes :** 1. Terms of redemption or conversion (if any) redeemable preference capital are to be stated together with earliest date of redemption or conversion. 2. Particulars of any option on unissued share capital are to be specified.			year is to be stated. Depreciation written off or provided shall be allotted under the different assets heads and deducted in arriving at the value of fixed assets. In every case where the original cost cannot be ascertained, without unreasonable expense or delay, the valuation shown by the books is to be given. For the purpose of this paragraph, such valuation shall be the net amount at which an asset stood in the company's books at the commencement of this Act after deduction of the amounts previously provided or written off for depreciation or diminition in values and where any such asset is sold, the amount of sale proceeds shall be shown as deduction. Where sums have been written off on a reduction of capital or a revaluation of assets, every balance sheet, (after the first balance sheet) subsequent to the reduction or revaluation shall show the reduced figures with the date of the reduction in places of the original cost.	

3. Particulars to the different classes of preference share are to be given.

These particulars are to be given along with share capital.

In the case of subsidiary companies, the number of shares held by the holding company as well as by the ultimate holding company and its subsidiaries shall be separately stated in respect of subscribed share capital. The auditor is not required to certify the correctness of such share holdings as certified by the management)

Reserves and surplus :

1. Capital Reserve
2. Capital Redemption reserve.
3. Share premium account (showing details of its utilisation in the manner provided in section 78 in the year of utilisation)
4. Other reserves specifying the nature of each reserve and the amount in respect there of .

Each balance sheet for the first five years subsequent to the date of the reduction, shall show also the amount of the reduction made.

Similarly, where sums have been added by writing up the assets,every balance sheet subsequent to such writing up shall show the increased figures with the date of the increase in place of the original cost. Each balance sheet for the first five years subsequent to the date of the writing up shall also show the amount of increase made.

Investments :

Showing nature of investments and mode of valuation, for example, cost or market value, and distinguishing between :

1. Investments in government or trust securities.
2. Investments in shares, debentures or bonds.
3. Immovable properties

	less: Debit balance in profit and loss account (if any). (The debit balance in the profit and loss account shall be shown as a deduction from the uncommitted reserves, if any) 5. Surplus i.e. balance in profit and loss account after providing for proposed allocations namely : Dividend, Bonus or reserves. 6. Proposed additions to reserves. 7. Sinking Fund. **Secured loans :** 1. Debentures. 2. Loans and Advances from banks 3. Loans and Advances for Subsidiaries 4. Other loans and Advances. (Loans from directors or manager should be shown separately) The Nature of security should be specified.			4. Investments in the capital of partnership firm 5. Balance of unutilised money raised by issues. **Current assets, loans and Advances :** **A. Current assets:** 1. Interest Accurued on Investments 2. stores and spare parts 3. Loose Tools. 4. Stock - in - Trade 5. Work - in - Progress 6. Sundry Debtors. a. Debts outstanding for a period exceeding six months b. Other debts **Less provision** In regard to sundry debtors particulars to be given separately of : a. debts considered good and in respect of which	

Unsecured Loans :

1. Fixed Deposits
2. Loans and Advances from subsidiaries
3. Short - term loans and Advances :
   a. From banks.
   b. From others.
4. Other loans and Advances :
   a. From banks.
   b. From others.

Current Liabilities and provisions :

A. Current Liabilities :

1. Acceptances
2. Sundry creditors.
   i) Total outstanding dues of small scale industrial undertakings
   ii) Total outstanding dues of creditors other than small scale industrial undertakings
3. Subsidiary companies
4. Advance payments and un expired discounts for the portion for which value

the company is fully secured

b. debts considered good for which the company holds no security other than the debtor's personal security and

c. debts considered doubtful or bad.

7. A. cash balance on hand

7. B. Bank Balance

   a. With scheduled banks

   b. With others.

