

Financial Accounting

Exam Digest

*Financial Accounting
Fast track*

CMA
PAPER 6, GR. I



Sanjay Welkins

2024 - 25

Financial Accounting

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Acknowledgments

For such a voluminous treatise, one, definitely cannot lay any sort of claim **over complete originality**. I must confess that I'm thoroughly indebted and grateful to my friends and authorities on the subject who inspired me in some or the other way in writing such a mammoth manual.

I take this opportunity to Dedicate this Voluminous and mammoth work to

1. Lord Shiva and Maa Parvati and Maa Saraswati Devi as I sincerely believe, without their blessings, nothing can be achieved;
2. My parents who made me realise at a very tender age itself that meaning of life is best understood with self efforts only.
3. My Wife - Bhawana Kandpal, who uncomplainingly let me allow to fully devote towards this work. She is always a source of great strength and remained so during this tenure too.
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6. My Son – Precious (Parth)/My Daughter - Sara/My nephew - Yaman /My niece – Ruhi, Aahaana, Aiyra - who always keep my world stress free.
7. All of my students who through their inquisitive queries helped me in understanding student's perspective in a better manner



First Word

Of late I was virtually bombarded with barrage of messages to come out with a Revisionary book for CMA GR. I Financial Accounting Subject .

So I decided to bring out a new book titled as 'Revisionary Exam Digest' . I can assure the student fraternity, even though it may seem just revisionary material yet it contains and covers comprehensively the entire spectrum of the syllabus . I have taken pains to include every topic even in this Concise volume .

A sincere, genuine and painstaking effort has been made to present a concise and compact source of study material for CFR in such a manner that the student fraternity not only gets most penetrative , precise and perfect guidance but also the required levels of efficiency, competence and confidence to confront the examination.

Full range of chapters have been presented in a structured manner divided in sections . Every chapters has been carefully crafted with conceptual back grounding and sectionally arranged topics.

Questions from latest examinations too have been added with full solutions.

*It is a concise yet comprehensive, updated and thoroughly researched treatise on **Financial Accounting**. I can assure the Student fraternity that they can faithfully bank upon it and in a quick time complete the course.*

I'm sure this book too would be taken up with same appreciation as you showed towards Flagship title Financial Accounting (2 volumes) .

I wish all and sundry a very best of luck and tremendous success in their efforts and pray to the almighty that each one you reach the most hallowed precincts of success. At the same time would like to have constructive suggestions from all the quarters

Sanjay K Welkins

21.05.24

Quality of a man is judged by the quality of books he reads

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About the Author

*Prof. Sanjay Welkins is one of the most Distinguished and Acclaimed faculty, in the country, **for Financial Reporting, IFRS ,Ind AS and AS.***

Penetrative and polished Studies complemented with in-depth well researched study material have become immensely popular among the Professional level Students as evidenced by staggering rush for his Books, Courses and sterling successes.

Sanjay Welkins is a noted author and has penned several bestselling books on Accounts and Financial Reporting - has also served as an Academic Guide, and as Consultant in reputed academic organisations - posses rich experience of more than 27 years – and his area of expertise are Indian Accounting Standards, Financial Reporting and Accounting Standards.

Prof. Sanjay Welkins has taught several thousand students over his career -achieving tremendous results with supremely high success rate.

He believes his breathtaking presentations, language proficiency and in-depth concept clarity that has earned him the trust levels of the student fraternity and perhaps made him the most sought after and preferred faculty.

In light of his illustrious career as a professor, Sanjay Welkins sir has been invited by several banks and other financial institutes as a guest speaker and to conduct workshops.

Prof. Welkins is currently helping CA, CMA aspirants clear their exams and realise their dream careers.



Paper – 6: Financial Accounting

100 Marks
New Syllabus

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

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PART A -
Practical Chapters + Theoretical Chapters

Chapter - 1

Branch Accounts Including Foreign Branches

1.	Meaning of Branch Branch can be defined as a segment of an enterprise normally controlled by head office being located in different geographical position. In practice, the branches are playing a vital role to put the original establishment in the existence. In order to cover wide range of market and thus wide clientele, an organization generally opens branches.
2.	Branch Accounting is an accounting system in which separate accounts are maintained for each branch of a corporate entity or organization. The primary objectives of branch accounting are better accountability and control, since profitability and efficiency can be closely tracked at the branch level.
3.	Types of branches- - Domestic branches / Inland Branches / Home branches - Foreign branches
3.1	Domestic Branches are those which are opened in the different parts of the nation, where the original undertaking being registered are called inland branches. Domestic branches may further be classified into – - Dependent branches & - Independent branches
3.2	Dependent branches Are the branches that do not keep their records but all the records are maintained by head office. They are not authorized to act solely without the prior permission of the head office. All the plans, policies, rules and regulations of these branches are totally formulated and executed by the head office. In other words, all the functions of dependent branch are totally controlled by head office. Dependent branches do not maintain separate books of account and wholly depend on Head Office. The result of the operation, i.e., profit or loss, is ascertained by Head Office. In other words Head Office maintains and opens a Branch Account in its book in order to find out the result of the operation. Branches supply some related information to the Head Office, i.e., position of cash, debtors stocks, etc.
3.3	Independent branches are those which maintain complete system of accounting. This particularly happens when their sizes are very large due to various functional complexities. In short, they prepare their accounts independently, i.e., they also purchase and sell goods for cash and credit independently in addition to the goods that are supplied by the Head Office. They may supply goods to Head Office, pay expenses and deposit cash in their own account like an independent unit. Thus, they maintain their own accounts under Double Account System. That is why they are called Independent Branch.

4.	Accounting Systems under Dependent Branches Under dependent branches accounts are prepared only in the head office books and generally following accounting systems are found in it- a] debtor system b] Stock and debtor system c] Whole sale branch system

Section - 1 - Debtor System

This system of accounting is suitable for the small-size branches. Under this, a Branch Account is opened for each branch in the head office ledger. All transactions are recorded in this account. The Branch Account is prepared in such a way that it discloses the profit or loss of the branch. Branch Account is a Nominal Account in nature. Head office may send goods to branch either at "Cost price" or "Selling price"

Journal Entries Under Debtor Method

For recording opening balances of Branch Assets:	Branch A/c Dr. To Branch Assets
For recording opening balances of Branch Liabilities	Branch Liabilities Dr. To Branch A/c
When goods are supplied by the Head Office/another branch to branch	Branch A/c Dr. To Goods sent to Branch A/c
When goods are returned by the branch/ branch customers directly to the Head Office	Goods Sent to Branch A/c Dr. To Branch A/c
When goods are supplied by the branch to another branch under instructions of Head Office	Goods Sent to Branch A/c Dr. To Branch A/c
When goods are supplied by the head office but not received by the branch	Goods-in Transit A/c Dr. To Branch A/c
When the Head Office meets the branch expenses or sends cash to the branch for meeting its expenses:	Branch A/c Dr. To Cash/Bank A/c
When remittances are received by the Head Office from the Branch/ Branch Customers	Cash/Bank A/c Dr. To Branch A/c
When remittances are sent by the branch but not received by the Head Office:	Cash in-transit A/c Dr. To Branch A/c
When the balance in goods sent to Branch Account is transferred	Goods sent to Branch A/c Dr. To Purchases A/c (in case of Trading concerns) or, To Trading A/c (in case of manufacturing concerns)
For recording the closing balances of Branch Assets:	Branch Assets A/c To Branch A/c
For recording the closing balances of Branch Liabilities	Branch A/c Dr. To Branch Liabilities
For recording Profit or Loss: (i) If credit side exceeds the debit side.	Branch A/c Dr. To General Profit & Loss A/c

(ii) If debit side exceeds the credit side	General Profit & Loss A/c Dr. To Branch A/c

Format of branch account in the books of Head office

Branch account

Details	Amount	Details	Amount
To Op Bal B/D		By bal b/d-	
Stock	xxx	o/s salaries	xxx
Debtors	xxx	creditors	xxx
Prepaid Expenses	xxx	By remittances	
Petty Cash	xxx	cash sales	xxx
Furniture	xxx	cash realized from debtors	xxx
Computer	xxx	sale of plant or any asset	xxx
Plant And Machinery	xxx	- expenses paid by BO	xxx
To Goods Sent To Branch A/C	xxx	- amount spent on purchase	
To Cash-Sent Towards Petty Expenses	xxx	of an asset by the branch	xxx
To Cash-Sent Towards		by goods sent to branch[returns]	xxx
-Rent	xxx	by goods in transit	xxx
-Wages And Salaries	xxx	by loading on	
-Advertising	xxx	goods sent to branch a/c	xxx
-Carriage And Freight	xxx	opening stock	xxx
-Purchase Of Asset	xxx	by bal c/d-	
To Loading On:		stock	xxx
-Goods Sent To Branch[Returns]	xxx	debtors	xxx
-Goods In Transit	xxx	prepaid expenses	xxx
-Closing Stock	xxx	petty cash	
To Balance c/d		op bal	xxx
Creditors	xxx	+cash sent by HO towards	
Outstanding expenses	xxx	petty expenses	xxx
To Net Profit [B.F.]	xxx	-petty expenses	xxx
		Furniture	xxx
		-depreciation	xxx
		Computer	xxx
		-depreciation	xxx
		Plant op bal	xxx
		Less: Dep.	xxx

Significant points:

- **The following items are to be ignored while preparing Branch Account under this method:**
- Bad debts, discount allowed, credit sales, sales returns by customers to branch, cash received by Branch from Branch Debtors, , since the debtors at the end appear at the adjusted figure.
- Depreciation and Profit/Loss on sale of fixed assets since fixed assets at the end appear at the adjusted figure.
- Abnormal Losses since stock at the end appears at the adjusted figure.
- Expenses met by Branch out of cash, since *either* reduced cash balance at the end is decreased or the liability at the end is increased.
- Purchase of Goods/Fixed Assets by Branch, since book value of Goods/Fixed assets at the end is increased and *either the* amount of remittances is reduced *or* the Creditors at the end are increased.
- Sale of Goods/Fixed Assets by Branch since book value of Goods/ Fixed assets at the end is decreased and *either* the amount of remittances is increased *or* the Debtors at the end are increased.

- Petty Cash Expenses paid by the Branch. The Branch Account is debited with the opening balance of Petty Cash and the amount of petty cash sent by the head office and is credited with the closing petty cash. For calculating closing petty cash, all expenses paid by the branch are taken into consideration. Therefore it should be ignored for preparation of Branch Account.

Invoice Price:

Sometimes, the Head Office does not want to reveal the cost of the goods to the Branch and therefore, invoices goods at a price which is higher than the Cost Price (CP). Such price is known as 'Invoice Price' (IP). The difference between the Invoice Price (IP) and the Cost Price (CP) is called 'Loading'.

How to Eliminate/Remove Loading:

When goods are sent at invoice price, for ascertaining correct profit/loss on Branch, the items recorded at invoice price should be brought down to cost price level. For this purpose, the loading including in the various items should be eliminated by passing the following adjusting entries

1. For loading on Opening Stock

Stock Reserve A/c	Dr.
To Branch A/c	

2. For loading (Net) on goods sent to Branch (i.e., Goods sent to Branch less Returns by Branch or Branch customers) to H.O.] :

3. Goods Sent to Branch A/c	Dr.
To Branch A/c	

4. For loading on closing stock

Branch A/c	Dr.
To Stock Reserve A/c	

Revisionary Question Bank

Section - 1

1.1

From the following particulars, prepare Branch Account showing the profit or loss of the Branch

	Rs.
Op. Stock at Branch	30,000
Goods sent to Branch	90,000
Sales (cash)	1,20,000
Expenses:	
Salaries	10,000
Other expenses	4,000

Closing stock could not be ascertained but it is known that the branch usually sells at cost plus 20%. The Branch Manager is entitled to a commission of 5% on the profit of the Branch before charging such commission.

Solution:

Books of Head Office
Branch Account

Details	Amount	Details	Amount
Opening stock	30,000	Remittances:	
Petty cash	-	Cash from debtors	-
Opening debtors	-	Cash sales	1,20,000
Goods sent to branch a/c	90,000	Goods sent to branch- returns	-
Cash –		Bal c/d :	
salaries	10,000	Debtors	-
Other expenses	4,000	Stock ; as per working	20,000
Petty cash	-	Petty cash	-
Net profit before commission	6,000		
Branch mgr. commission 5%	300		
Net profit after commission	5,700		

Workings :

1.Total sales as given	= 1,20,000
Less Profit margin 1/6 on sales	= 20,000
Cost of the goods sold	= 1,00,000
2.	
Op stock	= 30,000
+ goods sent to branch	= 90,000
Total available goods at cost	= 1,20,000
Less cost of goods sold	= 1,00,000
Closing stock	= 20,000

1.2 – Past Examinations

A company with HO at City X has a branch in City Z. The branch receives all goods from HO who remits cash for all expenses. Total sales by Branch for the year ended 31.03.22 amounted to Rs. 6,50,000 out of which 75% on credit. Other details for City Z Branch were as under:

	Rs.
Opening Stock at Branch	4,000
Closing stock at Branch	30,000
Opening Debtors	45,000
Closing Debtors	30,000
Petty cash in the beginning	250
Petty cash sent by HO	3,000
Petty cash spent	2,500
Expenses actually spent by branch	45,000
All sales are made by the branch at cost plus 25%.	

You are required to prepare the City Z branch account in the books of HO for the year ended 31.03.22.

Detailed Solution

Given in the question that all sales are made by the branch at cost plus 25%.

It means out of total sales of 6,50,000

Profit Margin is $25/125 = 1,30,000$

Cost of goods Sold must be $= 6,50,000 - 1,30,000 = 5,20,000$

Sanjay Welkins Classes	Branch Accounts - Revisionary Material

Now Branch is having opening stock of stock of Rs. 4,000

and closing stock of Rs. 30,000

so Goods sent to branch at cost must be :

Opening stock at cost	4,000	Sale of stock at cost	5,20,000
GSTB at Cost = B.F	5,46,000	Closing stock	30,000

Net Profit Rs. 82,500

Petty cash a/c Balance Rs. 750

Cash collected from debtors 5,02,500

Credit sales 6,50,000 x 75% = 4,87,500

Cash sales 6,50,000 x 25% = 1,62,500

Branch Account

Details	Amount	Details	Amount
b/d		Remittances :	
Petty Cash	250	Cash sales 25% of 6,50,000 = 1,62,500	1,62,500
Debtors	45,000	Cash from customers	5,02,500
Stock :	4,000		
Bank :Cash sent for petty expenses	3,000		
Bank – expenses	45,000		
Goods sent to branch from HO at cost	5,46,000	Bal c/d :	
		Debtors	30,000
		Stock :	30,000
Net profit	82,500	Petty Cash : op. Bal. 250 + petty cash sent 3,000 less petty cash spent 2,500	750

Branch Debtors A/c

Details	Amount	Details	Amount
Bal b/d	45,000	Cash from debtors - B.F	5,02,500
Credit sales 75% of 6,50,000	4,87,500	Bal c/d	30,000
	5,32,500		5,32,500

Invoicing

1.3 - Invoicing - Past Examinations

K-55 Limited has a branch at City F. Goods are invoiced to the branch at 20% profit on sales. The branch having been instructed to send all cash daily to the Head Office. All the 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 draw up branch accounts as it would appear in the books of the Head Office.

Stock on January 1, 2022 (invoice price)		Rs. 15,000

Sundry Debtors on January 1,2022		9,000
Cash in hand on January 1, 2022		400
Office furniture on January 1, 2022		1,200
Goods supplied by the Head Office (invoice price)		80,000
Goods returned to Head Office		1,000
Goods returned by Debtors		480
Cash received from debtors		30,000
Cash Sales		50,000
Credit Sales		30,000
Discount Allowed		300
Expenses paid by Head Office:		
Rent	1,200	
Salary	2,400	
Stationery & Printing	300	3,900
Petty expenses paid by Branch Manager		280
Provide depreciation on furniture by		10% p.a.
Stock on 31-12-2022 (invoice price)		14,000

Solution:

Books of Head Office

Branch Account

Details	Amount	Details	Amount
Opening stock	15,000	Remittances:	
Petty cash	400	Cash from debtors#	30,000
Opening debtors	9,000	Cash sales	50,000
Furniture	1,200		
Goods sent to branch a/c	80,000	Load on Opening stock	3,000
Cash –		Load on GSTB a/c	16,000
Salaries	2,400	Goods sent to branch- returns	1,000
Rent	1,200	Bal c/d :	
Stationery and printing	300	Debtors	8,220
Load on ; GSTB-R	200	Stock	14,000
closing stock	2,800		
Net profit	10,920	Petty cash (400 - 280)	120
		Furniture 1,200 - 120	1,080

Branch Debtors Account

Details	Amount	Details	Amount
Op bal b/d –	9,000	Cash from debtors –	30,000
Credit sales –	30,000	SR	480
		Bal c/d - Bal. fig.	8,220

1.4 – Past Examinations

Highland Enterprises is having their Head Office at City X and a branch at City Y. The Head Office invoices the goods to the branch at cost plus $33\frac{1}{3}\%$

The following are the transactions of the Head Office with the branch for the year ended 31-3-2022. You are required to prepare branch account.

Stock at Branch as on 1-4-21 (at invoice price)		40,000
Goods sent to the Branch (at invoice price)		2,50,000
Goods returned to HO		10,000
Cash Sales		1,00,000
Credit Sales		3,00,000
Discount / Allowances to customers		10,000
Stock at Branch as on 31-03-2022		60,000

It is estimated that 2% of the goods received are lost through natural wastage.

Detailed Hints :

Net Profit Rs. 2,25,000

Normal Loss shall be ignored.

In the Books of HO Branch Account

Opening Stock	40,000	Loading on opening stock $40,000 \times \frac{1}{4}$	10,000
GSTB	2,50,000	Loading on GSTB $-2,50,000 \times \frac{1}{4}$	62,500
		GSTB- R	10,000
		Remittances:	
Loading GSTB-R $10,000 \times \frac{1}{4}$	2,500	Cash Sales	1,00,000
		Cash from Debtors	2,90,000
Loading on Closing stock $60,000 \times \frac{1}{4}$	15,000		
Net Profit	2,25,000	Balance c/d	
		Stock	60,000

Branch Debtors Account

Details	Amount	Details	Amount
Op bal b/d –	-	Cash from debtors B.F	2,90,000
Credit sales –	3,00,000	Discount / Allowances	10,000
		Cl. Balance	-

1.5 – Past Examinations

Spectrum Limited has a branch at City K. You are required to calculate the invoice price of goods sent to branch and profit included thereon, from the following details:

Goods received from HO – Rs. 1,00,000

Goods in transit – Rs. 50,000

Goods are invoiced to branch at cost plus 25%.

Detailed Solution:

Invoice value of goods received Rs.1,00,000
 Add: Goods in transit Rs. 50,000
 Invoice value of the goods sent Rs. 1,50,000
 Profit Margin = $25/125 \times 1,50,000 = \text{Rs. } 30,000$

1.7 - Invoicing – Past Examination – 8 Marks

Breeze and Company is having its Branch at City X. goods are invoiced to the branch at 25% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars prepare branch account in the books of Head Office.

Stock on 1.4.2024	40,000
Sundry Debtors on 1.4.2024	25,000
Cash in hand on 1.4.2024	1,000
Office furniture on 1.4.2024	4,000
Goods invoiced from head office at invoice price	1,80,000
Goods returned to head office	6,000
Goods returned by debtors	1,250
Cash sales	1,20,000
Credit sales	70,000
Cash received from debtors	65,000
Discount allowed to debtors	300
Expenses paid by head office:	
Staff welfare	750
Salary	4,000
Telephone Expenses	1,200
Other Miscellaneous expenses paid by branch	700
Depreciation to be provided on branch furniture at 10% p.a.	
Stock on 31.03.2025 at invoice price	35,000

Solution:

Branch Account in the Books of Head Office

Balance b/d :		Loading on opening stock	10,000
Stock	40,000	Remittances :	
Debtors	25,000	Cash sales	1,20,000
Cash in hand	1,000	Cash from debtors	65,000
Furniture	4,000	Goods sent to branch - load	45,000
Goods sent to branch	1,80,000	Goods returned by branch to HO	6,000
Goods returned by branch- Loading	1,500		
Bank (expenses paid by HO)			
Staff welfare	750	Balance c/d :	
Salary	4,000	Stock	35,000
Telephone	1,200	Debtors	28,450
Load on closing stock	8,750	Petty Cash 1,000 - 700	300
Profit T/F To General P&L	47,150	Furniture 4,000 - 400	3,600

	3,13,350		3,13,350

1.8 - Invoicing –Past Examination – 4 Marks

Following is the information of Jammu Branch of Best limited, New Delhi for the year ending 31.03.2020:

- Goods invoiced to the branch at cost plus 20%
- The sale price is cost plus 50%

Other information: Rs.

(a) Stock as on 01.04.2019	2,20,000
(b) Goods sent during the year	11,00,000
(c) Sales during the year	12,00,000
(d) Expenses incurred at the branch	45,000

Ascertain:

- The profit earned by the branch during the year
- Branch stock reserve in respect of unrealised profit

Solution:

**In the books of Head office
Jammu Branch Account**

Opening stock	2,20,000	Loading on opening stock : $2,20,000 \times 20 / 120$	36,667
Goods sent to branch	11,00,000	Sales (presumed all sales are on cash basis)	12,00,000
Expenses	45,000	Loading on GSTB: $11,00,000 \times 20/120$	1,83,333
Loading on closing stock : $3,60,000 \times 20/120$	60,000		
Net profit	3,55,000	Balance c/d :	
		Closing stock (as per working note)	3,60,000
	17,80,000		17,80,000

Opening stock at IP		2,20,000	
+ GSTB :		11,00,000	
Total goods available at invoice price		13,20,000	
Less: invoice price of goods sold			
Sales	12,00,000		
Less 30/150 of 12,00,000	(2,40,000)	9,60,000	
Closing stock at invoice price		3,60,000	

How Much profit branch has earned from its own point of view:

Jammu Branch Trading Account

Opening stock	2,20,000		
Goods sent to branch	11,00,000	Sales	12,00,000

Expenses	45,000		
Net profit	1,95,000	Balance c/d :	
		Closing stock (as per working note)	3,60,000
	15,60,000		15,60,000

1.9 – Invoicing – Past Examination - 8 Marks

XYZ Company is having its Branch at City X. goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager. From the following particulars prepare branch account in the books of Head Office.

Stock on 1.4.2024	30,000
Sundry Debtors on 1.4.2024	18,000
Cash in hand on 1.4.2024	800
Office furniture on 1.4.2024	3,000
Goods invoiced from head office at invoice price	1,60,000
Goods returned to head office	2,000
Goods returned by debtors	960
Cash received from debtors	60,000
Cash sales	1,00,000
Credit sales	60,000
Discount allowed to debtors	160
Expenses paid by head office:	
Rent	1,800
Salary	3,200
Stationery and printing	800
Petty expenses paid by branch	600
Depreciation to be provided on branch furniture at 10% p.a.	
Stock on 31.03.2025 at invoice price	28,000

Solution:

Branch Account in the Books of Head Office

Balance b/d :		Loading on opening stock	6,000
Stock	30,000	Remittances :	
Debtors	18,000	Cash sales	1,00,000
Cash in hand	800	Cash from debtors	60,000
Furniture	3,000	Goods sent to branch - load	32,000
Goods sent to branch	1,60,000	Goods returned by branch to HO	2,000
Goods returned by branch-Loading	400		
Bank (expenses paid by HO)			
Rent	1,800	Balance c/d :	
Salary	3,200	Stock	28,000
Stationery and printing	800	Debtors	16,880

Load on closing stock	5,600	Petty Cash 800-600	200
Profit T/F To General P&L	24,180	Furniture 3,000 - 300	2,700
	2,47,780		2,47,780

Section - 2 - Stock And Debtor System

This method is applicable particularly adopted by organisations where there are large numbers of transaction. This method helps the Head Office to make efficient control.

Under this system, in the books of Head Office following accounts are prepared

- A] Branch stock account
- B] Branch debtors account
- C] Branch adjustment account
- D] Branch profit or loss account

Sometimes question may ask for, besides aforementioned accounts, branch expenses account and petty expenses a/c Also.

Demonstration - branch stock account

Details	amount	Details	amount
Opening stock	xxx	Cash sales	xxx
Goods sent to branch a/c	xxx	Credit sales	xxx
Surplus	xxx	Goods sent to branch[returns]	xxx
Sales return		Abnormal losses	xxx
[goods return by debtors]	xxx	Normal losses	xxx
		Goods in transit	xxx
		Goods t/f by this br to some other br.	xxx
		Allowances off selling price	xxx
		Deficiency/shortage/spoilage	xxx
		Closing stock	xxx

Demonstration branch adjustment account

Details	amount	Details	amount
Loading on-		loading on-	
Goods sent to br. a/c [returns]	xxx	Opening stock	xxx
Goods in transit	xxx	Goods sent to branch a/c	xxx
Closing stock	xxx	Surplus[full amt]	xxx
Goods t/f	xxx		
Abnormal losses	xxx		
Normal losses[full amt]	xxx		
Allowances off selling price	xxx		
Direct expenses like wages, carriage, freight	xxx		
Gross profit	xxx		

Branch Debtors Account

Details	Amount	Details	Amount
Opening balance b/d	xxx	Cash recd. from debtors	xxx
Credit sales	xxx	Bad debts	xxx
		Discount allowed to debtors	xxx
		Sales return [goods returned by debtors]	xxx
		Balance carried down	xxx

Demonstration Branch profit and loss account

Details	Amount	Details	Amount
Bad debts	xxx	Gross profit b/f	xxx
Discount allowed	xxx	Insurance claim recd	xxx
Abnormal loss at cost	xxx		
Rent	xxx		
Salary	xxx		
Advertising	xxx		
Promotional expenses	xxx		
Insurance	xxx		
Net profit [b/f]	xxx		

Important points

- 1] If balancing figure in the branch stock account appears on the debit side then preference order is-
 - a] opening stock [if not given]
 - b] Goods sent to branch a/c [if not given]
 - c] Surplus [provided there is no deficiency]
 - d] Sales return that is goods returned by the debtors
- 2] If balancing figure in the branch stock account appears on the credit side then preference order shall be:
 - a] closing stock provided it is not given
 - b] deficiency/shortage / spoilage
- 3] **Treatment of abnormal loss-**

first write the full amount on the credit side of branch stock account then write the loading amount on the debit side of the branch adjustment a/c and finally take the abnormal loss at cost towards debit side of the P&L a/c.
- 4] **Treatment of deficiency-**

Same as above.
- 5] **Treatment of normal losses –**

first write the full amt on the credit side of the branch stock a/c and then write full amount on the debit side of the branch adjustment a/c.
- 6] **If goods are returned directly by branch debtors to the HO**

In this case presume –goods first have been returned by the debtors to the branch and then branch has returned the goods to the HO. That is one need to split the transaction into two parts-a] goods returned by debtors to the branch and b] goods returned by the branch to the HO and now accordingly do the treatment. For the part [a] first write the amount on the credit side of the debtor's a/c and then put the figure on the debit side of branch stock a/c. For the part [b] first write the figure as “goods sent to branch a/c [returns]” on the credit side of the branch stock a/c and then take its loading towards debit side of the

branch adjustment a/c.

Revisionary Illustrative Question Bank

2.1 - Past Examinations

Lakes Ltd. sent goods to its Rutland Branch at cost plus 25%. From the following particulars prepare Branch Stock Account, Branch Adjustment Account and Branch Profit and Loss Account.

	Rs.
Opening Stock at Branch (invoice price)	5,000
Goods sent to Branch	20,000
Loss- in- transit at invoice price	2,500
Theft at invoice price	1,000
Loss in weight (normal) at invoice price	500
Sales	25,500
Expenses	8,000
Closing Stock at branch at invoice price	6,000
Claim received from insurance company for loss in transit by Head Office	2,000

Solution:

Branch Stock A/c

Details	Amount	Details	Amount
Bal b/d		Cash sales	
Goods sent to branch a/c		Credit Sales –	
		Goods sent to Branch - Returns	
		Deficiency / shortage / spoilage – B.F.	
		Bal. c/d : bal. fig.	

Branch Debtors A/c

Details	Amount	Details	Amount
Bal b/d		Cash from debtors	
Credit sales – bal fig		Discount allowed	
		Bal c/d- bal. Fig.	

Branch Adjustment A/c

Details	Amount	Details	Amount
Load on closing stock -		Load on opening stock	
Load on shortage		Load on GSTB a/c	
Load on GSTB- Returns		Load on goods t/f	
Gross profit – bal Fig.			

Branch Profit and Loss A/c

Details	Amount	Details	Amount
Branch expenses a/c		Branch adjustment a/c- Gross Profit	
Shortage of stock at cost			
Discount			
Net profit bal. fig.			

2.2. – Past Examinations

Fit and Fine Traders Ltd. sends goods to its Rudrapur Branch at cost plus 25%. The following particulars are available in respect of the branch for the year ended 31st March, 2022.

	Rs.
Opening Stock at branch at cost of branch	20,000
Goods sent to branch at invoice price	1,00,000
Loss in transit at invoice price	10,000
Pilferage at invoice price	4,000
Sales	1,22,000
Expenses	22,000
Closing Stock at branch at cost to branch	24,000
Recovered from insurance company against loss in transit	6,000

Show Ledger Accounts in the Head Office books for;

- (a) Branch Stock Account
- (b) Goods sent to Branch Account and
- (c) Branch Adjustment Account
- (d) Branch Profit & Loss Account

Solution -

Branch Stock a/c

Bal. B/D – Op. Stock	20,000	Credit Sales	1,22,000
GSTB A/C	1,00,000	Loss In Transit	10,000
Surplus – Excess Of Sale Price Over I.P	40,000	Pilferage	4,000
		Cl. Stock	24,000
	1,60,000		1,60,000

Branch Adjustment a/c

Load on cl. Stock	4,800	Load on op.. Stock	4,000
Load on abnormal loss – loss in transit + Pilferage	2,800	Load on GSTB a/c [gross]	20,000
Gross profit	56,400	Load on GSTB a/c	40,000
	64,000		64,000

Branch Profit and Loss a/c

Branch expenses a/c	22,000	Gross profit	56,400
Abnormal Loss at cost	11,200	Insurance Company	6,000
Net profit	29,200		
	62,400		62,400

2.3 – Past Examinations

Indian Traders Ltd. sends goods to its Chennai Branch at cost plus 25%. The following particulars are available in respect of the branch for the year ended 31st March, 2016.

	Rs.
Opening Stock at branch at cost to HO	64,000
Goods sent to branch at invoice price	12,00,000
Loss in transit at invoice price	15,000
Pilferage at invoice price	6,000
Sales	12,19,000
Expenses	60,000
Closing Stock at branch at cost to HO	32,000
Recovered from insurance company against loss in transit	10,000

Show Ledger Accounts in the Head Office books for;

- (a) Branch Stock Account
- (b) Goods sent to Branch Account and
- (c) Branch Adjustment Account
- (d) Branch Profit & Loss Account

Solution:

Branch Stock A/c

Details	Amount	Details	Amount
Bal b/d $64,000 + \frac{1}{4}$ of 64,000	80,000	Sales	12,19,000
Goods sent to branch a/c	12,00,000		
Surplus – B.F.	---	Abnormal loss : loss in transit + Pilferage	21,000
		Normal loss	---
		Bal. c/d : $32,000 + \frac{1}{4}$ of 32,000	40,000
	12,80,000		12,80,000

Branch Adjustment A/c

Details	Amount	Details	Amount
Load on closing stock $-40,000 \times \frac{1}{5}$	8,000	Load on opening stock $80,000 \times \frac{1}{5}$	16,000
Load on shortage	---	Load on GSTB a/c $12,00,000 \times \frac{1}{5}$	2,40,000
Load on A .Loss- Returns $21,000 \times \frac{1}{5}$	4,200	Surplus	---
Normal loss	---		
Gross profit – bal Fig.	2,43,800		

Branch Profit and Loss A/c			
Details	Amount	Details	Amount
Branch expenses a/c	60,000	Branch adjustment a/c- Gross Profit	2,43,800
Petty cash : amount spent	---	Insurance claim	10,000
Discount	---		
Bad debts	---		
Shortage of stock ,at cost	16,800		
Net profit bal. fig.	1,77,000		

2.4 - Manager's Commission

A Head Office at Mumbai has a Branch at Chennai in charge of a manager. The ratio of gross profit on turnover at the branch was 25% constant throughout the year.

The branch manager is entitled to a commission of 20 %, but subject to a deduction from such commission a sum equal to 50% of any ascertained deficiency of branch stock. All goods were supplied to the branch by the Head Office. From the following figures extracted from the branch books, calculate the commission due to the Manager for the year ended Dec. 31, 2025

	Rs.
Stock on 1-1-2025 (at cost)	90,000
Goods received from Head Office at cost	3,00,000
Sales	4,00,000
Establishment exp.	10,000
Drawings by Manager against commission	1,000
Stock on 31-12-2025 (at selling price)	1,00,000

Solution:

Branch Stock A/c			
Details	Amount	Details	Amount
Bal b/d cost 90,000 + 1/3 i.e. 30,000	1,20,000	Sales	4,00,000
Goods sent to branch a/c : cost 3,00,000 + 1/3 i.e. 1,00,000	4,00,000	Deficiency – B.F.	20,000
.		Closing stock	1,00,000

Branch Adjustment A/c			
Details	Amount	Details	Amount
Load on closing stock –1,00,000 x 1/4	25,000	Load on opening stock 1,20,000 x 1/4	30,000
Load on GSTB- R	-	Load on GSTB a/c 4,00,000 x 1/4	1,00,000
Load on G.I.T	-		
Load on Goods T/F	-		
Load on deficiency 20,000 x 1/4	5,000		
Normal loss (full)	-		
Gross profit – bal Fig.	1,00,000		

Branch Profit and Loss A/c

Details	Amount	Details	Amount
Establishment expenses a/c	10,000	Branch adjustment a/c- Gross Profit	1,00,000
Petty cash : amount spent	-	Insurance claim	-
Discount	-		
Bad debts	-		
Abnormal loss at cost	-		
Deficiency at cost 20,000 – 5,000	15,000		
Net profit bal. fig.	75,000		
Managerial Commission: paid (drawings against commission) 1,000 + O/S 6,500	7,500		
Net profit after commission	67,500		

Notes :

Rates	C.P + margin = I . P/ Sales
	75 + 25 = 100
	1/3 1/4
Calculation of Commission due:	
Commission : 75,000 x 20 / 100	15,000
Less 50% of deficiency that is 50% of 15,000	7,500
Manager's Commission	7,500
Less: drawings against commission that is commission already paid	1,000
Commission due	6,500

2.5

Messer's Nine O' Clock limited of City Y **opened** a branch at City X on 1st April 2025. Goods are sent to the BO at selling price which is cost plus 25 %.

The following transactions took place during the year

Goods sent to branch at cost to the HO	2,80,800
Cash sales	1,25,000
Credit sales	1,75,000
Cash collected from debtors	1,56,000
Discount allowed to the debtors	4,000
Cash sent to branch for :	
Wages	3,000
Freight	11,000
Other expenses	6,000
Spoilage w/off	500
Stock on 31 st March, 2023	55,500

Find out the result of the aforementioned transactions between HO and BO applying stock and debtor system.

Solution:

Branch Stock A/c

Details	Amount	Details	Amount
Bal b/d	---	Cash sales	1,25,000
Goods sent to branch a/c $2,80,800 + \frac{1}{4}$	3,51,000	Credit Sales –	1,75,000

Sanjay Welkins' Classes

Details	Amount	Details	Amount
Sales Return – B.F.	5,000	Goods sent to Branch - Returns	-
		Spoilage : Given	500
		Bal. c/d	55,500

*Note : in this question , credit side is bigger and thence balancing figure shall is appear on the debit side which cannot be taken as opening stock (as it is a new branch) or surplus (as spoilage is given and spoilage and surplus cannot co-exist) thus only alternative left is to consider it as **Sales Return**.*

Branch Adjustment A/c

Details	Amount	Details	Amount
Load on closing stock –	11,100	Load on opening stock	-
Load on GSTB- R	-	Load on GSTB a/c	70,200
Load on G.I.T	-		
Load on Spoilage	100		
Load on Abnormal Loss	-		
Normal loss (full)	-		
Gross profit – bal Fig.	59,000		

Branch Profit and Loss A/c

Details	Amount	Details	Amount
Branch expenses a/c	20,000	Branch adjustment a/c- Gross Profit	59,000
Petty cash : amount spent	-	Insurance claim	-
Discount	4,000		
Bad debts	-		
Abnormal loss at cost	-		
Shortage of stock ,at cost	400		
Net profit bal. fig.	34,600		

Branch Debtors A/c

Details	Amount	Details	Amount
Bal b/d	-	Cash from debtors	1,56,000
Credit sales	1,75,000	Discount allowed	4,000
		Bad debts	-
		Sales returns	5,000
		Bal c/d : Bal. Fig.	10,000

2.6 – Past Examinations

Concept and company with its Head office at City One - has a branch at City Two - to which goods were sent at $33\frac{1}{3}$ % above cost. Following further details are given for the year ending on 31.3.2022-

Goods sent branch	24,00,000
Stock at branch on 1.4.2021	1,20,000
Cash sales for the year	9,00,000
Return of goods by customers to the branch	30,000
Branch expenses –paid in cash	2,67,500
Branch debtors balance as on 1.4.2021	1,50,000

Discount allowed	5,000
Bad debts	7,500
Collection from debtors	13,50,000
Branch debtors Cheque returned dishonoured	25,000
Stock at branch on 31.3.2022	2,40,000
Branch debtors balance on 31.3.2022	1,82,500

Draw up the necessary ledger accounts like branch debtors, branch stock, branch adjustment a/c, and branch expenses.

Answers :Net profit – 2,80,000, credit sales – 14,00,000

Branch Stock A/c

Details	Amount	Details	Amount
Bal b/d	1,20,000	Cash sales	9,00,000
Goods sent to branch a/c	24,00,000	Credit Sales –	14,00,000
Sales returns	30,000	Goods sent to Branch - Returns	-
		Shortage B. F	10,000
		Bal. c/d	1,82,500

Branch Adjustment A/c

Details	Amount	Details	Amount
Load on closing stock –	60,000	Load on opening stock	30,000
Load on GSTB- R	-	Load on GSTB a/c	6,00,000
Load on G.I.T	-		
Load on Goods T/F	-		
Load on Shortage	2,500		
Normal loss (full)	-		
Gross profit – bal Fig.	5,67,500		

Branch Profit and Loss A/c

Details	Amount	Details	Amount
Branch expenses a/c	2,67,500	Branch adjustment a/c- Gross Profit	5,67,500
Petty cash : amount spent	-	Insurance claim	-
Discount	5,000		
Bad debts	7,500		
Shortage at cost	7,500		
Profit and loss a/c : net profit	2,80,000		

Branch Debtors A/c

Details	Amount	Details	Amount
Bal b/d	1,50,000	Cash from debtors	13,50,000
Credit sales – bal. fig.	14,00,000	Discount allowed	5,000
Bank- dishonour of cheque	25,000	Bad debts	7,500
		Sales returns	30,000
		Bal c/d	1,82,500

2.7 - Examination Question - 12 Marks:

F-88 Industries has its Head office in 'West-view' State and branch office at City-Nine - to which goods were invoiced at cost plus 25%. The branch sells both for cash and on credit. Branch expenses are paid direct from HO and Branch has to remit all cash received to the HO Bank account. From the Following details relating to calendar year 2021, prepare the accounts in the head office ledger and ascertain the branch profit. Branch does not maintain any books of account, but sends weekly returns to the HO-

Goods received from HO at IP	6,00,000
Stock at branch on 1.1.2021	60,000
Cash sales for the year	1,80,000
Return of goods by customers to the branch	6,000
Branch expenses rent, rates, taxes, salaries, wages , bonus , office expenses	84,000
Branch debtors balance as on 1.1.21	72,000
Discount allowed	8,000
Bad debts	6,000
Stock at branch on 31.12.2021	1,20,000
Credit sales	3,80,000
Goods returned by Branch to HO	12,000

Draw up the necessary ledger accounts like branch debtors, branch stock, goods sent to branch, branch adjustment a/c, and branch expenses.

Answers: Gross profit Rs. 1,31,600, Net profit – 33,600, credit sales – 2,80,800, balancing figure in debtors account: Cash received Rs. 4,32,000

Branch Stock a/c

Details	Amount	Details	Amount
Bal b/d	60,000	Cash sales	1,80,000
Goods sent to branch a/c	6,00,000	Credit Sales –	3,80,000
Sales returns .	6,000	Goods sent to Branch - Returns	12,000
Surplus	26,000	Bal. c/d	48,000

Branch Adjustment A/c

Details	Amount	Details	Amount
Load on closing stock –	24,000	Load on opening stock	12,000
Load on GSTB- R	2,400	Load on GSTB a/c	1,20,000
Load on G.I.T	-	Surplus	26,000
Load on Goods T/F	-		
Load on Abnormal Loss/ Shortage	-		
Normal loss (full)	-		
Gross profit – bal Fig.	1,31,600		

Branch Profit and Loss A/c

Details	Amount	Details	Amount
Branch expenses a/c	84,000	Branch adjustment a/c- Gross Profit	1,31,600
Petty cash : amount spent	-	Insurance claim	-

Discount	8,000		
Bad debts	6,000		
Abnormal loss / shortage at cost	-		
Profit and loss a/c : net profit	33,600		
	1,31,600		1,31,600

Branch Debtors A/c

Details	Amount	Details	Amount
Bal b/d	72,000	Cash from debtors B.F.	4,32,000
Credit sales –	2,80,000	Discount allowed	8,000
		Bad debts	6,000
		Sales returns	6,000
	4,52,000		4,52,000

Section – 3 - List Price / Catalogue Price

3.1 - When goods are sold at Invoice Price and List Price

Mister Ever young of Heart land invoices goods to its branch located at Toyland at 20% less than the list price which is cost plus 100% with the instructions to sell the goods to customers on cash at invoice price and on credit at list price. From the following details prepare –branch stock account, branch adjustment account branch debtor a/c and branch profit and loss a/c.