B. Loans and Advances :

8. A. Advances and loans to subsidiaries.

8. B. Advances and loans to partnership firm in which the company or any of its subsidiaries is a partner.

9. Bills of exchange

10. Advances recoverable in cash or in kind or for value to be received.

	has still to be given i.e. in the case of the following companies :Newspaper, Fire Insurance, clubs banking etc. 5. Unclaimed Dividends 6. Other liabilities (if any) 7. Interest accrued but not due on loans **B. Provisions :** 8. Provision for Taxation 9. Proposed Dividends 10. For contingencies 11. For providend fund scheme 12. For Insurance, pension and similar staff benefit schemes. 13. Other provisions. A foot note to the balance sheet may be added to show separately. 1. Claim against the company not acknowledged as debts. 2. uncalled liability on shares partly paid. 3. Arrears of fixed cumulative dividends.			11. Balances with customs, port trust etc. **Miscellaneous Expenditure** 1. Preliminary expenses 2. Expenses including commission or brokerage, under writing 3. Discount allowed on the issue of shares or debentures. 4. Interest paid out of capital during construction 5. Development expendiutre not adjusted 6. Other sums profit and loss account.	

VERTICAL FORM OF BALANCE SHEET

Name of the company____

Balance sheet as at ____

(I) Sources of Funds	Shedule No.	Figures as at the end of current Year	Figures as at the end of previous Year
1. Shareholder's Funds			
(a) Capital	________	________	________
(b) Reserves and surplus	________	________	________
2. Loan Funds			
(a) Secured loans	________	________	________
(b) Unsecured loans	________	________	________
(II) Application of Funds			
1. Fixed Assets			
(a) Gross Blocks	________	________	________
(b) Less Depreciation	________	________	________
(c) Net Block	________	________	________
(d) Capital work in progress	________	________	________
2. Investments			
3. Current Assets, Loan & Advances			
(a) Inventories	________	________	________
(b) Sundry debtors	________	________	________
(c) cash and bank balances	________	________	________
(d) other current Assets	________	________	________

Less : Current Liabilities and Provisions			
(a) Liabilities			
(b) Provisions			
Net current Assets			
3. (a) Miscellaneous expenditure to the extent not written off or adjusted			
(b) Profit & Loss Account			
TOTAL			

Notes :

1. Details under each of the above items be given in seperate schedules. The schedules shall incorporate all the information required to be given under part 1A of schedule VI read with notes containing general instruction for preparation of balance sheet
2. The schedules referred to above, accounting policies and explanatory notes that may be attached shall form an integral part of the balance sheet.
3. The figures in the balance sheet may be rounded off to the nearest '000 or '00 as may be convinient or may be expressed in letters of decimals of thousands.
4. A footnote to the balance sheet may be added to show seperately contingent liabilities.

21.8. ILLUSTRATIONS :

The following is the trial balance of suraj Co. Ltd. as at 30th June 2008:

	Rs	Rs
Stock, 30 - 06 - 2008	1,50,000	
Sales		7,00,000
Purchases	4,90,000	
Wages	1,00,000	
Discount		10,000
Furniture and Fittings	34,000	
Salaries	15,000	
Rent	9,900	

Sundry expenses	14,100	
Profit and loss appropriation		
Account (30 - 06 - 2007)		30,060
Dividend Paid	18,000	
Share capital		2,00,000
Debtors & Creditors	75,000	35,000
Plant & Machinery	58,000	
Cash and Bank	32,400	
Reserve		31,000
Patents and Trade Marks	9,660	
	10,06,060	10,06,060

Prepare trading account, profit and loss account, profit and loss appropriation account for the year ended 30-06-2008 and balance sheet as on that date. Take into consideration the following adjustments.

1. Stock on 30 - 06 - 2008 was valued at Rs. 1,64,000
2. Depreciation on fixed assets @ 10%
3. Make a provision for income - tax @ 50 %.

Solution :

SURAJ Co., Ltd.

Trading and profit and loss account
for the year ended 30-06-2008

	Rs.		Rs.
To opening stock	1,50,000	By sales	7,00,000
To purchases	4,90,000	By closing stock	1,64,000
To wages	1,00,000		
To gross profit c/d	1,24,000		
	8,64,000		8,64,000

To salaries	1,500	By gross profit b/d	1,24,000
To rent	9,900	By Discount	10,000
To sundry expenses	14,100		
To Depreciation on :			
Plant & Machinery	5,800		
Patents & Trade marks	966		
Furniture & fittings	3,400		
To Pro. for income Tax	42,417		
To Net profit c/d	42,417		
	1,34,000		1,34,000

Balance sheet of Suraj Co. Ltd.
as on 31-06-2008

Llabilities	Rs.	Assets		Rs.
Share capital	2,00,000	Fixed Assets		
Reserves & Surplus :		Plant and Machinery	58,000	
Reserve	31,000	less : Depreciation	5,800	52,200
Profit & loss Account	54,476	Furniture & fittings	34,000	
Current Liabilities and Provisions :		less : Depreciation	3,400	30,600
Creditors	35,000	Patents & Trade marks	9,660	
Provision for tax	42,417	less : Depreciation	966	8694
		Current Assets :		
		Stock		1,64,000
		Debotrs		75,000
		Cash at bank		32,400
	3,62,894			3,62,894

Illustration 4 :

The following balances have been extracted from the books of sai and sreya limited as on 31st March, 2008 :

	Rs.		Rs.
Freehold land	4,00,000	Income from investments	4,000
Buildings	1,50,000	Provision for	
		doubtful debt (1-4-2007)	4,000
Debtors	1,00,000	creditors	60,000
Stock (31-3-2008)	80,000	Provision for Depreciation (1-4-2007)	
Furniture	40,000		
Cash at bank	10,000		
Cash in hand	2,000		
Cost of goods sold	6,00,000	Buildings	10,000
Salaries and wages	30,000	Furniture	8,000
Mis. Expenses	16,000	Suspense	5,000
Investments in shares	3,60,000	Equity share capital	7,35,000
Interest	6,000	6% cum.pref. share cap.	1,60,000
Bad debts	2,000	Share premium	20,000
Repairs	3,000	Bank over draft	1,00,000
Advance payment of income tax	12,000	sales	3,50,000
		P & L A/C (1-4-2007)	5,000
	18,11,000		18,11,000

The following further particulars are available :

1. The land was revalued on 1st jan. 2008 at Rs. 6,00,000 by an expert valuer but no effect has been given in the books although the directors have decided to adjust the revalued amount.
2. Provision for doubtful debt is to be adjusted to 5% on the amount of debtors.
3. Equity share capital is composed of Rs.1 shares 72,800 fully paid and 1000 on which final call of Rs. 3 remains unpaid.

4. Suspense amount represents money received from the new allottee for re-issue of 1000 shares forfeited during the year for non payment of the final call, but no entry for adjustment there of has been passed.

5. Provision for taxation is to be made at 45 percent.

6. Market value of investment was Rs. 3,70,000 on 31st March 2008.

7. The company is managed by the directors who are entitled to a remuneration calculated at 3 percent of the annual net profits.

8. Depreciation is to be charged on

   Building at 2 percent

   Furniture at 10 percent

9. The land and buildings of the company are mortgaged in favour of the bank as security for overdraft sanctioned upto a limit of Rs. 5,00,000

10. Dividend on cum. pref. shares were in arrears for 5 years upto 31st March 2008. The directors have recommended payment of dividend for two years.

You are required to prepare the profit and loss account for the year ended 31st March 2008 and a balance sheet as on that date after making such assumptions as may be considered necessary. Ignore previous year's figures.