Stock in the beg	18,000
Debtors in the beg	10,000
Computer in the beg	50,000
Goods received from HO at invoice price	180,000
Cash sales	82,000
credit sales	120,000
Goods in transit as on the last day of the accounting year	10,000
Cash sent to branch for expenses	32,000
Actual expenses at the branch	30,000
Stock at the end	16,000
Bad debts w/off	400
Goods returned directly by the customers to the HO	1,500
Debtors at the end	8,100
Depreciation on computer by 20%	-

Complete solution:

Note- 1

100 / 200 : L.P into C.P

Cost price	Invoice price	List Price
100	(200 less 20% of 200) = 160	100 + 100 = 200
	60 / 160	40 / 200
	3/8	1 / 5
	IP into CP	List price into Invoice Price

Note - 2

Cash sales at	Invoice Price

Credit sales at	List price

Note – 3

Goods directly returned by customers to Head office



Note – 4



Branch Stock A/c

Details	Amount	Details	Amount
Bal b/d	18,000	Cash sales (I.P)	82,000
Goods sent to branch a/c	1,90,000	Credit Sales – L.P	1,20,000
Excess of List Price over Invoice Price 1,20,000 x 1/5	24,000	Goods in transit	10,000
Sales Return (L.P)	1,500	Goods sent to branch- returns (L.P)	1,500
		Shortage : B.F.	4,000
		Bal. c/d	16,000

Branch Adjustment A/c

Details	Amount	Details	Amount
Load on closing stock – 16,000 x 3 / 8	6,000	Load on opening stock 18,000 x 3 / 8	6,750
Load on GSTB- R - 1500 x 1/2	750	Load on GSTB a/c 1,90,000 x 3 / 8	71,250
Load on G.I.T – 10,000 x 3/8	3,750	Excess of List price over invoice price	24,000
Load on Goods T/F	-		
Load on Abnormal Loss	-		
Load on shortage 4,000 x 3 / 8	1,500		
Gross profit – bal Fig.	90,000		

Branch Profit and Loss A/c

Details	Amount	Details	Amount
Branch expenses a/c	30,000	Branch adjustment a/c- Gross Profit	90,000
Depreciation on personal computer	10,000	Insurance claim	-
Discount	-		
Bad debts	400		
Abnormal loss at cost	-		
Shortage of stock ,at cost : 4,000 - 1,500	2,500		
Net profit bal. fig.	47,100		

Branch Debtors A/c

Details	Amount	Details	Amount
Bal b/d	10,000	Cash from debtors	1,20,000
Credit sales	1,20,000	Discount allowed	--

	Bad debts	400
	Sales returns	1,500
	Bal c/d : Bal. Fig.	8,100

3.2 - When goods are sold at I.P and List Price – Past Examinations

R-777 enterprises invoice goods to its branch located at City Magnum at 20% less than the list price (catalogue price) which is cost plus 50% with the instructions to sell the goods to customers on cash at invoice price and on credit at list price and also to allow discount for prompt payments .

From the following details prepare –branch stock account, branch adjustment account branch debtor a/c and branch profit and loss a/c.

Stock in the beg	4,50,000
Debtors in the beg	3,60,000
Branch furniture in the beg	1,20,000
Cash sales	13,60,000
Credit sales	21,50,000
Goods invoiced to Branch	32,10,000
Goods returned by Branch at I.P.	84,000
Expenses Paid by HO : Rent 1,25,000 , Salaries 1,80,000	3,05,000
Stock at the end	5,10,000
Petty expenses paid by branch	11,000
Cash received from branch debtors	18,65,000
Remittances by Branch to HO	32,00,000
Discount allowed to branch debtors	1,85,000
Branch Bad debts	15,800
Goods returned by branch debtors	12,600

It was decided to make a provision for discount of Rs. 42,500 on closing debtors for prompt payment. Depreciate furniture @ 10% per annum.

3.3 - When goods are sold at I.P. and List Price – Past Examinations

G-force with its head office city X invoices goods to its Branch at City Y at 20% less than the catalogue price which is cost plus 50% with instructions that cash sales are to be at Invoice price and credit sales at catalogue price.

Details furnished are:

Stock in the begat branch at its cost	12,000
Goods sent to branch at cost to HO	1,40,000
Goods received by branch till close of the year	1,38,000
Cash sales	46,000
Credit sales	1,00,000
Stock lost by fire at cost	2,500

Calculate the amount of closing stock at branch.

Complete solution:

Note- 1

Cost price	Invoice price	List Price/ Catalogue Price
100	(150 less 20% of 150 = 120	100 + 50 = 150
	L.P into C.P	

Sanjay Welkins Classes	Branch Accounts - Revisionary Material

	20 / 120	30/ 150
	1/6	1 / 5
	IP into CP	List price into Invoice Price

To LP into cost = $50/150 = 1/3$

Note - 2

Cash sales at	Invoice Price
Credit sales at	List price

Branch Stock A/c

Details	Amount	Details	Amount
Bal b/d	12,000	Cash sales (I.P)	46,000
Goods sent to branch a/c 1,40,000 + 1/5 of 1,40,000 GSTB is given at cost it need to be brought up to IP therefore we need rate of profit on cost which would be 20/100	1,68,000	Credit Sales – L.P	1,00,000
Excess of List Price over Invoice Price $1,00,000 \times 1/5$	20,000	Goods in transit 1,68,000 -1,38,000	30,000
		Stock lost by fire 2,500 + 1/5 of 2,500 Stock lost is given at cost it need to be brought up to IP therefore we need rate of profit on cost which would be 20/100	3,000
		Bal. c/d – B.F.	51,000

Section 4 - Whole Sale Branch Accounts

Under this system HO sends goods to branches at invoice price[also known as wholesale price] and branches sell the goods to customers at list price [also known as catalogue price].under this system HO itself also sells the goods to customers –generally at wholesale price however it could also sells the goods at list price. If all the goods sent to the branch are sold out then there is no problem however if some of the goods remain unsold then unrealized profit on the same has to be wiped out in order to find out the true profits.

4.1 - Past Examination

Beta Limited having a Head Office at Mumbai has a branch at Nagpur. The Head office does whole sale trade only at cost plus 80%. The goods are sent to branch at the whole sale price namely, Cost plus 80%. The branch at Nagpur is wholly engaged in retail trade and the goods are sold at cost to HO plus 100%.

Following details are furnished for the year ended 31st March, 2017.

Details	Head office	Branch
Opening stock as on 1.4.2016	225,000	--
Purchases	25,50,000	--
Goods sent to Branch – cost to HO Plus 80%	954,000	--
Sales	27,81,000	950,000
Office expenses	90,000	8,500

Selling expenses	72,000	6,300
Staff salary	65,000	12,000

You are required to prepare Trading and Profit and Loss Account of the Head Office and Branch for. The year ended 31st March, 2017.

Answer – closing stock- 7,00,000, gross profit Rs. 16,60,000, Net Profit Rs. 13,89,000

Closing stock at branch – 99,000, gross profit – Rs. 95,000, Net profit – Rs. 68,200

Solution :

Note- 1

100 / 200 : L.P into C.P		
Cost price	Whole Sale Price / Invoice price	List Price
100	(100 + 80% of 100) = 180	100 + 100 = 200
	80 / 180	20 / 200
	4 / 9	1 / 10

HO Books

HO trading and profit and loss a/c

Op. stock	2,25,000	Goods sent to Branch a/c at WSP	9,54,000
Purchases	25,50,000	Sales at WSP	27,81,000
Gross : Profit (4,24,000 + 12,36,000)	16,60,000	Closing stock#	7,00,000
Expenses	2,27,000	Gross Profit	16.60.000
Unrealised Profit on Part of 'Goods sent to branch' Remaining unsold (Closing stock with branch)*= 99,000* x 4 / 9	44,000		
Net Profit	13,89,000		

Calculation of closing Stock with Head office

Op. stock available			2,25,000
Purchases			25,50,000
Cost of Goods available for sale			27,75,000
Less cost of :			
a)Goods sent to Branch		9,54,000	
	Less : Margin 4 / 9	4,24,000	5,30,000
b)cost of Sales		27,81,000	
	Less : Margin 4 / 9	12,36,000	15,45,000
Closing stock			7,00,000#

Calculation of closing Stock with Branch office

	WSP	List Price / Sales
Goods received by branch	9,54,000	
Sales by branch		9,50,000
WSP of Goods sold by branch	List price : 9,50,000 - 1 / 10 : 95,000 : 8,55,000	
Closing stock	99,000*	

HO Books

HO trading and profit and loss a/c

Op. stock	-	Sales	9,50,000
Goods sent to branch	9,54,000	Closing stock *	99,000
Gross profit	95,000		
Expenses	26,800	Gross profit	95,000
Net profit	68,200		

Section - 5 - Independent Branches

As the name suggests these branches do not depend completely on the HO- rather take independent decisions regarding purchases and sales. These branches keep a full system of accounting and prepare their own trial balance. This trial balance forms the basis for the HO to prepare branch trading and profit and loss a/c and incorporate the same in its books

Incorporation of Branch Trial Balance

With the help of the BO trial balance HO incorporates in its books branch assets liabilities and profit or loss a/c so that a consolidated balance sheet could be prepared which reflects performance of the entire organization.

Following steps are required for such incorporation-

1] Incorporation branch assets

Entry will be-branch asset a/c debit

To, branch a/c

2] Incorporation of branch liabilities

Entry will be-branch a/c debit

To, branch liabilities a/c

3] Incorporation of branch profit

Entry will be –branch a/c debit

To, branch profit and loss a/c

5.1

The HO of a business and its branch keep their own books and each prepares its own P&L a/c. the following are the balances appearing in the two sets of the books as on 31st DEC 2021 after ascertainment of profits and after making all the adjustments except referred to below:

Head office

Branch office

Details	Dr.	Cr.	Dr.	Cr.
Capital	-	100,000	-	-
Fixed assets	36,000	-	16,000	-
Stock	34,200	-	10,740	-
Debtors	7,820	-	4,840	-
Creditors	-	3,960	-	1,920
Cash	10,740	-	1,420	-
Profit and loss a/c	-	14660	-	3,060

BO account	29,860	-	-	-
Head office a/c	-	-	-	28,020

Set out the b/s of the business as on 31st Dec 2021 and the journal entries necessary to record the adjustments dealing with the following

1. On 31st Dec 2021, B.O had sent cheque for Rs 1,000 to the H.O not received by the H.O nor credited by the H.O to the B.O a/c.
2. Goods valued at Rs.840 had been forwarded by the H.O to the branch on 30th Dec 2021 but were not received by the B.O.
3. the profits shown by the B.O is to be T/F to the H.O a/c

Solution :

Reconciliation of balances :

Point No	HO will pass the entry	BO will pass the entry	As per HO books	As per BO books
			BO bal is : DR. 29,860	HO bal. Is Cr. 28,020
1.	Cheque in transit To BO	-	CR 1,000	-
2.	-	G.I.T To HO	-	Cr. 840
Reconciled Balances			Dr. 28,860	Cr. 28,860

Revised Trial Balances and Consolidated Balance sheet

	Revised Trial Balances				Consolidated Balance sheet	
	Head office Trial Balance		Branch office Trial Balance		Liabilities	Assets
	Debit	Credit	Debit	Credit	Amount	Amount
Capital	-	1,00,000	-	-	1,00,000	-
Profit and loss: Revised	-	14,660*	-	3,060	17,720	-
Creditors	-	3,960	-	1,920	5,880	-
Fixed assets	36,000	-	16,000	-	-	52,000
Stock	34,200	-	10,740	-	-	44,940
Debtors	7,820	-	4,840	-	-	12,660
Cash	10,740	-	1,420	-	-	12,160
Cheque in transit	1,000*	-	-	-	-	1,000
Goods in transit	-	-	840*	-	-	840
Branch account : Revised	28,860*	-	-	-	-	-
Head Office account: revised	-	-	-	28,860*	-	-
Total	1,18,620	1,18,620	33,840	33,840	1,23,600	1,23,600

5.2 - Past Examination – 3 Marks

Pass the entries in the Head Office books to record the following transactions:

1. A remittance of Rs. 35,000 made by Branch to HO on 29th March, 2022 and received by HO on 5th April, 2022.
Cash in transit

To Branch a/c

2. Goods of Rs. 63,000 sent by the Head office to Branch on 26th March, 2022 and received by the later on 4th April, 2022.

Goods in transit a/c Dr.

To, Branch a/c

3. Branch paid Rs. 30,000 as salary to a visiting HO official.

Salary a/c

Branch a/c

5.3 - Past Examination – 8 Marks

Pass necessary Journal entries in the books of an independent Branch of a company, wherever required, to rectify or adjust the following:

- 1] Income of Rs. 2,800 allocated to the Branch by HO but not recorded in the Branch books.
- 2] Provision for doubtful debts, whose accounts are kept by the HO, not provided earlier for Rs. 1,000
- 3] Branch paid Rs. 3,000 as salary to a HO Manager, but the amount paid has been debited by Branch Salaries Account.
- 4] Branch incurred travelling expenses of Rs. 5,000 on behalf of other branches, but not recorded in the books of Branch
- 5] A remittance of Rs 150,000 sent by the BO has not been received by the HO on the date of reconciliation.
6. HO allocates Rs. 75,000 to the Branch as Head Office Expenses, which has not yet been recorded by the Branch.
7. HO collected Rs. 30,000 directly from a Branch customer. The intimation of the fact has been received by the Branch only now.
8. Goods dispatched by the HO amounting to Rs. 10,000, but not received by the Branch till date of reconciliation. The goods have been received subsequently.

These Notes are property of Sanjay Welkins

Solution :

Journal of Branch Office

	Debit	Credit	Amount
1	Head office a/c	Income a/c	2,800
2	Provision for doubtful debts a/c	Head Office a/c	1,000
3	Head Office a/c	Salaries a/c	3,000
4	Head Office a/c	Cash a/c	5,000
5.	No Entry		
6.	Expenses a/c	Head Office a/c	75,000
7.	Head Office	Debtors a/c	30,000
8.	Goods in transit a/c	Head Office a/c	10,000

Section – 6 - Foreign Branches

1. Preface:

Branches which are situated outside the home country in which Head office is located, are known as Foreign Branches.

2. Accounting For Foreign Branches

For the purpose of accounting, AS 11 (revised 2003) classifies the foreign branches into two types:

a- **Integral Foreign Operations (IFO)** - the activities of which are an integral part of those of the reporting enterprise.

b. **Non-Integral foreign Operation (NIFO)** - that is the activities of which are not an integral part of the reporting enterprise

Any exchange difference arising on translation of financial Statements of Integral foreign Operations is recognised as **income or expense** in the period in which they arise while in case of non-integral foreign operations such differences are accumulated in **Foreign currency Translation Reserve**.

3. Foreign Currency Translation

As per AS-11 Revised following procedure should be adopted for translation of financial statements of a **Integral Foreign Operation (foreign branch)**-

- Revenue items except depreciation should be converted into reporting currency at **actual rates on the date of transactions** however if actual rates are not available then **average rates should be used**.
- Opening stock should be converted on the basis of **actual rates on the date of Purchase** however if such rates are not available then **opening rate** should be used- likewise in case of **closing stock** actual rates should be used but if same are unavailable then **closing rates should be used**.
- Depreciation should be translated **on the basis of rate used for translating the fixed asset**.
- Monetary items such as Cash, Bank Balance, Debtors, B/R, Prepaid Expenses, Creditors and B/P etc. should be translated on the basis of **closing rate**.
- Non- Monetary items (excluding stocks) like Fixed Asset should be translated using the Actual exchange rate at the date of Purchase.
- Other Revenue items such as purchases, sales, interest, expenses etc., should be translated on the basis of actual exchange rates however if same are unavailable then average rates should be used
- Goods received from HO :are taken at an amount which is recorded in the books of HO
- Balance in HO account in the Books of Branch Books: taken at amounts recorded in HO Books
- Remittances : at Actual Exchange Rate
- Contingent liability: Closing Rate

The net exchange difference arising from the translation of items in the financial statements of a foreign branch should be recognized as income or expense for the period-except to the extent adjusted in the carrying amount of the fixed asset.

It is important to note that unless otherwise stated, it is always reasonable to assume that the Branch is an Integral foreign Operation.

As per AS-11 Revised following procedure should be adopted for translation of financial statements of a **Non-Integral Foreign Operation (foreign branch)**-

- Revenue items except depreciation should be converted into reporting currency at **actual rates on the date of transactions** however if actual rates are not available then **average rates should be used**.

- Opening stock should be converted on the basis of **opening rate** – likewise, in case of **closing stock** actual rates should be used
- Depreciation should be translated **on the basis of closing rates**.
- **Monetary items** such as Cash, Bank Balance, Debtors, B/R, Prepaid Expenses, Creditors and B/P etc. should be translated on the basis of **closing rate**.
- **Non- Monetary items** (excluding stocks) like Fixed Asset should be translated using the **Closing exchange rates**.
- Other Revenue items such as purchases , sales, interest, expenses etc., should be translated on the basis of **actual exchange rates** however if same are unavailable then **average rates** should be used
- Goods received from HO :are taken at an amount which is recorded in the books of HO
- Balance in HO account in the Books of Branch Books: taken at amounts recorded in HO Books
- Remittances : at Actual Exchange Rate
- Contingent liability: Closing Rate

The net exchange difference arising from the translation of items in the financial statements of a Non-Foreign Integral Operation should be accumulated in Foreign Currency Translation Reserve until the disposal of Net Investment.

It is important to note that unless otherwise stated, it is always reasonable to assume that the Branch is an Integral foreign Operation.

Illustrative Question Bank

8.1

W-1 Incorporation, an Indian company has branch at Country X. The trial balance of the branch as at 31.03.2023 is as follows:

	\$	\$
Fixed Assets	51,000	
Opening stock	22,000	
Purchases	95,000	
Sales		1,66,000
Good sent from HO	34,000	
Carriage Inward and other branch expenses	5,000	
Debtors	9,000	
Creditors		7,000
Cash and Bank	3,000	
Head Office a/c		46,000
	2,19,000	2,19,000

- ♦ Head office sent goods to Branch for Rs. 15,00,000
 - ♦ The Head office Books have shown an amount of Rs. 20,00,000 due from Branch
 - ♦ Closing stock is \$ 20,000
 - ♦ On 1.4.2021 when fixed assets were purchased the rate of exchange was Rs. 60 to 1 \$
- Exchange rates –*
- ♦ on 1.4.2022: \$ 1 = Rs. 63

- ♦ On 31.3.2023 - \$ 1 = Rs. 67
- ♦ Average rate = \$ 1= Rs. 65

Required:

Presuming that Branch is an Integral foreign Operation, calculate the exchange difference.

Solution:

	\$	\$	Rate	Rs.	Rs.
Fixed Assets	51,000		60	30,60,000	
Opening stock	22,000		63	13,86,000	
Purchases	95,000		65	61,75,000	
Sales		1,66,000	65		107,90,000
Good sent from HO	34,000		Actual	15,00,000	
Carriage Inward and other branch expenses	5,000		65	3,25,000	
Debtors	9,000		67	6,03,000	
Creditors		7,000	67		4,69,000
Cash and Bank	3,000		67	2,01,000	
Head Office a/c		46,000	Actual		20,00,000
Total	2,19,000	2,19,000		1,32,50,000	1,32,59,000
Exchange difference - Loss				9,000	

8.2

W2-Incorporation, an Indian company has branch in Country X. The trial balance of the branch as at 31.03.2023 is as follows:

	\$	\$
Fixed Assets	51,000	
Opening stock	22,000	
Purchases	95,000	
Sales		1,66,000
Good sent from HO	34,000	
Carriage Inward and other branch expenses	5,000	
Debtors	9,000	
Creditors		7,000
Cash and Bank	3,000	
Head Office a/c		46,000
	2,19,000	2,19,000

- ♦ Head office sent goods to Branch for Rs. 15,00,000
 - ♦ The Head office Books have shown an amount of Rs. 20,00,000 due from Branch
 - ♦ Closing stock is \$ 20,000
 - ♦ On 1.4.2021 when fixed assets were purchased the rate of exchange was Rs. 60 to 1 \$
- Exchange rates –*
- ♦ on 1.4.2022: \$ 1 = Rs. 63
 - ♦ On 31.3.2023: \$ 1 = Rs. 67
 - ♦ Average rate: \$ 1= Rs. 65

Presuming that Branch is a **Non-Integral foreign Operation**, calculate the exchange difference.

	\$	\$	Rate	Rs.	Rs.

Sanjay Welkins Classes	Branch Accounts - Revisionary Material				

Fixed Assets	51,000		67	34,17,000	
Opening stock	22,000		63	13,86,000	
Purchases	95,000		65	61,75,000	
Sales		1,66,000	65		107,90,000
Good sent from HO	34,000		Actual	15,00,000	
Carriage Inward and other branch expenses	5,000		65	3,25,000	
Debtors	9,000		67	6,03,000	
Creditors		7,000	67		4,69,000
Cash and Bank	3,000		67	2,01,000	
Head Office a/c		46,000	Actual		20,00,000
Total	2,19,000	2,19,000		1,36,07,000	1,32,59,000
Exchange difference					3,48,000

Sanjay Welkins' Classes

Chapter 2

Departmental Accounts

1. Departmental Accounting System

A *departmental* accounting system is an accounting information system that records the activities and financial information about the department. Managers can use the financial information from the departmental accounting system to tell how profitable and efficient each department is.

Larger corporations can't be properly accounted for with one single, centralized accounting system. That is why the corporation is divided into many different departments like the shipping and receiving department, sales department, and manufacturing department. Many companies also departmentalize based on products. For instance, Microsoft has a Windows department, Xbox department, and Microsoft Office department.

Each one of these departments has its own accounting system to keep track of revenues and expenses. These accounting systems also provide useful efficiency ratios for management. Managers can use these ratios to evaluate the departments and consider merging departments or getting rid of some departments altogether.

Managers tend to look at whether the department is a cost center or profit center. Some departments that do not produce a profit are still worth keeping around because they share in the interdepartmental expenses like rent and utilities.

In the fast moving world each one of us is confronted with problem of paucity of time. Business world is first one to recognize that. Swiftly growing mall culture is finest evidence of this. Under one roof, variety of products is being offered which helps customer to save his precious time. Now days it has become a common practice among the traders to divide their business premises into several departments in order to cater to the ever growing needs of the consumers efficiently.

At the end of the year financial results are drawn in order to know-which department is earning higher profits or which one is going under losses or which one need expansion or which one is to be closed down. While preparing the final accounts one need to have necessary data with respect to –stock , purchases, sales, expenses etc .Further no problems arises in case of expenses which can be directly charged but some other expenses may have to apportioned according to reliable basis.

Rent and rates should be apportioned on the basis floor area

Repairs to machines on the basis of value of the machines

For apportioning electric lighting light points should be considered

For selling expenses like discount allowed, bad debts , selling commission, carriage on sales etc. sales should be the basis of segregation

Building expenses like rent, repairs etc. should be divided on the basis of space occupied

Labour welfare expenses should be allocated on the basis of no. of employees

Lighting should be divided on the basis of Light points while Insurance of stock average stock should be the basis

Group insurance should be allocated on the basis of direct wages and Power should be on the basis of H.P. or H.P x Hours-likewise Depreciation should be divided on the basis of value of assets-

Further if there are any canteen expenses then no. of employees should be considered yardstick

In order to divide works manager's salary, time spent on each department is considered as proper basis and finally carriage inwards must be charged on the basis of purchases of each department

2. Distinction Between Departmental And Branch Accounts

Under departmental accounts all accounts are maintained at one place but under branch accounts generally accounts are kept at the Head office however in case of independent branches accounts are maintained by the branch.

Further under departmental accounts one doesn't face the problem of geographical separation as departments are located at one place and therefore common expenses can be debited directly to the profit and loss account but branches are geographically separated and one has to face problem allocating even common expenses.

Likewise departments are always situated within the domestic territory but branches may be situated outside the domestic territory

3. Types of Problems

1. Problems concerning with allocation of expenses.
2. Problems relating with computation of departmental purchases.
3. Problems concerning with calculation of managerial commission
4. Problems related with inter departmental transfers at cost price
5. Problems related with inter departmental transfers at a loaded price

Illustrative Studies Bank

Section – 1 – Simple Allocation of Expenses

1.1

Following data have been extracted from the records of Patanjali Products Limited. You are required to prepare departmental Trading and profit and Loss Account for the year ended 2023

Particulars	Department A	Department B	Department C
Purchases ₹	1,50,000	3,00,000	3,00,000
Wages ₹	3,00,000	4,00,000	6,00,000
No. of Employees	30	40	40
Assets Value ₹	5,00,000	4,00,000	3,00,000
No. of Light Points	20	32	8
Area - Square Feet	900	1,200	300
Closing Stock ₹	60,000	90,000	1,40,000
Sales ₹	6,80,000	8,70,000	9,00,000

The expenses for the period were:

Staff welfare Expenses ₹ 22,000

Electricity Expenses ₹ 18,000

Rent and Rates ₹ 14,400

Depreciation ₹ 24,000

Selling Expenses ₹ 12,250

Detailed Solution:

Departmental Trading & Profit and loss a/c (for Year ended on 31.3.23)

	A	B	C		A	B	C
Opening Stock	-	-	-	Sales	6,80,000	8,70,000	9,00,000
Purchases	1,50,000	3,00,000	3,00,000	Closing Stock	60,000	90,000	1,40,000
Wages	3,00,000	4,00,000	6,00,000				
Gross Profit c/d	2,90,000	2,60,000	1,40,000				
	7,40,000	9,60,000	10,40,000		7,40,000	9,60,000	10,40,000

Staff welfare Expenses - 3:4:4	6,000	8,000	8,000	G.P b/d	2,90,000	2,60,000	1,40,000
Electricity : 20:32:8	6,000	9,600	2,400				
Rent & Rates - 3:4:1	5,400	7,200	1,800				
Dep. 5:4:3	10,000	8,000	6,000				
Selling Expenses - 68: 87:90	3,400	4,350	4,500				
Net Profit	2,59,200	2,22,850	1,17,300				
	2,90,000	2,60,000	1,40,000		2,90,000	2,60,000	1,40,000

1.2 – Allocation of Expenses

The trading and profit and loss account of T.V. and D.V.D. Co Ltd. For the half year ended 31st March 2021 is presented to you in the following manner.

Purchases:		Sales	
T.V. [A]	1,40,700	T.V. [A]	1,50,000
D.V.D. [B]	90,600	D.V.D. [B]	1,00,000
Spare parts for servicing [C]	64,400	Receipts from Servicing and repairs [C]	25,000
Salaries and wages	48,000	Stock on 31 st March 2021	
Rent	10,800	T.V. [A]	60,100
Selling expenses	11,000	D.V.D. [B]	20,300
Profit	34,500	Spare parts for servicing [C]	44,600

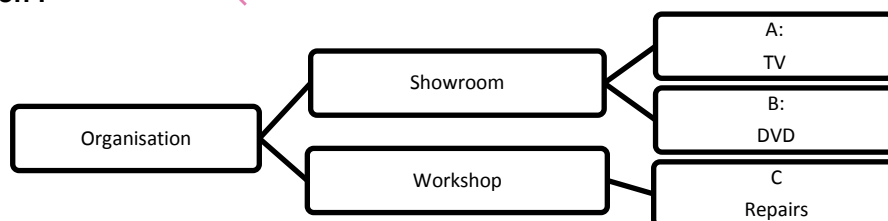
Prepare Departmental Accounts for each of the three Departments A, B and C mentioned above after taking into consideration the following information-

- 1] T.V. and DVD are sold at the showroom; servicing and repairs are carried out at the Workshop.
- 2] Salaries and Wages comprises as follows-
 Showroom $\frac{3}{4}$
 Workshop $\frac{1}{4}$

It was decided to allocate the showroom salaries and wages in the ratio of 1:2 between depts. A and B

- 3] The workshop rent is Rs.500 per month. The rent of the showroom is to be divided equally
- 4] The selling Expenses to be distributed in the ratio of turnover.

Detailed Solution :



Departmental Trading & Profit and loss a/c (for six months ended on 31.3.21)

	A	B	C		A	B	C
Purchases	1,40,700	90,000	64,400	Sales	1,50,000	1,00,000	25,000
Gross Profit c/d	69,400	29,700	5,200	Closing Stock	60,100	20,300	44,600
Salaries and wages	12,000	24,000	12,000	G.P b/d	69,400	29,700	5,200
Rent	3,900	3,900	3,000	Net Loss	-	2,200	10,800
S. Expenses	6,000	4,000	1,000				
Net Profit c/d	47,500	-	-				
	69,400	31,900	16,000		69,400	31,900	16,000

Notes:

				A	B	C
1	Salaries and Wages	48,000	Show Room $\frac{3}{4}$ of 48,000 = 36,000	$36,000 \times \frac{1}{3} = 12,000$	$36,000 \times \frac{2}{3} = 24,000$	
			Work shop $\frac{1}{4} = 12,000$			12,000
2.	Rent	10,800	Workshop 500 x 6 months = 3,000			3,000
			Show room 10,800 - 3,000 = 7,800	$7,800 \times \frac{1}{2} = 3,900$	$7,800 \times \frac{1}{2} = 3,900$	
3.	Sales Expenses	11,000	Sales ratio 6:4:1	6,000	4,000	1,000

1.3 - Examination Problem – 4 Marks - Allocation of expenses

State the basis on which the following expense, the benefit of which is shared by all is shared by all the departments is distributed among the departments among the departments:

- (a) Rent , rates and taxes, insurance of the buildings
- (b) Selling expenses such as discount, bad debts, selling commission and other such selling expenses
- (c) Carriage inward
- (d) Depreciation
- (e) Interest on loan
- (f) Profit or loss on sale of investment
- (g) Wages
- (h) Lighting and heating expenses

Solution:

- (a) Floor area if given otherwise on time basis
- (b) Sales of each department
- (c) Purchase of each department
- (d) Value of assets of each department or time basis
- (e) Utilisation of loan amount In each department if available otherwise in combined profit and loss a/c
- (f) Equal or shown in general profit and loss a/c
- (g) Time devoted to each department
- (h) Consumption of energy by each department

1.4 - Examination Problem – 4 Marks - Allocation of expenses

Give the basis of allocation of the following common expenditure among different departments:

- (i) insurance of the buildings
- (ii) discount and bad debts
- (iii) discount received
- (iv) repairs and maintenance of capital assets
- (v) advertisement expenses
- (vi) labour welfare expenses
- (vii) PF/ ESI contributions
- (viii) Carriage inward

Solution:

- (i) Floor area if given otherwise on time basis
- (ii) Sales of each department
- (iii) Purchase of each department
- (iv) Value of assets of each department or time basis
- (v) Sales of each department

- (vi) Number of employees In each department
- (vii) Wages and Salaries of each Department
- (viii) Purchase of each department

Section – 2 – Interdepartmental Transfers

2.2 - Inter- Departmental Transfers

From the following figures prepare accounts to disclose total profit and the profit of the two departments, X and Y:

	Rs.		Rs.
Opening Stock:		Sales:	
X	15,200	X	1,00,000
Y	10,800	Y	80,000
Purchase:		Purchase Return:	
X	75,100	X	1,100
Y	69,800	Y	800
Carriage inwards	2,860	Discount Received	1,430
Salaries:			
X	9,000		
Y	8,500		
General (salaries)	11,600		
Rent & Rates	6,000		
Advertising	8,100		
Insurance	1,000		
General Expenses	5,400		
Discount Allowed	1,800		
Accountancy Charges	500		

The following further information is supplied:

1. Goods transferred from department X to Y were Rs. 5,000. This has not been recorded.
2. General salaries are to be allocated equally.
3. Allocate carriage inward and discount received on suitable basis.
4. The area occupied is in the ratio of 3:2.
5. Insurance premium is for a comprehensive policy, allocation being inconvenient.
6. The closing stock of the two departments were: X- Rs. 17,800 and Y- Rs. 15,600
7. Allocate Advertising, General Expenses and Discount Allowed in the ratio of Sales.

Solution

Departmental Trading and Profit and loss a/c

	X	Y		X	Y
Opening stock	15,200	10,800	Sales	1,00,000	80,000
Purchases	75,000	69,800	Transfer	5,000	-
Carriage Inwards (on Net Purchases basis 74:69)	1,480	1,380	Closing Stock	17,800	15,600
Transfer	-	5,000			
Gross Profit	32,120	9,420			
Salaries	9,000	8,500	Gross Profit b/d	32,120	9,420
General Expenses 1:1	5,800	5,800	Discount Received - on Net Purchases	740	690

			Basis 74: 69		
Rent and Rates 3:2	3,600	2,400	Net Loss		13,390
Advertising 5:4	4,500	3,600			
General Expenses 5:4	3,000	2,400			
Discount Allowed Sales Ratio 5:4	1,000	800			
Net Profit	5,960	-			

General Profit and Loss A/c

Net Loss b/f	13,390	Net Profit b/f	5,960
Insurance	1,000	Balance c/d (Loss)	8,930
Accounts charges	500		

Section – 3 –
Inter-Departmental Transfers & Unrealised Profits

3.1 - Examination Problem - Interdepartmental Transfer and Concept of URP

Leno Ltd. Manufacturing an electronic component operates with departments X and Y. Transfers are made between the departments of both- purchased and manufactured goods. Goods purchased are transferred at cost and manufacturing goods are transferred only at selling price as is the case with open market.

Transactions for the year ended 30th June 2023 are given below:

DETAILS	DEPTT X	DEPTT Y
Op. stock	20,000	15,000
Sales	190,000	135,000
Wages	12,500	7,500
Purchases	100,000	80,000
Closing stock-		
Purchased goods	2,000	5,000
Manufactured goods	7,000	8,000

The following were the transfers-

- From deptt. X to deptt.-Y- purchased goods Rs.6,000 and Finished goods Rs.20,000.
- From deptt. Y to deptt. X- purchased goods Rs.5,000 and finished goods Rs. 35,000.
- Stocks were valued at cost to the deptt. concerned. Only in closing stock of manufactured goods in the deptt. transferred finished goods are 20 %.

Prepare profit and loss account for the relevant year.

Solution:

Departmental Trading and Profit and loss a/c

	X	Y		X	Y
Opening stock	20,000	15,000	Sales	1,90,000	1,35,000
Purchases	1,00,000	80,000	T/F of Purchased Goods	6,000	15,000
Wages	12,500	7,500	T/F of Finished Goods	20,000	35,000
T/F of Purchased Goods	5,000	6,000	Closing Stock :		
T/F Finished Goods	15,000	20,000	Purchased Goods	2,000	5,000
Gross Profit	52,500	59,500	Finished Goods	7,000	8,000
Expenses	-	-	Gross Profit b/d	52,500	59,500
Net Profit	52,500	59,500			

General Profit and Loss A/c

Unrealised Profit : X	400	Net Profit b/f :	
: Y	490	X	52,500
Bal. c/d	1,11,110	Y	59,500

Calculation of Unrealised Profit :

	X	Y
1. Closing Stock of Finished Goods/ Mfg. Goods	7,000	8,000
2. Inter- Departmental transferred Goods , included in Closing stock @ 20%	1,400	1,600
3. Profit Margin rates : Gross Profit/ Sales + T/F of Fin. Goods	<u>52,500</u>	<u>59,500</u>
	1,90,000+20,000	1,35,000+35,000
4.	25% on sales	35% on sales
Unrealised Profit 2 x 4	490	400

3.2 - Inter Departmental Transfers/ Calculation of URP on Closing As Well As Opening Stock

M/S White & Co. has two departments P (cloth) & Q Ready-made clothes). The Ready - made clothes were made by the firm itself out of clothes supplied by department P at normal selling price. From the following particulars prepare Departmental trading and profit and loss a/c for the year ended 31st Mar. 2023 and also ascertain the net profit.

	P	Q
Opening stock	31,50,000	5,32,000
Purchases	2,10,00,000	1,68,000
Sales	2,31,00,000	47,25,000
Transfer to deptt Q	31,50,000	-
Manufacturing expenses	-	6,30,000
Selling expenses	2,10,000	73,500
Rent and warehousing	8,40,000	5,60,000
Closing stock at cost to the deptt.	21,00,000	6,72,000

In addition to the above, the following information is made available for necessary consideration :

The stock in the department Q may be considered as consisting of 75% of cloth and 25% other expenses. The Department P earned a gross profit at the rate of 15% in 2019-20. General expenses of the business as a whole amount to Rs. 10,85,000.

Examination Problem - 8 Marks

Solution -

Departmental trading and Profit and Loss account

Fig. in '000

	Cloth	Readymade		Cloth	Ready made
Op. Stock	3150	532	Sales	23100	4725
Purchases	21000	168	Closing stock	2100	672
Mfg. Exps	-	630	Transfer	3150	
Transfer	-	3150			
Gross Profit c/d	4200	917			
Selling expenses	210	73.5	Gross Profit	4200	917
Rent and warehousing	840	560			
Net profit	3150	283.5			

General Profit and Loss Account

	Amount		Amount
Stock reserve – closing	80.64	Stock Reserve – op.	59.850
General expenses	1085	Net Profit : cloth	3150
Net profit	2327.71	Readymade	283.5

Calculation of stock reserve:

In Opening stock of Ready-made department

75% of stock is Cloth, that is, portion of Cloth included in Readymade garments (supplied by Cloth Department) = $5,32,000 \times 75\% = 3,99,000$. **Stock Reserve will be $3,99,000 \times 15\% = 59,850$**

Similarly closing stock Department - Readymade contains 75% of Cloth that is $6,72,000 \times 75\% = 5,04,000$

Gross Profit rate of current year of Cloth Department

$$= \frac{42,00,000}{2,31,00,000 + 31,50,000} \times 100 = 16\%$$

$$2,31,00,000 + 31,50,000$$

$$\text{Unrealised Profit on closing stock} = 5,04,000 \times 16\% = 80,640$$

3.3 - Inter Departmental Transfers/ Calculation of URP On Closing As Well As Opening Stock

M/S Red & Co. has two departments P (timber) & Q (furniture). The Furniture was made by the firm itself out of Timber supplied by department P at normal selling price. From the following particulars prepare Departmental trading and profit and loss a/c for the year ended 31st Mar. 2022 and also ascertain the net profit.

	P	Q
Opening stock	3,00,000	50,000
Purchases	20,00,000	15,000
Sales	22,00,000	4,50,000
Transfer to deptt Q	3,00,000	-
Manufacturing expenses	-	60,000
Selling expenses	20,000	6,000
Closing stock at cost to the deptt.	2,00,000	60,000

In addition to the above, the following information is made available for necessary consideration :

The stock in the department Q may be considered as consisting of 75% of Timber and 25% other expenses. The Department P earned a gross profit at the rate of 20% in 2020-21. General expenses of the business as a whole amount to Rs. 1,00,000.

Examination Problem

Solution -

Departmental trading and Profit and Loss account - Amount in Rs.

	P	Q		P	Q
Op. Stock	3,00,000	50,000	Sales	22,00,000	4,50,000
Purchases	20,00,000	15,000	Closing stock	2,00,000	60,000
Mfg. Exps	-	60,000	Transfer	3,00,000	-
Transfer	-	3,00,000			
Gross Profit c/d	4,00,000	85,000			
Selling expenses	20,000	6,000	Gross Profit	4,00,000	85,000
Net profit	3,80,000	79,000			

General Profit and Loss Account

	Amount		Amount
Stock reserve – closing	7,200	Stock Reserve – op.	7,500
General expenses	1,00,000	Net Profit : P	3,80,000

Net profit	3,59,300	Q	7,500

Calculation of stock reserve:

Opening stock of furniture (Q)

75% of stock is timber that is portion of timber included in furniture (supplied by P) = $50,000 \times 75\% = 37,500$.

Stock Reserve will be $37,500 \times 20\% = 7,500$

Similarly closing stock Department Q (furniture) contains 75% of timber (supplied by P) that is $60,000 \times 75\% = 45,000$

Gross Profit rate of current year of P = $\frac{4,00,000}{22,00,000 + 3,00,000} \times 100 = 16\%$

Unrealised Profit on closing stock = $45,000 \times 16\% = 7,200$

Section - 4 – Calculation of Corrected Profits and Manager's commission

4.1-

Department X sells goods to department Y at a profit of 25 % on cost and to deptt Z at 10 % profit on cost. Department Y sells goods to X and Z at a profit of 15 % and 20 % on sales respectively. Department Z charges 20% and 25 % profit on cost to deptt X and Y respectively.

Department managers are entitled to 10% commission on net profit subject to unrealized profit on departmental sales being eliminated. Departmental profits after charging manager's commission but before adjustment of unrealized profit are as under;

Department X Rs. 36,000

Department Y Rs. 27,000

Department Z Rs. 18,000

Stock lying at different deptts at the end of the year is as under:

Deptt	Deptt X	Deptt Y	Deptt Z
t/f from deptt X		15000	11,000
t/f from deptt Y	14,000		12,000
t/f from deptt Z	6,000	5,000	

Find out the correct departmental profits after charging managers commission .