Solution :

Sai and Sreya limited
Profit and loss account
for the year ended 30-06-2008

	Rs.		**Rs.**
To cost of goods sold	6,00,000	By sales	7,00,000
To gross profit c/d	1,00,000		
	7,00,000		7,00,000

To salaries & wages		30,000	By gross profit b/d	1,00,000
To Mis. expenses		16,000	By Income from investments	4,000
To interest		6,000		
To Bad debts	2,000			
Add Provision	5,000			
	7,000			
less existing provision	4,000	3,000		
To Repairs		3,000		
To Directors remuneration		1,230		
To Depreciation :				
Builidng	2,800			
Furniture	3,200	6,000		
To provision for tax		17,460		
To Net profit c/d		21,310		
		1,04,000		1,04,000

Profit and loss Appropriation A/C

	Rs.		Rs.
To proposed dividend		By balance b/d	5,000
(preference shares)	19,200	By Net profit	21,310
To Balance c/d	7,110		
	26,310		26,310

Sai and Sreya limited
Balance sheet
as on 31- 03-2008

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Share Capital Authorised			Fixed Assets		
6% cumulative pref.			land at cost	4,00,000	
shares of Rs. 100 each		XXXX	Add Appreciation	2,00,000	6,00,000
issued, subscribed and			Buildings at cost	1,50,000	
and paid up			less depreciation	12,800	1,37,200
73,800 equity shares			furniture at cost	40,000	
of Rs. 10 each fully			Less : Depreciaton	11,200	28,800
paid up		7,38,000			
1600,6% cum. pref					
shares of Rs.100			Investments (at cost)		
each fully paid up		1,60,000	In fully paid shares		
		8,98,000	(Market value		
Reserves & surplus :			Rs. 3,70,000)		3,60,000
Share premium		20,000	Current assets,		
Capital reserve :			Loans and advances:		
Profit on reissue of			A. current Assets		
Forfeited shares	2,000		stock valued at cost		80,000
Appreciation in land	2,00,000	2,02,000	Debtors (unsecured)		
profit and loss			exceeding 6months)	1,00,000	
Account		7,110			
Secured loan :			Less : provision		
Bank overdraft			for doublful debts	5,000	95,000
Secured by mortgage			Cash at Bank	10,000	
of co's land & Buildings		1,00,000	Cash in hand	2,000	8,000
Current Liabilities			B. Loans & advances		
& provisions:					
A. current liabilities			Income tax paid in		
sundry creditors		6,1230	in advance		12,000
B. Provisions					
Provisions for					
taxation	17,460				
Proposed dividend	19,200	36,660			
		13,25,000			13,25,000

Contingent liability arrears of cummulative preference dividend for 3 years **Rs. 28,800.**

Working Notes :

1. Calculation of Net profit for director's remuneration :

   Profit before provision for taxation, provision for bad debts but after writing off

   Bad debts Rs. 4,000

   Director's remuneration 3 % thereof 1,230

2. Depreciation has been calculated on written down value.

3. Calls in arrear on 1000 shares @ Rs. 3 per share amounts to Rs. 3,000, amount received against these shares from new allottee is Rs. 5,000. The difference has been credited to capital reserve.

21.9 . SUMMARY :

Companies have a statutory obligation to prepare final accounts. Sections 210 and 211 of the companies Act govern the preparation of final accounts. The balance sheet of a company shall be either in a horizontal form or a vertical form.

21.10 . MODEL QUESTIONS :

1. Give a specimen form of balance sheet and profit and loss account of a company according to companies Act.

2. Give an imaginary form of the profit and loss appropriation account of a limited company.

3. Write short notes on :

   a. provisions for taxation and dividends.

   b. corporate dividend tax

4. Write down the important provisions of sec 210 and 211 of companie's Act for preparation and presentation of final accounts.

5. Breifly explain the terms Interim dividend and final dividend.

21.11 EXERCISES :

1. Following balances are extracted on 31st march 2008 from the books of Rao company ltd :

	Rs.		Rs.
Factory premises at cost	4,50,000	Share capital	
Plant & Machinery at cost	3,49,160	30,000 7% preference shares	
Motor lorries at cost	73,000	Shares of Rs. 10 each	3,00,000
Sundry Debtors	1,21,780	60,000 shares (equity)	
Bad debts written off	2,850	of Rs. 10 each	6,00,000
Rent, Rates and taxes	28,400	Profit and loss A/C	16,240
Advertisment	19,500	Gross profit for the year	2,46,640
Cash in hand and at Bank	68,500	Provision for doubtful debts	9,000
Directors fees	3,600	Sundry creditors	1,29,640
Audit fees	10,000	Transfer fees	110
Stock on 31-3-2002	1,14,600	Accrued wages	12,840
Rent & taxes paid in advances	7,980	staff benevolent fund	17,900
Salaries and wages	32,000		
Dividends paid on preference shares	21,000		
Dividend on equity shares	15,000		
Discount on issue of shares	15,000		
	13,32,370		13,32,370