Step a

Analysis

X	Sells	Y at a profit of 25 % on cost	25/125	1/5
		Z at 10 % profit on cost	10/110	1/11
Y	Sells	X at a profit of 15 % on sales	15/100	
		Z at a Profit of 20 % on sales	20/100	
Z	Sells	X at a profit of 20 % on Cost	20/120	1/6
		Z at a Profit of 25 % on Cost	25/125	1/5

b. Net Profit before Commission

	X	Y	Z
Net Profit before commission	40,000	30,000	20,000
Commission 1/9 of NP after Commission*	4,000	3,000	2,000
Net Profit after Managers' Commission: Given	36,000	27,000	18,000

*If NP before commission is 100 then commission is 10 and NP after Commission is 90

So rate of commission on NP after Commission = $10 / 90$ or $1/9$

c. Unrealised Profit on stock lying with departments

	X	Y	Z	Total
T/F from X	-	3,000	1,000	4,000
		(15,000 x 1/5)	11,000 x 1/11	
T/F from Y	2,100	-	2,400	4,500
	14,000 x 15/100		12,000 x 20/100	
T/F	1,000	1,000	-	2,000
	6,000 x 1/6	5,000 x 1/5		

d. Statement showing corrected Profits

	X	Y	Z
Net Profit before commission	40,000	30,000	20,000
Less URP	4,000	4,500	2,000
Net profit after URP	36,000	25,500	18,000
Less: Commission @ 10%	3,600	2,550	1,800
Corrected Profits	32,400	22,950	16,200

4.2- Examination Problem - 8 Marks

- (a) Department X sells goods to department Y at a profit of 25 % on cost and to deptt Z at 20 % profit on cost.
- (b) Department Y sells goods to X and Z at a profit of 15 % and 20 % on Sales respectively.
- (c) Department Z sells goods and charges 20% and 25 % profit on cost to deptt.P and S respectively.
- (d) Department managers are entitled to 10% commission on net profit subject to unrealized profit on departmental sales being eliminated. Departmental profits after charging manager's commission but before adjustment of unrealized profit are as under;

Department X	Rs. 1,80,000
Department Y	Rs. 1,35,000
Department Z	Rs. 90,000

- (e) Stock lying at different deptts. at the end of the year is as under-

Deptt	Deptt X	Deptt Y	Deptt Z
T/F From Deptt X		75,000	57,000
T/F From Deptt Y	70,000		60,000
T/F From Deptt Z	30,000	25,000	

Find out the correct departmental Profits after charging Managerial commission and calculate the unrealised profit of each department.

Answers:

Corrected Profits of Respective Departments: 1,57,950 / 1,14,750 / 81,000

Unrealised profits of respective departments: 24,500 / 22,500 / 10,000

Correct Managerial commission: 17,550 / 12,750 / 9,000

Answer:

Calculation of Correct Departmental Profits After Charging Manager's Commission:

Particulars	Department X	Department Y	Department Z
Profit after charging Managers' Commission	1,80,000	1,35,000	90,000
(+) Manager's commission (1/9)	20,000	15,000	10,000
Profit before commission & unrealised profit	2,00,000	1,50,000	1,00,000
(-) Unrealised profit on stock - WN	(24,500)	(22,500)	(10,000)
Profit before Managers' commission	1,75,500	1,27,500	90,000
(-) Commission of Managers' @ 10%	(17,550)	(12,750)	(9,000)
Correct Departmental Profit	1,57,950	1,14,750	81,000

*** Working Note:**

1. Calculation for unrealised profit on stock.

Particulars	Department X(Rs.)	Department Y(Rs.)	Department Z(Rs.)	Total
Unrealised profit of Department – X	—	1/5 of 75,000 = 15,000	1/6 of 57,000 = 9,500	24,500
Unrealised profit of Department – Y	15% of 70,000 = 10,500	—	20% of 60,000 = 12,000	22,500
Unrealised profit of Department – Z	1/6 of 30,000 = 5,000	1/5 Of 25,000 = 5,000	—	10,000

Section - 5 – Uniform Gross Profit Rate

5.1 - Examination Problem – 5 Marks

Metro Mall has three Departments and submits the following information for the year ending on 31.03.2025.

Purchases Units

Particulars	A	B	C	Total Rs.
Purchases (units)	5,000	10,000	15,000	-
Purchases (Rs.)				8,40,000
Sales (units)	5,200	9,800	15,300	-
Selling Price Rs. Per unit	40	45	50	
Closing stock Units	400	600	700	

You are required to prepare departmental trading account of Metro Mall assuming that the rate of gross profit on sales is uniform in each case.

Answer :

Departmental Trading Account for the year ended 31st March, 2011

Particulars	A (Rs.)	B (Rs.)	C (Rs.)	Particulars	A (Rs.)	B (Rs.)	C (Rs.)
To Opening Stock(W.N. 4)	14,400	10,800		By Sales	2,08,000	4,41,000	7,65,000
To Purchases (W.N. 2)	1,120,000	2,70,000	30,000	By Closing stock (W.N.4)	9,600	16,200	21,000
			4,50,000				
Gross profit	83,200	1,76,400	3,06,000				
	2,17,600	4,57,200	7,86,000		2,17,600	4,57,200	7,86,000

Working Notes:

(1) Profit Margin Ratio

Selling price of units purchased:	Rs.
Department A (5,000 units x 7 40)	2,00,000
Department B (10,000 units x 7 45)	4,50,000
Department C (15,000 units x 7 50)	7,50,000

Total selling price of purchased units	14,00,000
Less: Purchases	(8,40,000)
Gross profit	5,60,000

$$\text{Profit Margin ratio} = \frac{\text{Gross Profit}}{\text{Selling Price}} \times 100 = \frac{5,60,000}{14,00,000} \times 100 = 40\%$$

(2) Statement showing department-wise per unit cost and purchase cost

Particulars	A	B	C
Selling price per unit (Rs.)	40	45	50
Less: Profit margin @ 40% (Rs.)	(16)	(18)	(20)
Purchase price per unit (Rs.) No. of units purchased	24	27	30
Units Purchased	5,000	10,000	15,000
Purchases (Purchase cost per unit x units purchased)	1,20,000	2,70,000	4,50,000

(3) Statement showing calculation of department-wise Opening Stock (in units)

Particulars	A	B	C
Sales (Units)	5,200	9,800	15,300
Add: Closing Stock (Units)	400	600	700
	5,600	10,400	16,000
Less: Purchases (Units) Opening Stock (Units)	(5,000)	(10,000)	(15,000)
	600	400	1000

(4) Statement showing department-wise cost of Opening and Closing Stock

Particulars	A	B	C
Cost of Opening Stock (Rs.)	600 x 24	400 x 27	1,000 x 30
Cost of Closing Stock (Rs.)	14,400	10,800	30,000
	400 x 24	600 x 27	700 x 30
	9,600	16,200	21,000

5.2 – Examination Problem – Modified

Platinum Stores has three Departments and submits the following information for the year ending on 31.03.2021.

Purchases Units

Particulars	P	Q	R	Total Rs.
Purchases (units)	1,500	3,000	3,600	6,00,000
Sales (units)	1,500 @ Rs. 160	2,880 @ 180	3,744 @ 200	-
Closing Stocks in Units	150	240	9	

You are required to prepare departmental trading account assuming that the rate of gross profit on sales is uniform in each case.

Detailed Hints:

1	Gross profit Ratio	Sale Value of Purchased Units 1,500 x 180 + 3,000 x 180 + 3,600 x 200	Total Rs. 15,00,000
		Less : Purchase Cost	6,00,000
		Gross Profit	9,00,000
	GP Ratio	9,00,000 / 15,00,000 x 100 = 60%	
2.	Cost Per Unit	P = 160 – 60% = 64	
		Q = 240 – 60% = 72	
		R = 200 – 60% = 80	
3.	Calculation of Opening Stock = Sales + Closing stock - Purchases	P = 1530 + 150 – 1500 = 180 Q = 2,880 + 240 – 3,000 = 120 R = 3,744 + 9 – 3,600 = 153	

4.	Gross Profit	P 1,48,880	
		Q 2,11,040	
		R 4,49,280	

Sanjay Welkins' Classes

Chapter - 3

Hire Purchase and Instalment Sale Transactions

1. Preface to Hire Purchase System

Means an agreement under which goods are lent on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which-

- Possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical installments.
- The property in such goods to pass on the payment of last installment
- Such person has a right to terminate the contract or agreement at any time before the property so passes
- Hire purchase means the total sum payable by the hirer under hire purchase agreement including any depositor initial payment. But it does not include any sums payable as penalty as compensation or as damages for a breach of the contract.

2. Hire Purchase Agreement

Such agreement should be in writing and state the following

1. The hire purchase of the goods
2. The cash price of the goods
3. The date on which agreement was entered into
4. Number of installments and the amount of each installment and also the dates on which such installments are payable and the person to whom and the place where it is payable
5. Description of the goods.

3. Hire Purchase Charges

It refers to the difference of hire purchase price and cash price .As a rule such charges should not exceed 30% of cash price installment.

4. Termination of hire purchase agreement

The hirer can terminate the agreement at any time provided he gives 14 days notice to the owner. In this Case he shall have to re-deliver the goods.

5. Rights Of The Hirer

If the owner of the goods seizes the goods on the termination of the agreement in that case he shall have to refund to the hirer the amount by which the amounts paid by the hirer plus the value of the goods on the date of seizure exceed the hire purchase price. Such refund has to be made within 30 days from the date on which notice is served by the hirer, but if that is not done then interest at 12% per annum has to be paid on the amount from the date of expiry of thirty days.

6. Permission of Court to Repossess The Goods By The Owner

The owner is allowed to repossess the goods only if he makes an application to the appropriate.

7. Rights Of The Owner On Termination

On the termination of the agreement the owner will have the right to retain the hire which has already been paid and to recover the arrears of the hire dues. He will also have to repossess the goods.

8. Difference Between Hire Purchase Sale And Instalment Sale

Under this system time of passing property is stipulated which is generally on the payment of last instalment however under instalment sale ownership is passes as soon as the transaction is completed.

Under hire purchase sale the seller has the right to repossess the goods on account of default made by the purchaser where as under instalment sale the seller can only sue the purchaser. Further under hire purchase sale the buyer has the choice to return the goods and terminate the agreement on the other hand under instalment system there is no such right. Also, under hire purchase sale the buyer cannot sell the goods that is, his position is like a bailee however under instalment sale buyer can sell the goods as per his will and desire.

9. Features Of Hire Purchase Agreement

1. Possession : The hire vendor transfers only possession of the goods to the hire purchaser immediately after the contract for hire purchase is made.
2. Installments : The goods are delivered by the hire vendor on the condition that a hire purchaser should pay the amount in periodical instalments.
3. Down Payment : The hire purchaser generally makes a down payment, i.e., an amount on signing the agreement.
4. Constituents of Hire purchase instalments : Each instalment consists of two elements- finance charge (interest on unpaid amount) and capital payment.
5. Ownership : The property in goods is to pass to the hire purchaser on the payment of the last instalment and exercising the option conferred upon him under the agreement.
6. Repossession : In case of default in respect of payment of even the last instalment, the hire vendor has the right to take the goods back without making any compensation.

10. Terms Used In Hire Purchase Agreements**1. Hire Vendor :**

Hire vendor is a person who delivers the goods along with its possession to the hire purchaser under a hire purchase agreement.

2. Hire Purchaser :

Hire purchaser is a person who obtains the goods and rights to use the same from hire vendor under a hire purchase agreement.

3. Cash Price :

Cash price is the amount to be paid by the buyer on outright purchase in cash.

4. Down Payment :

Down payment is the initial payment made to the hire vendor by the hire purchaser at the time of entering into a hire purchase agreement.

5. Hire Purchase Instalment :

Hire purchase instalment is the amount which the hire purchaser has to pay after a regular interval upto certain period as specified in the agreement to obtain the ownership of the asset purchased (on payment of the last installment) under a hire purchase agreement. It comprises of principal amount and the interest on the unpaid amount.

6. Hire purchase price :

It means the total sum payable by the hire purchaser to obtain the ownership of the asset purchased under hire purchase agreement. It comprises of cash price and interest on outstanding balances.

11. Accounting Treatment in the Books of Hire Purchaser

The following methods are followed:

- (1) Cash Price Method
- (2) Interest Suspense Method

11.2: Journal Entries In The Books of The Buyer/Purchaser

A. Cash Price Method:

Particulars	Debit (Rs.)		Credit (Rs.)
1.	Hire Purchase A/c Dr. To, Hire Vendor A/c [Cash price]	xxxx	xxxx
2.	Hire Vendor A/c Dr. To, Bank A/c [Down payment]	xxxx	xxxx
3.	Interest A/c Dr. To, Hire Vendor A/c	xxxx	xxxx
4.	Hire Vendor A/c Dr. To, Bank A/c [Instalment amount]	xxxx	xxxx
5.	P/L A/c Dr. To, Interest A/c To, Depreciation A/c	xxxx	xxxx

B. Interest Suspense Method:

Particulars	Debit (Rs.)		Credit (Rs.)
1.	Hire Purchase Asset A/c [Cash Price] Dr. Interest Suspense A/c [Total Interest] Dr. To, Hire Vendor A/c [H.P price]	xxxx xxxx	xxxx
2.	Hire Vendor A/c Dr. To, Bank A/c [Down payment]	xxxx	xxxx
3.	Interest A/c Dr. To, Interest Suspense A/c	xxxx	xxxx
4.	Hire Vendor A/c Dr. To, Bank A/c [Instalment amount]	xxxx	xxxx
5.	P/L A/c Dr. To, Interest A/c To, Depreciation A/c	xxxx	xxxx

11.2 Accounting treatment in the Books of Vendor

Date	Particulars	Amount	Amount
	Hire Purchaser A/c. Dr. To Asset A/c. Sale of asset on hire purchase		
	Bank A/c. Dr. To Hire Purchaser A/c Receipt of down payment		
	Hire Purchaser A/c. Dr. To Interest A/c. Interest Due		
	Bank A/c. Dr. To Hire Purchaser A/c. Receipt of Instalment		
	Interest A/c. Dr. To P/L A/c. Interest credited to P/L		

11.3

Disclosure In The Balance Sheet	

Assets	
Fixed Assets:	
Asset (at cash price)	
Less: Depreciation	
Liabilities	
Hire Purchase Creditors:	
Balance in hire vendor's A/c	
interest accrued not yet due	

12. Repossession

1. In a hire purchase agreement, the hire purchaser has to pay up to the last instalment to obtain the ownership of goods.
2. If the hire purchaser fails to pay any of the instalments, the hire vendor takes the asset back in its actual form without any refund of the earlier payments to the hire purchaser.
3. The amounts received from the hire purchaser through down payment and instalments are treated as the hire charges by the hire vendor.
4. This act of recovery of possession of the asset is termed as repossession.
5. Repossessed assets are resold to any other customer after repairing or reconditioning (if necessary). 6. Repossessions are then accounted for in a separate "Goods Repossessed Account".
7. So far as the repossession of assets are concerned, the hire vendor can take back the whole of the asset or a part thereof depending on the agreement between the parties.
8. The former is called "Complete Repossession" and the latter is called "Partial Repossession".

13. Complete or Full Repossession

The hire vendor closes Hire Purchaser's Account by transferring balance of Hire Purchaser Account to Goods Repossessed Account.

The hire purchaser closes the Hire Vendor's Account by transferring the balance of Hire Vendor Account to Hire Purchase Asset and then finding the profit and loss on repossession in Asset Account.

After repossession, the vendor may incur expenses on repossessed stock and may sell the same in due course of time.

Particulars	Books of hire purchaser		Books of hire vendor	
Purchase/Sales	Asset A/c	...Dr.	Hire Purchaser A/c	.Dr.
	To Hire Vendor A/c		To Sales A/c	
Installment	Hire Vendor A/c	...Dr.	Cash A/c	.Dr.
	To Cash A/c		To Hire Purchaser A/c	
Interest	Interest A/c	.Dr.	Hire Purchaser A/c	.Dr.
	To Hire Vendor		To Interest A/c	
Repossession	Hire Vendor A/c	.Dr.	Goods Repossessed A/c	...Dr.
	To Asset A/c		To Hire Purchaser	

14. Partial Repossession

1. In case of a partial repossession, only a part of the asset is taken back by the hire vendor and other part is left with the hire purchaser. The Journal Entries are as usual up to the date of default (excepting entry for payment) in the books of both the parties.
2. As a portion of the asset is still left with the hire purchaser, neither party closes the account of the other in their respective books.
3. Assets are repossessed at a mutually agreed value (based on agreed rate of depreciation which is an enhanced rate).

4. The hire vendor debits the Goods Repossessed Account and credit the Hire Purchaser Account with the value as agreed upon on the repossession.
5. Similarly, the hire purchaser debits the Hire Vendor Account and credits the Assets Account with the same amount.
6. If the repossessed value is less than the book value of the asset which is repossessed, the difference is charged to the Profit and Loss Account of the hire purchaser as 'loss on surrender'.
7. For the remaining portion of the asset lying with the hire purchaser, the (Hire Purchaser) applies the usual rate of depreciation and shows the Asset Account at its usual written- down value.

15. Instalment Payment System

In instalment payment system, the ownership of the goods is passed immediately to the buyer on the signing the agreement.

The accounting entries under instalment payment system are similar to those passed under the hire-purchase system.

15.1 Books of buyer :

1. Buyer debits asset account with full cash price, credits vendor's account with full instalment price and
2. debits interest suspense account with the difference between full cash price and full instalment price. Interest is debited to interest suspense account (not interest account) because it includes interest in respect of a number of years.
3. Every year interest account is debited and interest suspense account is credited with the interest of current year.
4. Interest account, at the end of the year, is closed by transferring to profit and loss account.
5. The balance of vendor account should be shown in the balance sheet after deducting amount in interest suspense account .
6. Vendor is paid the instalment due to him and entry for the depreciation is passed in the usual way.

15.2 Books of Seller :

1. The seller debits the purchaser with the full amount (instalment price) payable by him and credits sales account by the full cash price and credits interest suspense account by the difference between the total instalment price and total cash price.
2. Seller, like the buyer, also transfers the amount of interest due from the interest suspense account interest account every year.
3. Interest account is closed by transferring to profit and loss account and the purchaser account should be shown in the balance sheet after deducting amount in interest suspense account.
4. On receiving the instalment the vendor debits cash/bank account and credits purchaser's account.

16. Analysis of The Hire Purchase Price :

The hire purchase price is always greater than the cash price, since it includes interest payable over and above the price of the goods to compensate the seller for the sacrifice he has made by agreeing to receive the price by instalments and the risk that he thereby undertakes. It is thus made up of following elements:

- (a) cash price;
- (b) interest on unpaid instalments; and
- (c) a charge to cover the risk involved in the buyer de-faulting to pay one or more of instalments of price or that of his returning the goods in a damaged condition.

Illustrative Case Studies

Section – 1 - Calculation of Interest

1.1

X purchased a Truck on hire purchase system. The total cash price of the truck is Rs. 31,960, payable Rs. 8,000 down and three installments of Rs. 12,000, Rs. 10,000 and Rs. 4,000 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 X.

[Ans. I- Rs. 1,198, II- Rs. 658, III- Rs. 184]

Calculation of Interest

Details	Cash price	Gross Instalment	Interest	Cash price portion
	31,960			
Down payment	8,000	8,000	-	8,000
Balance	23,960			
1st Instalment on 31.12.2020	10,802	12,000	1,198	10,802
Balance	13,158			
2 nd Instalment on 31.12.2021	9,352	10,000	658	9,342
Balance	3,816			
3 rd Instalment 31.12.2022	3,816	4,000	184*	3,816
		34,000	2,040	31,960

1.2

H-888 Ltd. purchased a machine on hire purchase basis from Quality Machinery Co. Ltd. on the following terms:

- Cash price Rs. 80,000
- Down payment at the time of signing the agreement on 1.1.2019 Rs. 21,622.
- 5 annual instalments of Rs. 15,400, the first to commence at the end of twelve months from the date of down payment.
- Rate of interest is 10% p.a.

You are required to calculate the total interest and interest included in cash instalment.

Solution:

Calculation of interest

	Total (Rs.)	Interest in each instalment (1)	Cash price in each instalment (2)
Cash Price	80,000		
Less : Down Payment	(21,622)	Nil	Rs. 21,622
Balance due after down payment	58,378		
Interest/Cash Price of 1st instalment	-	Rs. 58,378 x 10/100	Rs. 15,400 - Rs. 5,838
		= Rs. 5,838	= Rs. 9,562
Less : Cash price of 1st instalment	(9,562)		
Balance due after 1st instalment	48,816		
Interest/cash price of 2nd instalment	-	Rs. 48,816 x	Rs. 15,400 - Rs. 4,882
		10/100	= Rs. 10,518

		= Rs. 4,882	
Less: Cash price of 2nd instalment	(10,518)		
Balance due after 2nd instalment	38,298		
Interest/Cash price of 3rd instalment	-	Rs. 38,298x10/100	Rs. 15,400 - Rs. 3,830
		= Rs. 3,830	= Rs. 11,570
Less: Cash price of 3rd instalment	(11,570)		
Balance due after 3rd instalment	26,728		
Interest/Cash price of 4th instalment	-	Rs. 26,728 x10/100	Rs. 15,400 - Rs. 2,672
		= Rs. 2,672	= Rs. 12,728
Less : Cash price of 4th instalment	(12,728)		
Balance due after 4th instalment	14,000		
Interest/Cash price of 5th instalment	-	Rs.14,000 x10/100	Rs. 15400 - Rs. 1,400
		=Rs. 1,400	= 14,000
Less : Cash price of 5th instalment	(14,000)		
Total	Nil	Rs. 18,622	Rs. 80,000

Total interest can also be calculated as follow:

(Down payment + instalments) - Cash Price

= Rs. [21,622+(15400 x 5)] - Rs. 80,000 = Rs. 18,622

1.3

– Pure Instalment i.e. Instalment is Not Inclusive of Interest

On first January, 2018 Mister five purchased a machine from Mister seven on hire purchase system. The particulars are as follows

- cash price 20,000
- 8,000 to be paid down at the time of signing of the contract
- balance in three annual instalments of 4,000 rupees each plus interest
- interest charges on outstanding balance at 5%

Depreciation at 10% on SLM basis.

Calculate interest.

Calculation of Interest

	Cash price	Gross Instalment	Interest	Cash price portion
	20,000			
Down payment	8,000	8,000	-	8,000
Balance	12,000			
1st instalment on 31.12.2018	4,000	4,600	600	4,000
Balance	8,000			
2 nd Instalment on 31.12.2019	4,000	4,400	400	4,000
Balance	4,000			
3 rd Instalment	4,000	4,200	200	4,000

1.4

Rate of Interest is not given

H-999 Ltd. acquired a delivery van on hire purchase on 01.04.2019 from C-1 Enterprises. The terms were as follows :

Particulars	Amount (Rs.)

Hire Purchase Price	180,000
Down Payment	30,000
1st installment payable after 1 year	50,000
2nd installment after 2 years	50,000
3rd installment after 3 years	30,000
4th installment after 4 years	20,000

Cash price of van Rs. 1,50,000 You are required to calculate Total Interest and Interest included in each instalment.

Solution:

1. Calculation of total Interest and Interest included in each installment

$$\begin{aligned} \text{Hire Purchase Price (HPP)} &= \text{Down Payment} + \text{instalments} \\ &= 30,000 + 50,000 + 50,000 + 30,000 + 20,000 = 1,80,000 \end{aligned}$$

2. Total Interest = 1,80,000 - 1,50,000 = 30,000

3. Step.

Calculation of outstanding balances –

Total Hire Purchase price	1,80,000
Less Down Pay.	30,000
1 st o/s balance	1,50,000
First instalment	50,000
2 nd o/s balance	1,00,000
Second instalment	50,000
3 rd outstanding balance	50,000
Third and final instalment	30,000
4 th Balance outstanding	20,000
4th and final instalment	20,000

4th step : Interest allocation

Balance outstanding	Amount	Ratio	Interest allocation
1	1,50,000	15	14,062
2	1,00,000	10	9,375
3	50,000	5	4,687
4	20,000	2	1,876
		32	30,000

Case – When Cash Price Is Not Given

1.5

Martin super taxi services purchased three taxis on first Jan of the current year from the Suzuki services on HPS. It was agreed to make the payments as follows:

1. 1. 18 signing amount]	10,350
31.12.18 1st Instalment	19,965
31.12. 19 2nd Instalment	19,965
31.12 .20 3rd Instalment	19,965

Interest was reckoned at the rate of 10% per annum. Depreciation was charged at the rate of 20% on diminishing balance method.

Prepare relevant accounts in the books of the purchasers.

Solution:

In this question cash price is not given therefore rate of interest which is always on cash price shall have to be converted on instalment price

Cash price 100

Then interest @ 10% Rs. 10

Therefore instalment shall be 110

Or rate of instalment on HPP or on Instalment is 10/110

Instalment Number in reverse order	Amount of instalment	Amount due at the time of instalment x Interest 10/110	Cash price portion
3 i.e. last instalment	19,965	$19,965 \times 10 / 110$ 1815	18,150
2 nd i.e. last but one instalment	19,965	$(19,965 + 18,150) \times 10 / 110$ =3465	16,500
1 st instalment	19,965	$(19,965 + 16,500 + 18,150) \times 10 / 110$ = 4965	15,000
0 instalment i.e. down pay.	10,350	----- nil-----	10,350
Therefore total cash price			60,000

1.6

Top limited purchased machinery on HPS from bottom limited. The terms are that Top limited shall pay 20,000 rupees as down payment and four annual instalments of 11,000 rupees each commencing from the beginning of the next year. Top limited charged depreciation at the rate of 10% per annum while rate of interest was 10% on cost as per diminishing balance method.

Show interest calculation and ledger accounts in the books of top limited.

[Cash price 54869; interest on first install-3487 second-2735 third install-1909 and fourth-1000]

Section – 2 – Full Repossession

2.1

F1 Purchased a machine from F2 for Rs. 5,60,000 payment to be made Rs. 1,50,000 down and three Instalments of Rs. 1,50,000 each at the end of each year. F1 Depreciates asset at 10% per annum on written down value method. Because of financial constraints, F1 having paid down payment and first instalment at the end of the first year, could not pay second instalment and the seller took possession of the asset.

Prepare Machine account and vendor's account in the books of F1. Also give purchasers' account in the books of F2.

Detailed Solution:

Total Interest = HPP - Cash Price = 6,00,000 - 5,60,000 = 40,000

Rs.

	Outstanding amount	Ratio of Outstanding amount	Interest 40,000 in the ratio of 3:2:1
Total Hire Purchase Price	6,00,000		
Less: Down Payment	1,50,000		
Outstanding amount - 1	4,50,000	3	20,000
Less: First Instalment	1,50,000		
Outstanding amount - 2	3,00,000	2	13,333
Less: Second Instalment	1,50,000		
Outstanding amount - 3	1,50,000	1	6,667
Less: Third Instalment	1,50,000		
	-	6	40,000

Ledger Accounts
In the books of F1 -
Hire Vendor - F2 A/c

Sanjay Welkins Classes	Hire Purchase Transactions - Revisionary Material

Date	Details	Amount	Date	Details	Amount
1 Yr. Beg	To Cash – down payment	1,50,000	1st Yr. beg.	Machine a/c	5,60,000
1 Yr. end	To Cash – 1st Instal.	1,50,000	1st Yr. end	Interest	20,000
	Bal c/d	2,80,000			
		5,80,000			5,80,000
2 Yr. beg	To Cash - 2nd Inst.	-	2nd Yr. Beg.	Bal b/d	2,80,000
	To Machine (repossession)- B.F.	2,93,333	2nd yr. end	Interest	13,333
		2,93,333			2,93,333

Machine Account

Date	Details	Rs.	Date	Details	Rs.
Yr. 1 Beg.	F2 - Hire vendor a/c	5,60,000	Yr. 1 end	Depreciation	56,000
				Balance c/d - B.F	5,04,000
Yr. 2 Beg.	Balance b/d	5,04,000	Yr. 2 end	Depreciation	50,400
				F2 - Hire vendor	2,93,333
				Profit and loss a/c - B.F.	1,60,267

In the books of F2 (Hire Vendor)

Hire Purchaser - F1's a/c

Date	Details	Rs.	Date	Details	Rs.
Yr. 1 Beg.	Hire Sales a/c	5,60,000	Yr. 1 Beg.	Bank - D. Payment	1,50,000
End	Interest	20,000	End	Bank - 1st Inst.	1,50,000
				Bal. c/d - b.f.	2,80,000
Yr. 2 Beg.	Balance b/d	2,80,000	Yr. 2 end	Bank - 2nd Inst.	-
End	Interest	13,333		Goods repossessed	2,93,333

2.2

Wilson brothers purchased a truck from Tata Motors limited for Rs. 11,20,000 - payment to be made Rs. 3,00,000 down payment and three Instalments of Rs. 3,00,000 at the end of each year. Rate of Interest is charged at 5% p.a. The buyer depreciates the truck at 10% p.a. on written down value method. On account of severe financial crunch, the purchaser, having paid the down payment and the first instalment at the end of first year, could not pay the second instalment and as a result Tata motors took possession of the truck.

The vendor, after spending Rs. 25,000 on repairs sold it for Rs. 9,00,000.

Prepare necessary accounts in the books of both the parties.

Detailed Solution:

Calculation of Interest:

	Cash Price	Gross Instalment	Interest	Cash price Portion
	11,20,000			
Year 1 - Beg. Down Payment	3,00,000	3,00,000	-	3,00,000
Balance	8,20,000			
Year 1 - end - 1st Instalment	2,59,000	3,00,000	41,000	2,59,000
Balance	5,61,000			
Year 2 -end - 2nd instalment - default	3,28,050	3,00,000	28,050	3,28,050

In the books of Wilson Brothers (Hire Purchaser)

Hire Vendor - Tata Motors limited a/c

Date	Details	Rs.	Date	Details	Rs.
Yr. 1 Beg.	Bank a/c: D. payment	3,00,000	Yr. 1 Beg.	Truck a/c	11,20,000
End	Bank a/c - 1st Inst.	3,00,000	End	Interest	41,000
	Balance c/d - b.f.	5,61,000			
		11,61,000			11,61,000
Yr. 2 End	Bank - 2nd Inst.	-	Yr. 2 Beg.	Bal. b/d	5,61,000
End	Truck - repossession	5,89,050	End	Interest	28,050
		5,89,050			5,89,050

Machine Account

Date	Details	Rs.	Date	Details	Rs.
Yr. 1 Beg.	Hire vendor a/c	11,20,000	Yr. 1 end	Depreciation	1,12,000
				Balance c/d - B.F	10,08,000
Yr. 2 Beg.	Balance b/d	10,08,000	Yr. 2 end	Depreciation	1,00,800
				Hire vendor	5,89,050
				Profit and loss a/c - B.F.	3,18,150

In the books of Tata Motors (Hire Vendor)

Hire Purchaser - Wilson Brothers a/c

Date	Details	Rs.	Date	Details	Rs.
Yr. 1 Beg.	Hire Sales a/c	11,20,000	Yr. 1 Beg.	Bank - D. Payment	3,00,000
End	Interest	41,000	End	Bank - 1st Inst.	3,00,000
				Bal. c/d - b.f.	5,61,000
Yr. 2 Beg.	Balance b/d	5,61,000	Yr. 2 end	Bank - 2nd Inst.	-
End	Interest	28,050		Goods repossessed	5,89,050

Goods Repossessed a/c

Date	Details	Rs.	Date	Details	Rs.
Yr. 1 Beg.	Hire Purchaser a/c	5,89,050	Yr. 1 Beg.	Bank - Sale	9,00,000
End	Bank - repairs	25,000			
		2,85,950			

Section – 3- Partial Repossession

3.1– Past Examination Question

X transport company purchased from Delhi Motors 3 tempos costing 50,000 each on HPS on 1.1.2019. Payment was to be made Rs 30,000 down and remainder in three instalments –payable on 31.12.201, 31.12.2020 and 31.12 2021 **together with 9%.**

X company writes off depreciation at the rate of 20%on diminishing value method.

It paid the amount due on 31.12.2019 but could not pay the next one –consequently Delhi Motors agreed to leave one tempo with the purchaser and repossessed the other two tempos on the basis of 30% depreciation annually.

Show the necessary accounts in the books of purchaser.

Answer: Loss on repossession Rs. 15,000

1 . Calculation of interest

Details	Cash price	Gross instalment	Interest	Cash price portion
	1,50,000			
Down payment on 1.1.19	30,000	30,000	-	30,000
	1,20,000			

Sanjay Welkins Classes	Hire Purchase Transactions - Revisionary Material

1 st instalment on 31.12.19	40,000 ⁴	50,800 ²	10,800 ¹	40,000 ³
	80,000			
2 nd instalment on : default 31.12.20	40,000	47,200	7,200	40,000
	40,000			
3 rd instalment on 31.12.21	40,000	43,600	3,600	40,000

2. Value of goods repossessed from point of view of :

Vendor		Buyer
Cash price 2 x 50,000	1,00,000	1,00,000
Depreciation	30,000	20,000
	70,000	80,000
Depreciation	21,000	16,000
	49,000	64,000
	Loss = 15,000	

3. Value of machine still with the buyer / machine retained

Particulars	Amount
1 x 150,000	1,50,000
Depreciation	30,000
	1,20,000
Depreciation	24,000
	96,000

3.2 – Past Examination Question

Shivkumar bought 2 cars from 'Fair Value Motors Pvt. Ltd. on 1-4-2022 on the following terms:

Down payment	6,00,000
1st Installment at the end of first year	4,20,000
2nd Installment at the end of 2nd year	4,90,000
3rd Installment at the end of 3rd year	5,50,000

Interest is charged at 10% p.a.

Shivkumar provides depreciation @ 25% on the diminishing balances.

On 31-3-25 Shivkumar failed to pay the 3rd installment upon which 'Fair Value Motors Pvt. Ltd. repossessed 1 car. Shivkumar agreed to leave one car with Fair Value Motors Pvt. Ltd. and adjusted the value of the car against the amount due. The car taken over was valued on the basis of 40% depreciation annually on written down basis. The balance amount remaining in the vendor's account after the above adjustment was paid by Shivkumar after 3 months with interest @ 20% p.a.

You are required to:

- Calculate the cash price of the cars and the interest paid with each installment.
- Prepare Car Account and Fair Value Motors Pvt. Ltd. Account in the books of Shivkumar assuming books are dosed on March 31, every year. Figures may be rounded off to the nearest rupee.

Answer:

Rate of Interest is 10% per annum

It means if Cash Price is 100 then Interest is Rs. 10

	Cash price	Interest	HP Instalment
	100	10	110
Rates	10/100		10/110

Install. No.	Amount of Instalment	Amount due at the time of Instalment	Interest	Cash Price Portion

Third	5,50,000	5,50,000	50,000	5,00,000
Second	4,90,000	5,00,000 + 4,90,000	90,000	4,00,000
First	4,20,000	5,00,000 + 4,00,000 + 4,20,000	1,20,000	3,00,000
Down Payment	6,00,000	-	-	6,00,000
				18,00,000

Alternative way of Calculation of Cash Price

End of Installment	Closing Balance After Payment of Installment	Amount of Installment	Closing Balance Before payment of Installment	Interest @ 10% or 10 /110 on HPI	Opening Balance
III	—	5,50,000	5,50,000	50,000	5,00,000
II	5,00,000	4,90,000	9,90,000	90,000	4,00,000
I	9,00,000	4,20,000	13,20,000	1,20,000	3,00,000
			Total	2,60,000	12,00,000

Let the cash price be :

Total of Opening Balance + Down Payment = Rs. 12,00,000 + Rs. 6,00,000 = Rs. 18,00,000

In the books of Srikumar

Fair Value Motor A/c

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
1.4.22	To Bank (Cash Down)	6,00,000	1.4.22	By Car A/c	18,00,000
31.3.23	To Bank (Instalment)	4,20,000	31.3.23	By Interest A/c	1,20,000
31.3.23	To Bank c/d	9,00,000			
		19,20,000			19,20,000
31.3.24	To Bank	4,90,000	1.4.23	By Balance b/d	9,00,000
	To Balance c/d	5,00,000	31.3.24	By Interest	90,000
		9,90,000			9,90,000
31.3.25	To Car A/c (WN -1)	1,94,400	1.4.24	By Balance b/d	5,00,000
	To Balance c/d-	3,55,600	31.3.25	By Interest	50,000
		5,50,000			5,50,000
30.6.25	To Bank A/c	3,73,380	1.4.25	By Balance b/d	3,55,600
			30.6.25	By Interest 3,55,600 x 3/12 x 20/100	17,780
		3,73,380			3,73,380

Car's Account

Date	Particulars	Amount (Rs.)	Date	Particulars	Amount (Rs.)
1.4.22	To Fair Value Motors Pvt. Ltd. A/c	18,00,000	31.3.23	By Depreciation A/c	4,50,000
		18,00,000		By Balance c/d	13,50,000
1.4.23	To Balance b/d	13,50,000	31.3.24	By Depreciation A/c	3,37,500
		13,50,000		By Balance c/d	10,12,500
1.4.24	To Balance b/d	10,12,500	31.3.25	By Fair Value Motors	
				By Depreciation A/c	2,53,125
				By Pvt. Ltd. A/c (WN -1)	1,94,400
				By Provision for loss	

Sanjay Welkins Classes	Hire Purchase Transactions - Revisionary Material

			(B.F)	1,85,288
			By Balance c/d	3,79,687
		10,12,500	(Cars Retained)	
				10,12,500

Working Notes:

1.

Valuation of Car Repossed

Particulars	Value to Vendor
Rate of Depreciation	40% on cash price
Value as on 1.4.2022	18,00,000
Less: Depreciation	(7,20,000)
Value as on 1.4.2023	10,80,000
Less: Depreciation	(4,32,000)
Value as on 1.4.2024	6,48,000
Less: Depreciation	(2,59,200)
Value of 2 cars as on	
31.3.2025	3,88,800
Less: Value of 1 car taken over	1,94,400
Value of car after repossession	1,94,400

Retained:

Particulars	Value to Purchaser
Rate of Depreciation	25% on cash price
Value as on 1.4.2012	18,00,000
Less: Depreciation	(4,50,000)
Value as on 1.4.2013	13,50,000
Less: Depreciation	(3,37,500)
Value as on 1.4.2014	10,12,500
Less: Depreciation	(2,53,125)
Value of 2 cars as on	
31.3.2015	7,59,375
Less: Value of 1 car taken over	3,79,688
Value of car after repossession	3,79,687

2. Loss on Takeover = Rs. 3,79,688 -1,94,400 = Rs. 1,85,288.

Section - 4 - Hire Purchase Trading & Debtor System

4.1

Past Examination – 16 Marks

ABC limited has Hire- Purchase department. Goods are sold at cost plus 50%. From the following particulars draft Hire- Purchase trading account and compute profits or loss for the year ended 31.3.2023:

1.4.2022	Instalments due but not collected	10,000
1.4.2022	Stock at shop at cost	36,000
1.4.2022	Instalments not yet due	18,000
31.3.2023	Stock at shop	40,000
31.3.2023	Instalments due but not collected	18,000
	Other details:	

Total instalments became due	1,32,000
Goods purchased	1,20,000
Cash received from customers	1,21,000

Goods on which due installments could not be collected were repossessed and valued at 30% below original cost. The vendor spent Rs. 500 on getting goods overhauled and then sold for Rs. 2,800.

Profit – HP Trading profit 42,400, total net profit - Rs. 43,300

Rates :

Cost	Margin/load	HPP
100	50	150
50/100		50/150
1/2		1/3

Stock in shop a/c

Opening bal. b/d	36,000	Goods sold on hire at cost – b.f	1,16,000
Purchases	1,20,000	Closing bal c/d -	40,000

Hire Purchase Stock a/c

Opening bal. b/d	18,000	Instalment due during the year (IDDTY)	1,32,000
GHOH – at cost : 1,16,000 + ½ of 1,16,000 i.e. 58,000	1,74,000	Closing bal c/d - b.f.	60,000

Hire Purchase Debtors a/c

Opening bal. b/d	10,000	Cash Received / Instal. Recd.	1,21,000
IDDTY	1,32,000	Goods repossessed a/c : bal. fig.	3,000
		Bal. c/d	18,000

Goods repossessed a/c

H.P. Debtors a/c	3,000	Hire Purchase Adjustment a/c	1,600
		Balance c/d : balancing figure	24,000
b/d	1,400	Sale	2,800
Cash- expenses	500		
Profit t/f to Gen. P&L a/c	900		

Hire Purchase Adjustment a/c

Stock Reserve Closing i.e loading on Cl. bal of HPS a/c: 60,000 x 1/3	20,000	Stock Reserve opening i.e loading on OP. bal of HPS a/c : 18,000 x 1 / 3	6,000
Goods repossessed a/c: loss on repossession	1,600	Load on GHOH a/c: 1,74,000 x 1/3	58,000
Profit T/F to General P&L a/c	42,400		

Hire Purchase Trading a/c

Opening balance : b/d :		Cash Received	1,21,000
Hire Purchase Stock a/c	18,000	Stock Reserve opening i.e loading on OP. bal of HPS a/c : 60,000 x 1/3	6,000
H.P. debtors	18,000	Load on GHOH a/c : 1,74,000 x 1/3	58,000
GHOH a/c	1,74,000	Goods repossessed – Estimated value	1,400
Stock Reserve – closing i.e loading on closing balance of Hire purchase stock a/c	20,000	Closing bal c/d	
Net profit t/f to Gen. P&L a/c	42,400	Hire purchase stock a/c	60,000
		Hire purchase debtors a/c	18,000

Calculation of estimated value of goods repossessed

Goods repossessed : unpaid balance	60,000	
Less load : 1/3	20,000	
Cost	40,000	
Less 40%	16,000	
Estimated value	24,000	
Entries for goods repossessed		
Goods repossessed a/c	60,000	
To H. P. Debtors a/		60,000
H.P. Adjustment a/c	36,000	
To Goods repossessed a/c		36,000

4.2

Past Examination Question – 8 Marks

S limited has Hire- Purchase department. Goods are sold at cost plus 60%. From the following particulars draft Hire- Purchase trading account and compute profits or loss for the year ended 31.3.2023:

Goods with customers on 1.4.2022 [instalments are not due]	3,20,000
Instalments due on 1.4.2022 [customers are paying]	20, 000
Cash received from customers	11,20,000
Goods re-possessed from customers valued at 40%	16,000
Unpaid instalments in respect of re-possessed goods	40,000
Goods with customers on 31.3.2023 [instalments not due]	7,20,000
Goods sold on hire-purchase during the year [1.4.2022 to 31.3.2023]	16,00,000

Profit – Rs. 4,26,000

Hire purchase stock

Particulars	Amount	Particulars	Amount
Op. bal b/d	3,20,000	IIDDTY -BF	12,00,000
GSOH :	16,00,000	Bal c/d -	7,20,000

Hire Purchase Debtors

Particulars	Amount	Particulars	Amount
Op b/d	20,000	Cash	11,20,000
IDDTY	12,00,000	G.R.	40,000
		Bal. c/d - BF	60,000

Goods repossessed a/c

H.P. Debtors a/c	40,000	Hire Purchase Adjustment a/c	24,000
		Balance c/d : balancing figure	16,000
b/d	16,000	Sale	-
Cash- expenses	-		
Profit t/f to Gen. P&L a/c	-		

Hire Purchase Adjustment a/c

Stock Reserve Closing i.e loading on Cl. bal of HPS a/c: $7,20,000 \times \frac{60}{160}$	2,70,000	Stock Reserve opening i.e loading on OP. bal of HPS a/c : $3,20,000 \times \frac{60}{160}$	1,20,000
Goods repossessed a/c: loss on repossession	24,000	Load on GHOSH a/c: $16,00,000 \times \frac{60}{160}$	6,00,000
Profit T/F to General P&L a/c	4,26,000		

Hire Purchase Trading a/c

Opening balance : b/d :		Cash Received	11,20,000
Hire Purchase Stock a/c	3,20,000	Stock Reserve opening i.e loading on OP. bal of HPS a/c :	1,20,000
H.P. debtors	20,000	Load on GHOSH a/c :	6,00,000
GHOSH a/c	16,00,000	G. Repossessed a/c : Estimated value	16,000
Stock Reserve – closing i.e loading on closing balance of Hire purchase stock a/c	2,70,000	Closing bal c/d :	
Net profit t/f to Gen. P&L a/c	4,26,000	Hire purchase stock a/c	7,20,000
		Hire purchase debtors a/c	60,000

4.3

Past Examination Question – 8 Marks

Wye sells goods on Hire-Purchase at cost plus 50% prepare hire-purchase Trading a/c from the information given below:

Stock with customers on hire-purchase price [opening]	1,62,000
Stock in hand at shop [opening]	3,24,000
Installments overdue [opening]	1,35,000
Purchases during the year	10,80,000
Goods re-possessed [instalments not due Rs. 36,000]	9,000
Stock at shop excluding re-possessed goods [closing]	3,60,000
Cash received during the year	10,35,000
Instalments over due [closing]	1,62,000

The vendor spent Rs. 2,000 on goods re-possessed and then sold it for Rs. 15,000.

HP Trading profit 3,39,000 / Total Net Profit - Rs. 3,43,000

Stock in-shop

Particulars	Amount	Particulars	Amount
Op b/d	3,24,000	GSOH at cost -BF	10,44,000
Purchases	10,80,000	Bal c/d	3,60,000

Hire purchase stock

Particulars	Amount	Particulars	Amount
Op. bal b/d	1,62,000	IIDDTY	10,62,000
GSOH : cost 10,44,000		G.R.	36,000
+ 1/2 5,22,000	15,66,000	Bal c/d - BF	6,30,000

Hire Purchase Debtors

Particulars	Amount	Particulars	Amount
Op b/d	1,35,000	Cash	10,35,000
IDDTY	10,62,000	Bal. c/d	1,62,000

Goods repossessed a/c

H.P. Debtors a/c	36,000	Hire Purchase Adjustment a/c	27,000
		Balance c/d : balancing figure	9,000
b/d	9,000	Sale	15,000
Cash- expenses	2,000		
Profit t/f to Gen. P&L a/c	4,000		

Hire Purchase Adjustment a/c

Sanjay Welkins Classes	Hire Purchase Transactions - Revisionary Material

Stock Reserve Closing i.e loading on Cl. bal of HPS a/c: 6,30,000 x 1/3	2,10,000	Stock Reserve opening i.e loading on OP. bal of HPS a/c : 1,62,000 x 1/3	54,000
Goods repossessed a/c: loss on repossession	27,000	Load on GHOSH a/c: 15,66,000 x 1/3	5,22,000
Profit T/F to General P&L a/c	3,39,000		

Hire Purchase Trading a/c

Opening balance : b/d :		Cash Received	10,35,000
Hire Purchase Stock a/c	1,62,000	Stock Reserve opening i.e loading on OP. bal of HPS a/c :	54,000
H.P. debtors	1,35,000	Load on GHOSH a/c :	5,22,000
GHOSH a/c	15,66,000	G. Repossessed a/c : Estimated value	9,000
Stock Reserve – closing i.e loading on closing balance of Hire purchase stock a/c	2,10,000	Closing bal c/d :	
Net profit t/f to Gen. P&L a/c	3,39,000	Hire purchase stock a/c	3,60,000
		Hire purchase debtors a/c	1,62,000

Sanjay Welkins' Classes

Chapter 4

Accounting for Leases

1. A **Lease** is an agreement under which lessee (the person/entity, who takes possession of the property) get the right to use the premises for the agreed period of time in lieu of the rent as agreed between both Lessor (owner) and lessee. Lessor has an ownership right of assets, but still lessee has an unrestricted right to use that asset.

Every lease contract should cover the following terms –

- ♦ Period of lease.
- ♦ Timing of the payment to be made along with the amount of rent.
- ♦ About maintenance expenses, taxes, insurance, provision for renewal of lease agreement.

18. Classification of leases: Lease may be two types;

- Finance and
- operating lease

17.1 A lease is classified as finance lease

in any of the following situations-

- The lease transfers ownership of the asset at a price.
- The lessee has the option to purchase the asset at a particular price.
- The lease term is for the major part of the economic life of the asset
- At the inception of the lease, the present value of the minimum lease payment is equal to the fair value of the leased asset.

17.2

A lease which is not a finance lease is classified as an operating lease.

18. Leases in the financial statements of lessees

18.1 Finance leases

At the inception of a finance lease, the lessee should recognise the lease as an asset and a liability. Such Recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease, or the present value of the minimum lease payments from the standpoint of the lessee, whichever is less. In calculating the present value of the minimum lease payments, the discount rate is the interest rate implicit in the lease. If this implicit interest rate is not available, the discount rate is the lessee's incremental borrowing rate.

The leased asset should be depreciated over the lease period or the useful life economic life whichever is shorter, on a systematic basis as per AS-10, as if the lessee is owner of the asset. The depreciation amount, which affects the carrying amount of leased asset, and the finance expenses, which affect the related liability, may not be same. Consequently, the carrying amount of asset and the related liability may not be equal in the balance sheet.

Lease rentals should be apportioned and recognised as repayment of liability (that is Principal amount recognised at the inception of lease) and payment of interest should be computed and recognised on reducing balance basis.

Initial direct costs e.g. legal fee, registration expenses etc., should be added to cost of the asset.

18.2 Operating leases

Asset under lease should not be recorded.

In case of operating lease, the lessee gets or uses the asset for a limited period or for limited purpose. The rental paid to the lessor is in the nature of revenue expense for the period. The rental paid to the lessor during the period is charged against the income of the period. Operating lease does not affect the balance sheet of the lessee.

19.1 Finance leases

The lessor should recognise assets given under a finance lease in its balance sheet as a receivable at an amount equal to the net investment in the lease. Net investment in Lease = Present Value of Minimum Lease Payment (from lessor point of view) + Present value of unguaranteed residual value accruing to Lessor.

Depreciation should not be recorded by lessor.

Lease rentals should be apportioned and recognised as receipt against "Receivable" (i.e. Principal amount recognised at the inception of lease) and interest income. Interest should be computed and recognised on reducing balance basis.

Initial direct costs such as legal fee, registration expenses et-cetera should be written off in the profit and loss a/c immediately or may be deferred over lease term.

19.2 Operating lease

The lessor should present an asset given under operating lease in its balance sheet under fixed assets. Lease income from operating leases should be recognised in the statement of profit and loss on a straight line basis over the lease term, or on some other systematic basis. The depreciation on leased assets should be based on the normal depreciation policy of the lessor for similar assets, and the AS-6.

The depreciation amount and other costs incurred to earn the lease income are treated as expenses in the income statement.

If the lessor of the opening lease is the manufacturer / dealer of the asset, then the selling profit which arises in case of normal sale is not recognised, because the operating lease is not a sale.

Illustrative Studies

Case Study - 1

Stunning Limited took a 7 year finance lease under which the annual lease rental has been fixed at Rs. 1,20,000. The implicit rate of interest has been estimated at 11%. Find out the finance charge for different years.

PV Factors at 11%

Year	1	2	3	4	5	6	7	Total
PV Factors	.901	.812	.731	.659	.593	.535	.482	4.712

Response –

Annual lease rental is Rs. 1,20,000 for a period of 7 years. The fair value of the asset is equal to the PV @ 11% that is Rs. 1,20,000 x PV factor at the rate of 11% for 7 years that is 4.712.

PV = 1,20,000 x 4.712 = 5,65,440

The finance charge can be ascertained as follows

Year	Payment	Finance charge 11% of outstanding amount	Repayment	Outstanding
0	-	-	-	5,65,440
1	1,20,000	62,200	57,800	5,07,640
2	1,20,000	55,840	64,160	4,43,480
3	1,20,000	48,780	71,220	3,72,260
4	1,20,000	40,950	79,050	2,93,210
5	1,20,000	32,250	87,750	2,05,460
6	1,20,000	22,600	97,400	1,08,060
7	1,20,000	11,940	1,08,060	-

Finance charge for different years has been computed @ 11% on the amount outstanding in the beginning of the year. For the last year, the interest has been adjusted for the approximations made in earlier years.

Entries in the books of Lessee in the first year

1.	Asset on Lease A/c Dr.	5,65,440	

	To lease liability		5,65,440	
2.	Lease Liability A/c Dr. Finance Charge Dr. To Bank	57,800 62,200		1,20,000
3.	Depreciation (PL) To Asset on Lease	80,777	80,777	
4.	Other Charges a/c To Bank a/c	-	-	
4.	Profit & Loss A/c Dr. To Depreciation A/c To Finance Charges To Other charges	1,42,977	80,777 62,200 -	

Case Study - 2

Footfalls Limited took a machine on lease from waterfalls limited on the following terms-

- Annual lease rental Rs. 50,000
- Useful life 15 years
- Lease term 13 years
- Implicit rate of interest 15%

At the end of the lease period, the expected fair value of the asset is Rs. 75,000 and Footfalls Limited has an option to buy the asset at this price. You are required to find out the amount at which the finance lease be recognised in the books by Footfalls Limited. PV factor at 15% for 13 years is 5.583.

Response

Lease should be recognised as follows =

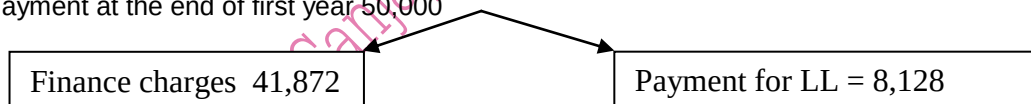
PV = annual lease payment x PV factor for 13 years

50,000 x 5.583 = 2,79,150

Calculation of Finance charges

First year : 2,79,150 x 15 % = 41,872

Annual Payment at the end of first year 50,000



Entry

Lease Liability a/c	Dr. 8,128
Finance charges a/c	Dr. 41,872
To Bank a/c	50,000

Case Study - 3

A Ltd. leased machinery to B Ltd. on the following terms:

(Rs. in lakhs)

Fair value of the machinery	20.00
Lease term	5 years
Lease Rental per annum	5.00
Guaranteed Residual value	1.00
Expected Residual value	2.00
Expected Rate of Return	15%

Depreciation is provided on Straight line Method @10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the First year.

Response

Books of Lessee :

Initial Recognition:

FV or cost & PV of Lease Payments whichever is lower

Calculation of present value of Minimum lease payments

Year	Lease rentals in lacs	Discount factor	Discounted value
1	5	0.8696	4,34,800
2	5	0.7561	3,78,050
3	5	0.6575	3,28,750
4	5	0.5718	2,85,900
5	5 + 1 = 6	0.4972	2,98,320
			17,25,820

Present value of MLP is less than fair value of Rs. 20,00,000, so the leased asset and liability should be recognized at Rs. 17,25,820 in the books of lessee (B Ltd)

Apportionment of MLP into finance charge and principal amount at the end of the year:

Year	Payment	Finance charge 16% of O/S amount	Repayment Payment less finance charges	Outstanding
0		-	-	17,25,820 -
1	5,00,000	2,58,873	2,41,127	14,84,693
2	5,00,000	2,22,704	2,77,296	12,07,397
3	5,00,000	1,81,110	3,18,890	8,88,507
4	5,00,000	1,33,276	3,66,724	521,783
	6,00,000	78,267	5,21,733	-

Entries in the books of B Ltd. (lessee) in first year

1	Asset on Lease A/c Dr. To lease liability	17,25,820	17,25,820	
3	Lease Liability A/c Dr. Finance Charge Dr. To Bank	2,41,127 2,58,873	5,00,000	
	Depreciation a/c Dr. To Asset on Lease a/c	1,72,582	1,72,582	
4	Profit & Loss A/c Dr. To Depreciation A/c To Finance Charges	4,31,455	1,72,582 2,58,873	

Calculation of unearned finance income

Unearned finance income = Gross investment – PV of Gross Investment.

Gross Investments : Lease Payments including GRV + UGRV (Unguaranteed Residual Value)

GI	=	LP including GRV	+	UGRV
		5 Lakhs x 5 + GRV of 1 Lakhs		1 Lakhs
27		26	+	1
Net Investments i.e. PV of GI	=	PV of LP	+	PV of UGRV
17,75,540.50		17,75,540	+	1 x 0.4972 = 0.4972

Unearned Finance Income = Rs. (GI Rs. 27,00,000 - NI Rs. 17,75,540) = Rs. 9,24,460

Case Study - 4

ABC limited took a machinery on lease from XYZ limited the fair value being Rs. 10,00,000.

- Economic life of the machine as well as lease term is = 4 years
- at the end of each year, ABC limited pays Rs. 3,50,000.
- the lessee has Guaranteed a Residual value Rs. 50,000 on expiry of the lease to the lessor
- however XYZ limited estimates that the Residual value of the machinery will be Rs. 35,000 only.
- the Implicit interest rate is 16%
- and PV Factors at 16% for 1, 2, 3, and 4th year are .8621, .7432, .6407, and .5523 respectively.
- PV Factors at 16%

Year	1	2	3	4	Total
PV Factors	.862	.756	.658	.572	4.712

Calculate the value of Machinery to be considered by ABC limited and the finance charges

Response

Calculation of present value of Minimum lease payments

Year	Lease Payments	Discount factor at 16 %	Discounted value
1	3,50,000	0.8621	
2	3,50,000	0.7432	
3	3,50,000	0.6407	
4	3,50,000 + 50,000	0.5528	
			10,07,220

Cost / FV = 10,00,000

PV of MLP = 10,07,220

Lower = 10,00,000

Apportionment of MLP into finance charge and principal amount at the end of the year:

Year	Payment	Finance charge 16% of O/S amount	Repayment Payment less finance charges	Outstanding
0		-	-	10,00,000
1	3,50,000	1,60,000	1,90,000	8,10,000

Books of Lessor

Calculation of unearned finance income

Unearned finance income = Gross investment – PV of Gross Investment.

Gross Investments : Lease Payments including GRV + UGRV (Unguaranteed Residual Value)

GI	=	LP including GRV	+	UGRV
14,50,000		3,50,000 x 4 + GRV 50,000		-
Net Investments i.e. PV of GI	=	PV of LP	+	PV of UGRV
10,07,720		10,07,720	+	-

Unearned Finance Income = Rs. (GI Rs. 14,50,000 - NI Rs. 10,07,720) = Rs. 4,42,280

Entries in the books of Lessor in first year

1.	Net Investments in lease Dr. To Asset on Lease a/c	10,07,720	10,07,720	
2.	Bank A/c Dr. To Net Investments in Lease a/c	3,50,000	1,90,000	

	To Finance Income		1,60,000	
3.	Profit & Loss A/c Dr. To Finance Charges	1,60,000	1,60,000	

Case Study - 5

Indian giants limited has initiated a lease for a period of three years in respect of a machine costing Rs. 1,50,000 with an expected useful life of 4 years. Under the lease agreement, the asset would revert back to India giants limited at the end of lease period.

The un-guaranteed residual value [UGRV] of asset after the lease term is estimated at Rs. 20,000.

The implicit rate of interest is 10% and the *annual lease payments have been determined in such a way that the present value of lease payment plus residual value is equal to the fair value [cost] of the asset.*

Find out the amount of annual lease payment, gross investment in the asset, net investment in the asset and unearned finance income from the point of view of Indian Giants Limited, the lessor.

The present value of annuity factor of Rupee 1 due at the end of 3rd year at 10% IRR is 2.246. The PV of Rupee due at the end of 3rd year at 10% rate of interest is 0.751.

PV of GI that is Net Investments	=	PV of LP including GRV	+	PV UGRV
1,50,000	=	?		20,000 x .751
1,50,000	=	1,34,974 B.F		15,026

Percentage of lease payments to Fair Value	1,34,974 / 1,50,000 x 100 90 % covers substantial portion of Fair Value ; therefore Finance lease
PV of lease Payments = 1,34,974	Annual Lease Payments x PV of Annuity Factor at 10% for 3 years X x 2.246 1,34,974 / 2.246 = 60,024
Gross investments = Lease Payments + GRV + UGRV	(60,024 x 3 = 1,80,072) + UGRV 20,000 2, 00,072
Less : PV of MLP + UGRV	1,34,974 + 15,026 = 1,50,000
Unearned finance income	50,072

Case Study - 6

Indian giants limited has initiated a lease for a period of three years in respect of a machine costing Rs. 6,00,000 with an expected useful life of 5 years. Under the lease agreement, the asset would revert back to India giants limited at the end of lease period. The unguaranteed residual value [UGRV] of asset after the lease term is estimated at Rs. 60,000. The implicit rate of interest is 10%.

The implicit rate of interest is 10% and the *annual lease payments have been determined in such a way that the present value of lease payment plus residual value is equal to the fair value [cost] of the asset.*

The present value of annuity factor of Rupee 1 due at the end of 3rd year at 10% IRR is 2.24868. The PV of Rupee due at the end of 3rd year at 10% rate of interest is 0.7513.

State with reasons whether the lease constitutes finance lease and also compute unearned finance income.

Response:

PV of GI that is Net Investments	=	PV of LP including GRV	+	PV UGRV
6,00,000	=	?		60,000 x .7513
6,00,000	=	5,54,922		45,078

		B.F	

PV of lease Payments =	Annual Lease Payments x PV of Annuity Factor at 10% for 3 years
5,54,922	X x 2.24868
	5,54,922/ 2.24868= 2,46,777
Gross investments = Lease Payments + GRV + UGRV	(2,46,777x 3) + UGRV 60,000 = 8,00,331
Less : PV of MLP + UGRV	5,54,922 + 45,078 = 6,00,000
Unearned finance income	2,00,331

Sanjay Welkins' Classes

Chapter 5

Accounting for Insurance Claims

1. Preface

A business house is always susceptible to various losses such as loss due to fire or theft or burglary etc. The loss of caused by fire is extreme and serious as it not only destroys the assets but also affects the earning capacity of the firms. Thus, in order to avoid the intensity of loss due to fire more often than not organizations resort to fire insurance policy. If fire insurance policy has been taken and loss occurs in that case organizations ask the fire insurance companies to indemnify them.

2. Fire insurance policy is generally of two types –

Loss of stock policy and

Loss of profit policy

3. Under loss of stock policy following are the steps for computing claim for loss of stock

1. First of all prepare memorandum trading account from the beginning of the current accounting year up to the date of fire. On the debit of it post opening stock, purchases up to the date of fire, direct expenses up to the date of fire and credit it with sales up to the date of fire. Now apply gross profit rate on the sales to arrive at gross profit. Balancing figure of Memorandum trading Account shall be closing stock [which would have been had fire not taken place].

2. Now subtract any salvage value from this amount to arrive at extent of amount of loss of stock. Finally compare amount of stock [as per MTA] with amount of policy amount and if policy amount happens to be more than the stock amount then full amount of loss of stock shall be claimed. However if policy amount happens to be less than stock as per MTA then average clause shall be applied and amount of claim shall be arrived at.

4. Loss of profits policy

Under loss of stock policy firm insures itself against loss of stock. While under loss of profits policy firm insures itself against loss of consequential profits. When fire destroys infrastructure of the organization, activities of the business gets disturbed and it takes some time to recover and reach the normal level of business activities. It is then natural that, in the affected period firm shall not be able to have the same level of sales which in normal circumstances it would have had. In other words, in the disturbed period, firm shall have lesser sales and consequently lesser profits. Thus their would be some loss of profits. In order to save itself from such loss of profits, firm's resort to 'Loss of profits policy'.

Under loss of profit policy, following are the steps to compute total loss and prepare statement of claim.

1	Rate of gross profit :	
	Net profit for the last financial year	xxx
	Add insured standing charges	xxx
		xxx
	Turnover for the last year	xxx
	Rate of gross profit = $\frac{\text{net profit for the last year} + \text{insured standing charges}}{\text{Turnover of the last financial year}} \times 100$	xxx
2	Compute Short sales :	
	Standard turnover	xxx

	± increasing or decreasing trend	xxx
		xxx
	- turnover during the dislocation period which is at par with the indemnity period of 6 months	xxx
3	Annual turnover adjusted :	
	Annual turnover of 12 months prior to the date of fire	xxx
	± increasing or decreasing trend	xxx
		xxx
4	Qualifying amount of additional working capital or additional expenses	
a	Actual expenses	xxx
b	Gross profit on sale generated by additional expenses	xxx
c	Proportionate amount of additional expenses <u>Gross profit on annual adjusted turnover x additional expenses</u> Gross profit shown in the numerator + uninsured standing charges	xxx
	Least of the a, b, c	xxx
5	Claim –	
	Loss of profit on short sales	xxx
	Allowable additional expenses	xxx
	Less saving in insured standing	xxx
	Total claim	xxx
	Compare adjusted annual turnover with amount of policy .If amount of policy happens to be more than adjusted annual turnover then full amount Claim computed as above shall be admitted however if amount of policy happens to be less than adjusted annual turnover then Application of average clause shall take place for determining the amount of claim to be admitted by the insurance company.	xxx

5. Standing Charges

Standing charges or fixed overhead charges are to be paid even if there is a reduction in turnover or stoppage of work which include; Rent, Rates and Taxes; Salaries to payment Staffs; Depreciation of fixed Assets, Director's Remuneration; Sundry standing charges which are restricted to 5% of the total of specified insured standing charges. Under loss of profit insurance, gross profit means net profit + insured standing charges.

6. Indemnity Period

"The period commences at the date of damage and ends not later than the stated number of months thereafter. This is the maximum period in respect of which the insurers are liable and should the business recover and becomes normal before the expiry of such period, liability at once ceases." In short, it comes from the period of damage upto the date when the business begins its normal operational activities or it is the period commencing on the day on which the damages occurs and may vary from three months to a period of years. The period is selected by the proposer and should be sufficient to extend over the full period of any likely interruption.

7. Indemnity

Indemnity is the difference between the actual profit earned after the damage and that which should have been earned had no damage occurred.

8. Standard Turnover

Turnover during that period in the twelve months immediately preceding the date of the damage which corresponds with the indemnity period

9. Annual Turnover

It is the period of 12 months immediately before the date of damage.

10. Net Profit

It is the ordinary net profit of the business which is disclosed by the income statement excluding capital receipts and payments. It excludes non-operating income (i.e., income from investment) for the purpose of insurance indemnity.

11. Gross Profit

Gross Profit is the total of the net profit plus insured standing charges. If there is no net profit the amount would be insured standing charges less such a proportion of any net trading loss.

12. Meaning of Fire

For purposes of insurance, fire means:

1. Fire (whether resulting from explosion or otherwise) not occasioned or happening through:
 - (a) Its own spontaneous fomentation or heating or its undergoing any process involving the application of heat;
 - (b) Earthquake, subterranean fire, riot, civil commotion, war, invasion act of foreign enemy, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection, military or usurped power.
2. Lightning.
3. Explosion, not occasioned or happening through any of the perils specified in 1 (a) above.
 - (i) of boilers used for domestic purposes only;
 - (ii) of any other boilers or economizers on the premises;
 - (iii) in a building not being any part of any gas works or gas for domestic purposes or used for lighting or heating the building.

Section – 1 - Loss of Stock Policy**1.1.**

Kent Limited has taken out a fire policy of Rs. 1,60,000 covering its stock. A fire occurred on 31st March, 2021. The following particulars are available:

Stock at cost on 31.12.2020	60,000
Purchases till the date of fire	2,60,000
Sales to the date of fire	1,80,000
Carriage inwards	1,600
Commission on purchase to be paid	@ 2%
Gross Profit @ 50% on cost	

Salvage value of stock after fire was Rs. 41,360.

Required : 1. Loss of Stock 2. Amount of claim to be made against the insurance company assuming average clause is applicable.

Memorandum Trading Account 1.1.21 - 31.03.21

Particulars	Amount	Amount	Particulars	Amount	Amount
Op stock		60,000	Sales		1,80,000
Purchases		2,60,000	Closing stock	Bal. fig.	2,06,800

Particulars	Amount	Amount	Particulars	Amount	Amount
Carriage Inwards		1,600			
Commission on Purchases payable 2% of 2,60,000		5,200			
Gross profit	50 % on cost or 50/150 on Sales: 50/150 x 1,80,000	60,000			

Loss of stock :

Closing stock as Memorandum Trading a/c	2,06,800
Stock salvaged	41,360
Loss of stock	1,65,440

Insurance claim :

	Closing stock	Amount of policy
Amount	2,06,800	1,60,000
loss of stock policy amount	1,65,440	? = $\frac{1,65,440 \times 1,60,000}{2,06,800} = 1,28,000$

1.2.

A fire occurred on 15th September 2021 in the premises of Nine AM Limited from the following figures; calculate the amount of claim to be lodged with the insurance company for loss of stock.

Particulars Amount

Rs.

Stock at cost on 1.1.2020	40,000
Stock at cost on 1.1.2021	60,000
Purchases in 2020	80,000
Purchase from 1.1.2021 to 15.9.2021	1,76,000
Sales in 2020	1,20,000
Sales from 1.1.2021 to 15.9.2021	2,10,000

During the current year cost of purchase has risen by 10% above last years' level. Selling prices have gone up by 5%. Salvage value of stock after fire was Rs. 4,000.

Trading Account 1.1.20 - 31.12.220

Particulars	Amount	Amount	Particulars	Amount	Amount
Op stock		40,000	Sales		1,20,000
Purchases		80,000	Closing Stock		60,000
Gross profit	Bal fig.	60,000			

Gross profit rate on Sales

Gross profit rate on Sales	<u>60,000</u>
	1,20,000
	1/2 or 50%

In this question it is given that "Purchase Prices were raised by 10%" ...therefore Gross Profit rate shall have to re-adjusted in the light of changed prices

	Cost	Profit	Sales
Gross profit 10% on sales means	50	50	100
Upward rise of 10% in Purchase prices (it means rise in cost)	5	-	-
Upward rise of 5% in Selling prices (it means rise in Sales)	-	-	5
Revised position	55 ²	50 ³	105 ¹
Revised gross profit ration :			50/ 105 x 100 = 47.619%

Memorandum Trading Account 1.1.21 - 15.09.21

Particulars	Amount	Amount	Particulars	Amount	Amount
Op stock		60,000	Sales		2,10,000
Purchases		1,76,000	Closing stock	Bal. fig.	1,26,000
Gross profit	47.619 % of 2,10,000	1,00,000 (approx.)			

Loss of stock :

Closing stock as Memorandum Trading a/c	1,26,000
Stock salvaged	4,000
Loss of stock	1,22,000

Insurance claim :

Since Policy amount is not given claim amount can't be computed.

1.3.

A fire occurred in the premises of Bishop Limited on 1.4.2022 and a considerable part of the stock was destroyed.

The stock salvaged was Rs. 28,000, Bishop Limited had taken a fire insurance policy for Rs. 1,71,000 to cover the loss of stock by fire.

You are required to ascertain the insurance claim which the company should claim from the insurance company for the loss of stock by fire. The following particulars are available:

Stock at cost on 1.1.21	1,44,000
Stock on 31.12.2021	2,42,000
Wages paid during 2021	1,00,000
Wages Paid from 1.1.22 till 1.4.22	18,000
Purchases for the year 2021	9,38,000
Sales for the year 2021	11,60,000
Purchases from 1.1.22 to 1.4.22	1,82,000
Sales from 1.1.22 to 1.4.22	2,40,000

Bishop Limited had in June 2021 consigned goods worth Rs. 50,000, which unfortunately were lost in an accident.

Since there was no insurance cover taken, the loss had to be borne by him full.

Stocks at the end of each year for and till the end of calendar year 2020 had been valued at cost less 10%. From 2021, however there was a change in the valuation of closing stock which was ascertained by adding 10% to its costs.

Solution :

Trading Account 1.1.21 - 31.12.21

Particulars	Amount	Particulars	Amount
Op stock	1,60,000 ¹	Sales	11,60,000
Purchases	9,38,000	Stock sent on consignment lost	50,000
Wages	1,00,000	Closing Stock ²	2,20,000
Gross profit	2,32,000		

Rate of Gross Profit $2,32,000 / 11,60,000 \times 100 = 20\%$

Notes:

1. Till the end of year 2020 closing Stock was valued at cost Less 10%

	Cost price	Recorded Price
	100	90
	?	1,44,000
	$1,44,000 \times 100 / 90 = 1,60,000$	

2. From 2021, however there was a change in the valuation of closing stock which was ascertained by adding 10% to its costs

	Cost price	Recorded Price
	100	110
	?	2,42,000
	$2,42,000 \times 100 / 110 = 2,20,000$	

Memorandum Trading Account 1.1.22 - 31.03.22

Particulars	Amount	Particulars	Amount
Op stock	2,20,000	Sales	2,40,000
Purchases	1,82,000	Closing stock - B.F	2,28,000
Wages	18,000		
Gross profit 20% of 2,40,000	48,000		
	4,68,000		4,68,000

Loss of stock :

Closing stock as Memorandum Trading a/c	2,28,000
Stock salvaged	28,000
Loss of stock	2,00,000

Insurance claim :

	Closing stock	Amount of policy
Amount	2,28,000	1,71,000
loss of stock policy amount	2,00,000	$? = \frac{2,00,000 \times 1,71,000}{2,28,000} = 1,50,000$

Section – 2

Abnormal Line of Goods / Damaged Goods / Slow Moving Goods

2.1

On 1.4.22 a fire occurred in the godown of M/s. Rook Limited and most of the stocks were destroyed. The records of the company revealed the following particulars:

1.	Stock as at 1.1.2021	Rs. 75,000
2.	Stock as at 31.12.21	Rs. 80,000
3.	Purchases during 2021	Rs. 3,10,000
4.	Sales during 2021	Rs. 4,00,000
5.	Purchases from 1.1.2022 till the date of fire	Rs. 75,000
6.	Sales from 1.1.22 till the date of fire	1,00,000

Other Information:

(i) While valuing the stock 2021, Rs. 500 was written off whose cost was Rs. 4,800. A portion of this stock was sold in June, 2022 at a loss of Rs. 400; cost was Rs. 2,400. The godown and the cost of the stock were fully insured. Compute the amount of claim to be lodged to the Insurance Company.

Solution :

Trading Account 1.1.20 - 31.12.220

Particulars	Amount	Amount	Particulars	Amount	Amount
Op stock		75,000	Sales		4,00,000
Purchases		3,10,000	Closing Stock	Normal : 75,700 + Abnormal 4,300 not w/off + Abnormal w/off 500	80,500
Gross profit	Bal fig.	95,500			

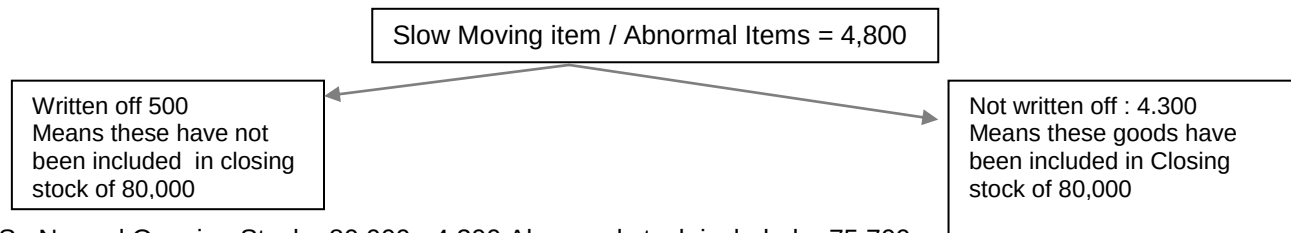
Memorandum Trading Account 1.4.22 - 31.3.22

Particulars	Amount	Amount	Particulars	Amount	Amount
	Normal goods	Abnormal goods		Normal goods	Abnormal goods
Opening stock	75,700	4,800 - 500	Sales 1,00,000 - Sale of abnormal items 2,000	98,000	2,000
Purchases :	75,000		P&L Loss on sale		400
		-		-	
Gross profit $95,500 / 4,00,000 \times 98,000$	23,398	-	Closing stock : b.f.	76,098	1,900

Loss of goods :

Stock as per memorandum trading a/c : Normal 76,098 + Abnormal 1,900	77,998
Less salvaged	5,000
=	72,998
Claim:	Closing stock Amount of policy

Since, given that stock was fully insured, so entire amount of loss, that is Rs. 72 998, shall be claimed



So Normal Opening Stock : 80,000 - 4,300 Abnormal stock included = 75,700

Abnormal stock : 4,500 + 300 = 4,800

2.2

On 30.09.22, the stock of M/s. Knight Limited was lost in a fire accident and most of the stocks were destroyed. The records of the company revealed the following particulars:

1.	Stock at cost as at 1 .4 .2021	Rs. 75,000
2.	Stock at cost as at 31.03.22	Rs. 1,04,000
3.	Purchases less returns for the year ended 31.03.22	Rs. 5,07,500
4.	Sales less returns for the year ended 31.3.2022	Rs. 6,30,000
5.	Purchase less returns up to 30.09.2022	Rs. 2,90,000
6.	Sales less returns up to 30.09.2022	Rs. 3,68,100

Other Information:

(i) While valuing the stock on 31.03.2021, due to obsolescence 50% of the value of stock which originally cost Rs. 12,000 was written off. In May 2022, 3/4th of these stock was sold at 90% and it is now expected that the balance of the obsolete stock would also realize the same price, subject to the above, G.P had remained uniform throughout. Stock to the value of Rs. 14,400 was salvaged. Compute the amount of claim to be lodged to the Insurance Company.

Solution :

Trading Account 1.1.21 - 31.03.22

Particulars	Amount	Amount	Particulars	Amount	Amount
Op stock		75,000	Sales		6,30,000
Purchases		5,07,500	Closing Stock	Normal : 98,000 + Abnormal 6,000 not w/off + Abnormal w/off 6,000	1,10,000
Gross profit	Bal fig.	1,57,500			

Gross Profit % on Sales = $(1,57,500 / 6,30,000) \times 100 = 25\%$

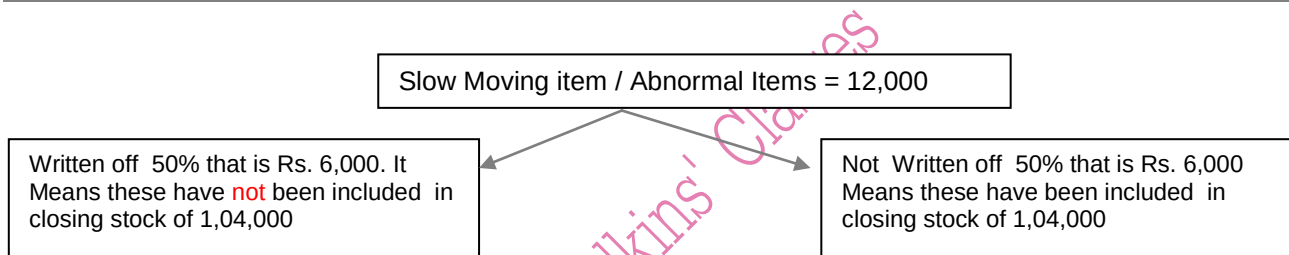
Memorandum Trading Account 1.4.22 - 31.09.22

Particulars	Amount	Amount	Particulars	Amount	Amount
	Normal goods	Abnormal goods		Normal goods	Abnormal goods
Opening stock	98,000	12,000 - 6,000	Sales 3,68,100 - Sale of abnormal items 8,100	3,60,000	8,100
Purchases :	2,90,000		P&L Loss on sale 3/4th of abnormal stock = 3/4 of 6,000 = 4,500		900

			Sold at 90% i.e. 90% of 9,000 = 8,100 So Loss = 9,000 - 8,100		
		-	P/L : Loss on valuation of balance of Stock: Balance of stock : 1/4 x 12,000 = 3,000 Expected to realise at 90% viz. 2,700 so loss = 300	-	300
Gross profit 25% of 3,60,000	90,000	6,000 B.F	Closing stock :	1,18,000 B.F	2,700 1/4 of 12,000 less 300

Loss of goods :

Stock as per memorandum trading a/c : Normal 1,18,000 + Abnormal 2,700	1,20,700
Less salvaged	14,400
=	1,06,300



So Normal Closing stock as at 1.4.21 Rs. : 1,04,000 - 6,000 Abnormal stock included = 98,000

Section – 3 - Loss of Profit Policy

3.1

The premises of Water limited were partially destroyed by fire on 1.3.2016 and as a result, the business was practically disorganized upto 31.8.2016. The company is insured under a loss of profits policy for Rs. 1,65,000 having an indemnity period of 6 months.

From the following information, prepare a claim under the policy :

Actual turnover during the period of dislocation – 13.2016 to 31.8.2016	80,000
Turnover for the corresponding period in the 12 months immediately before the fire – 1.3.2015 to 31.8.2015	2,40,000
Turnover for the 12 months immediately preceding the fire – 1.3.2015 to 28.2.2016	6,00,000
Net profit for the last financial year	90,000
Insured charges for the last financial year	60,000
Uninsured standing charges	5,000
Turnover for the last financial year	5,00,000

Due to substantial increase in trade, before and upto the time of the fire, it was agreed that an adjustment of 10% should be made in respect of the upward trend in turnover. The company incurred additional expenses amounting to Rs. 9,300 immediately after the fire and but for this expenditure, the turnover during the period

of dislocation would have been only Rs. 55,000 there was also a saving during the indemnity period of Rs. 2,700 in insured standing charges as a result of the fire.

Detailed Solution:

1	Rate of gross profit :	
	Net profit for the last financial year	90,000
	Add insured standing charges	60,000
		1,50,000
	Turnover for the last year	5,00,000
	Rate of gross profit = $1,50,000 \times 100 / 5,00,000$	30%
2	Short sales :	
	Standard turnover	2,40,000
	+ 10% increasing trend	24,000
		2,64,000
	- turnover during the dislocation period	80,000
		1,84,000
3	Annual turnover adjusted :	
	Annual turnover 1.3.2015 to 23.2.2016	6,00,000
	Add ; 10% increasing trend	60,000
		6,60,000
4	Additional expenses	
a	Actual expenses 9,300	
b	Gross profit on sale generated by additional expenses $30/100 [80,000 - 55,000] = 7,500$	
c	Gross profit on annual adjusted turnover x additional expenses Gross profit shown in the numerator + uninsured standing charges $30\% \text{ of } 6,60,000 / 30\% \text{ of } 6,60,000 + 5,000 = 9071$	
	Least of the a, b, c	7,500
5	Claim	
	Loss of profit on short sales 30% of 1,84,000	55,200
	Allowable additional expenses	7,500
	Less saving in insured standing	2,700
		60,000
	Application of average clause = $60,000 \times 1,65,000 / 1,98,000$	50,000

Section – 4 Loss of stock as well as Loss of Profit Policy

4.1

Dial 101s trading and profit and loss a/c for the year ended 31.12.2015 were as follows:

Trading and profit and loss a/c –

Opening stock	20,000	Sales	10,00,000
Purchases	6,50,000	Closing stock	90,000
Manufacturing expenses	1,70,000		
Gross profit	2,50,000		
	10,90,000		10,90,000
Administrative expenses	80,000	Gross profit	2,50,000
Selling expenses	20,000		

Finance charges	1,00,000		
Net profit	50,000		
	2,50,000		2,50,000

The company had taken out a fire policy for Rs. 3,00,000 and a loss of profits policy for Rs. 1,00,000 having an indemnity period of 6 months. A fire occurred on 1.4.2016 at the premises and the entire stock were gutted with nil salvage value. The net quarter sales that is 1.4.2016 to 30.6.2016 was severely affected. The following are the other information:

Sales during the period	1.1.16 to 31.3.16	2,50,000
Purchases during the period	1.1.16 to 31.3.16	3,00,000
Manufacturing expenses	1.1.16 to 31.3.16	70,000
Sales during the period	1.4.16 to 30.6.16	87,500
Insured Standing charges		50,000
Actual expenses incurred after the fire		60,000

The general trend of the industry shows an increase of the sales by 15% and decrease in Gross Profit by 5% due to increased cost.