The provision for doubtful debts is to be made upto Rs. 10,200. The factor premises, plant and Machinery and motor lorries are to be depreciated by 3%, 15% and 20% respectively. Authorised capital of the company is Rs. 10,00,000 divided into 1,00,000 shares of Rs. 10 each. You are required to prepare.

i. profit & loss account for the year and 31 - 3- 2008.

ii. A balance sheet as at 31 -3-2008 in the form prescribed under the companies Act, 1986. previous years figures are not required and also ignore taxation.

2. The following trial balance has been extracted from the books of ZYX Ltd. as on 31st march 2008. You are required to prepare profit and loss account and balance sheet as on that date.

Debit	Rs.	Credit	Rs.
Land & building	34,000	Share capital	1,00,000
Furniture	6,000	General Reserve	5,000
Plant & Machinery	15,000	10 % debentures	40,000
stock on 31st March 2008	75,000	Sundry creditors	4,000
Salaries	25,000	Gross profit	75,000
Debtors	10,000	Interest on Investments	1,000
5% Investments	20,000	Profit & loss A/C on 1st April	35,000
Bank	5,000		
Advance income tax	2,000		
Debentures interest	2,000		
Directors fees	7,000		
Rent, Rates and insurance	24,000		
Good will	35,000		
	2,60,000		2,60,000

Depreciate the following assets :

Land & Building at 10% p.a, plant & Machinery 8% p.a, provision for bad debts at 6%

The directors have recommended :

a. Transfer Rs. 3,000 to general reserve A/C

b. Equity dividend at 10% on teh paid up capital

c. Provision for income tax for Rs. 4,000

3. The following information is extracted from lakshmi ltd. on 31st march, 2008. You are required to prepare profit and loss account and Balance sheet as on that date.

Debit	Rs.	Credit	Rs.
Factory premises	4,50,000	Share capital (9000 shares)	9,00,000
Plant & Machinery	3,60,000		
Motor lorries	1,40,000	Profit & loss A/C	24,000
Sundry debtors	1,20,000	Gross profit for the year	2,60,000
Bad debts written off	4,000	Provision for doubtful debts	5,000
Rent & Taxes	25,000		
Advertisment	10,000	Sundry creditors	75,000
Bank	20,000	Transfer fee	8,000
Director's fee	5,000	Out standing salaries	5,000
stock 31st march 2008	1,40,000	General Reserve	33,000
Salaries , wages	30,000		
Dividend paid interim	6,000		
	13,10,000		**13,10,000**

Additional Information :

The provision for doubtful debts is to be made upto Rs. 15,000/- factory premises and plant and machinery are to be depreciated at 10% p.a. Provide for income tax Rs. 20,000/- final dividend at Rs. 5/- per share is payable.

4. From the following trial balance of Naidu company ltd. prepare profit and loss appropriation account and balance sheet after making the following adjustment, as per compaines Act-

Debit	Rs.	Credit	Rs.
land & Building	50,000	Profit & loss appropriation A/C	7,000
Machinery	40,000	Profit & loss A/C (for the Current year	31,000
Interim dividend	6,000		
stock	34,000	Share capital	1,00,000
Debtors	25,000	Creditors	10,000
Bank	15,000	Reserve fund	17,000

Calls in arrears	10,000	Employes provident fund	8,000
Investments	50,000	Share premium account Debentures	50,000
	2,30,000		**2,30,000**

Transfer Rs. 10,000 to reserve fund, Rs. 5,000 to employees provident fund and provide Rs. 5,000 towards dividend on equity shares.

5. The following balances are extracted from the books of Tirupathi earth movers ltd. as on 31-3-2008.

Debit	Rs.	Credit	Rs.
stock 1-4-2007	3,77,000	Profit and loss Account	66,170
Fuel and power	13,390	Sales	4,74,500
Salaries and wages	2,82,100	Share capital	6,50,000
Purchases	3,01,860	provision for tax	19,500
Rent and taxes	9,750	Provision for bad debts	8,190
Insurance	13,000	Bank loan (secured)	
Prepaid expenses	35,750	on fixed assets	1,62,500
Repairs to Buildings	3,900	General Reserve	1,30,000
Repairs to Machinery	23,400	Unclaimed dividends	2,080
Managerial commission	13,650	sundry creditors	1,31,300
Directors fees	780	Bills payable	41,600
Land and Buildings	6,17,500	Out standing expenses	97,500
Machinery & plant	4,55,000	Managerial commission outstanding	2,340
Furniture	11,050	Depreciation Account	8,11,200
Office equipment	5,200	Mis. Receipts	780
Motor vehicles	29,250		
sundry debtors	3,77,000		
Cash in hand	4,225		
Cash at Bank	23,855		
	23,97,660		23,97,660

Prepare trading and profit and loss Account for the year ended 31-3-2008 and a balance sheets as on that date in the prescribed form, taking the following into consideration -

i. stock at cost on 31 - 3- 2008 was Rs. 6,60,400

ii. Provide Rs. 26,000 for further taxation

iii. Depreciation written off was as follows as on 31 - 3- 2007 land and buildings Rs. 3,75,960. Machinery & plant Rs. 4,02,090, Furniture Rs. 9,750 office equipment Rs. 4,550 and Motor vehicles Rs. 18,850.

iv. No depreciation should be provided for 2007 - 08

v. All amounts due to the company by the debtors are unsecured. Debts for Rs. 8,190 are over six months old of which Rs. 2,600 are bad and to be written off now, the rest are doubtful. All other debts are considered good.

vi. The directors transfered Rs. 78,000 to general reserve and recommended a dividend of Rs.750/- per share for the year ended 31-3-2008.

vii. The nominal capital of the company is 13,000 shares of Rs. 100 each all of which have been issued and subscribed for and Rs. 50 per share paid up.

6. The following is the trial balance of Pavan and Pavani co. Ltd. as at 30th June 2008. Prepare trading and profit and loss account and balance sheet.

	Rs.	Rs.
Authorised capital		5,00,000
50,000 shares of Rs. 10 share Subscribed capital 10,000 shares of Rs. 10 per share		1,00,000
Call in arrears	6,400	
Land	10,000	
Buildings	25,000	
Plant and Machinery	15,000	
Furniture and fixtures	3,200	
Carriage inwards	2,300	
Wages	21,400	
Salaries	4,600	
Bad debt provision 1.7.07		1,400

Sales return and sales	1,700	80,000
Bank Charges	100	
Coal, gas and water	700	
Rates and taxes	800	
Preliminary expenses	500	
Purchases and purchases returs	50,000	3,400
Bills receivable and bills payable	1,200	1,000
Discount on issue of debenture	1,000	
General expenses	1,900	
Sundry debtors and creditors	42,800	13,200
Stock 1.7.2007	25,000	
Fire insurance	400	
Cash in hand and at bank	15,500	
Share premium		6,000
General reserve		24,000
Discount	500	
	2,30,000	2,30,000

Adjustments :

1. Charge depreciation on buildings at 2 1/2%, plant and machinery at 10% and furniture and fixtures @ 10%
2. Make a provision of 5% on sundry debtors for bad debts.
3. Unexpired fire insurance Rs. 120
4. Provide the following outstanding liabilities, wages Rs. 3,200, Salaries Rs. 500, Rent, rates and taxes Rs. 235
5. Write off preliminary expenses
6. The value of stock as on 30th june 2008 was Rs. 30,000.