Ascertain the claim for stock and loss of profit .

Answers- Gross profit percentage 25% - 5%, closing stock on 31.3.2006 260,000, claim 260,000

Loss of profit 5% of 200,000, annual adjusted turnover = 750,000 + 15% + 250,000

Detailed Solution:

Part A : loss of stock Policy

Memorandum Trading Account 1.1.16 ...1.4.16

Particulars	Amount	Amount	Particulars	Amount	Amount
Opening stock		90,000	Sales		2,50,000
Purchases		3,00,000	Closing stock – B.F.		2,60,000
Manufacturing expenses		70,000			
Gross profit @ 20%		50,000			

Calculation of loss of stock:

Closing stock	2,60,000
Less Salvaged value of stock	Nil
Loss of stock	2,60,000

Claim for loss of Stock

Policy amount is Rs. 3,00,000 and closing stock amount is 2,60,000

Therefore entire loss of stock that is Rs. 2,60,000 shall be claimed

Part B: loss of Profit policy

1st step :

Calculation of gross profit Ratio

Gross profit ratio :	$\frac{\text{Net profit of last year 50,000 + Insured standing charges of Rs. 50,000*}}{\text{Sales of Rs. 87,500}} \times 100 = 10\%$

	Sales of last year 10,00,000 * out of total expenses given in the profit and loss account of last year, Selling expenses are not of Standing nature...therefore total standing expenses 1,80,000 out which insured are 50,000 and un-insured are 1,30,000
Less : decrease	5%
Effective rate	5%

2nd Step: Calculation of adjusted annual turnover:

Sales of 12 month preceding the date of fire	12 months period prior to the date of fire is 31.3.16 ...1.1.16 + 31.12.15 ...1.4.15 Sales of last year are 10,00,000 9 months sales of last year are $10,00,000 \times 9 / 12 = 7,50,000$ (1.4.15 to 31.12.15) + 3 months sale of 1.1.16 to 31.3.16 Rs. 2,50,000 Total sales of 12 months prior to the date of fire = $7,50,000 + 2,50,000 = 10,00,000$
Add % increasing trend	15% of 7,50,000 = 1,12,500 trend shall be applied on last year's sale only as current year's 3 months sale are at current year prices
Adjusted annual turnover (AAT)	11,12,500

3rd step: Calculation of Gross Profit on adjusted annual turnover:

Adjusted annual turnover (AAT)	11,12,500
Gross profit on AAT @ 5%	55,625 ; also known as Insurable amount

4th step : calculation of short Sales:

Standard turnover (last Year) for the period corresponding to Dislocated period	$10,00,000 \times 3 / 12 = 2,50,000$
Add: increasing trend 15%	37,500
	2,87,500
Less : actual turnover in dislocated period	87,500
Short Sales	2,00,000

5th step :Calculation of claim :

Loss of profit = short sales x Gross profit rate	$2,00,000 \times 5 \%$		10,000
Additional expenses : least of			
Actual expenses		60,000	
GP on increased turnover during dislocated period % of	5% of 87,500	4,375	
Additional expenses x Gross profit on AAT/ Gross profit on AAT + Un-Insured charges	$60,000 \times 55,625$ ----- $55,625 + 1,30,000$	17,980	4,375
Total loss			14,375

Less savings			0
Net loss of profit			14,375

6 step : claim receivable :

Insurable amount that is GP on AAT	55,625
Policy amount	1,00,000
Claim for 14,375	$14,375 \times 100,000 / 55,625 = 28,842$ But restricted to loss amount 14,375 as claim cannot exceed amount of loss

Section 5: Calculation of Policy Amount and Claim

5.1

Calculate the amount of Insurance claim to be lodged, based on the following information:

Value of stock destroyed by fire Rs.90,000

Insurance policy amount (subject to average clause) Rs.65,000

Value of stock salvaged from fire Rs.40,000

Solution :

Total stock before fire	90,000 + 40,000
Claim	$\frac{90,000 \times 65,000}{1,30,000} = 45,000$

5.2 - Calculation of Insurance claim

In January, 2016 a firm took an insurance policy for Rs. 60 lakhs to insure goods against fire subject to average clause. On 7th March, 2016 a fire broke out destroying goods costing Rs. 44 lakhs. Stock in the godown was estimated at Rs. 80 lakhs. Compute the amount of insurance claim.

Amount of insurance claim will be :

	Closing stock	Amount of policy
Amount	80 lakhs	60 lakhs
loss of stock policy amount	44 lakhs	$? = 44 \times 60 / 80 = 33 \text{ lakhs}$

5.3 - Calculation of Policy Amount

A trader intends to take a loss of profit policy with indemnity period of 6 months; however, he could not decide the policy amount. From the following details suggest the policy amount:

- Turnover in the last financial year 4,50,000
- Standing charges in the last financial year 90,000
- Net profit earned in last year was 10% of turnover and the same trend expected in the subsequent year.
- Increase in turnover expected 25%.

To achieve additional sales, trader has to incur additional expenditure of Rs. 31,250.

Solution-

Computation of gross Profit :

Gross profit ratio = $\frac{\text{Net Profit} + \text{Standing Charges}}{\text{Turnover of Last Year}} \times 100$

$\frac{45,000 + 90,000}{4,50,000} \times 100 = 30\%$

Computation of policy amount

Turnover in the last financial year	4,50,000
Add: 25% increase in turnover	1,12,500
	5,62,500
Gross profit on increased turnover 5,62,500 x 30%	1,68,750
Add: additional standing charges	31,250
Policy should be taken for	2,00,000

5.4 - Recording of shortfall in claim amount - Past Examination

A company lodged a claim to insurance company for Rs. 5,00,000 in September , 2016. The claim was settled in February, 2017 for Rs. 3,50,000. How will you record the short fall in claim settlement in the books of the company?

Solution:

Profit and loss a/c	Dr. 1,50,000
To, Insurance Company	1,50,000
<i>Shortfall in insurance claim transferred to P&L a/c</i>	

Sanjay Welkins' Classes

Chapter: 6

Not For Profit Organisations

Meaning

As the name suggests, a not for profit organization is a legal entity that is operated for the benefit of the society as a whole rather than for the benefit of a sole proprietor or a group of partners or shareholders. In every society we may find such organizations operating with the chief objective of social upliftment and welfare. Their primary aim may be social, educational, religious or charitable and take the form of clubs, societies or charitable societies and so on. Such organizations depend upon donations from members or outsiders for their funding requirements.

Certain concerns like Clubs, Charitable Institutions, Medical Association, Societies, etc. do not intend to earn profit. They render service to the society or to their members. Their members do not get any share of profit or dividend. These concerns are known as non-profit concerns as their transactions are service-based but not profit-based. Their annual accounts are regularly prepared to convey their financial affairs to their members or others like (govt. etc.) for seeking financial grants.

If the size of the concern is small, the accounting records are usually kept under single entry system. Complete double entry system is followed only in big concerns. In any case they all prepare — (A) Receipts & Payments Account for a financial period; (B) Income & Expenditure Account for a financial period and (C) Balance Sheet at the end of the financial period.

A. Receipts & Payments Account

1. It is an Account which contains all Cash and Bank transactions made by a non-profit organization during a particular financial period.
2. It starts with the opening balances of Cash and Bank. All Cash Receipts both capital & revenue during the period are debited to it.
3. All Cash Payments both capital & revenue during the period are credited to this Account. It ends with the closing Cash and Bank Balances.
4. While recording the Cash and Bank transactions all entries are made on Cash Basis.
5. It is a summary of Cash Book.
6. It follows Real Account

FORMAT OF RECEIPTS AND PAYMENT ACCOUNT

Receipts	Amount	Payments	Amount
Balance b/d:		Revenue expenditure	
Cash	xxx	Annual sports expenses	xxx
Bank	xxx	Salaries and wages	xxx
Revenue receipts		Rent and rates and taxes	xxx
Subscription		Insurance	xxx
For last year	xxx	Audit fees	xxx
For current year	xxx	Printing and stationery	xxx
For next year	<u>xxx</u>	Honorarium	xxx
Entrance fees	xxx	Bank charges	xxx
General donations	xxx	Postage and telegrams	xxx
Govt. grants	xxx	Water and electricity	xxx
Contribution to annual dinner	xxx	Conveyance and travelling	xxx
Rent	xxx	Sundry expenses	xxx

Sanjay Welkins Classes	Consignment Accounts - Revisionary Material

Receipt on annual spots meet	xxx	Annual dinner expenses	xxx
Sale of old newspapers	xxx	Capital payments	xxx
Sale of old magazines	xxx	Books	xxx
Sundry receipts	xxx	Investments	xxx
Capital receipts	xxx	Furniture, plant , buildings	xxx
Specific donations	xxx	Equipments	xxx
Legacy	xxx		
Endowment fund	xxx		
Life membership fees	xxx		
Tournament fund	xxx		
Prize fund	xxx		
	xxx		xxx

B.

Income & Expenditure Account

1. It follows Nominal Account.
2. All expenses of revenue nature for the particular period are debited to this Account on accrual basis.
3. Similarly all revenue incomes related to the particular period are credited to this account on accrual basis.
4. All Capital incomes and Expenditures are excluded.
5. Only current year's incomes and expenses are recorded. Amounts related to other periods are deducted. Amounts outstanding for the current year are added.
6. Profit on Sale of Asset is credited. Loss on Sale of Asset is debited. Annual Depreciation on Assets is also debited.
7. If income is more than expenditure, it is called a Surplus, and is added with Capital or General Fund etc. in the Balance Sheet.
8. If expenditure is more than in come, it is a deficit, and is deducted from Capital or General Fund etc. in the Balance Sheet.

Format of income and expenditure account

Income	Amount	Expenditure	Amount
Revenue payments	Xxx	Revenue Income	Xxx
surplus	xxx	deficit	xxx

C.

Balance Sheet

The Balance Sheet is prepared in the similar way as followed in a Trading concern. The marshalling of the assets and liabilities may be made in order of liquidity or in order of permanence.

Calculation of opening capital Fund : (If not mentioned)

Opening Capital Fund = Opening Assets - Opening Liabilities.

DISTINGUISH BETWEEN RECEIPTS AND PAYMENTS A/C AND INCOME EXPENDITURE A/C

Points of distinction	Receipts and payments A/c	Income and expenditure A/c
1. Nature	It is a statement of cash transaction for a period. (Real A/c)	It is another name of profit and loss A/c of non-trading concerns viz, hospitals, clubs, societies, educational institutions etc. (Nominal A/c)
2. Commencement	It commences with the opening balance of cash in hand and at bank.	It does not begin with any opening balance.

3.closing balance	This shows cash in hand or at bank at the end of the accounting year.	There is no closing balance but the difference between the two sides shows either surplus or deficit.
4.Capital and revenue items	All items whether of capital or revenue nature are shown in this account	Only revenue items are taken into consideration while preparing this account i.e. capital items are totally excluded.
5. Period	All receipts and payments whether relating to the current period, succeeding or preceding periods are taken into consideration.	Only current period's income and expenditure are taken into consideration while preparing this account i.e. income and expenditure relating to succeeding or preceding periods are excluded.
6. Balance sheet	It is not necessary to prepare balance sheet along with this account.	The balance sheet must be prepared in order to accommodate real and personal accounts along with this account.
7. Adjustments	No adjustments are required to be made at the end of the year.	In order to find out the true income or expenditure of the current year, all adjustments (i.e. outstanding expenses, prepaid expenses, income received in advance) are made at the end.
8. System	It is based on cash system.	It is based on accrual system.

Donations

- (a) Donation received for a particular purpose should be credited to Special Fund. For ex-ample, Donation received for Building should be credited to Building Fund A/c.
- (b) For other donations received the by-laws or rules of the concern should be followed.
- (c) If there is no such rule, donations received of non-recurring nature should be credited to Capital Fund. Recurring donations received should be credited to Income & Expenditure Account.
- (d) Donation paid by the concern should be debited to Income & Expenditure Account.

Legacy received :

It is to be directly added with Capital Fund after deduction of tax,(if any). It is a kind of donation received according to the will made by a deceased person.

Entrance Fees or Admission Fees

- (a) The rules or by-laws of the concern should be followed.
- (b) If there is no such rule, Admission or Entrance Fees paid once by members for acquiring membership should be added with Capital Fund.
- (c) If such fees are of small amounts covering the expenses of admission only, the fees may be credited to Income & Expenditure Account.

Subscriptions

- (a) Annual subscriptions are credited to Income & Expenditure Account on accrual basis.
- (b) Life membership subscription is usually credited to a separate account shown as a liability. Annual Subscription apportioned out of that is credited to Income & Expenditure Account and deducted from the liability. Thus the balance is carried forward till the contribution by a member is fully exhausted. If any member dies before hand, the balance of his life Membership contribution is transferred to Capital Fund or General Fund.

Section – 1 - Preparation of Subscription account**1.1**

Following is an extract of receipts and payment account. Find out amount of subscriptions to be shown under income and expenditure account:

Sanjay Welkins' Classes

Subscriptions	
For last year	10,000
For current year	1,00,000
For next year	20,000

Additional information:

1. Subscriptions in arrear/due /outstanding for last year Rs. 15,000.
2. Subscriptions outstanding for current year Rs. 30,000
3. Subscriptions received in advance for next year Rs. 20,000.

Answer: Rs. 130000.

Detailed Solution:

Subscription a/c					
Opening due:		15,000	Opening advance:		-
Subscriptions in arrear/due /outstanding for last year			subscription received last year for current year		
Income and expenditure a/c	B.F	1,30,000*	Cash : total subscription received in current year	10,000 + 1,00,000 + 20,000	1,30,000
Closing advance :		20,000	Closing Due :		
subscription received in current year for next year			subscription due at the end of the year:		
			Last year' due: total due till the end of last year	5,000	
			15,000 - out that 10,000 received in current year		
			Current year	30,000	35,000

1.2

Find out the amount of subscriptions to be shown in the income and expenditure account.

Receipts and payment account for the year ended 31.12.2019

Subscriptions:	
For 2018	20,000
For 2019	200,000
For 2020	30,000
	2,50,000

Additional information:

1. subscriptions in arrear for last year [2018] amounted to Rs. 20,000
2. subscriptions in arrear for the year 2019 amounted to Rs. 35,000
3. subscriptions received in advance for 2020 amounts to Rs. 30,000

Answer: Rs. 235000.

Detailed Solution:

Subscription a/c					
Opening due:		20,000	Opening advance:		-
subscriptions in arrear/due /outstanding for last year			subscription received last year for current year		
Income and expenditure a/c		2,35,000*	Cash : total subscription received in current year		2,50,000
Closing advance :		30,000	Closing sue :		
subscription received in current year for next year			subscription due at the end of the year:		
			Last year	-	

Sanjay Welkins Classes	Consignment Accounts - Revisionary Material

			Current year	35,000	35,000

1.3

There were 450 members in a club each paying an annual subscriptions of Rs. 50. Rs. 500 was in arrears as on 31.12.2018. Subscriptions received during 2019 were Rs. 22,300. It included Rs. 450 for 2018 and Rs. 750 for the year 2020. Calculate the amount of subscriptions in arrears as on 31.12.2019 by preparing Subscriptions account.

Amount to be shown in income and expenditure a/c Rs. 22500, subscription due at the end of current year 1,450

Detailed Solution:

Subscription a/c

Opening due: subscriptions in arrear/due /outstanding for last year		500	Opening advance: subscription received last year for current year		-
Income and expenditure a/c	450x 50	22,500	Cash : total subscription received in current year		22,300
Closing advance : subscription received in current year for next year		750	Closing sue : subscription due at the end of the year:		
			Last year	50	
			Current year	1,400	1450*

1.4

How will deal with the following in the income and expenditure account and Balance sheet of a club as on 31.12.2017:

Subscriptions received during 2017	Rs. 25,000
Subscriptions outstanding as on 31.12.2016	Rs. 5,000
Subscriptions outstanding as on 31.12.2017	Rs. 10,000
Subscriptions received in advance as on 31.12.2016	Rs. 7,500
Subscriptions received in advance as on 31.12.2017 for 2018	Rs. 5,000

Solution:

Subscription a/c

Opening due: subscriptions in arrear/due /outstanding for last year		5,000	Opening advance: subscription received last year for current year		7,500
Income and expenditure a/c		32,500*	Cash : total subscription received in current year		25,000
Closing advance : subscription received in current year for next year		5,000	Closing sue : subscription due at the end of the year:		
			Last year		
			Current year		10,000

1.5

How will deal with the following in the income and expenditure account and Balance sheet of a club as on 31.3.2018:

Subscriptions received for the year ended 31.03.17 Rs. 12,000
 Subscriptions Received for the year ended 31.03.2018 Rs. 6,15,000
 Subscriptions Received for the year ended 31.03.2019 Rs. 18,000
 There are 500 members and annual subscription is Rs. 1,500 per member.
 On 31.3.2018 a sum of Rs. 15,000 was still in arrear for the year ended 31.12.17

Detailed Solution:

Subscription a/c

Opening due: subscriptions in arrear/due /outstanding for last year	12,000+ 15,000	27,000	Opening advance: subscription received last year for current year		-
Income and expenditure a/c	500 x 1,500	7,50,000	Cash : total subscription received in current year		6,45,000
Closing advance : subscription received in current year for next year		18,000	Closing sue : subscription due at the end of the year:		
			Last year	15,000	
			Current year	1,35,000	1,50,000

1.6

Om Shanti club has 500 members with annual fee of Rs. 1,000 per member. At the end of the accounting year, accountant noticed that 40 members have not paid annual fee and 70 members had paid fee in advance. Help the accountant to compute cash receipts of annual fee for the year.

Subscription a/c

Opening due: subscriptions in arrear/due /outstanding for last year		nil	Opening advance: subscription received last year for current year		nil
Income and expenditure a/c	500 x 1,000	5,00,000	Cash : total subscription received in current year: B.F.		5,30,000
Closing advance : subscription received in current year for next year	70x 1,000	70,000	Closing sue : subscription due at the end of the year:		
			Last year	40 x 1,000	40,000
			Current year		

1.7

Find out the amount of subscriptions to be shown in the income and expenditure account.

Receipts and payment account for the year ended 31.03.2021

Subscriptions: For 2019-20 4,000 For 2020-21 20,000 For 2021-22 <u>6,000</u>	30,000

Additional information:

1. subscriptions in arrears on 31.03.2020 Rs. 5.000

2. subscriptions in arrears on 31.03.21 Rs. 4,000
3. subscriptions received in advance on 31.03.2020 for 2020-21 Rs. 5,000

Detailed Solution:

Sanjay Welkins' Classes

4. Subscription a/c

Opening due: subscriptions in arrear/due /outstanding for last year	5,000	Opening advance: subscription received last year for current year		5,000
Income and expenditure a/c	28,000*	Cash : total subscription received in current year		30,000
Closing advance : subscription received in current year for next year	6,000	Closing sue : subscription due at the end of the year:		
		Last year	1,000	
		Current year	3,000	4,000
	39,000			39,000

1.8: CMA Examination Problem - 2 Marks, Modified

Compute the amount of subscription for the year 2022 from the following particulars relating to Town Club:

	01.01.21	31.12.22
Subscriptions outstanding	9,500	7,000
Subscriptions received in advance	2,800	5,200
Subscription received during the year Rs. 1,45,000		

Answer :Rs. 1,40,100

1.9: CMA Examination Problem - 2 Marks, Modified

Compute the amount of subscription for the year 2022 from the following particulars relating to Hill View Club:

Subscription received during the year ending 31.03.2022 Rs. 2,56,000, out of which Rs. 8,000 was for the year 2022 – 23 and 11,000 for the year 2020 -21

Subscription was outstanding on 01.04.21 Rs. 18,000 and on 31.03.22 for 2021-22 Rs. 21,000.

Answer: Rs. 2,58,000

Section - 2 – Preparation of Income and expenditure Account and balance sheet

2.1

Following is extract of Receipt and Payment Account of Fine Evening Club for the year ended 31.03.22:

Receipts	Amount	Payments	Amount
Match Fund	1,00,000	Match Expenses	90,000
Tournament Receipts	25,000	Tournament Expenses	18,000
Interest on Match Fund Investments	10,000		

On 1.4.21 Club had following Balances :

Match Fund Rs. 2,00,000

Match Fund Investment: Rs. 2,00,000

Show treatment of above items while preparing annual accounts of the Club.

2.5 – CMA – Examination Problem – 10 Marks - Modified

Shiva City College presents the following information to you:

Receipts and payment account for the year ended 31.3.2025

Opening balance	6,00,000	Salaries and Allowances	21,15,000
Tuition Fees	18,00,000	P.F. Contribution	1,66,200
Grants	9,00,000	Printing and Stationery	51,000
Interest on Bank F.D.	9,000	Books for Library	78,000
Hall Rent	30,000	Postage and Telegram	15,000
		Newspapers and periodicals	9,000

Sanjay Welkins Classes	Consignment Accounts - Revisionary Material

		Laboratory Equipments	29,400
		Telephone Expenses	25,000
		Repairs for buildings	32,000
		Misc. charges	18,000
		Audit fee	10,000
		Creditors for outstanding	21,000
		Bank Fixed Deposit	4,00,000
		Closing Balance	3,69,400
	33,39,000		33,39,000

Balance sheet as on 31.03.2024

O/S Expenses	21,000	Cash and bank	6,00,000
Building Fund	18,00,000	Furniture	10,50,000
Scholarship fund	3,00,000	Land and building	48,00,000
General Reserves	15,00,000	Tuition Fee O/s	66,000
Capital Fund	39,15,000	Library books	7,20,000
		Fixed Deposit in bank	3,00,000
	75,36,000		75,36,000

Other Information:

It was ascertained that Rs. 1,70,000 was outstanding by way of tuition fees on 31.03.2020

The creditors outstanding for library books amounted to Rs. 30,000 at the end of the financial year 2019-20

Outstanding salaries were Rs. 90,000 as on 31.03.20

Depreciation to be charged on:

1. Land and buildings at 5%
2. Furniture and fixtures @ 10%
3. Library books @ 20%

You are required to prepare Income and expenditure account for the year ended 31.3.2020 and the balance sheets as on 31.3.2019 and 31.3.2020.

Detailed Solution:

Income and expenditure account for the year ended 31.03.25

Expenditure	Amount	Income	Amount
Dep. On L. Books	1,65,600	Tuition Fee Recd 18,00,000 + CY o/s 1,70,000 - LY o/s 66,000	19,04,000
Salary and allowances 21,15,000 + 90,000	22,05,000	Grants	9,00,000
Dep. On L/B	2,40,000	Interest on fixed Deposits	9,000
Dep. On F/F	1,05,000	Hall Rent	30,000
Postage and Telephone	15,000	Deficiency - B.F.	1,98,800
Newspapers and periodicals	9,000		
Telephone Expenses	25,000		
Repairs	32,000		
Misc. Charges	18,000		
A. Fees	10,000		

Balance - sheet as at 31.3.25

	Last Year	Current year		Last year	Current year
Creditors for L. Books		30,000	Tuition fee		66,000
Salary o/s		90,000	Cash		3,69,400
Building Fund		18,00,000	F/F		9,45,000
Scholarship Fund		5,00,000	L. Books		6,62,400
General Reserve		15,00,000	L/B		45,60,000
C. Fund (B.F.)		37,16,200	Lab. Equipments		29,400

		Fixed Deposits	7,00,000

Creditors for L. Books a/c

		Bal. b/d	-
Bal. c/d	30,000	Purchases (on credit) B.F.	30,000

L. Books a/c

b/d	7,20,000	I/E : Dep. 8,28,000 x 20%	1,65,600
R/P	78,000	c/d : BF	6,62,400
Credit Purchases	30,000		

F/F a/c

b/d	10,50,000	Depreciation: @ 10%	1,05,000
R/P	-	c/d	9,45,000

Lab. Equipment a/c

b/d	-		-
R/P	29,400	c/d - BF	29,400

Outstanding Expenses a/c

RP	21,000	b/d - B.F.	21,000

Fixed Deposit a/c

b/d	3,00,000		-
R/P	4,00,000	c/d - BF	7,00,000

Building Fund a/c

		b/d -	18,00,000
Bal. c/d - BF	18,00,000		

2.9 – CMA – Examination Problem – 10 Marks Modified

Following is the Balance Sheet of Parth Library Society for the year ended 31-3.2024:

Receipts	Amount - Rs.	Payments	Amount – Rs.
Capital Fund	7,93,000	Electricals fittings	1,50,000
Expenses Payable	7,000	Furniture	50,000
		Books	4,00,000
		Investments in Securities	1,50,000
		Cash at Bank	25,000
		Cash in Hand	25,000
Total	8,00,000	Total	8,00,000

The Receipts and Payments account for the year ended for the year ended on 31.03.25 is given below

Receipts	Amount	Payments	Amount
Balance b/d :		Electric charges	7,200
Cash at Bank	25,000	Postage and stationery	5,000
Cash in Hand	25,000	Telephone charges	5,000
Entrance Fees	30,000	Books purchased 1.4.2021	60,000
Membership Subscription	2,00,000	O/S Expenses Paid	7,000
Sale of Old Papers	1,500	Rent	88,000
Hire of Lecture Hall	20,000	Investment in Securities	40,000
Interest on securities	8,000	Salaries	66,000
		Balance c/d :	
		Cash at bank	20,000
		Cash in hand	11,300
	3,09,500		3,09,500

Other Information:

- Membership subscription included Rs. 10,000 received in advance
- Provide for outstanding Rent Rs. 4,000 and Salaries Rs. 3,000
- Electrical fittings, Furniture and Books to be depreciated @ 10% including additions
- 75% of entrance fees to be capitalised
- Interest on securities is to be calculated @ 5% p.a. including purchased made on 01.10.2024.

Requirement: Preparation of Income and Expenditure account for the year ended 31.03.25 and a Balance sheet on that date.

Detailed Solution:

Income and expenditure account for the year ended 31.03.25

Expenditure	Amount	Income	Amount
Rent 88,000 + CY o/s 4,000	92,000	Membership Subscription	1,90,000
Salary 66,000 + 3,000	69,000	Entrance fee 30,000 x 25%	7,500
Dep. On E. Fittings	15,000	Interest on Securities : Recd. 8,000 + Accrued 500	8,500
Dep. On F/F	5,000	Sale of old papers	1,500
Dep. On Books	60,000	Hire of Lecture Hall	20,000
Postage	5,000		
Telephone Expenses	25,000		
Tel. Charges	5,000		
O/s Expenses : RP 7,000 - LY O/s 7,000	-	Deficiency - B.F.	16,700

Balance - sheet as at 31.3.25

	Last Year	Current year		Last year	Current year
Subs. In adv.	-	10,000	Electrical Fittings	1,50,000	1,35,000
O/s Rent	-	4,000	F/F	50,000	45,000
O/s Salaries		3,000	Books	4,00,000	4,14,000
Entrance fee 30,000 x 75%	-	22,500	Investments	1,50,000	1,90,000
LY O/s Expenses	7,000	-	Accrued Interest	-	500
C. Fund (B.F.)	7,93,000	7,76,300	Cash at Bank	25,000	20,000
			Cash in hand	25,000	11,300

Subscription a/c

I/E - B.F	1,90,000	Bal. b/d	-

Closing adv.	10,000	R/P	2,00,000

Books a/c

b/d	4,00,000	I/E : Dep.	46,000
R/P	60,000	c/d : BF	4,14,000

F/F a/c

b/d	50,000	Depreciation: @ 10%	5,000
R/P	-	c/d	45,000

Electrical Fittings a/c

b/d	1,50,000	Dep. 10%	15,000
R/P	-	c/d - BF	1,35,000

Investment in Securities a/c

b/d	1,50,000		-
R/P	40,000	c/d - BF	1,90,000

2.11

On the basis of the following information, prepare Income and Expenditure Account for the year ended 31st March, 2020:

Receipts and Payments Account for the year ended 31st March, 2020

Receipts	Rs.	Payments	Rs.
To Cash in hand (opening)	1,300	By Salaries	2,58,000
To Cash at Bank (opening)	3,850	By Rent	71,500
To Subscriptions	4,94,700	By Printing & Stationery	3,870
To Interest on 8% Govt. Bonds	4,000	By Conveyance	10,600
To Bank Interest	160	By Scooter purchased	50,000
		By 8% Govt. Bonds	1,00,000
		By Cash in hand (closing)	840
		By Cash at Bank (closing)	9,200
	5,04,010		5,04,010

- (i) Salaries paid includes Rs.6,000 paid in advance for April, 2020. Monthly salaries paid were Rs.21,000.
- (ii) Outstanding rent on 31st March, 2019 and 31st March, 2020 amounted to Rs.5,500 and Rs.6,000 respectively.
- (iii) Stock of printing and stationery material on 31st March, 2019 was Rs.340; it was Rs.365 on 31st March, 2020.
- (iv) Scooter was purchased on 1st October, 2019. Charge 20%p.a. depreciation on it.
- (v) Investments were made on 1st April, 2019.
- (vi) Subscriptions due but not received on 31st March, 2019 and 31st March, 2020 totaled Rs.14,000 and Rs.12,800 respectively. On 31st March, 2020 subscription amounting to Rs.700 had been received in advance for April, 2020.

Answer – Surplus 1,57,515, Subscription - 4,92,800

Detailed Solution:

Income and expenditure account for the year ended.....

Expenditure	Amount	Income	Amount
Salaries : 2,58,000 – advance 6,000	2,52,000	Subscriptions*	
Rent 71,500 + C.Y o/s 6,000 – LY O/s 5,500	72,000	Interest on 8% Govt. Bonds : Recd 4,000 + to be recd.	8,000

Sanjay Welkins Classes	Consignment Accounts - Revisionary Material

		4,000	
Printing and stationery*	3,845	Bank Interest	160
Conveyance	10,600		
Depreciation on scooter*	5,000		
Surplus*	1,57,515		5,00,960
	5,00,960		

Balance - sheet

	Last Year	Current year		Last year	Current year
o/s Rent	5,500	6,000	Salaries in advance		6,000
Subs. In adv.	-	700	Stock of printing	340	365
Capital fund	13,990	1,71,505	Subs. o/s	14,000	12,800
			Cash in hand	1,300	840
			Cash at bank	3,850	9,200
			Int. on investment to be recd.		4,000
			Scooter		45,000
			Investments		1,00,000

Subscription account

Opening due: subscriptions in arrear/due /outstanding for last year		14,000	Opening advance: subscription received last year for current year		-
Income and expenditure a/c		4,92,800	Cash : total subscription received in current year		4,94,700
Closing advance : subscription received in current year for next year		700	Closing sue : subscription due at the end of the year: Last year Current year		12,800

Stock of printing & stationery a/c

b/d	340	I/E : consumed*	3,845
R/P	3,870	c/d	365

Scooter a/c

		Depreciation: $50,000 \times 20\% \times 6/12$	5,000
R/P	50,000	c/d	45,000

Investment in 8% Govt. Bonds a/c

b/d	-		
R/P	1,00,000	c/d *	1,00,000

2.12 – CMA Examination Problem – 10 Marks - Modified

From the following Receipts and payment account of Sodepore Recreation Club and the additional information prepare an income and expenditure account for the year ended on 31.12.2022:

Receipts and payment account for the year ended 31.12.2022

Receipts	Amount Rs.	Payments	Amount Rs.
Cash in hand	1,000	Rent of club house	2,600
Cash at Bank	12,000	Painting of club house	1,400
Members Subscription :		Wages of ground maintenance	3,000

2021 : 200		General expenses	2,000
2022 : 3,600		Electricity Charges	3,600
2023 : 400	4,200	Investments	20,000
Life Membership Subscription	4,000	Secretary's honorarium	1,200
Sale of Tickets of annual exhibition	20,000	Annual meeting Expenses	800
Sale of refreshment	24,000	Sports Equipments	3,600
Interest on Investments	2,600	Purchase of refreshments	11,000
Sale of old Furniture	200	Printing and stationery	1,000
(Original Cost on 1.1.16 Rs.1,000)		Insurance	600
		Cash in hand	4,000
		Cash at bank	12,600
	68,000		68,000

Additional information:

1. On 31.12.2021 Outstanding Subscription was Rs. 300.
2. On 31.12.2021 advance subscription for 2022 received was Rs. 100.
3. On 31.12.2022 outstanding subscription for 2022 was Rs. 600.
4. A life Membership Scheme was introduced in 2021. Under the scheme, Life membership premium is Rs. 1,000 and it was to be apportioned to income $\frac{1}{10}^{\text{th}}$ every year over a period of 10 years. Life membership subscription totalling Rs. 5,000 collected during 2021
5. On 1.1.2022 Investments was Rs. 40,000 and accrued interest on such date was Rs. 2,400
6. On 1.1.2021 furniture costing Rs. 16,000 were purchased and it was decided to write off depreciation on furniture and sports equipment @ 10% on cost.
7. In 2021, a plot of land was purchased for Rs. 20,000 to construct Club House
8. Other assets and liabilities of club are :

Amount in Rs.

	Stock of Refreshments	Prepaid Insurance	Accrued Rent	Creditors for refreshments
31.12.2021	3,800	140	400	800
31.12.22	4,200	100	200	1,000

Detailed Hints:

Surplus Rs. 19,800 /Subscription credited to I/E Rs. 4,300 / LMF credited to I/E Rs. 900 that is $\frac{1}{10}$ of LMF received last year 5,000 and $\frac{1}{10}^{\text{th}}$ of LMF received in current year i.e. 4,000 / Closing Capital Fund :
 $88,640 + 19,800 = 1,08,440$ / Balance sheet total Rs. 94,940.

Section – 3
Preparation of Receipts and Payments account from Income and Expenditure account

3.1 CMA Examination Problem – 12 Marks

Following is the Income and Expenditure account of Rising Sun Club for the year ended 31-3-2019:

Expenditure	Amount - Rs.	Income	Amount – Rs.
Salaries	1,20,000	Subscriptions	1,60,000
Printing and stationery	6,000	Entrance fees	10,000
Rent	12,000	Contribution for annual dinner	20,000
Repairs	10,000	Profit on annual sports meet	20,000
Sundry expenses	8,000		
Annual dinner expenses	30,000		
Interest to bank	6,000		

Sanjay Welkins Classes	Consignment Accounts - Revisionary Material

Depreciation on sports equipments	6,000		
Excess of income over expenditure	12,000		
	2,10,000		2,10,000

The above account had been prepared after the following adjustments:

Subscriptions outstanding on 31.03.2018	12,000
Subscriptions received in advance on 31.03.2018	9,000
Subscriptions received in advance on 31.03.2019	5,400
Subscriptions outstanding on 31.03.2019	15,000

- Salaries outstanding at the beginning and the end of the financial year were Rs. 8,000 and Rs. 10,000 respectively.
- Sundry expenses included prepaid insurance expenses of Rs. 1,200.
- The club owned a freehold ground valued Rs. 2,00,000.
- The club had sports equipment on 1.4.2018 valued at Rs. 52,000.
- At the end of the year after depreciation, the sports equipment amounted to Rs. 54,000.
- The club raised a loan of Rs. 40,000 from bank on 01.01.2018, which was unpaid till 31.03.2019.
- On 31.03.2019 cash in hand was Rs. 32,000.

Prepare receipt and payment account of the club for the year ended 31.03.2019 and a Balance sheet as on that date.

Detailed Solution:

Receipts and Payments for the year ended.....

Receipts	Amount	Payments	Amount
Opening balance - bal. figure	27,800	Salaries	1,18,000
Subscription	1,53,400	Sundry expenses	9,200
Entrance fee	10,000	Printing and stationery	6,000
Contribution for annual dinner	20,000	Rent	12,000
Profit on annual sports meet	20,000	Repairs	10,000
		Annual dinner expenses	30,000
		Interest	6,000
		Sports equipment	8,000
		Bal. c/d	32,000

Balance - sheet

	Last year	Current year		Last year	Current year
Subs in advance	9,000	5,400	Subs. due	12,000	15,000
Salaries o/s	8,000	10,000	Prepaid insurance	-	1,200
Loan	40,000	40,000	Cash	27,800	32,000
Capital fund	2,34,800	2,46,800	Sports equipment	52,000	54,000
			Freehold ground	2,00,000	2,00,000

Subscription account

Opening due: subscriptions in arrear/due /outstanding for last year		12,000	Opening advance: subscription received last year for current year		9,000
Income and expenditure a/c		1,60,000	Cash : total subscription received in current year: B.F.		1,53,400
Closing advance :		5,400	Closing sue : subscription		15,000

subscription received in current year for next year			due at the end of the year: Last year Current year		

Outstanding items a/c

	Receipts and payments : B.F.	+ op. o/s	- closing o/s	I/ E a/c : given
Salaries a/c	1,18,000	8,000	10,000	1,20,000

Sundry Expenses a/c / prepaid insurance

Op. bal. b/d	Nil	I/E	8,000
R/P – B.f.	9,200	Cl. bal	1,200

Freehold buildings a/c

Op. bal b/d	2,00,000	Bal. c/d – B.f.	2,00,000

Sports equipment a/c

b/d	52,000	I/E	6,000
R/ P – B.f.	8,000	Bal. c/d	34,000

Loan a/c

Bal. c/d – b.f.	40,000	b/d	40,000

3.2 – CMA Examination Problem – 15 marks - Modified

Following is the Income and Expenditure account of Gama Club for the year ended 31-3-2022:

Expenditure	Amount - Rs.	Income	Amount – Rs.
Salaries	19,500	Subscriptions	68,000
Rent	4,500	Donation	5,000
Printing	750		
Insurance	500		
Audit fees	750		
Games and Sports	3,500		
Subscription written off	350		
Miscellaneous expenses	14,500		
Loss on sale of furniture	2,500		
Dep. on sports equipments	6,000		
Dep. on Furniture	3,100		
Excess of income over expenditure	17,050		
	73,000		73,000

The above account had been prepared after the following adjustments:

	31.03.21	31.03.22
Subscriptions outstanding	2,600	3,700
Subscriptions received in advance	1,000	1,500
Outstanding Expenses:		
Rent	500	800
Salaries	1,200	350
Audit fee	500	750
Sports Equipments less Dep.	25,000	24,000

Sanjay Welkins Classes	Consignment Accounts - Revisionary Material

Furniture less Dep.	30,000	27,900
Prepaid Insurance	-	150

Book value of furniture sold is Rs. 7,000

Entrance fee capitalised Rs. 4,000

On 1.04.21 cash in hand is Nil and bank overdraft is Rs. 15,000

On 31.03.22, cash in hand is Rs. 850 and rest is bank balance.

Detailed Hints

Bank balance : 7,250

Subscription to be shown in R?P a/c : 67,050

Receipts and Payments for the year ended.....

Receipts	Amount	Payments	Amount
b/d : Cash in hand	-	Op bal. b/d : BOD	15,000
Subscription - W N	67,050	Salary - WN - 2	20,350
Sale of F/F - WN	4,500	Audit fee - WN - 4	500
Entrance fee - WN	4,000	Purchase of Sports Equipments WN 5	5,000
Donations	5,000	Pur. o F/F - WN - 6	650
		Printing	750
		Games and sports	3,500
		Misc. Expenses	14,500
		Balance c/d - Cash in hand	850
		- Bank - B.F.	7,250

Balance - sheet

	Last Year	Current year		Last year	Current year
Subs. In Adv.	1,000	1,500	Cash	-	850
O/s Rent	500	800	Bank	-	7,250
o/s Salary	1,200	350	Subscription due	2,600	1,500
o/s Audit	500	750	Prepaid Insurance	-	150
Bank overdraft	15,000	-	Sport Equipment	25,000	24,000
Entrance fee	-	4,000	F/F	30,000	27,900
Capital fund - B.F	39,400	56,450			

Subscription account

Opening due:	2,600	Opening advance:	1,000
Income and expenditure a/c	68,000	Cash : total subscription received in current year - B.F.	67,050
Closing advance :	1,500	Closing sue : subscription due at the end of the year:	3,700
		For Last year	
		For Current year	

O/S Rent a/c

R/P - B.F.	4,200	Bal. b/d	500
Bal. c/d -	800	I/E a/c	4,500

O/S Salary a/c

R/P - B.F.	20,350	Bal. b/d	1,200
Bal. c/d	350	I/E a/c	19,500

O/S Audit Fee a/c

R/P - B.F.	500	Bal. b/d	500
Bal. c/d	750	I/E a/c	750

Stock of Equipment a/c

Op b/d	25,000	I/E :	6,000
R/P B.F.	5,000	c/d	24,000

Building a/c

b/d	10,000	Dep B.F..	500
		Bal c/d	1,000
c/d	2,500		

F/F a/c

b/d	30,000	I/E: depreciation	3,100
R/P - Purchase B.F.	8,000	I/E : Loss on sale of F/F	2,500
		R/P ::Bank	4,500
		c/d - B.F.	27,900

Prepaid Insurance a/c

b/d	-	I/E	500
R/P : B.F.	650	c/d -	-

Creditor for supplies a/c

R/P	600	Bal. b/d	800
Bal. c/d - b.f.	200		

Section – 4

Preparation of Receipts and Payments and Income and Expenditure Account and Balance Sheet

4.1 – CMA Examination Problem – 4+4+2 Marks

A Town Club provides you information relating to assets and liabilities as on 01.01.2021.

Prepare (i) Receipts and Payment Account and (ii) Income and Expenditure Account for the year ended 31.12.21

- Cash in hand Rs. 4,000
- Subscription receivable Rs. 400
- Furniture Rs. 2,000
- Sports Material Rs. 1,200
- Investments 5,000
- Buildings Rs. 10,000
- Outstanding Creditors for supplies Rs. 800.

During the year , the club did the following business :

1. Subscription received including the arrears Rs. 6,000
2. Subscription due Rs. 600
3. Paid outstanding creditors for supplies Rs. 600
4. Subscription to newspapers Rs. 1,000
5. Sports Materials purchased Rs. 2,000
6. Sale of old News papersRs. 100
7. Meeting Expenses Rs. 900
8. Lighting expenses Rs. 800
9. Establishment Salaries Rs. 2,000

10. Stock of sports materials at the end Rs. 1,000
11. Interest received on Investments Rs. 150 and outstanding Rs. 50
12. Borrowings Rs. 4,000
13. Purchased furniture on 31.12.21 Rs. 800
14. Expenditure on annual dinner Rs. 750
16. Donations received Rs. 3,600 out of which 50% capitalised
17. Depreciation on furniture and buildings 5%

Detailed Solution :

Receipts and Payments for the year ended.....

Receipts	Amount	Payments	Amount
b/d : Cash in hand	4,000	Creditors for supplies	600
Subscription	6,000	Subscription to N/P	1,000
Interest Received	150	Meeting Expenses	900
Borrowings	4,000	Lighting Expenses	800
Donations	3,600	Establishment Salaries	2,000
		Purchase of F/F	800
		Annual dinner expenses	750
		Balance c/d - B.F	10,900

Income and expenditure account for the year ended.....

Expenditure	Amount	Income	Amount
Subscription to N/P	1,000	Subscription	6,200
Meeting Expenses	900	Interest Recd. 150 + o/s 50	200
Lighting Expenses	800	Donations 3,600 x 50%	1,800
Establishment Salaries	2,000		
depreciation on F/F	100		
Annual dinner Expenses	750		
Depreciation on buildings	500		
Depreciation on sports Material	200		
Surplus	1,950		

Balance - sheet

	Last Year	Current year		Last year	Current year
Creditors for supplies	800	200	Cash	4,000	10,900
Borrowings	-	4,000	Subscription due	400	600
Donations	-	1,800	o/s Interest		50
Capital fund - B.F	21,800	23,750	Sport material	1,200	1,000
			Investments	5,000	5,000
			Buildings	10,000	9,500

Subscription account

Opening due: subscriptions in arrear/due /outstanding for last year		400	Opening advance: subscription received last year for current year		-
Income and expenditure a/c		6,200*	Cash : total subscription received in current year		6,000

Closing advance : subscription received in current year for next year		-	Closing sue : subscription due at the end of the year: Last year Current year		600

Stock of Material a/c

Op b/d	1,200	I/E : Dep. /consumed	200
		c/d	1,000

Building a/c

b/d	10,000	Dep B.F..	500
		Bal c/d	1,000
c/d	2,500		

F/F a/c

b/d	2,000	I/E: depreciation 2,000 x 5%	100
R/P	800	c/d - B.F.	2,700

Investment a/c

b/d	5,000		
		c/d - b.f.	5,000

Creditor for supplies a/c

R/P	600	Bal. b/d	800
Bal. c/d - b.f.	200		

4.2 – CMA Examination Problem – 15 Marks

Following is the summary of Receipts and Payments of Radix Clinic for the year ended 31.03.22:

Opening cash balance	56,000
Donations received (including Rs. 50,000 for building fund)	1,55,000
Payment to creditors for Medicines supply	2,10,000
Salaries	70,000
Purchase of Medical Equipments	1,05,000
Medical camp collections	87,500
Subscriptions Received	3,50,000
Interest on Investments @ 9 % per annum	63,000
Honorarium to Doctors	1,90,000
Telephone expenses	6,000
Medical camp expenses	10,500
Miscellaneous expenses	7,000

Additional Information

	31.03.21	31.03.22
Subscriptions outstanding	10,500	15,400
Subscriptions received in advance	8,400	4,900
Stock of medicine	70,000	1,05,000
Medical Equipments	1,47,000	2,14,200
Building	3,50,000	3,15,000
Creditors for Medicine supply	63,000	91,000
Investments	7,00,000	7,00,000

You are required to prepare R/P a/c and I/E a/c for the year ended 31.03.22.

Sanjay Welkins Classes	Consignment Accounts - Revisionary Material

Detailed Solution :

Receipts and Payments for the year ended.....

Receipts	Amount	Payments	Amount
b/d : Cash in hand	56,000	Creditors for medicines	2,10,000
Donations	1,55,000	Salaries	70,000
Medical camp collections	87,500	Purchase of Med. Equipment	1,05,000
Subscriptions Received	3,50,000	Honorarium to Doctors	1,10,000
Interest on Investments	63,000	Establishment Salaries	2,000
		Telephone Expenses	6,000
		Medical camp expenses	10,500
		Misc. Expenses	7,000
		Closing Cash - B.F.	1,13,000

Income and expenditure account for the year ended.....

Expenditure	Amount	Income	Amount
Salaries	70,000	Subscription	3,58,400
Honorarium	1,90,000	Donations	1,05,000
Telephone Expenses	6,000	Medical Camp Collections	87,500
Medical camp Expenses	10,500	Interest on Investments	63,000
Misc. Expenses	7,000		
Dep. On Med. Equipments	37,800		
Depreciation on buildings	35,000		
Depreciation on sports Material	2,03,000		
Surplus - B.F.	54,600		

Balance - sheet

	Last Year	Current year		Last year	Current year
Creditors for supplies	800	200	Cash	56,000	1,13,000
Borrowings	-	4,000	Subscription due	10,500	15,400
Donations	-	1,800	Stock of Medicines	70,000	1,05,000
Capital fund - B.F	21,800	23,750	Medical Equipments	1,47,000	2,14,200
			Investments	7,00,000	7,00,000
			Buildings	3,50,000	3,15,000

Subscription account

Opening due:		10,500	Opening advance:		8,400
Income and expenditure a/c		3,58,400*	Cash : total subscription received in current year		3,50,000
Closing advance :		4,900	Closing sue : subscription due at the end of the year:		15,400

Creditor for Medicine a/c

Cash	2,10,000	Bal. b/d	63,000
Bal. c/d - b.f.	91,000	Purchases - B.F	2,38,000

Stock of Medicine a/c

Op b/d	70,000	I/E : Dep. /consumed	2,03,000

Credit Purchases	2,38,000	c/d	1,05,000

Building a/c

b/d	3,50,000	Dep. B.F..	15,000
		Bal c/d	3,15,000
c/d	2,500		

Medical Equipment a/c

b/d	1,47,000	I/E: depreciation B.F.	37,800
R/P	1,05,000	c/d -	2,14,200

Investment a/c

b/d	7,00,000		
		c/d - b.f.	7,00,000

Section – 5 - Preparation of Balance Sheets

5.1

Income and expenditure account for the year ended 31.3.2015 of ABC education society is given below:

Salaries	8,300	Subscriptions	47,800
Scholarships	41,300	Government grants	5,300
Rent	2,800	Proceeds of tickets for entertainment	8,300
General expenses	3,100	Advertisement in Souvenir	1,500
Audit fees	600	Interest for full year @ 6% p.a.	
Cost of printing of tickets and Souvenir	1,500		
Cost of entertainment	3,500		
Loss on sale of furniture [book value Rs.800]	300		
Depreciation on furniture	6,000		
Surplus			

Receipts and payment account for the year ended 31.3.2015

Receipts	Rs	Payments	Rs.
Balance b/d	3,800	Salaries	9,400
Subscriptions	46,000	Scholarships	40,100
Government grants	5,300	Rent	2,600
Sale of tickets	8,300	General expenses	3,100
Advertisement in souvenir	4,600	Printing of tickets and Souvenir	1,200
Interest	1,000	Cost of entertainment	3,500
Sale of furniture	500	Furniture	2,000
		Balance c/d	7,600

On 31.3.2014, subscription due were Rs. 1,500, furniture on that date was Rs. 6,000. Prepare balance sheets as on 31.3.2014 and on 31.3.2015.

Detailed Solution:

Balance - sheet

	Last Year	Current year		Last year	Current year
Salaries outstanding	1,100	-	Cash	3,800	7,600
Scholarships outstanding	-	1,200	Subs due	1,500	3,300
Rent o/s	-	200	Adv. o/s	-	500
Printing o/s	-	300	Interest o/s	-	500

Sanjay Welkins Classes	Consignment Accounts - Revisionary Material				

Audit fee o/s	-	600	Furniture	6,000	6,600
Capital fund	35,200	41,200	investments	25,000	25,000
	36,300			36,300	

Subscription account

Opening due: subscriptions in arrear/due /outstanding for last year		1,500	Opening advance: subscription received last year for current year		-
Income and expenditure a/c		47,800	Cash : total subscription received in current year		46,000
Closing advance : subscription received in current year for next year		-	Closing sue : subscription due at the end of the year: Last year Current year		3,300*

Furniture a/c

b/d	6,000	R/P – sale	500
R/P	2,000	I/E – loss	300
		I/E – dep.	600
		c/d *	6,600

Investment a/c

b/d	25,000	c/d – b.f.	25,000

	Payment side of R/P a/c	Exp. Side of I/E a/c	Difference	Treated as
Salaries	9,400	8,300	1,100	CY o/s
Scholarships	40,100	41,300	1,200	CY o/s
Rent	2,600	2,800	200	CY o/s
Printing	1,200	1,500	300	CY o/s

	receipts side of R/P a/c	Income side of I/E a/c	Difference	Treated as
advertisements	4,600	5,100	500	CY o/s
Interest	1,000	1,500	500	CY o/s

5.2

Receipts and payment account and the income and expenditure account of a club for the year ended 31.3.2018 were as follows:

Receipts and payment account

Cash at bank on 1.4.2017	15,000	Books	30,000
Subscriptions:		Stationery	2,400
2016-17 6000		Salary	33,000
2017-18 43000		Water and electricity	3,900
2018-19 500	49,500	Balance on 31.3.2018	22,200
Interest on investments	10,000		
Rent received	12,000		
Special donations	5,000		

Income and expenditure account

Stationery	2,100	Subscriptions	48,000

Salary	36,000	Interest	10,000
Water and electricity	4,100	Rent	12,000
Depreciation:			
Buildings	5,000		
Books	7,000		
Furniture	1,000		
Surplus	14,800		

On 31.3.2017, the Club's assets included – Buildings Rs. 100,000, Books Rs. 40,000, furniture Rs. 10,000, 10% Investments Rs. 100,000 [bought at par], stock of stationery Rs. 500, Subscriptions due Rs. 6,500, Interest accrued Rs. 5,000, Rent receivable Rs. 1,000.

There were no liabilities on that date.

Prepare balance sheet as on 31.3.2017 and on 31.3.2018.

Detailed Solution:

Balance - sheet

	Last Year	Current year		Last year	Current year
Subs in advance	-	500	Cash at bank	15,000	22,200
Donation	-	5,000	Subs due	6,500	5,500
Water and electricity o/s	-	200	Interest accrued	5,000	5,000
Salaries o/s	-	3,000	Rent receivable	1,000	1,000
Capital fund	2,78,000	2,92,800	Stock of stationery	500	800
			Books	40,000	63,000
			Furniture	10,000	9,000
			Buildings	1,00,000	95,000
			investments	1,00,000	1,00,000

Subscription account

Opening due: subscriptions in arrear/due /outstanding for last year	6,500	Opening advance: subscription received last year for current year	-
Income and expenditure a/c	48,000	Cash : total subscription received in current year	49,500
Closing advance : subscription received in current year for next year	500	Closing sue : subscription due at the end of the year:	
		Last year	500
		Current year	5,000
			5,500*

Buildings a/c

b/d	1,00,000	I/E	5,000
		c/d *	95,000

Books a/c

b/d	40,000	I/E	7,000
R / P	30,000	c/d *	63,000

Furniture a/c

b/d	10,000	I/E	1,000
R/P	-	c/d *	9,000

Investment a/c

b/d	1,00,000	c/d *	1,00,000

Sanjay Welkins Classes	Consignment Accounts - Revisionary Material

Stock of stationery a/c

b/d	500	I/E	2,100
R/P	2,400	c/d *	800

Interest Accrued a/c

b/d	5,000	R/P	10,000
I/E	10,000	c/d *	5,000

Rent Receivable a/c

b/d	1,000	R/P	12,000
I/E	12,000	c/d *	1,000

	Payment side of R/P a/c	Exp. Side of I/E a/c	Diff.	Treated as
Salary	33,000	36,000	3,000	C.Y. o/s
W/E	3,900	4,100	200	C.Y. o/s

	Receipts side of R/P a/c	Income side of I/E a/c	Diff.	Treated as
Donations	-	5,000	5,000	Capitalised item

Chapter - 7

Consignment Accounts

1. Preface:

Consignment basically refers to sending of goods from one person to another to be sold by him on his behalf of the sender. The person sending the goods is known as consignor and the person to whom goods have been sent is known as an agent. Agent sells the goods on behalf of the consignor and further goods shall be sold at the risk of the consignor. Against his services, agent shall charge some commission. Agent is given generally following types of commission-

1. Normal commission
2. Over-riding commission
3. Del-credere commission

2. Commission

General or normal commission is one which is given as per the normal practice of the trade. **Over-riding commission** is an extra commission given besides the normal commission so that consignee works with greater enthusiasm and efforts. **Del-credere commission** is a special commission given to the consignee. It is given to safeguard himself [consignor] from any bad debts which might arise on account of credit sales incurred by the consignee. Thus when del-credere commission is given to the consignee in that case any bad debts which shall arise shall be borne by consignee on the other hand if no del-credere commission is given in that case bad debts arising on account of credit sales shall be borne by consignor. It is important to note all types of commission are paid and computed at given percentage of gross sales unless otherwise stated.

3. Difference between Sale and Consignment

- In respect of sale the property in goods is transferred to the buyer immediately whereas in consignment the property is transferred to the buyer only when goods are sold by the consignee. The ownership of goods remains with the consignor when goods are transferred to the consignee by the consignor.
- In respect of sale, the risk attaching to the goods passes with ownership to the buyer. In case of a consignment, the risk attaching to the goods does not pass to the consignee who acts as a mere agent. If there is any damage or loss to the goods it is borne by the consignor provided the consignee has taken reasonable care of the goods and the damage or loss is not due to his negligence.
- The relationship of consignor and consignee is that of a principal and an agent as in a contract of agency whereas the relationship of buyer and seller is governed by the Sale of Goods Act.
- Unsold goods on consignment are the property of the consignor and may be returned if not saleable in the market whereas goods sold on sale basis are normally not returnable unless there is some defect in them.

4. Direct Expenses

Fright inwards, carriage inwards, loading and unloading charges, landing charges, Octroi, port dues, customs and clearance et cetera].

5 .Indirect Expenses

Godown rent, sales expenses, insurance, salesman's commission et cetera.

6 .Advance

Amount paid in advance by a consignee to consignor as security called as advance.

7. Calculation of Abnormal Loss:

Cost of unsold cases / Units @ ...		xxx
Proportionate Expenses Incurred by Consignor:		xxx
Proportionate Direct Expenses incurred by Consignee	However, Shall not be considered if loss has taken place prior to receipt of goods	xxx
		xxx

Working Notes:

Calculation of Consignment Stock:

Cost of unsold cases/ Units @ xxx		xxx
Proportionate Expenses Incurred by Consignor:		xxx
Proportionate Direct Expenses incurred by Consignee		xxx
		xxx

8 .Accounting for Consignment Business

Sr. No.	In the Books of Consignor	In the Books of Consignee
1	When goods are sent to the consignee Consignment A/c Dr To Goods Sent on Consignment A/c (Being Goods Sent on Consignment)	No need to do any Entry in this case As an agent, the consignee is not liable to pay for the goods received on consignment. Therefore, he makes no entry in his financial books on such receipts. As, however, he is liable to account for the goods received, he keeps as adequate record in an appropriate memorandum book.
2	Expenses Incurred by Consignor Consignment A/c Dr To Cash/Bank A/c (Being Expenses incurred on consignment)	Not Applicable
3	Advance given by consignee Cash/Bank A/c Dr To Consignee's A/c (Being advance received from consignee)	Consigner A/c Dr To Bank/Cash A/c (Being Advance amount paid to Consignor)
4	Expenses Incurred by Consignee Consignment A/c Dr To Consignee's A/c (Being Expenses incurred by consignee)	Consigner A/c Dr To Bank/Cash A/c (Being Expenses incurred on goods received on consignment)
5	Sale by Consignee Consignee's A/c Dr	Cash (for cash sale) A/c Dr Debtors (for Credit Sale) A/c Dr

Sr. No.	In the Books of Consignor	In the Books of Consignee
	To Consignment A/c (Being Sales incurred by consignee)	To Consignor A/c (Being goods sold)
6	Commission to Consignee Consignment A/c Dr To Consignee's A/c (Being Commission on sale due to consignee)	Consigner A/c Dr To Commission A/c (Being Commission earned)
7	Remittance from Consignee Cash/Bank A/c Dr To Consignee's A/c (Being due amount received from consignee)	Consigner A/c Dr To Bank/Cash A/c (Being Balance due Payment made to consignor)
8	Entry for Profit on Consignment Profit & Loss A/c Dr To Consignment A/c (Being Profit earned on consignment)	Not Applicable
9	Loss on Consignment Consignment A/c Dr To Profit & Loss A/c (Being Loss incurred on Consignment transferred to the profit & Loss Account)	Not Applicable

9. Formats

Books of Consignor

Consignment Account

GSOC -	-	-	xxx	Abnormal Loss: WN	xxx
Cash - Expenses	-	-	xxx	Consignee - Sales -	xxx
Consignee:				Consignment Stock a/c - WN	xxx
Direct Expenses		xxx			
Indirect Expenses		xxx			
Commission:	% of Sales	xxx	xxx		
Net Profit			xxx		
			xxx		xxx

Consignee Account

Consignment - sales	xxx	Consignment - Expenses & Commission	xxx
		Bank - B.F	xxx
	xxx		xxx

Abnormal loss a/c

Consignment -	xxx	Insurance Company	xxx
		P/L - B.F	xxx
	xxx		xxx

Books of Consignee

Consignor Account

Cash - Expenses incurred by Consignee on consignment	xxx	Cash Sales / Credit Sales	xxx
Commission a/c	xxx		xxx
Bank - b.f	xxx		
	xxx		xxx

Commission a/c

Bad debts (here , Bad debts can be possible only when Del credere commission is allowed to consignee and consignee incurs some credit sales and some debtors fail to pay)	xxx	Consignor a/c	xxx
Net Profit - B/F	xxx		
	xxx		xxx

10. Commission :

		Commission	Amount
% on invoice price	It means % of Invoice price of Goods sold	% of IP of the goods sold	xxx
% of any surplus realised	It means % of Excess of actual sales over invoice price of Goods sold	% of (Actual Sales - IP of the goods sold)	xxx
% Del- credere commission	Always on total sales <i>Unless specifically stated on credit sales</i>	% of Sales	xxx
			3,150

Illustrative Question Bank

1. Examination Problem 3 Marks:

From the following particulars ascertain the value of unsold stock on consignment:

Goods sent - 1,000 kg	Rs. 20,000
Consignor's Expenses	Rs. 4,000
Consignee's non-recurring expenses	Rs. 3,000
Sold - 800 kgs.	Rs. 40,000
Loss due to natural wastage - 100 kg	-

Detailed Solution :

	Kg	Cost in Rs.
Goods sent	1,000	20,000
Consignor's Expenses		4,000
Consignee's non-recurring expenses		3,000
	1,000	27,000
Less normal Loss	100	-
Cost	900	27,000
Cost of unsold stock i.e. 1,000 - 800 - 100	100	? 27,000 x 100 / 900 - Rs. 3,000

2: Examination Problem 7 Marks

Irani and company of chennai had consigned 6,000 shirts to Vikram of Jaipur at cost of 425 each. Irani and Company paid freight Rs. 50,000 and insurance Rs. 7,500. During the transit 550 shirts were totally damaged by the fire. Vikram took delivery of the remaining shirts and paid Rs. 82,000 on customs duty. Vikram had sent a bank draft to Irani and company for Rs. 3,50,000 as advance payment.

5,000 shirts were sold by him at Rs. 550 each. Expenses incurred by Vikram on Godown Rent and advertisement etc., amounted to Rs. 12,000. He is entitled to a commission of 5%.

One of the customer to whom goods sold on credit could not pay the value of 40 shirts which is not recoverable. Vikram settled his account immediately. Nothing was recovered from the insurer for the damaged goods.

Prepare:

Consignment to Vikram account

Vikram account

In the books of Irani and company.

Detailed Solution :

**In the Books of Irani and Company
Consignment Account**

To GSOC	25,50,000	By Vikram - Sales : 5,000 x 550	27,50,000
To Cash - Expenses	57,500	By Abnormal Loss a/c : 550 x 425 = 2,33,750 + PE of Consignor: $\frac{57,500 \times 550}{6,000} = 5,271$	2,39,021
To Vikram Account:		Consignment Stock: Cost of Unsold stock : 450 x 425 = 1,91,250 Add: PE of: a. Consignor: $\frac{57,500 \times 450}{6,000} = 4,312.50$ b. Consignee: $\frac{82,000 \times 450}{5,450} = 6,770.64$	2,02,333
Custom duty 82,000 + Godown Rent 12,000 + Commsiision 5,000 x 550 x 5% i.e. 1,37,500	2,31,500		
Debtors a/c (bad debts)	22,000		
Profit on Consignment	3,30,354		
	31,91,354		31,91,354

3: Examination Problem 8 Marks

Mister N sends goods to the value of Rs. 9,37,500 at cost to Mister J on consignment basis to be sold at 5% commission on sales on 01.01.23, J accepted a bill of Rs. 2,50,000 drawn by N for 4 months on the same date.

N discounted the bill with his banker @ 15% p.a. on 01.02.23.

N incurred Rs. 75,000 by way of freight and other expenses, whereas expenses of J were Rs. 50,000 out of which 60% were non-recurring .

J sent the final balance of Rs. 7,68,750 to N on 31.05.23 along with account sales. The gross Profit margin is 25% on sales and 10% of the goods remained unsold with J.

Required:

a. Consignment account and

b. J's Account

Detailed Solution :

In the Books of N
Consignment Account

To Goods Sent on Consignment	9,37,500	By J - Sales : Cost of 90% of 9,37,500 = 8,43,750 + 25/75 = 2,81,250 GP rate 25% on sales so on cost will be 25/75	11,25,000
To Cash - Expenses	75,000		
To J Account: Expenses 50,000 + Commission 56,250	1,06,250	Consignment Stock: Cost of Unsold stock : 10% of 9,37,500 = 93,750 Add: PE of: a. Consignor: $\frac{75,000 \times 10}{100} = 7,500$ b. Consignee: $\frac{30,000 \times 10}{90} = 3,000$	1,04,250
Profit on Consignment	1,10,500		
	12,29,250		12,29,250

J's Account

Consignment a/c	11,25,000	BR	2,50,000
		Consignment a/c:	1,06,250
		Bank = balance	7,68,750

4. Examination Problem 2 Marks

A of Jaipur sent goods of Rs. 2,50,000 to V of Mumbai on Consignment. A paid Rs. 8,500 as Railway freight and Rs. 4,240 as insurance.

2 % goods are damaged in the V's godown due to normal circumstances. V incurred cartage Rs. 5,140 and selling expenses Rs. 14,700.

Calculate the value of stock of unsold 15% of the goods sent to V.

Detailed Solution :

		Cost in Rs.
Goods sent	100 %	2,50,000
Consignor's Expenses		12,740
Consignee's Direct expenses		5,140
		2,67,880
Less normal Loss	2%	-
Cost	98%	2,62,522
Cost of unsold stock i.e. 15%	15%	$\frac{15 \times 2,62,522}{98}$ = 40,182

5. Examination Problem 2 Marks:

Rs. 3,25,000 is total cost of 6,500 units, Consignor's expenses are Rs. 65,000, units lost in transit was 700 units and consignee's non-recurring expenses amounted to Rs. 4,300. What will be value of stock?

Detailed solution:

	Units	Cost in Rs.

Goods sent	6,500	3,25,000
Consignor's Expenses		65,000
	6,500	3,90,000
Less: units lost in Transit (abnormal loss)	700	42,000
Cost of 6,500 units is 3,90,000		
Therefore cost of 700 units		
= $\frac{700 \times 3,90,000}{6,500}$		
6,500		
Cost of 5,800 units after abnormal loss	5,800	3,48,000
Consignee's Non-recurring expenses		4,300
Total Cost of	5,800	3,52,300

6: Examination Problem 2 Marks

From the following particulars, calculate the value of unsold goods on consignment:

Goods sent - 1,500 kg	Rs. 3,30,000
Consignor's Expenses	Rs. 13,000
Consignee's non-recurring expenses	Rs. 7,000
Sold - 1,000 kgs.	Rs. 3,50,000
Loss due to natural wastage - 100 kg	-

Detailed Solution :

	Kg	Cost in Rs.
Goods sent	1,500	3,30,000
Consignor's Expenses		13,000
Consignee's non-recurring expenses		7,000
	1,500	3,50,000
Less normal Loss	100	-
Cost	1,400	3,50,000
Cost of unsold stock i.e. 1,500 - 1,000 - 100	400	?
		$\frac{3,50,000 \times 400}{1,400}$
		- Rs. 1,00,000

Chapter : 8

Accounting for Joint Ventures

1. Meaning and features

Joint venture may be defined as temporary partnership between two or more persons without the use of firm name, limited to carrying out a particular business plan in which persons concerned agree to share capital and results of the venture. The persons who have combined to undertake the venture are known as co-venturer. A joint venture may take any of the following forms- speculation in shares, underwriting of shares, construction of building or any other asset, joint consignment of goods etcetera.

Features- it is a temporary partnership

The partnership is for a specific purpose

Such association is generally without the use of firm's name

Main purpose is to make quick profits through joint bearing of risk

2. Difference between Joint Ventures and Partnerships

Partnerships and joint ventures seem to be similar as both are created by two or more different persons for carrying out business objectives. Further common features like an agreement between parties and the sharing of profits and losses also exist in both.

Yet both have the following differences as well.

1. Parties Involved

Parties in a joint venture are called joint-venturers or co-venturers, while a partnership firm comprises of partners.

2. Duration

Parties generally create joint ventures for achieving specific objectives only. The venture comes to an end after the achievement of these objectives, unless parties agree to continue working together.

Partnerships, on the other hand, do not have such fixed durations. The firm can continue until partners agree to dissolve it or until the happening of certain events.

3. Entity's Name

Joint ventures don't require a unique name. Parties can refer to it using their own names. Partnership firms must always have its own unique name to signify its separate identity.

4. Profit/Loss Ascertainment

Since joint ventures have specific purposes, parties can ascertain their profits or losses upon the fulfillment of these objectives. If they continue to work together thereafter, they have to ascertain their profits annually. Partnership firms always ascertain their profits annually.

5. Books of Accounts

Parties to joint ventures need not maintain separate books of accounts for their common activities. One of the co-venturers can maintain all these accounts in its own books. Partnership firms have to mandatorily maintain books of accounts.

6. Closure of Business

Joint venture businesses usually come to an end once the purposes for which they were formed are achieved by the parties.

In the case of partnerships, partners can dissolve their firm with mutual consent. The firm also gets dissolved if a new partner joins or an existing partner leaves or dies.

3.0 Distinguish between Consignment and Joint Venture

1. Relationship - The Consignor is principal- while the consignee is agent. Relationship between Co-venturers is that Partners.

2. Nature of Business :Agent is not necessarily a partner hence it is not a partnership. Joint Venture is a partnership although temporary.

3. Powers :Consignee being an agent is simply a servant and has to obey the instructions of the Principal .Co-ventures enjoy full powers as to sale and purchase of goods and collections of dues etc.

4. Scope :Consignment is concerned only with the sale of movable goods. Joint Venture may be undertaken for any type of legal business e.g. construction of roads, building etc. in addition to purchase and sale of goods.

5. Finance :Consignor (Principal) provides Funds while in respect of Joint ventures funds are provided by the Venturers

6. Profits and commission: The Consignee is entitled to receive only commission and reimbursement of his expenses in the pre determined ratios while in respect of Joint venture ,Profits (or losses) are shared by the Co-ventures in agreed ratio. Further, Commission may or may not be granted to Co-ventures.

7. Number of Persons :There are normally two parties namely the principal and the agent. The number of Co-venturers will be at least two though it may be more than two with equal status i.e. that each is a principal and agent at the same time like partners.

4. Methods of recording joint venture transactions

A. when separate Sets of Books are maintained

Under this method following accounts are opened

1. Joint bank account
2. Accounts of co-venturers
3. Joint venture account

Account entries in the books under this method:

S. No.	Transaction	Entry
1	For amount contributed by the co-venturer for Joint venture	Joint bank account To, Co-venturer a/c
2	For purchase of goods	Joint venture a/c To, Joint bank a/c
3	When goods are purchased or supplied by any co-venturer for joint venture	Joint venture a/c To, co-venturer a/c
4	For payment of expenses	Joint venture a/c To, Joint bank a/c
5	For sale of goods or when contract price is received	Joint bank a/c To, Joint venture a/c
6	When co- venturer takes away unsold stock	Co-venturer a/c To, Joint venture a/c
7	For transferring the profit of joint venture	Joint venture a/c To, co-venturer a/c
8	For final settlement – in case amount due to partner then	Co-venturer a/c To, Joint bank account
9	For final settlement- in case amount is due from the co-venturer	Joint bank account To, Co-venturer a/c

Illustrative Question Bank

1.

A and B enter a joint venture to prepare a film for the Government. The Government agrees to pay Rs.200,000. A contributes Rs.20,000 and B contributes Rs.30,000. These amounts are deposited into a Joint Bank Account. Payments made out of the joint bank account were:

Purchase of equipment-	12,000
Hire of equipment-	10,000
Wages-	90,000
Material-	20,000
Office expenses-	10,000

Alfa paid 4000 as licensing fee. On completion, the film was found defective and the government made a deduction of 20000. The equipment was taken over by Beta at a valuation of 4000. Separate books of account were maintained for the joint venture accounting whose profits were divided in the ratio of A- 2/5 and B- 3/5. Prepare required ledger accounts.

Ans:

Joint bank A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To A	20,000		By joint venture a/c-	142,000
	To B	30,000		equipment – 12000	
	To joint venture a/c	180,000		Hire of equipment- 10000	
				Wages – 90000	
				Materials – 20000	
				Office expenses – 10000	
				By A	39,200
				By B	48,800
		230,000			230,000

Joint venture A/c

Date	Particulars	Amount	Date	Particulars	Amount
-	To Joint Bank a/c	142000	-	By joint bank a/c (200000-20000)	180000
	equipment – 12000		-	By B (equipment was taken)	4000
	Hire of equipment- 10000				
	Wages – 90000				
	Materials – 20000				
	Office expenses – 10000				
-	To A- licensing fee	4000			
-	To profit to: Alfa	38000			
	15200 Beta 22800				
		184000			184000

A's A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To joint bank a/c (repayment)	39200		By joint bank a/c	20000
				By joint venture a/c-Fees	4000
				By joint venture a/c-Profit	15200
		39200			39200

B's A/c

Date	Particulars	Amount	Date	Particulars	Amount
	To joint venture a/c-Equipment	4000		By joint bank a/c	30000
	To joint bank a/c –Repayment	48800		By joint venture a/c-Profit	22800
		52800			

B: When record is made in each party's book

Under this method each co-venturer shall open a joint venture account [to know the result of the venture] and other co-venturer's account [to find out the amount due from him or due to him].

Following entries are passed under this method:

Date	Particulars		Amount (Dr.)	Amount (Cr.)
1. Goods supplied to venture out of business	Joint Venture Account	Dr.	xx	
	To Purchases A/c			xx
	(Being goods supplied to Joint Venture from the business stock)			
2. Incurrence of expenses or purchase for venture	Joint Venture Account	Dr.	xx	
	To Bank/ Creditors A/c			xx
	(Being paid for expenses or purchases regarding the Joint Venture)			
3. When other co-venturers incurs expense or supplies goods	Joint Venture Account	Dr.	xx	
	To Co-venturer's A/c			xx
	(Being expenses incurred or goods supplied to the Joint Venture by other co-venturers)			
4. For venture sale	Bank / Debtors A/c	Dr.	xx	
	To Joint Venture Account			xx
	(Being Joint Venture sale)			
5. For venture sale made by the co-venturer	Co-venturer's A/c	Dr.	xx	
	To Joint Venture Account			
	(Being venture sale made by the co-venturers)			
6. Bill of Exchange drawn on the co-venturer	Bills Receivable A/c	Dr.		
	To Co-venturer's A/c			xx
	(Being bills receivable drawn on co-venturer)			
7. Discounting of bill	Bank A/c	Dr.	xx	
	Joint Venture A/c	Dr.	xx	
	To Bills Receivable A/c			xx
	(Being bill discounted)			
8. Acceptance of bill drawn by other co-venturer	Co-venturer's A/c	Dr.	xx	
	To Bills Payable A/c			xx
	(Being bill accepted drawn by the other co-venturer)			
9. Bill discounted by the other co-venturer	Joint Venture A/c	Dr.	xx	
	To Co-venturer's A/c			xx
	(Being Joint Venture A/c debited with the amount of discount on the bill)			
10. For venture profit	Joint Venture A/c	Dr.	xx	
	To Profit & Loss A/c (own share)			xx
	To Co-venturer's A/c (their share)			xx
	(Being profit on Joint Venture shared)			
11. For venture loss	Profit & Loss A/c (own share)	Dr.	xx	
	Co-venturers A/c (their share)	Dr.	xx	
	To Joint Venture Account			xx
	(Being loss on Joint Venture shared)			

Date	Particulars		Amount (Dr.)	Amount (Cr.)
12. Settlement of claim				
a. Payment due to co-venturer	Co-venturer A/c	Dr.	xx	
	To Bank A/c			xx
	(Being payment made to co-venturers)			
b. Payment due from co-venturer	Bank A/c	Dr.	xx	
	To Co-venturer's A/c			xx
	(Being payment received from co-venturer)			

2.

R and K entered into a joint venture in timber trade. Profits were to be shared equally. R was to buy timber and send it to K, who would sell it.

On 1.1.2005, R bought timber worth Rs. 40000 and incurred Rs. 1600 as expenses on sending it to K. he immediately drew upon K a bill for Rs. 40000 for 3 months. It was discounted at 18% p.a. on 4th January, 2005.

K paid Rs. 3600 as freight, Rs. 1300 as commission to agents and Rs. 3000 as rent. The whole timber was disposed of for Rs. 65000. R received a cheque from K for the amount due on 31.3.2005.

Prepare ledger accounts in the books of both the parties.

Solution:

Books of R

Joint Venture A/c			
	Rs.		Rs.
To Bank A/c (Purchase)	40,000	By K (Sale)	65,000
To Bank A/c (Expenses)	1,600		
To B/R (Discount)	1,800		
To K			
Freight	3,600		
Commission to agents	1,300		
Rent	3,000		
To Profit on Joint Venture			
Transferred to :			
Profit & Loss a/c	6,850		
Ram	6,850		
	65,000		65,000

K's A/c

	Rs.		Rs.
To Joint Venture A/c	65,000	By Joint Venture A/c	7,900
		By Joint Venture A/c	6,850
		By BR A/c	40,000
		by, Bank – B.F	10,250
	50,250		50,250

C: Memorandum Joint Venture Method or When each party records only his transactions

Under this method, co-venturers record only their own transactions. For this purpose, they open 'Joint Venture with Co-venturer's A/c'. They debit all the expenses, incomes, profits and losses from the joint venture to this account. However, we cannot ascertain profit from this account. For determining the profits of the Joint Venture, we prepare 'Memorandum Joint Venture A/c'.

1.(a) On receipt of any amount / Bills Receivable from other Co-Venturer:	
Cash/Bank/Bills Receivable A/c Dr.	
To, Joint Venture with..... A/c	
1.(b) On discounting Bills Receivable:	
Bank A/c Dr.	(with net proceeds)
Joint Venture with A/c Dr.	(with discount)
To, Bills Receivable A/c	(with total)
2. On purchase of goods:	
Joint Venture with A/c Dr.	(with total)
To, Cash/Bank A/c	(with cash purchase)
To, Supplier's A/c	(with credit purchase)
3. On making payment to supplier	
Supplier's A/c Dr.	(with total)
To, Cash/Bank/Bills Payable A/c	(with payment made)
To, Joint Venture with..... A/c	(with discount received)
4. On supply of goods out of own stock:	
Joint Venture with A/c Dr.	(if supplies at cost)
To, Purchases/Goods sent on Joint Venture A/c	(if supplies at profit)
5. On payment of expenses:	
Joint Venture with A/c Dr.	(with total)
To, Cash/Bank A/c	(with cash expenses)
To, Creditor's A/c	(with outstanding expenses)
6. On sale of goods:	
Cash/Bank A/c Dr.	(with cash sales)
Customer's A/c Dr.	(with credit sales)
To, Joint Venture with..... A/c	(with total)
7. On receiving payment from a customer:	
Cash/Bank A/c Dr.	(with the payment received)
Joint Venture with A/c Dr.	(discount allowed/bad debt)
To, Customer's A/c	(with the payment received)
8. On taking away of unsold goods:	
Goods Sent on Joint Venture A/c Dr.	
To, Joint Venture with..... A/c	
9. On considering some commission/salary to the Co-Venturer:	
Joint Venture with A/c Dr.	
To, Commission/Salary A/c	
10. On recording the share of Profit/Loss:	
(a) When profit-	
Joint Venture with A/c Dr.	
To, Profit & Loss A/c	
(b) When loss-	
Profit & Loss A/c Dr.	

To, Joint Venture with..... A/c

3.

Self - attempt Problem – memorandum method

Sea and Sand entered into a joint venture to purchase and sell New Year gifts. They agreed to share the results equally. On 5th November, 2009, Sea purchased goods worth Rs. 1,00,000 and spent Rs. 6,000 in sending the goods to Sand. He also paid Rs. 2,000 for insurance. On the same date Sea drew a bill of exchange upon Sand for Rs. 100,000 at two months. He got the bill discounted @ 18% per annum.

Sand spent Rs. 3,000 on cartage, Rs. 5,000 as rent and 5,000 on advertisement. He sold all the gifts for Rs. 2,00,000 after retaining gifts worth Rs. 2,000 for his personal use. He sent a cheque to Sea for the amount due on 8th January, 2010. Prepare relevant account under Memorandum system.

Profit Rs. 78,000 , Balance received by Sea Rs. 50,000

**Books of Sea
Joint Venture with Sand a/c**

Date	Details	Amount	Date	Details	Amount
	Bank a/c :			BR/c	1,00,000
	Purchases	1,00,000			
	Expenses	8,000			
	Profit and loss a/c – share of profit	39,000			
	Discount charges	3,000		Bank a/c – final amount received	50,000
		1,50,000			1,50,000

Memorandum Joint venture a/c

Date	Details	Amount	Date	Details	Amount
	Sea a/c -			Sand a/c – sale	2,00,000
	Purchases 1,00,000	1,08,000		Sand - Drawings	2,000
	Expenses 8,000				
	Sand – Expenses	13,000			
	Discount charges of bill 1,00,000 x 18% x 2/12	3,000			
	Profit and loss a/c – Sea 39,000, Sand 39,000	78,000			
		2,02,000			2,02,000

4.

A1 and A2 enter into a joint venture to buy and sell Air conditioners on 1st April 2019. On 1st April 2019, A1 sent a cheque of Rs.500,000 to A2.

On 4th April 2019, A2 purchased 400 Air-conditioners each at a cost of Rs.4,000 each.

He sent the Air -Conditioners to A1.

A1 collected them and paid the freight of Rs.4,000 on 15th April.

On 25th May 2019, A1 settled the account with P1 and sent him a cheque. They share profits equally.

The details of sales by A1 are:

Date	No. of A.Cs	Sale Price per A.C.	Discount on the sales price
16 th April 2019	40	6000	20%
30 th April 2019	200	5600	Nil
15 th May 2019	160	5400	10%

In Atul's book show:

1. Joint Venture with A2 A/c
2. Memorandum Joint Venture A/c

Detailed Solution:

In the books of A1
Joint Venture with A2 A/c

Date	Particulars	Amount	Date	Particulars	Amount
1 Apr	To Bank A/c (cheque)	5,00,000	16 Apr	By Bank A/c (sales)	1,92,000
15 Apr	To Bank A/c (freight)	4,000	30 Apr	By Bank A/c (sales)	11,20,000
25 May	To Profit & Loss A/c (share of profit)	2,42,800	15 May	By Bank A/c (sales)	7,77,600
25 May	To Bank A/c (settlement)	13,42,800			
		<u>20,89,600</u>			<u>20,89,600</u>

Memorandum Joint Venture A/c

Particulars	Amount	Particulars	Amount
To Cost of 400 A.C.s	1600,000	By Sale proceeds (net)	
To Freight	4,000	40 A.C.s @ 4800	1,92,000
To Profit:	4,85,600	200 A.C.s @ 5600	11,20,000
A1	2,42,800	160 A.C.s @ 4860	7,77,600
A2	<u>2,42,800</u>		
	<u>20,89,600</u>		<u>20,89,600</u>

Sanjay Welkins' Classes

Chapter : 9

Final Accounts of Profit Making Entities (Non- Corporate Bodies)

What are financial statements? Discuss the objectives of financial statements.