7. The following is the trial balance of Raji and co. as on 31.12.2008 prepare profit and loss account and balance sheet of the company.

Particulars	Dr. Rs.	Cr. Rs.
Stock (1.1.2002)	7,500	
Sales		25,000
Purchases	24,500	
Wages	5,000	
Discounts	700	
Salaries	750	
Rent	495	
General expenses (Including insurance)	1,705	
Profit and loss Account (1.1.2002)		1,503
Dividend paid	900	
Capital 1,000 shares of Rs. 10 each		10,000
Debtors and creditors	3,750	1,750
Machinery	2,900	
Cash in hand	1,620	
Reserves		1,550
Bad debts	483	
	50,303	50,303

Additional information :

a. Stock on 31.12.2008 Rs. 8,200

b. Depreciate machinery at the rate of 10% per annum

c. provide 5% discount on debtors

d. Allow 2 1/2% discount on creditors

e. One month rent at the rate of Rs. 550 per annum was due on 31.3.2009

f. Six months insurance was unexpired at Rs. 75 per annum

g. Provide managing Directors commission at 15% on the net profits before deducting his commission.

8. Radha co. ltd. is a company with an authorised capital of Rs. 5,00,000 divided into 5,000 equity shares of Rs. 100 each on 31 - 3 - 2008, 2,500 shares were fully called up. The following are the balances extracted from the ledger of the company as on 31 - 3-2008.

	Rs.		Rs.
Stock	50,000	Advertising	14,300
Sales	4,25,000	Debtors	38,700
Purchases	3,00,000	Creditors	35,200
Wages (productive)	70,000	Plant and Machinery	80,500
Discount allowed	4,200	Furniture	17,100
Discount Received	3,150	Cash & Bank	1,34,700
Insurance upto 30-6-08	6,720	Reserve	25,000
Salaries	18,500	Loan from	
Rent	6,000	managing Director	15,700
General expenses	8,950	Bad debts	3,200
profit and loss account	6,220	Call in Arrears	5,000
Printing and stationary	2,400		

You are required to prepare trading and profit and loss account for the year ended 31-3-2008 and balance sheet as on that date of the company.

The following further information is given :

1. Closing stock Rs. 91,500.
2. Depreciation to be charged on plant and Machinery and funiture at 15% and 10% respectively.
3. Outstanding liabilities - wages Rs. 5,200 ; salaries Rs. 1,200 and Rent Rs. 600.
4. Dividend @ 5% on paid up share capital to be provided.

10. The following is the trial balance of vanaja and co as on 31.12.2008 prepare profit and loss account and balance sheet of the compnay.

Particulars	Rs.	Rs.
Stock (1.1.2001)	7,500	
Sales		25,000
Purchases	24,500	
Wages	5,000	

Discounts	700	
Salaries	750	
Rent	495	
General expenses (Including insurance)	1,705	
Profit and loss Account (1.1.2001)		1,503
Dividend paid	900	
Capital 1,000 shares of Rs. 10 each		10,000
Debtors and creditors	3,750	1,750
Machinery	2,900	
Cash in hand	1,620	
Reserves		1,550
Bad debts	483	
	50,303	50,303

Additional information :

a. Stock on 31.12.2008 Rs. 8,200

b. Depreciate machinery at the rate of 10% per annum

c. provide 5% discount on debtors

d. Allow 2 1/2% discount on creditors

e. One month rent at the rate of Rs. 550 per annum was due on 31.3.2008

f. Six months insurance was unexpired at Rs. 75 per annum

g. Provide managing Director's commission at 15% on the net profits before deducting his commission.

21.12 REFERENCE BOOKS :

1. Financial Accounting - S.P. Jain & K.L. Narang

2. An introduction to Accountancy - Dr. S.N. Maheswari & Sk. Maheswari

3. Financial Accounting - R.L. Gupta & V.K. Gupta

4. Advanced Accountancy - M. C. Shukla & T.S. Grawal

5. Advanced Accounting - K.R. Pall.

6. Advanced Accounting - S.P. Jain & K.L. Narang

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