Meaning of financial statements: Traditionally the trading and profit and loss a/c (or income statement) and the balance sheet (or position statement) are called Financial Statement or Final Accounts. But now a days a third statement namely Cash flow Statement is also prepared particularly in the case of companies listed on the stock exchange.

Trading and Profit & Loss A/c (or Income Statement) shows the results (or Financial Performance) of the operations of the business during and accounting period.

Balance Sheet (or Position Statement) shows the financial position of the business at a particular point of time.

Financial statements are prepared to active the basic objectives of accounting, which are:

- i) to find out the profit earned or loss incurred.
- ii) to depict its financial position at a given point of time.

What is a Trading Account? Explain the need of preparing a Trading Account?

Trading Account: Trading A/c is a part of the profit and loss account that shows the result of buying and selling of goods and services during an accounting period.

Purpose of Trading A/c: Trading A/c is prepared to know the gross profit or gross loss during the accounting period. For ascertaining gross profit, it is necessary to know;

- i) Cost of goods sold
- ii) Net sales
 - i) cost of goods sold= opening stock+ net purchases (i.e., cash purchases+ credit purchases- purchase return) + direct expenses- closing stock
 - ii) Net sales= cash sales+ credit sales- sales returns

Gross profit= net sales- cost of goods sold.

I. **items of the debit side of trading A/c:**

- i) Opening stock in the stock in the beginning of an accounting period.
- ii) Purchases refer to purchases of those goods in which the enterprise deals in.
- iii) Direct expenses refer to those expenses which are incurred to bring the inventories in their present location and condition (e.g., carriage inward, freight, custom duty inward etc.)

II. **Items of the credit side of trading A/c:**

- i) Sales: cash sales+ credit sales- sales returns.
- ii) Closing stock: the stock at the end of an accounting period refers to the goods lying unsold at the end of an accounting period.

Format of a Trading Account

Trading Account of....

For the period ending on

particulars	Amt.	Particulars	Amt.
To opening stock	xxx	By sales	xxx
To purchases xxx		Less sales returns <u>xxx</u>	xxx
Less purchase returns <u>xxx</u>	xxx	By closing tock	xxx
To direct expenses	xxx	By abnormal loss of stock	xxx
To wages and salaries	xxx	By gross loss t/f to P & L A/c	xxx
To freight inward	xxx		xxx

To carriage inward	xxx		xxx
To cartage inward	xxx		
To gross profit t/f to P & L A/c	xxx		
	xxx		
	xxx		xxx

Format of a Profit and Loss Account

PROFIT AND LOSS A/C

Dr.	Particulars	Amount	Particulars	Cr. Amount
		Rs.		Rs.
	To Gross Loss b/d (Transferred from Trading A/c)		By Gross Profit b/d (Transferred from Trading A/c)	
	Office expenses :—		By Rent from Tenant	
	To Salaries		By Rent (Cr.)	
	To Salaries & Wages		By Discount received	
	To Rent, Rates & Taxes		Or Discount (Cr.)	
	To Printing & Stationery		By Commission Received	
	To Postage		By Interest on Investments	
	To Lighting		By Dividend on Shares	
	To Insurance Premium		By Bad-Debts Recovered	
	To Telephone Charges		By Profit on sale of Assets	
	To Legal Charges		By Income from other Sources	
	To Audit Fees		By Miscellaneous Income	
	To Travelling Expenses		By Net Loss (if any)	
	To Establishment Expenses		Transferred to Capital A/c	
	To Trade Expenses			
	To General Expenses			
	Selling and Distribution Expenses:			
	To Carriage Outwards, or Carriage on Sales			
	To Advertisement			
	To Commission			
	To Brokerage			
	To Bad-debts			
	To Export duty			
	To Packing charges			
	To Delivery Van Expenses			
	To Stable expenses			
	Miscellaneous expenses :—			
	To Discount Allowed			
	To Repairs			
	To Depreciation			
	To Interest (Dr.)			
	To Bank Charges			
	To Entertainment Expenses			
	To Conveyance Expenses			
	To Donation and Charity			
	To Loss on Sale of Assets			
	To Net Profit—			
	Transferred to Capital A/c			

Key Notes

Expenses which are not related to the business are not written in the Profit and Loss Account such as - medical expenses incurred on self or spouse or relative , any Domestic and household expenses of the

proprietor, Income-Tax, and Life Insurance Premium etc. such expenses are, as a matter of fact, nothing but Drawings and as such, deducted from Capital from the liabilities side of the Balance Sheet.

Balance Sheet

To ascertain the financial position of the business has to be fulfilled. This is done by preparing the balance sheet.

The balance sheet is thus a statement (list) of all capital and deferred (part of) revenue items. To make the list meaningful all that the business owns (assets) are listed on one side of the page, and all that the business owns (liabilities) on the other. The assets are listed on the right side of the page whereas the liabilities on the left.

It is important to note here that the balance sheet is not an account. It is only a statement of accounts. As mentioned above, the accounts are only listed here, i.e., in other words, they are not transferred here as for the trading and manufacturing A/c and Profit & Loss A/c. Thus there is no journal entry behind the appearance of items in the balance sheet.

The balance sheet is always captioned as on.....and for the year ending.....unlike the Trading and Profit & Loss A/c. This is because a given value of an asset (or liability) is valid only for a given date.

Specimen of a Balance Sheet

Liabilities	Amt.	Assets	Amt.
Capital xxx		Fixed Assets	
Add: if any		Less Depreciation on each if any	xxx
a) Additions during the year xxx		a) Goodwill	xxx
b) Interest on capital xxx		b) Land and Buildings	xxx
c) Profit of the year <u>xxx</u>		c) Railway Sidings	xxx
Less: if any		d) Plant & Machinery	xxx
a) Drawings during the year xxx		e) Furniture & Fittings	xxx
b) Interest on drawings xxx		f) Patents, Trademarks and Designs	
c) Loss of the year <u>xxx</u>	xxx	g) livestock	xxx
Reserves and surplus loans		h) Vehicle etc.	xxx
a) Secured loans/ mortgage loans xxx	xxx	Investment	xxx
b) Unsecured loans xxx	xxx	a) Long Term	
Current liabilities		b) Short Term	xxx
a) Bank overdraft xxx	xxx	current assets	xxx
b) Bills payable xxx	xxx	a) Accruals	
c) Sundry creditors xxx	xxx	b) Stores & Spare Parts	xxx
d) Other creditors xxx	xxx	c) Loose Tools	xxx
e) Income received in advance xxx	xxx	d) Closing Stock	xxx
f) Outstanding payments xxx	xxx	e) Sundry Debtors	xxx
		f) Cash in Hand/ Cash at Bank	xxx
		g) Bills Receivable/ Prepaid	xxx
			xxx

Arrangement Assets Or Liabilities Or Marshalling

Arrangement of assets and liabilities in the balance sheet is also known as "Marshalling", i.e. sequencing the balance sheet items. The assets on the right hand side and the liabilities an capital on the left hand side can be arranged in two as follows;

- In the order of liquidity:** Here, assets which can be converted into cash easily are written first and other assets having least liquidity appear at the bottom of the balance sheet. Banking and financial companies, sole proprietorship concerns follow this arrangement.
- In the order of performance:** assets deemed to the used permanently in the business are written first. The most liquid asset is written at the bottom. Liabilities begin with capital first, then the long term liabilities and finally the short term liabilities and at the bottom. The company as defined under the companies Act, 1956, follows this arrangement.

Uses of Balance Sheet

1. Actual capital invested in the business can be calculated.
2. The financial position can be ascertained.
3. Various ratios can be worked out from the balance sheet which indicates the efficiency of the management.
4. Balance sheet can be the basis for fixing the purchase consideration of the business.
5. It helps us to find the proprietary interest of person or business organisation.
6. The trends of working capital of the business can be ascertained by comparing balance sheets of few years and remedial actions can be taken.

Limitation Of Balance Sheet

Balance sheet has the following limitations:

1. Fixed assets appear in the balance sheet at historical cost less depreciation till date. A conventional balance sheet cannot give the correct value of such assets. Again intangible assets appear at the balance at book values which has no relations with the market values
2. Balance sheet cannot show the intangible assets like skill and loyalty of the staff, technical know-how, etc.
3. A conventional balance sheet may not guide readers properly in inflationary situations.
4. Often, balance sheet shows some assets like preliminary expenses, Debenture discount, etc. which have no market value. These fictitious assets unnecessarily increase the total value of the assets.
5. Values of most of the current assets are found from the estimates and hence the balance sheet does not present the true financial position of the business.

Adjustment Entries

When item given in trial balance	Treatment in Trading & Profit & Loss A/c	Treatment in Balance Sheet
Closing stock	—	Shown on the assets side under current assets head.
Accrued income	—	Shown on the assets side under current asset head.
Advance/ unearned income	—	Shown on the liabilities side under the current liabilities side head.
Outstanding expenses	—	Shown on liabilities side under current liabilities head.
Prepaid expenses	—	Shown on the assets side under current assets head.
Interest on capital	Shown on debit side of profit & Loss A/c	—
Interest on drawings	Shown on the credit side of profit & loss A/c	—
Discount allowed when provision for discount on debtors was not opened	Shown on debit side of profit & Loss A/c as a separate item.	—
Discount allowed when	Shown on debit side of	—

provision for discount on debtors was opened	provision for discount on debtors A/c.	
Discount received when reserve for discount on credit was not opened.	Shown on the credit side of Profit & Loss a/c as a separate item.	—
Discount received when reserve for discount on creditor was open.	Shown on the credit side of reserve for discount on credit A/c.	—
Bad debts when provision for doubtful debts A/c was not opened.	Shown on the debit side of P & L A/c and shown separately.	—
Bad debts when provision for doubtful debts A/c was opened	Shown on the debit side of Provision for doubtful debts A/c.	—

Some Basic Points / Adjustments

Closing Stock	Inventory taking is generally done after the end of the year and therefore it is generally shown as an adjustment . It is valued at Cost Price or Realisable Value, whichever is less. The basic principle underlying the valuation of closing stock (Prudence or conservatism) is that anticipated losses should be taken into account, but all unrealized gains should be ignored. Adjustment entry for Closing stock is:— Closing Stock A/c To Trading A/c (Closing Stock brought into books) Dr.
	▪ Generally, the closing stock is given outside the Trial Balance i.e. that is as an adjustment it is so because closing stock is valued after the end of the year i.e. the after the accounts have been closed. As such, Closing Stock will be reflected at two places, i.e., on the Credit side of the Trading A/c and on the Assets side of the Balance Sheet. ▪ but sometimes, Closing Stock appears inside the Trial Balance which means stock taking has been done prior to the closure of the accounts- under such a situation, closing stock will be shown only on the Assets side of the Balance Sheet. (it implies that the entry to incorporate the closing stock in the books has already been passed and it has already been deducted out of ' Purchases Account' given in the Trial Balance.
Outstanding Expenses or Expenses Due but not Paid	Implies that ,These expenses have been incurred during the year but have been left unpaid on the date of preparation of final accounts. In other words, the benefit of such expenses has been derived during the year but the payment of which has not yet been made. Outstanding Expenses first of all, will be added to the concerned expenses on the debit side of Trading or Profit and Loss Account and also will be shown on the Liabilities side of the Balance Sheet. Outstanding Expenses Account is a Personal Account because it represents those persons to whom the payment is to be made. Often, outstanding expenses are given inside the Trial Balance in that case such O/s Expenses shall be shown on the liabilities side only because it means that it has already been added to the concerned expenses. Outstanding Expenses Account is a Representative Personal Account and always shows a credit balance.
Prepaid Expenses or Unexpired	These are the expenses which have been paid in advance for the next year during the current year itself. In other words, the benefit of such payments will be available in the next accounting year.

Expenses or Expenses Paid in Advance	Prepaid Expenses, will be deducted from the concerned expenses on the debit side of Trading or Profit and Loss Account and will also be shown on the Assets side of the Balance Sheet. Prepaid Expenses is a Personal Account because it represents those persons to whom the payment has been made in advance. If Prepaid Expenses have been given inside the Trial Balance, they will be shown on the Assets side only because it means that it has already been deducted out of the concerned expenses. Prepaid Expenses Account is a Representative Personal Account and always shows a debit balance.									
Depreciation	Depreciation is the loss or fall in the value of fixed assets due to their constant use and expiry of time. Depreciation will be shown on the debit side of the Profit and Loss Account because it is a loss or expense and will also be deducted from the value of the concerned asset on the Assets side of the Balance Sheet.									
Accrued Income or Income Receivable	▪ Quite often an entity earns income such as interest on securities, commission, rent etc., during the current year but does not actually receives by the end of the year. Such incomes are known as 'Accrued Incomes' or 'Earned Incomes'. ▪ Such Incomes firstly, are presented on the credit side of the Profit & Loss Account and also reflected on the Assets side of the Balance Sheet because the amount is yet to be received.									
Unearned Income or Income Received in Advance	▪ Often an entity receives income in the current year but entire amount does not relates to current year that is some portion of it relates to next or subsequent year. Such portion of this income which belongs to the next year is known as 'Unearned Income' or 'Income received but not earned'. ▪ Such incomes, once, will be deducted from the concerned income on the Credit side of Profit & Loss Account and shall also be shown on the Liabilities side of the Balance Sheet									
	If 'Unearned Incomes' are given in the Trial Balance, they will be shown on the Liabilities Side only - which means same has already been deducted out of the concerned income. Unearned Income Account is a Representative Personal Account and always shows a Credit Balance.									
Interest on Capital	Capital invested by the proprietor is treated as a loan to the business earning interest at a fixed rate. Also if this amount would not have been invested in the business then also owner could have had earned some interest. Say, if 10% interest is to be allowed on the capital of Rs. 5,00,000, the adjusting entry for this will be as follows :— Interest on Capital A/c Dr. 50,000 To Capital A/c 50,000 (Interest allowed on Capital) Interest on capital is an expense from the perspective of business and hence it is shown on the debit side of Profit & Loss Account and it is an income to the proprietor and hence is added to his capital.									
Interest on Drawings	Often, the proprietor draws cash or goods for his personal/private use. Such withdrawals are termed as Drawings. We have seen that Business/Entity/ firm pays interest on capital to the owner as such, charges interest on the drawings when owner withdraws. Trial Balance as at 31st March, 2021 <table><tr><td></td><td>Dr. (Rs.)</td><td>Cr. (Rs.)</td></tr><tr><td>Capital Ac</td><td></td><td>10,00,000</td></tr><tr><td>Drawings A/c</td><td>1,00,000</td><td></td></tr></table> Adjustment:— Entity Charged Rs.5,000 as interest on drawings. Answer : Entry :— Drawings A/c Dr 5,000 To Interest on Drawings A/c 5,000 (Interest charged on drawings) Interest on Drawings is an income to the business and hence it is shown on the credit side of		Dr. (Rs.)	Cr. (Rs.)	Capital Ac		10,00,000	Drawings A/c	1,00,000	
	Dr. (Rs.)	Cr. (Rs.)								
Capital Ac		10,00,000								
Drawings A/c	1,00,000									

	Profit & Loss Account. At the same time, it is an expense from the proprietor's view and hence will be deducted from the capital on the Liabilities side of the Balance Sheet. <table><tr><td>Dr.</td><td colspan="2">Profit & Loss Ac</td><td>Cr.</td></tr><tr><td></td><td>Rs.</td><td></td><td>Rs.</td></tr><tr><td></td><td></td><td>By Interest on Drawings</td><td>5,000</td></tr></table> <table><tr><th colspan="4">Balance Sheet</th></tr><tr><th colspan="2">Liabilities</th><th>Amount</th><th>Assets</th><th>Amount</th></tr><tr><td>Capital</td><td>10,00,000</td><td>Rs.</td><td></td><td>Rs.</td></tr><tr><td>Less : Drawings</td><td>1,00,000</td><td></td><td></td><td></td></tr><tr><td></td><td>9,00,000</td><td></td><td></td><td></td></tr><tr><td>Less : Interest on Drawings</td><td>8,85,000</td><td></td><td></td><td></td></tr><tr><td>5,000</td><td></td><td></td><td></td><td></td></tr></table>	Dr.	Profit & Loss Ac		Cr.		Rs.		Rs.			By Interest on Drawings	5,000	Balance Sheet				Liabilities		Amount	Assets	Amount	Capital	10,00,000	Rs.		Rs.	Less : Drawings	1,00,000					9,00,000				Less : Interest on Drawings	8,85,000				5,000																			
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5,000																																																														
Interest on Loan	Loan is a Liability of the firm and the interest on such loan will be an expense. If up-to-date interest has not been paid on the Loan, the unpaid interest will have to be calculated and will be treated just like outstanding expenses. If the item of 'Loan' appears on the debit side of Trial Balance, it will mean that the amount has been lent to outsiders. It will be an asset in this case and interest on such loan will be an income for the firm. When the Loan appears on the credit side of the Trial Balance, interest on it will be an expense and hence will be recorded on the debit side of Profit & Loss Account. Outstanding amount of such interest will also be added to Loan Account on the Liabilities side of the Balance Sheet.																																																													
	Trial Balance Extracts of Entity as at 31st March, 2021 <table><tr><td></td><td>Dr. (Rs.)</td><td>Cr. (Rs.)</td></tr><tr><td>Loan from bank @ 12% p.a.</td><td></td><td>10,00,000</td></tr></table> Adjustment:— Interest on Loan is due for the entire year. Answer: <table><tr><td>Interest on Loan A/c</td><td>Dr. 1,20,000</td><td></td></tr><tr><td>To Outstanding Interest A/c</td><td></td><td>1,20,000</td></tr></table> (Adjustment for Outstanding interest on Loan) Final Accounts: <table><tr><td>Dr.</td><td colspan="2">Profit & Loss A/C</td><td>Cr.</td></tr><tr><td></td><td>Rs.</td><td></td><td></td></tr><tr><td>To Interest on Loan</td><td>1,20,000</td><td></td><td></td></tr></table> <table><tr><th colspan="4">Balance Sheet</th></tr><tr><th colspan="2">Liabilities</th><th>Amount</th><th>Assets</th><th>Amount</th></tr><tr><td colspan="2"></td><td>Rs.</td><td></td><td>Rs.</td></tr><tr><td>Loan from Bank</td><td></td><td></td><td></td><td></td></tr><tr><td>10,00,000</td><td></td><td></td><td></td><td></td></tr><tr><td>Add: Outstanding Interest</td><td>11,20,000</td><td></td><td></td><td></td></tr><tr><td>1,20,000</td><td>0</td><td></td><td></td><td></td></tr></table>					Dr. (Rs.)	Cr. (Rs.)	Loan from bank @ 12% p.a.		10,00,000	Interest on Loan A/c	Dr. 1,20,000		To Outstanding Interest A/c		1,20,000	Dr.	Profit & Loss A/C		Cr.		Rs.			To Interest on Loan	1,20,000			Balance Sheet				Liabilities		Amount	Assets	Amount			Rs.		Rs.	Loan from Bank					10,00,000					Add: Outstanding Interest	11,20,000				1,20,000	0			
	Dr. (Rs.)	Cr. (Rs.)																																																												
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1,20,000	0																																																													
Bad Debts	Entity sells goods on credit - persons to whom goods have been sold on credit are known as 'Debtors'. Sometimes due to some or other reasons (say due to the dishonesty, death or insolvency of a debtor), entity fails to recover / receive full amount from Debtors. When it appears to entity that a particular amount will not be recovered it classifies it as 'Bad-debts'. Bad-debt is a loss to the firm and is therefore written on the debit side of the Profit & Loss Account. If Bad-debts are given in the adjustments, then first of all bad debts shall be debited to profit and loss a/c and then shall also be deducted from debtors on the assets side of the Balance Sheet.																																																													

Trial Balance extract of Entity X-5 as at 31st March, 2021

	Dr. (Rs.)	Cr. (Rs.)
Bad-Debts	5,000	
Sundry Debtors	5,00,000	

Adjustment:— Write off further Bad-debts Rs.10,000.

Answer:

1.Rs. 5,000 of Bad debts appearing in trial balance shall be posted to debit side of Profit and loss a/c. no further treatment is needed.

2. Bad debts of 10,000 given in adjustments shall be put towards debit side of P&L a/c and shall also be deducted from debtors in the balance sheet. entry shall be:

Bad-debts A/c Dr. 10,000
 To Sundry Debtors A/c 10,000
 (Further Bad-debts written off)

Dr.	Particulars	Rs.	Profit & Loss a/c	Rs.	Cr.
	To Bad-debts	5,000			
	Add: Further Bad-debts	10,000	15,000		

Balance Sheet as at 31st March, 2021

Liabilities	Amount	Assets	Amount
	Rs.		Rs.
		Sundry Debtors	5,00,000
		Less : Bad-debts	10,000
			4,90,000

Provision for
Bad and
Doubtful
Debts

Debtors at the end of the year may include some debts which are doubtful. A provision is created to cover any possible loss on account of bad-debts likely to occur in future. Such a provision is created at a fixed percentage on debtors every year and is called 'Provision for Bad and Doubtful Debts'.

The amount of Provision for Doubtful Debts on the one hand, is shown on the debit side of the Profit and Loss Account and on the other hand, is deducted from Sundry Debtors on the assets side of the Balance Sheet, so that the debtors may appear at their realisable value in the Balance Sheet.

Example

Trial as at 31st March, 2023

	Dr. (Rs.)	Cr.(Rs.)
Debtors	1,00,000	

Adjustment:— Create a provision for Bad and Doubtful Debts @ 10 % on Debtors.

Answer

Profit and Loss A/c Dr. 10,000
 To Provision for Bad and Doubtful Debts A/c 10,000
 (Adjustment for creation of provision at @10% on Debtors)

Dr.	Particulars	Rs.	Profit & Loss a/c	Rs.	Cr.
	To Provision for Bad and Doubtful Debts	10000			

Balance Sheet as at 31st March, 2023

Liabilities	Amount	Assets	Amount
	Rs.		Rs.
		Debtors	1,00,000
		Less : Provision for	
		Bad and Doubtful Debts 10,000	90,000

The provision of Rs.10,000 created in 2023 will be carried forward to the next year and will be shown on the credit side of the Trial Balance of the year 2024.

This provision of Rs.10,000 is termed as 'New Provision' in the year 2023 and the same provision of Rs.10,000 will be termed as 'Old Provision' in the year 2024.

In 2024 when the bad-debts actually occur, the bad-debts will be met from this Old Provision. At the end of 2024 a fresh provision (New Provision) is made again on the amount of Debtors at a fixed percentage.

The amount of Bad-debts is added to the amount of New Provision on the debit side of Profit & Loss Account and the amount of Old Provision will be deducted from the total of the two.

The amount of Old Provision will be given on the credit side of the Trial Balance or in other words, the amount of provision which is given on the credit side of the Trial Balance will be treated as Old Provision.

As the New Provision is given in adjustments, it will also be deducted from Debtors on the assets side of Balance Sheet in order to complete its double entry.

Trial Balance of Entity- Y-6 as at 31st March, 2023

	Dr. (Rs.)	Cr. (Rs.)
Bad-Debts Account	5,000	
Provision for Doubtful Debts 1-4-22		12,500
Debtors	4,00,000	

Adjustment : Create a provision for Doubtful Debts @ 5 % on Debtors.

Pass Journal Entries and show the necessary Ledger Accounts and Balance Sheet.

Answer:

Date	Particulars	L.F.	Dr. (Rs.)	Cr. Rs.
31.03 .2023	Provision for Doubtful Debts Ac Dr.		5,000	
	To Bad-debts A/c (Bad-debts transferred to old provision)			5,000
	Profit & Loss A/c Dr.		12,500	
	To Provision for Doubtful Debts A/c			12,500
	(Net amount charged to P & L A/c)			

Note : (1) Net Amount chargeable to P & L A/c :—

Bad-Debts Rs. 5,000

Add: New Provision required at 5% on Rs.4,00,000 20,000

25,000

Less : Old Provision 12,500

This amount is to be shown on the Debit of P & L A/c 12,500

Dr. Bad-Debts Account			Cr.		
Date	Particulars	Amount	Date	Particulars	Amount
2021		Rs.	2021		Rs.
March 31	To Balance b/d	5,000	March 31	By Provision for	
	(As per Trial Balance)			Doubtful Debts A/c	5,000

Dr. Provision For Doubtful Debts Account						Cr.	
Date	Particulars	Amount	Date	Particulars	Amount	Amount	
2021		Rs.	2020		Rs.		
March 31	To Bad-Debts A/c	5,000	April 1	By Balance b/d			
				(Old Provision)	12,500		
			2021				
March 31	To Balance c/d		March 31	By Profit & Loss A/c			
	(New Provision 5% on Rs.4,00,000)	20,000		(Balancing figure)	15,000		
		25,000			4,800		
			2021				
			April 1	By Balance b/d	4,000		

Dr.	Profit & Loss A/C				Cr.
Particulars		Rs.	Particulars		Rs.
To Provision for Doubtful Debts A/c:					
Bad-debts	5,000				
Add: New Provision	20,000				
	25,000				
Less : Old Provision	12,500	12,500			
Balance Sheet as at March 31, 2021					
Liabilities		Amount	Assets		Amount
		Rs.	Sundry Debtors	4,00,000	Rs.
			Less : Further Bad-debts	-	
				4,00,000	
			Less: New Provision		
			(5 % on 4,00,000)	20,000	3,80,000

When Bad Debts are Given in Adjustments :— Most of the time you find, Bad-debts are given in adjustments. In such a situation ,these further Bad-debts will be written on the debit side of the P & L A/c and will also be deducted from debtors on the assets side. New Provision in this case, will be calculated on the amount of debtors which remain after deducting the amount of Bad-debts there from.

The following balances appeared in the Trial Balance of Entity K-7 as at 31st March 2020 :
Rs.

Sundry Debtors	6,10,000
Bad Debts	10,000
Provision for Bad-debts	40,000

Adjustments :
Further Bad-debts Rs.6,000; provision for Bad-debts 10%.
Show journal entries and the Bad-debts Account, Provision Account, Debtors Account, Profit and Loss Account and Balance Sheet.

Answer:

Journal

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
2020				
March 31	Bad-debts A/c	Dr	6,000	
	To Sundry Debtors A/c			6,000
	(Further Bad-debts)			
March 31	Provision for Doubtful Debts A/c	Dr	16,000	
	To Bad Debts A/c			16,000
	(Bad debts adjusted against the provision)			
March 31	Profit and Loss A/c	Dr	36,400	
	To Provision for Doubtful Debts A/c			36,400
	(Net amount charged from P & L A/c)			

Note:(1)

Net Amount chargeable from P & L A/c	Rs.
Bad-Debts (10,000 + 6,000)	16,000
Add: New Provision : 10% on (6,10,000 - 6,000)	60,400
76,400	
Less: Old Provision	40,000
36,400	

Dr.	Bad-Debts Account				Cr.
Date	Particulars	Amount	Date	Particulars	Amount
2020		Rs.	2020		Rs.
March 31	To Balance b/d	10,000	March 31	By Provision for	
March 31	To Sundry Debtors A/c	6,000		Doubtful Debts A/c	16,000
		16,000			16,000

Dr.	Provision For Doubtful Debts Account				Cr.
Date	Particulars	Amount	Date	Particulars	Amount
2020		Rs.	2020		Rs.
March 31	To Bad Debts A/c	16,000	April 1	By Balance b/d	
March 31	To Balance c/d			(Old Provision)	40,000
	(New Provision)	60,400	2020 March 31	By Profit & Loss A/c	
				(Balancing figure)	36,400
		76,400			76,400

Dr.	Profit & Loss Account for the year ended March 31, 2020				Cr.
Particulars		Rs.	Particulars		Rs.
To Provision for Doubtful Debts A/c:					
Bad-debts	10,000				
Add: Further Bad-debts	6,000				
	16,000				
Add: New Provision	60,400				
	76,400				
Less: Old Provision	40,000	36,400			

BALANCE SHEET as at March 31, 2020

Liabilities	Amount Rs.	Assets	Amount Rs.
		Sundry Debtors	6,10,000
		Less : Further Bad-debts	6,000
			6,04,000
		Less: New Provision	
		(10% on 3,02,000)	60,400
			5,43,600

Provision for Discount on Debtors

Entities allow cash discount to those debtors from whom the payment is received promptly or within a fixed period. It an expense of the business and is therefore debited to the Profit & Loss Account. Obviously there would be certain debtors who would make early payment in the next accounting year and would be allowed such discount. As per Prudence concept a provision for such discount is created in the current year itself. The entry will be -

Dr.

To Provision for Discount on Debtors A/c
(Provision for discount created on good Debtors)

Such provision is reflected on the debit side of the Profit & Loss Account and is also deducted from Sundry Debtors on the Assets side of the Balance Sheet.

One may need to note that discount will be allowed only to those debtors who will make prompt payment.

As such, the provision for discount is calculated on good debtors left after deducting further bad-debts given in adjustments and the provision for doubtful debts required to be made at the end of year.

In other words, first of all, further bad-debts given in adjustments will be deducted from Debtors and then provision for doubtful debts will be calculated on the balance of Debtors and lastly, provision for discount will be calculated on the remaining amount of Debtors.

Extracts Of Trial Balance of Entity - F-99 as at 31st March, 2021

	Dr.(Rs.)	Cr.(Rs.)
Bad-Debts	18,000	
Provision for Bad & Doubtful Debts (1-4-2020)		37,500
Sundry Debtors	10,00,000	

Adjustments :

- (i) Write off further Bad-debts Rs.10,000.
 - (ii) Provision for Doubtful Debts is to be maintained at 5% on Sundry Debtors.
 - (iii) Create a provision for discount on Sundry Debtors at 3%.
- Show effect on Profit & Loss Account and Balance Sheet.

Answer :

Profit & Loss a/c

Dr.	for the year ended 31st March, 2021		Cr.
Particulars	Rs.	Particulars	Rs.
To Bad Debts 18,000			
Add: Further Bad Debts 10,000			
	28,000		
Add: New Provision (5% on Rs.10,00,000 i.e., - 10,000)			
49,500			
77,500			
Less : Old Provision 37,500	40,000		
To Provision for Discount (3% on Rs. 9,40,500 i.e., 10,00,000-10,000 - 49,500)			
	28,215		

Balance Sheet as at 31st March, 2021

Liabilities	Amount	Amount
	Rs.	Rs.
		Sundry Debtors 10,00,000
		Less : Further Bad Debts 10,000
		1,98,000
		Less : New Provision for Doubtful Debts (5% on 9,90,000) 49,500
		9,40,500
		Less: Provision for Discount (3% on 9,40,500) 28,215
		9,12,285

Abnormal Loss

Sometimes losses occur due to some abnormal circumstances such as accident, fire, flood, earthquakes etc. Such losses are called Abnormal Losses. These may be divided into two categories :—

- a. Abnormal Loss A/c
- To Purchases A/c

Dr.

	b. Profit & Loss A/c Dr. To Abnormal A/c c. Insurance Claim a/c Dr. To, P/L Say Goods worth Rs. 5,00,000 were destroyed by fire and a claim of 4,00,000 has been accepted by the Insurance Company. Entry :— (a) Abnormal Loss A/c Dr. 5,00,000 To Purchases A/c 5,00,000 (b) Insurance Claim or Insurance Company A/c Dr. 4,00,000 Profit & Loss A/c Dr. 5,00,000 To Abnormal Loss A/c 5,00,000 (c) Insurance claim Receivable a/c Dr. 4,00,000 To P/L 4,00,000 Rs. 5,00,000 will be deducted from Purchases on the debit side of Trading A/c and will be shown on the debit side of Profit and Loss A/c and Rs.4,00,000 will be reflected on the credit side of P/L and also on the Assets side of the Balance Sheet.
Goods given as Charity	Charity in the form of Goods :— Occasionally, certain amount of goods are given away as charity. The following entry will be passed for it:— Charity A/c Dr. To Purchases A/c (Goods given away as charity) Shall be deducted from Purchases because it reduces the goods purchased and shall also be shown on the debit side of P & L A/c because it is business expense.
	Goods distributed as free samples ;— Sometimes the goods which the business deals in are distributed as free samples for the purpose of advertising these goods. The following adjusting entry should be passed for it:— Advertisement A/c Dr. To Purchases (Goods distributed as free samples) It will be deducted from purchases in the Trading A/c and will also be shown on the Debit side of P & L A/c because it is an expense of business.
	Drawings in Goods :— If the proprietor of the business has taken some goods for his personal use from the business, the entry will be :— Drawings A/c Dr. To Purchases A/c (Goods taken by proprietor for personal use) Shall be deducted from Purchases in the Trading Account and shall also be deducted from the Capital on the liabilities side of the Balance Sheet as Drawings.
Deferred Revenue Expenditure	For Explanation please see chapter Revenue and Capital Expenditure
Capital Expenditure	For Explanation please see chapter Revenue and Capital Expenditure
	Manager's Commission on Net Profit :— Sometimes, in addition to his regular salary, the manager is entitled to a commission on net profit. This is done to induce him to take more interest in the business. Since the Commission is always calculated at the end of the accounting period, it is treated as outstanding expenses and the following adjusting entry is passed for it : Commission A/c Dr. To Outstanding Commission A/c On the one hand, it will be recorded on the debit side of P & L A/c because it is a business expense and on the other hand, shown on the Liabilities side as an outstanding expense.

	Method of Calculating the Commission :—This Commission may be based :— (a) On profits before charging such Commission. (b) On profits after charging such Commission. (a) On profits before charging such Commission :— Suppose, the profit earned by the firm before allowing the Manager's Commission is Rs.22,000 and the Manager is entitled to a Commission of 10% on Net Profit before charging his Commission, the Commission will be calculated as follows :— $\text{Manager's Commission} = 22,000 \times \frac{10}{100} = \text{Rs.2,200.}$ (b) On profits after charging such Commission :— Suppose, the profit earned by the firm before allowing the Manager's Commission is Rs.22,000 and the Manager is entitled to a Commission of 10% on Net Profit remaining finally after charging his Commission, the Commission will be calculated as follows :— $\text{Manager's Commission} = 22,000 \times \frac{10}{110} = \text{Rs.2,000.}$ In other words, it means that out of every Rs. 110 of profit, the Commission will be Rs.10.				
	Goods purchased and included into stock but omitted to be recorded :— Sometimes the goods are purchased and included in stock as well, but these are omitted to be recorded in the books of accounts. The following entry will be passed to make a record of such purchases : <table> <tr> <td>Purchases A/c</td><td>Dr.</td></tr> <tr> <td>To Creditors A/c</td><td></td></tr> </table> (Goods purchased on credit but omitted to be recorded) Shall be added to purchases on the debit side of Trading Account and shall also be added to the Creditors on the Liabilities side.	Purchases A/c	Dr.	To Creditors A/c	
Purchases A/c	Dr.				
To Creditors A/c					
	Sale of Goods on Approval Basis :— Sometimes goods are sold to the customer on approval (or return) basis, i.e., if the goods are liked by him, he may keep them and if they are not liked by him, he may return them. Such goods cannot be regarded as sale unless consent is received during the accounting period. In case, the goods have been recorded as actual sale and no consent has been received up to the end of accounting period, the following entry will have to be passed to cancel the sale :— <table> <tr> <td>Sales A/c</td><td>Dr.</td></tr> <tr> <td>To Debtors (Customer's) A/c</td><td></td></tr> </table> (Goods sold on sale or return basis recorded as sale, now rectified) Treatment- Sales will be reduced on the credit side of Trading Account and Debtors will also be reduced on the Assets side of Balance Sheet. Cost price of the Goods lying with the customer will be calculated and then treated just like the closing stock. As such, it will be added to the Closing Stock on the credit side of Trading Account and the stock thus increased will also be shown on the Assets side of Balance Sheet.	Sales A/c	Dr.	To Debtors (Customer's) A/c	
Sales A/c	Dr.				
To Debtors (Customer's) A/c					

Illustrative Questions

Q. 1

Following is extract of the trial balance of Mister Hand- shake.

Capital	-	500000
Purchases /sales	300000	700000
Commission	-	300000

Adjustments:

- I] Goods of the value of Rs.10000 were taken by the proprietor for his own use but no entry was made in the books of accounts.
- II] Provide 10% p.a. interest on capital

- lii] Goods worth Rs. 500 were distributed as free samples.
 Iv] Commission has been received for three years.
 Show the treatment of the above.

Q.2

Following is the extract of trial balance of Mister Sedate.

	Debit	Credit
Capital	-	500,000
Debtors	400,000	-
Bad debts	5,000	-
Provision for bad and doubtful debts	-	10,000
Purchases / sales	200,000	400,000

Adjustment:

- Goods costing Rs.12,000 but sold at Rs.15,000 to a customer on approval basis. But so far approval has not been received.
- Write off bad debts Rs.20,000 and provide for doubtful debts at the rate of 10 %

Financial Statements with Adjustments Entries and their Accounting Treatment

In order to prepare a true and fair financial statement, there are some very important adjustments those have to be done before finalization of the accounts (*as shown in the following illustration*) –

Q - 3 -

Compute amount of Good debtors and net Balance of debtors from the following:

- Debtors Rs. 1,00,000
- Bad debts Rs. 2,000
- Provision for Doubtful debts Rs. 10%
- Discount to debtors 10%

Solution :

▪ Debtors	1,00,000
▪ Less Bad debt	2,000
▪ = Doubtful	98,000
▪ Less Provision for doubtful debt @10 %	<u>9,800</u>
▪ = Good	88,200
▪ Less provision for discount @ 10%	<u>8,820</u>
▪ Net balance	<u>79,380</u>

Q - 4 -

Examination Problem - 4 Marks

The provision for Doubtful Debt A/c shows a balance of Rs. 10,000 on Jan 01, 2021. The bad debt during the year 2021 amounted to Rs. 6,000. The sundry debtors on Dec 31.12. 2021 were Rs. 1,00,000.

On Dec 31 2021 there was an additional bad debt of Rs. 6,000. Create a new provision @ 10 % on debtors. Bad debt recovered Rs. 1,000.

You are required to show necessary ledger accounts and balance sheet.

Bad Debts a/c

	To Sundry Debtors	12,000		By Prov. For Doubtful Debts	12,000

Provision for d/d a/c

	To Bad debts	12,000		By bal b/d	10,000
	6,000 + 6,000				

Sanjay Welkins Classes	Final Accounts of Profit Making Entities - Revisionary Material

			By P/L	11,400
	To bal c/d 1,00,000 - 6,000 x 10%	9,400		
		21,400		21,400

Bad Debts Recovery a/c

	To P/L	1,000	By bank	1,000

P/L a/c

	To P.F.D.D A/c		By bank	1,000
	New Provision	9,400		
	Add Bad debts	12,000		
		21,400		
	Less: old provision	10,000		
		11,400		

CMA - Examination Problem - 8 Marks - Dates/Names Modified

On 1.4.23 the Balance of provision for bad and doubtful debts was Rs. 13,000. the Bad debts during the year 2023-24 were Rs. 9,500.

The Sundry debtors as on 31st March, 2024 stood at Rs. 3,25,000 out of these debtors of Rs. 2,500 are bad and cannot be realised. The Provision for bad and doubtful debts is to be raised to 5% on sundry debtors.

Pass necessary entries for Bad debts and its provision on 31st March, 2024.

Prepare the necessary ledger accounts.

Bad Debts a/c

	To Sundry Debtors 9,500 + 2,500	12,000	By Prov. For Doubtful Debts	12,000

Provision for d/d a/c

	To Bad debts	12,000	By bal b/d	13,000
	9,500 + 2,500			
			By P/L	15,125
	To bal c/d - Debtors 3,25,000 Less Bad debts at the end of the year 2,500 = 3,22,500 X PFDD @ 5 %	16,125		
		28,125		28,125

CMA - Examination Problem - 3 marks- Dates/Names Modified

M/s High-Value Bros. had a provision for bad debts of Rs. 13,000 against their book debts on 1.4.2022. During the year ended 31st March, 2023, Rs. 8,500 proved irrecoverable and it was desired to maintain the provision for debts @ 5% on debtors which stood at Rs. 3,90,000 before writing off Bad debts.

Prepare the provision for bad debts account for the year ended March 31, 2023.

Bad Debts a/c

	To Sundry Debtors 9,500 + 2,500	12,000	By Prov. For Doubtful Debts	12,000

Provision for d/d a/c

	To Bad debts	8,500	By bal b/d	13,000
			By P/L	14,575
	To bal c/d -	19,075		

Debtors 3,90,000 Less Bad debts at the end of the year 8,500 = 3,81,500 x PFDD @ 5 %				
	27,575			27,575

CMA - Examination Problem - 7 Marks - Dates/Names Modified

A company maintains its reserve for bad debts @ 5% and reserve for discount on debtors @2%. you are given the following details:

	2021	2022
Bad debts	800	1,500
Discount allowed	1,200	500
Sundry Debtors before proving for bad debts and discounts	60,000	42,000

On 01.01.2021, Reserve for Bad Debts and Reserve for Discount on debtors had balance of Rs. 4,550 and 800 respectively.

Show Reserve for bad debts and Reserve for Discount on debtors for the year 2021 and 2022.

Reserve for bad Debts or Provision for D/D a/c as at 31.12.21

To Bad debts		800	By bal b/d	4,550
To PL - B.F		850		
To bal c/d -				
Debtors	60,000			
- Discount	1,200			
- Bad debts at the end of the year	800			
	58,000			
PFDD @ 5% of 58,000		2,900		
		4,550		4,550

Reserve for bad Debts or Provision for D/D a/c as at 31.12.22

To Bad debts		1,500	By bal b/d	2,900
			By P/L - B.F.	600
To bal c/d -				
Debtors	42,000			
- Discount	500			
- Bad debts at the end of the year	1,500			
	40,000			
PFDD @ 5% of 40,000		2,000		
		3,500		3,500

Reserve for Discount a/c at 31.12.21

To Discount Allowed	1,200	By bal b/d	800

To Balance c/d :			
2% of 58,000 - 2,900	1,102	P/L - B.F.	1,502
	2,302		2,302

Reserve for Discount a/c at 31.12.22

To Discount Allowed	500	By bal b/d	1,102
To Balance c/d :			
2% of 40,000 - 2,000	760	P/L - B.F.	1,502
	1,260		1,260

CMA - Examination Problem - 15 Marks - Dates/Names Modified

From the following trial balance of a trader on 31.3.2020, prepare trading and profit and loss account for the year ending on 31.3.2025 and a balance sheet as on that day after giving effect to the under mentioned adjustments:

Debit balance	Rs.	Credit balance	Rs.
Stock 1.4.2024	1,35,000	Sales	46,25,000
Purchases	28,50,000	Returns	22,500
Returns	35,000	Discount received	15,500
Carriage Inwards	24,000	Provision for Bad debts	35,000
Carriage Outwards	33,000	Interest on Investments	42,000
Wages	1,25,000	Sundry Creditors	4,55,000
Salaries	3,52,000	Capital	31,05,000
Printing and Stationery	6,500		
Insurance Premium	15,000		
Repairs	11,000		
Discount Allowed	30,500		
Bad Debts	28,000		
Advertisement	38,000		
Drawings	2,10,000		
Investments	8,00,000		
Furniture & Fixtures	3,50,000		
Office Equipments	2,45,000		
Land and buildings	15,00,000		
Sundry Debtors	6,90,000		
Establishment Expenses	35,000		
Cash at Bank	7,24,000		
Cash in hand	63,000		
	83,00,000		83,00,000

Adjustments:

- i. Closing stock of goods amounted to Rs. 1,85,000 and of Stationery amounted to Rs. 1,500
- ii. Depreciate land and buildings 10% , Office Equipment 15% and F/F @ 10%
- iii. Insurance Premium paid on 1.7.2024 for one year
- iv. Write off Further as bad debts Rs. 6,000 and maintain a provision for bad and doubtful debts of 5 % on debtors.
- v. Provision made for discount on debtors @ 2%
- vi. Goods costing Rs. 12,500 used for giving free samples to customers.
- vii. Goods costing Rs. 25,000 were sent on 26.3.2025 on approval basis to a customer for Rs. 40,000. This was recorded as actual sale but approval was not received till 31.3.25
- viii. Outstanding Salaries were for one month
- ix. Investments were made @ 7.50% per annum on 1.05.2024.

Detailed Solution:
Trading and Profit and loss account

Opening stock	1,35,000	Sales 46,25,000 less goods on approval 40,000 less returns 35,000	45,50,000
Purchases 28,50,000 - returns 22,500 - free samples 12,500	28,15,000	Closing Stock 1,85,000 + approval 25,000	2,10,000
Carriage Inwards	24,000		
Wages	1,25,000		
Gross Profit c/d	16,61,000		
	47,72,500		47,72,500
Free Samples	12,500	Gross profit b/d	16,61,000
Carriage Outwards	33,000	Int. on Investments : 42,000 + Accrued 13,000 Investments made on 1.5.19 so interest Till 31.3.20 i.e for 11 months must be = $8,00,000 \times 7.5\% \times 11/12 = 55,000$. However Int. received is Rs. 42,000. So difference 13,000 shall be considered accrued.	55,000
Salaries 3,52,000 + O/S 32,000	3,84,000	Discount Received	15,500
Printing and stationery 6,500 less closing stock 1,500	5,000		
Insurance Premium 15,000 Less Prepaid 3/12 of 15,000	10,000		
Repairs	11,000		
Provision for Discount	42,755		
Provision For Bad debts	30,250		
Advertisement	38,000		
Depreciation on : F/F 35,000 + Off. EQ. 36,750 + Land and buildings 1,50,000	2,21,750		
Establishment Expenses	35,000		
Net Profit	9,08,245		
	17,31,500		17,31,500

Bad Debts

b/d	28,000	By Balance T/f to Prov. for Bad debts	33,000
Debtors	5,000		
	33,000		33,000

Provision for Bad Debts

Bad debts	33,000	b/d	35,000
Balance c/d	32,250	P/L - Bal. fig.	30,250
5% of 6,45,000			
	65,250		65,250

Provision for Discount

Discount Allowed	30,500	Bal. b/d	Nil
Balance c/d	12,255	P/L - Bal. fig.	42,755
2% of Debtors balance 6,12,750			
	42,755		42,755

Balance Sheet

Capital 31,05,000 + Net Profit	38,03,245	Office Equipments 2,45,000-15% i.e	2,08,250

9,08,245 – drawings 2,10,000		36,750	
Sundry Creditors	4,55,000	F/F 3,50,000 - Dep. 10%	3,15,000
O/S Salaries	32,000	L/B 15,00,000 – Dep. 10%	13,50,000
		Stock of goods 1,85,000 + 25,000	2,10,000
		Stock of Stationery	1,500
		Investments	8,00,000
		Interest Accrued	13,000
		Debtors 6,90,000 – sent on approval 40,000 = 6,50,000 Less bad debts 5,000 Less provision for D/D= 32,250 (6,45,000 x 5%) Balance = 6,12,750 Less Provision for Discount 12,255	6,00,495
		Prepaid Insurance	5,000
		Cash at bank	7,24,000
		Cash in hand	63,000
	42,90,245		42,90,245

Sanjay Welkins' Classes

Chapter 10

Depreciation

1. Explain the Meaning of Depreciation

Depreciation is a permanent, continuous and gradual shrinkage in the book value of a fixed asset. It is the fall in the quality or value of a fixed asset through physical wear and tear due to use or passage of time or from any other cause. Depreciation takes place irrespective of regular repairs and maintenance. As the asset is used for business purpose, the annual loss in the value of the asset is like any other expenditure.

Hence, the cost of fixed assets has to be written off over its useful economic life as a loss.

Thus, depreciation is a process of allocating the cost of a fixed asset over its estimated useful life in a rational and systematic manner.

2. Definition of Depreciation

The Institute of Chartered Accountants of India has defined depreciation as “a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined.”

Depreciation Accounting has been defined by the American Institute of Certified Public Accountants as “a system of accounting which aims to distribute the cost or other basic value of tangible capital assets less salvage (if any) over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation and not of valuation.”

3.State the Characteristics of Depreciation

The following are the important characteristics of depreciation:

- Depreciation refers to a permanent, continuous and gradual decrease in the utility value of a fixed asset and it continues till the end of the useful life of the asset.
- Depreciation is a charge against profit (i.e. revenue earned) for a particular accounting period.
- Depreciation is always computed in a systematic and rational manner since it is not a sudden loss.
- Depreciation is a process of allocation of expired cost and not of valuation of fixed assets.
- Whatever method for calculating depreciation is followed, the exact amount of depreciation can never be calculated, and it can only be estimated.
- Depreciation is caused due to physical factors and functional factors.
- Depreciation is must, i.e. it always takes place whether the asset is carefully handled or neglected.
- If the market value of a fixed asset is fluctuating, the same does not affect the amount of depreciation so made on the respective assets.
- Depreciation is calculated in respect of fixed assets only, i.e. plant, machinery, furniture etc.
- Total depreciation cannot exceed its depreciable value or original cost where the scrap value is nil.

4.Explain the Causes of Depreciation

- (i) *Physical Wear and Tear Resulting from Use:* Tangible fixed assets like, machinery, buildings, furniture etc. get worn out or torn out on account of friction, strain, weathering, intensity of use, chemical reaction, handling etc. This is the most important cause of charging depreciation in respect of such assets which are in constant use.
- (ii) *Physical Deterioration Resulting from Atmospheric Exposure:* Number of assets deteriorates for being continually exposed nature.
- (iii) *Passage of Time:* A machine also becomes potentially useless by the passage of time. It is so even if the machine is kept continuously idle.

- (iv) *Depletion*: Wasting assets such as mines and quarries lose their value because they get exhausted on account of continuous extractions.
- (v) *Obsolescence*: Sometimes an asset becomes useless because of technical changes within the industry, technical progress in other industries, changes in tastes and habits of consumers, changes in supply and locations of natural resources etc.

5. Explain various Objectives of Providing Depreciation

The objectives of providing depreciation are as follows:

- (i) *To ascertain the correct profit*: When a particular asset is used for earning the income of the business, the depreciation in the value of assets should be deducted from the income in order to calculate the correct and real profit of the business.
- (ii) *To present true financial position*: In order to show the true financial position of the business in the balance sheet, it is necessary that assets must be shown at their true values after deducting reasonable depreciation. If depreciation is not provided, the assets will be overstated in the financial statements and it will be against sound business principles.
- (iii) *To make provision for replacement of assets*: Since depreciation is a non-cash expense, the amount charged can be kept separately and utilised for the replacement of the fixed asset after the expiry of the useful life of the asset.
- (iv) *To ascertain the proper cost of the product*: In order to ascertain the cost of production, it is necessary to charge depreciation as an item of cost of production.
- (v) To maintain the capital invested in the cost of the asset intact in the business so that it can be reinvested in profit earning process.
- (vi) To derive maximum tax benefit.
- (vii) *To meet the legal requirements*: In the case of joint stock companies, it is necessary to charge depreciation on fixed assets before declaring dividends.

6.State Factors in Measurement of Depreciation

The factors which affect measurement of depreciation are given below:

- (i) The original cost of asset: The cost includes all cost incurred in acquiring the asset, i.e. purchase price including transportation and installation costs, if any.
- (ii) The additions, if any, made to the assets during the year taking into consideration the date on which these additions were made.
- (iii) The estimated useful life of the asset.
- (iv) The scrap or the residual value of the asset.
- (v) Obsolescence, i.e., the chance of the asset going out of fashion.
- (vi) The working hours of the asset concerned.
- (vii) The repairs and renewals.
- (viii) The skill of the operators who handle the asset.
- (ix) The legal provisions or other restrictions relating to depreciation.

7. Write a note on Depletion:

Depletion is used in respect of natural resources such as oil, coal, timber and minerals etc. It is well known that these resources are limited in quantity and we cannot extract them up to infinite time. Value of these resources gets reduced or exhausted as we extract or remove these resources from their sources. In this context, a systematic apportionment and allocation of total acquisition cost of the natural resources over the periods in which revenue is contributed by such resources is called depletion.

8. Write a note on Amortization:

Amortization is used in respect of intangible assets such as goodwill, trademarks, patents, copyrights and other intellectual property rights. These intangible assets have a limited useful life. So total acquisition cost of the asset should be allocated and apportioned over the periods during which the benefit is derived from them. In this context, a systematic apportionment of total acquisition cost is called amortization.

- When no date of addition is mentioned, depreciation may be charged for half of the year on the assumption that addition was made in the middle of the year.
- Assets sold during the year should be depreciated from the beginning of the year till the date of sale.

Advantages

- It is a simple and easy method.
- The value of the asset can be completely written off, i.e. the value can be reduced to zero its estimated scrap value.
- This method can be applied where asset gets depreciated because of effluxion of time like furniture, equipments, patents, leasehold etc.
- There is no change either in the rate or amount of depreciation over the useful life of the asset.
- The value of the asset each year in the balance sheet is reasonably fair.

Disadvantages

- The assumption that the asset shall be equally useful throughout its life seems to be illogical.
- It does not take into account the effective utilization of the asset.
- Even though the asset is used uniformly from period to period, the total charge for the use of the asset keeps on increasing every year.
- This is because cost of repairs in each subsequent year rises though equal amount of depreciation is written off every year.

12. Explain Diminishing Balance Method /Reducing Balance Method/Written Down value method

Under this method, depreciation is calculated at a certain percentage each year on the balance of the asset which is brought forward from the previous year. The amount of depreciation charged for each period is not fixed but it goes on decreasing gradually as the opening balance of the asset in each year will reduce. Thus, amount of depreciation becomes higher at in the earlier periods and becomes gradually lower in subsequent periods, while repairs and maintenance charges increase gradually.

Advantages / Disadvantages

- It is a simple and easy method.
- Every year, there is an equal burden for using the asset. This is because depreciation goes on decreasing every year whereas cost of repairs increases.
- The value of the asset cannot be brought down to zero.
- The obsolescence problem is given due care since major part of the depreciation is charged in earlier years and the management may find it easy to replace the asset.
- Depreciation is neither based on the use of the asset nor distributed evenly throughout the useful life of the asset.
- Income tax authorities recognize this method.

All items including additions are added together and depreciated at the same rate.

13.

Write a note on Distinction Between Straight Line Method And Diminishing Balance Method Of Depreciation

- Depreciation is charged at a fixed rate on the original cost of the asset.
Depreciation is charged at a fixed rate on the original cost in the first year and on the written down value (cost-minus total depreciation) in the subsequent years.
- The amount of depreciation remains the same in all the years of useful life of the asset.
The amount of depreciation goes on decreasing year after year.
- The total burden on the profit and loss account is more in the later years because the repair charges increase while the amount of depreciation remains the same.
The total burden on the profit and loss account is almost same in the early years as well as is the later years because of more depreciation plus repairs cost in the beginning and less depreciation plus more repairs cost in the later years.
- The book value of the asset becomes zero or equal to scrap value.

The book value never becomes zero.

- (v) It is easy to calculate the rate of depreciation.
It requires the use of mathematical tables.
- (vi) It is suitable where repair charges are less and obsolescence is not frequent.
It is suited where repair charges are more in later years and also where there is obsolescence.

14. Explain Change In Method of Depreciation in the light of AS 10

Consistency principle of accounting requires that same accounting practices and methods should be observed and followed from year to year as otherwise the reported profit or loss will not be comparable.

Hence, it is expected that the concern should consistently follow the method of depreciation which is once chosen. However, sometimes, a change in the method becomes inevitable.

Ministry of Corporate affairs vide notification dated 30/03/2016 notified Companies (Accounting Standards) Amendment Rules, 2016

Accounting Standard 6 on Depreciation Accounting, is now omitted. Depreciation is now covered under AS-10. As per AS-10 the depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.

The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a *change* should be accounted for as a change in an **accounting estimate** in accordance with AS 5. It means Retrospective calculation of depreciation is now not required. New method shall be applied now **prospectively**

15. Calculation of Profit Or Loss On Assets Sold

Assets may be sold or discarded before or on the expiry of its useful life. Then it is necessary to calculate the profit or loss, if any, on such sale. For this purpose the book value of the assets at the date of sale is to be calculated by deducting the total depreciation from the date of purchase to the date of sale from the original cost. If the sale price is more than the book value there is profit on sale of the assets and if the sale price is less than the book value, the difference will be loss on sale.

Profit or loss on sale of assets = Sale price of asset - Book value of the asset on the date of sale

Book value of the asset on the date of sale = Original cost of the asset – Total depreciation on the asset till date of sale

a. The following journal entries are passed to record the above transactions when the depreciation is directly credited to the asset account:

- (i) On sale of assets:

Bank Dr.xxx

To Assets Account (with the sale price) xxx

- (ii) For profit on sale of asset:

Asset Account Dr.xxx

To Profit and Loss Account xxx

(In case of loss the above entry is reversed.)

b. When Provision for Depreciation Account is maintained then the asset account appears at its cost price and the following accounting procedure is followed:

- (i) Transfer of accumulated depreciation including the depreciation created at the time of sale:

Provision for Depreciation Account Dr.

To Asset Account

- (ii) On sale of the asset:

Bank Dr.

To Asset Account

- (iii) If the amount of accumulated depreciation and sale price put together is less than the original cost of the asset, the difference is loss on sale and transferred to profit and loss account:

Profit and Loss Account Dr.

To Asset Account

(iv) In case the accumulated depreciation and sale price put together is more than the original cost of the asset, the difference is treated as profit on sale and is credited to profit and loss account:

Asset Account Dr.

To Profit and Loss Account

When Provision for Depreciation Account is maintained on sale of asset, alternatively, it is suggested to open an 'Asset Disposal Account' in such case the following accounting entries may be passed:

(i) On transfer of original cost of asset to Asset Disposal Account:

Asset Disposal Account Dr.

To Asset Account

(ii) On sale of the asset:

Bank Dr.

To Asset Disposal Account

(iii) On transfer of Provision for Depreciation Account to Asset Disposal Account:

Provision for Depreciation Account Dr.

To Asset Disposal Account

(iv) For profit on disposal of asset:

Asset Disposal Account Dr.

To Profit and Loss Account

(In case of loss the above entry is reversed.)

Illustrative Question Bank

Section - I SLM / WDV / Sum of digit Method of Depreciation

Q - 1 A Machine is purchased for ₹ 7,00,000 . Expenses incurred on its cartage and installation ₹ 3,00,000. Calculate the amount of depreciation @ 20% per annum according to straight line method for first year ending on 31.3. 22 if Machine is purchased on -

- a. 1.4.21
- b. 1.7.21

Q - 2

R-99 Limited acquired machinery on 1st July 2023 at a cost of ₹ 90,000 and spent ₹ 10,000 for its installation. The firm writes off depreciation at 10% per annum on diminishing balance method. The books are closed on 31st March every year. Show Machinery Account and Depreciation Account for three years.

Detailed Solution:

Books of R-99 Machinery Account

1.7.2019	Bank (90,000 + 10,000)	1,00,000	31.03.20	Depreciation –	7,500
				c/d	92,500
		30,000			1,00,000
1.4.2020	Bal. b/d	92,500	31.03.21	Dep.	9,250
				c/d	83,250
		92,500			92,500
1.04.21	Bal. b/d	83,250	31.03.22	Dep.	8,325

				c/d	74,925
		83,250			83,250

Q - 3

On 1.4.21 a Machine was purchased for ₹ 1,00,000 and 50,000 was paid for installation. Assuming the rate of depreciation as 10% on reducing balance method, calculate the amount of depreciation up to 31.3.23

Q - 4

On 1.4.2020, a firm purchased machinery for Rs.2,00,000. On 1.10.2020; an additional machinery costing Rs.1,00,000 was purchased. On 1.10.2021, the machinery purchased on 1.4.2020 was sold for Rs..90,000. On 1.10.2022, new machinery was purchased for Rs.2,50,000 while the machinery purchased on 1.10. 2010 was sold for Rs.85,000 on the same day.

The firm provides depreciation on its machinery at the rate of 10% per annum on original cost. It closes its books of accounts on 31st of March of each year. Show the machinery account for three accounting years ending on 31.3.2013.

Solution:

Machinery Account

1.4.2020	Bank	2,00,000	31.3.21	Depreciation – 20,000 + 5,000	25,000
1.10.2020	Bank	1,00,000		c/d	2,75,000
1.4.21	Bal. b/d	2,75,000	1.10.21	Bank a/c	90,000
				Dep. on M1 sold: 2,00,000 x 10% x 6/12	10,000
				P&L	80,000
				(WDV of M1 on the date of sale : 2,00,000 - 20,000 - 10,000 = 1,70,000 Sold for 90,000 Loss 80,000	
			31.3.22	Dep. on M 2	10,000
				Bal. c/d - M2	85,000
		2,75,000			2,75,000
1.4.22	Bal. b/d - M2	85,000	1.10.22	Bank - M2 sold	80,000
1.10.22	Bank - M3	2,50,000		Dep. On M2 1,00,000 x 10% x 6/12	5,000
	P&L : (WDV of M2 on the date of sale : 1,00,000 - 5,000 - 10,000 - 5,000 = 80,000 Sold for 85,000 Gain on sale : 5,000	5,000	31.3.23	Dep. On M3 2,50,000 x 10% x 6/12	12,500
				Balance c/d : M3	2,37,500

Q - 5 Sum of the units Method:

Depreciation for the period = Production during the year / Total Production

A Machine is purchased for ₹ 60,00,000 -estimated life of which is 10 Years and estimated residual value is ₹ 4,00,000.

Estimated production of Machine during the whole life is 2,00,000 units.

Production Pattern is as follow:

Year	Production Units

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

Compute Depreciation on the basis of Sum of the Units Method

Solution:

Year	Computation	Depreciation
1 - 2	$[20,000 / 2,00,000] \times 56,00,000$	5,60,000
3 - 6	$[15,000 / 2,00,000] \times 56,00,000$	4,20,000
7 - 10	$[25,000 / 2,00,000] \times 56,00,000$	7,00,000

Section - II : Change in Method of Depreciation

2.1 Change in Method

A limited company purchased on 1.1.2018 a second hand machinery for Rs. 12,000 and immediately sent Rs.8,000 on its overhauling. On 1st July in the same year additional machinery costing Rs.10,000 is purchased. On 1.7.2020 the machinery purchased on 1.1.2018, having become obsolete is sold for Rs.4,000 and on same date fresh plant is purchased at a cost of Rs.24,000.

Depreciation is provided at the rate of 10% p.a. on original cost on 31.12. of every year. In 2021, however, the company changes the method of providing depreciation and adopts the method of writing off 15% per annum on the diminishing balance method.

Show the machinery account from 2018 to 2021.

Plant Account

1.1.2018	Bank (12,000 + 8,000)	20,000	31.12.18	Depreciation – 2,000 + 500	2,500
1.7.2018	Bank	10,000		c/d	27,500
		30,000			30,000
1.1.19	Bal. b/d	27,500	31.12.19	Dep.	3,000
				c/d	24,500
		27,500			27,500
1.1.20	Bal. b/d	24,500	1.7.20	Bank a/c	4,000
1.7.20	Bank	24,000		Dep.	1,000
				P&L	11,000
				(20,000 – 5,000 – 4,000)	
				Dep. 1,000 + 1,200	2,200
				Bal. c/d	30,300
		48,500			48,500
1.1.21	Bal. b/d	30,300	31.12.21		
				Dep. 15% on 30,300	4,545
				Bal. c/d	25,755
		30,300			30,300
1.1.12	Bal. b/d	25,755			

Computation of loss on Sale of machinery on 1.7.20

Cost of machinery sold [as on 1.1.18]	20,000
Less dep. @ 10% p. a. for $2\frac{1}{2}$ years	5,000
Book value as on 1.7.2020	15,000
Less realised value	4,000

Loss on sale of machinery	11,000

Solution has been done as per provisions of AS-10

2.2

X purchased a second hand machinery on 1.2.2021 for Rs.50,000 and paid Rs. 11,000 for it's over hauling and Rs. 5,000 for its installation which was completed by 31.3.2021. The company provides depreciation on its machinery at 15% on diminishing balance method from the date it was put to use and closes its books on 31st of December every year. On 1.10.2022, a repair work was carried out on the machine and Rs. 5,000 were paid for the same. The machine was sold on 31.10.2023, for a sum of Rs. 11,000 and an amount of Rs. 1,000 was paid as dismantling charges. Prepare machinery account from 2021 to 2023.

Answer : loss on sale Rs. 33,566.

Machinery Account

1.2.2021	Bank	50,000	31.12.21	Depreciation – 15% of 66,000 for 9 months	7,425
31.3.2021	Bank	16,000		c/d	58,575
		66,000			66,000
1.1.22	Bal. b/d	58,575	31.12.22	Dep. : 15 % of 55,875	8,786
				c/d	49,789
		58,575			58,575
1.1.23	Bal. b/d	49,789	1.10.23	Bank a/c	10,000
	Bank			Dep. 15% on 49,789 for 10 months	6,223
				P&L : bal. fig.	33,566
		49,789			49,789

Key Notes :

Repairs cost is not capitalised since it is a routine expense.

Cost of dismantling has been deducted from sale price for calculating loss on sale of machine

2.3

Neha limited purchased a machine on 1.1.2020 for Rs. 1,60,000 and spent on its over- hauling Rs. 40,000. Another machine was purchased on 1.7.2020 for Rs. 80,000. On 1.7.2022, the machine purchased on 1.1.2020 was sold for Rs. 1,00,000. On the same date another machine was purchased for Rs. 30,000 and was installed on 30.9.2022.

Under the existing practice, the company provides depreciation at 10% on original cost. However, from 2023, it was decided to adopt written down value method and to charge depreciation at the rate of 15% per annum.

Prepare Machinery account in the books of Neha limited from 2020 to 2023.

Answer : Balance in machinery account Rs. 692983. Loss on sale Rs. 50000

Books of Neha limited

Machinery Account

1.1.2020	Bank (1,60,000 + 40,000)	2,00,000	31.12.20	Depreciation – 20,000 + 4,000	24,000
1.7.2020	Bank	80,000		c/d	2,56,000
		2,80,000			2,80,000
1.1.21	Bal. b/d	2,56,000	31.12.21	Dep. 20,000 +8,000	28,000
				c/d	2,28,000
		2,56,000			2,56,000

1.1.22	Bal. b/d	2,28,000	1.7.22	Bank a/c	1,00,000
30.9.22	Bank	30,000		Dep.	10,000
				P&L	50,000
			31.12.22	Dep.	8,750
				Bal. c/d	89,250
		2,58,000			2,58,000
1.1.23	Bal. b/d	89,250	31.12.23		
				Dep. a/c	13,387.50
				c/d	75,862.50
		89,250			89,250.00

Solution has been done as per Provisions of AS -10 - which states change in depreciation method should be applied prospectively.

Section III : Machinery disposal / Provision for depreciation

3.1

F - 54 purchased a machine for ₹ 1,00,000 on 1.1.2022. Another machine costing ₹ 1,50,000 was purchased on 1.7.2023. On 31.12.2024, the machine purchased on 1.1.2022 was sold for Rs. 50,000. The company provides depreciation at 15% on SLM basis.

The company closes its accounts on 31st of December every year.

Prepare - Machinery account, Machinery Disposal account and provision for depreciation account.

Section IV - Question of Depreciation in respect of AS 10

4.1

A company has purchased plant and machinery in the year 2024-25 for Rs. 90 lacs. A balance of Rs. 10 lakhs is still payable to the suppliers for the same. The supplier waived off the balance amount during the financial year 2025-26. The company treated it as income and credited to profit and loss account during 2025-26.

Whether accounting treatment of the company is correct. If not, state with reasons.

Response

As per AS-10 the cost of PPE/Fixed assets may undergo changes subsequent to its acquisition or construction on account of exchange fluctuation, price adjustments, and changes in duties or similar factors. Hence, the treatment done by the company is not correct. Rs. 10 lakhs should be deducted from the cost of fixed assets.

4.2

P-13 Limited purchased a car on 1.4.23 for Rs. 18 lakhs from a supplier- who normally offers 3 months credit facility. However, P-13 acquired it under an agreement whereby it would pay the amount of the car after a period of 2 years. Presume borrowing rate as 10%. Show the amount of cost of car. PVF at 10% for 2 years i.e. 0.826.

Response

Cost of the car shall be: Cash Price equivalent

Cash price equivalent shall be: $18,00,000 \times \text{PVF at } 10\% \text{ for } 2 \text{ years i.e. } 0.826$

$= 14,86,800$

out of total absolute payment of 18,00,000, 14,86,800 shall be treated as payment towards cost of plant and balance of 3,13,200 as interest

4.3

Y-555 limited acquired a machinery for Rs. 1,20,000 having an useful life of 10 years with zero residual value. At the end of 3rd year, it was reassessed that machine is useful for only 5 more years. Calculate the depreciation for 4th year and onwards.

4.4

Z-2125 limited acquired a machinery for Rs. 1,20,000 having an useful life of 10 years with zero residual value. At the end of 3rd year, due to price adjustments the cost of the machine increased by Rs. 6,000 also it was reassessed that machine is useful for further 9 more years after which it could fetch Rs. 9,000. Calculate the depreciation for 4th year and onwards

4.5

T-45 limited is having a building costing Rs. 12,00,000. It is depreciated as per straight line method. Estimated working life is 10 years and residual value is Rs. 2,00,000. Entity adopts revaluation model and during the fourth year entity building was revalued upwards by Rs. 3,00,000 and residual value was reassessed at Rs. 3,00,000. Also remaining useful life was reassessed as 10 years. Find depreciation charge for 4th year and onwards.

Response

Land and buildings are separable assets and are accounted for separately, even when they are acquired together.

4.6

As an auditor what would you do in the following situations? The method of depreciation on plant and machinery is to be changed from SLM basis to WDV basis from the current year.

Response

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

4.7

State briefly the duty of an auditor with regard to the following-

No depreciation has been charged for the year ended 31.3.2018, in respect of a spare Bus purchased during the year and kept ready by the company for use as stand- by on the ground that it was not used during the year.

Response

As per AS-10 PPE, Dep. is measure of the wearing out consumption or other loss of value of a depreciable asset arising from—

1. Expected usage
2. effluxion of time or
3. Obsolescence through change in technology or market trends.

Thus depreciation has to be charged even in case of those assets which are not used at all during the year as there is effluxion of time.

4.8

A company acquired a machine on 1.04.21 for Rs. 5,00,000. The company charged depreciation upto 2023-24 on SLM basis with estimated working life of 10 years and scrap value of Rs. 50,000.

From 2024-25, the company decided to change depreciation method at 20% reducing balance method.

Compute the amount of depreciation to be debited to Profit and loss account for the year 2024-25

Response

Annual depreciation = $(5,00,000 - 50,000)/10 = 45,000$

WDV at the end of 2023-24 = $5,00,000 - 45,000 \times 3 = 3,65,000$

Depreciation to be charged in 24-25:
 Book value as at 31.03.24 = 3,65,000
 Depreciation = 3,65,000 x 20% = 73,000

4.9

A computer costing Rs. 60,000 is depreciated on a straight line basis assuming 10 years working life and Nil Residual value, for three years. The estimate of remaining useful life after third year was reassessed at 5 years. Calculate depreciation as per provisions of AS- 10.

Response

Present Book value that is after 3 years $60,000 - (60,000 \times 3) = 42,000$

Revised Depreciable amount per annum = $42,000/5 = 8,400$

4.10

A machinery with useful life of 6 years was purchased on 1.04.2016 for Rs. 1,50,000. Depreciation was provided on SLM for first three years considering a residual value of 10% of cost.

In the beginning of 4th year the company re-assessed the remaining useful life of the machinery at 4 years and residual value was estimated at 5% of the original cost.

The accountant re-calculated the revised depreciation historically and charged the difference to profit and loss account.

You are required to comment on the treatment by accountant and calculate the depreciation to be charged for the fourth year.

Response

Depreciation per year	$1,35,000/6$	22,500
Depreciation for 3 years	$22,500 \times 3$	67,500
WDV at the beginning of the 4th Year	$1,50,000 - 67,500$	82,500
Revised Depreciation:		
Depreciable amount	$(82,500 - 1,50,000 \times 5\%) / 4$	
	$82,500 - 7,500$	75,000
Remaining Life		4 years
Depreciation for the 4th year and onwards		18,750

4.11

Sunshine Ltd. expects that a plant has become useless which is appearing in the books at Rs. 20 lakhs gross value. The company charges SLM depreciation on a period of 10 years estimated life and estimated scrap value of 3%. At the end of 7th year the plant has been assessed as useless. Its estimated net realisable value is Rs. 6,20,000. Determine the loss/gain on retirement of the fixed assets.

Response

- Cost of the plant Rs. 20,00,000
- Estimated realisable value Rs. 60,000
- Depreciable amount Rs. 19,40,000
- Depreciation per year Rs. 1,94,000
- Written down value at the end of 7th Year = $20,00,000 - (1,94,000 \times 7) = \text{Rs. } 6,42,000$

As per of AS-10 items of PPE/Fixed Assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realisable value and are shown separately in the financial statements. Any expected loss is recognized immediately in the profit and loss statement. Accordingly, the loss of Rs. 22,000 ($6,42,000 - 6,20,000$) to be shown in the and loss account and asset of Rs. 6,20,000 to be shown in the balance sheet separately.

4.12

F-99 limited expects that a plant becomes useless which is appearing in the books at Rs. 10 lakhs gross value. The company charges SLM depreciation over an estimated period of 10 years and estimated scrap

value is 3% of the cost. At the end of the 7th year the plant has been assessed as useless and decided to sell. Its estimated net realisable value is Rs. 3,10,000. Determine the loss/gain on retirement of the PPE.

Response

Cost of the plant Rs. 10,00,000

Estimated RV at the beginning = $10,00,000 \times 3\% = 30,000$

Depreciable amount $10,00,000 - 30,000 = 9,70,000$

Depreciation per year = $9,70,000 / 10 = 97,000$

WDV at the end of 7th year = $10,00,000 - 97,000 \times 7 = 3,21,000$

- Such asset is stated at the lower of net book value and net realisable value in the financial statement.
- Any expected loss is recognized immediately in the profit & loss statement.
- It should be separately shown in financial statement i.e., balance sheet.

In the given case, the expected loss is $3,21,000 - 3,10,000 = 11,000$ which should be charged to SPL

Further PPE should be shown in the balance sheet at Rs. 3,10,000

Sanjay Welkins' Classes

Chapter - 11

Accounting for Incomplete Records

1. Chapter Crux

1. Single entry system as put by Kohler is- a system of book keeping in which as a rule only records of cash and of personal accounts are maintained and thus it is always incomplete and varies with the circumstances. Since under this system only one aspect of the transaction is recorded arithmetical accuracy is questionable and as a consequence chances of fraud and misappropriation get enhanced. Also, neither trading nor profit and loss account can be prepared under this system which is a serious drawback. Likewise, on account of absence of records of real accounts, preparation of balance sheet too becomes a cumbersome task.

2. Features

Single Entry System has the following features.

- Maintenance of books by a sole trader or partnership firm : The books which are maintained according to this system can be kept only by a sole trader or by a partnership firm.
- Maintenance of cash book: In this system it is very often to keep one cash book which mixes up business as well as private transactions.
- Only personal accounts are kept: In this system, it is very common to keep only personal accounts and to avoid real and nominal accounts. Therefore, sometimes, this is precisely defined as a system where only personal accounts are kept.
- Collection of information from original documents: For information one has to depend on original vouchers, example, in the case of credit sales, the proprietor may keep the invoice without recording it anywhere and at the end of the year the total of the invoices gives an idea of total credit sales of the business.
- Lack of uniformity: It lacks uniformity as it is a mere adjustment of double entry system according to the convenience of the person.

Difficulty in preparation of final accounts: It is much difficult to prepare trading, profit and loss account and balance sheet due to the absence of nominal and real accounts in the ledger.

1. Single entry system is generally found in sole trading concerns or even in partnership firms to some extent but never in case of limited liability companies on account of legal requirements.
2. There are basically 3 types of single entry systems:
 - i. Pure Single Entry
 - ii. Simple Single Entry
 - iii. Quasi Single Entry
3. Single entry system ignores the concept of duality and therefore, transactions are not recorded in their two-fold aspects.

3. Adopted by

- Generally by small sole proprietorship and partnership businesses do not maintain double entry book keeping system.
- They keep record of the cash transactions and credit transactions only. Sometimes they do not maintain records of all transactions.

On account of this it may be stated as incomplete records.

4. Types

(i) Pure single entry:

In this, only personal accounts are maintained with the result that no information is available in respect of cash and bank balances, sales and purchases, etc. In view of its failure to provide even the basic information regarding cash etc., this method exists only on paper and has no practical application.

ii) Simple single entry:

In this, only: (a) personal accounts, and (b) cash book are maintained. Although these accounts are kept on the basis of double entry system, postings from cash book are made only to personal accounts and no other account is to be found in the ledger. Cash received from debtors or cash paid to creditors is simply noted on the bills issued or received as the case may be.

iii) Quasi single entry:

In this: (a) personal accounts, (b) cash book, and (c) some subsidiary books are maintained. The main subsidiary books kept under this system are Sales book, Purchases book and Bills book. No separate record is maintained for discounts, which are entered into the personal accounts. In addition, some scattered information is also available in respect of few important items of expenses like wages, rent, rates, etc. In fact, this is the method which is generally adopted as a substitute for double entry system.

5. Profits under single entry system can be computed either through

- Net worth method or
- Conversion method

6. Net worth method

In order to compute profits under **Net worth method** following steps are required-

1. Preparation of statement of affairs in the beginning in order to compute opening capital.
2. Preparation of statement of affairs at the end in order to find out closing capital
3. Then apply the following format-

Closing capital	xxx
Add drawings made during the year	xxx
Less opening capital	xxx
Less fresh or additional capital	xxx
= profit	

7. Conversion Method

When it is desired to compute profits through preparation of trading and profit and loss account under single entry system in that case conversion method is used – however it involves plethora of steps and it is quite cumbersome. Since records are incomplete therefore need to be converted into double entry records and for the same one need to prepare –

- Cash book
- Debtors account
- Creditors account
- B.R. account
- B.P account

These accounts shall deliver information with respect to missing figure like-

- Cash sales or closing balance of cash or bank a/c
- Credit sales or closing balance of debtors or amount received from debtors.
- Credit purchases or amount paid to creditors or closing balance of creditors.
- Total bills received from the debtors or closing balance of B.R.
- Total bills accepted or closing balance of B.P.

Similarly sometimes opening capital is not given in that case a statement of affairs is prepared at the beginning.

Once all figures have been arrived at, then one can easily prepare the trading and profit and loss a/c.

8. Benefits of Single Entry System

- (a) It's quick and easy to maintain.
- (b) One doesn't require employing a qualified accountant.
- (c) This is extremely useful for business run by individuals where the volume of activity is not large,
- (d) It is economical as it does not need a comprehensive record keeping.

9. Limitations / Weaknesses of Single Entry System

- As principle of double entry is not followed, the trial balance cannot be prepared. As such, arithmetical accuracy cannot be guaranteed.
- Profit or loss can be found out only by estimates as nominal accounts are not maintained.
- It is not possible to make a balance sheet in absence of real accounts.
- d) It is very difficult to detect frauds or errors.
- Valuation of assets and liabilities is not proper.
- The external agencies like banks cannot use financial information. A bank cannot decide whether to lend money or not.

It is quite likely that the business and personal transactions of the proprietor get mixed.

10. Difference between Statement of affairs & Balance Sheet

1. Statement of affairs -It is prepared on the basis of transactions partly recorded on the basis of double entry book keeping and partly on the basis of single entry. Most of the assets are recorded on the basis of estimates, assumptions, information gathered from memory rather than records.
Balance sheet - It is based on transactions recorded strictly on the basis of double entry book keeping; each item in the balance sheet can be verified from the relevant subsidiary books and ledger. Hence the balance sheet is not only reliable, but also dependable.
2. Statement of affairs - In this statement, capital is merely a balancing figure being excess of assets over capital. Hence assets need not be equal to liabilities.
Balance sheet - Capital is derived from the capital account in the ledger and therefore the total of assets side will always be equal to the total of liabilities side.
3. Statement of affairs -Since this statement is prepared on the basis of incomplete records, it is very difficult, to locate the assets and liabilities, if they are omitted from the books.
Balance sheet -There is no possibility of omission of any item of asset and liability since all items are properly recorded. Moreover, it is easy to locate the missing items since the balance sheet will not agree.
4. Statement of affairs -The valuation of assets is generally done in an arbitrary manner; therefore no method of valuation is disclosed.
Balance sheet -The valuation of assets is done on scientific basis, that is original cost in the case of new assets and depreciated amount on the basis of cost minus depreciation to date for used assets. Any change in the method of valuation is properly disclosed.
5. Statement of affairs - The object of preparing this statement in the calculation of capital figures in the beginning and at the end of the accounting period respectively.
Balance sheet -The object of preparing the balance sheet is to ascertain the financial position on a particular date.

11. Difference between single entry system and double entry system:

The distinctions between double entry system and single entry system are as follows:

- (i) In double entry system both the aspects (debit and credit) of all the transactions are recorded. But in single entry system, there is no record of some transactions; some transactions are recorded only in one of their aspects whereas some other transactions are recorded in both of their aspects.
- (ii) Under double entry system, various subsidiary books such as sales book, purchases book etc are maintained. Under single entry system, no such subsidiary books except cash book which is also considered as a part of ledger is maintained.

- (iii) In the case of double entry system, there is a ledger which contains personal, real and nominal accounts. But in single entry system, the ledger contains some personal accounts only.
- (iv) Under double entry system, preparation of trial balance is possible whereas it is not possible to prepare a trial balance in single entry system. Hence accuracy of work is uncertain.
- (v) Under double entry system, Trading A/c, Profit & Loss A/c and the Balance Sheet are prepared in a scientific manner. But under single entry system, it is not possible – only a rough estimate of profit or loss is made and a Statement of Affairs is prepared which resembles a balance sheet in appearance but which does not present an accurate picture of the financial position of the business.

Illustrative Question Bank

Section I - Net Worth Method

1.1 – Past Examination

The closing capital of Mister A on 31.3.2017 was Rs. 1,50,000. On 1.4.2016 his capital was Rs. 60,000. During the year he had, drawn Rs. 40,000 for domestic expenses. He introduced Rs. 25,000 as additional capital in February, 2017. Find out his net profit for the year.

Answer – 1,05,000

1.2 — Past Examination

Closing capital	Rs. 4,00,000
Opening capital	Rs. 3,50,000
Net profit for the year	Rs. 1,00,000
Additional capital introduced	Rs. 30,000

Calculate the amount of drawings

Answer – Rs. 80,000

1.3 - Past Examination

A trader purchased goods for Rs.1,70,000. The opening stock of inventory prior to the said purchase was Rs.30,000. His sales was Rs.2,10,000. Find out the closing stock of inventory if the Gross profit margin is 25% on cost.

Answer – Rs. 32,000

Cost of goods sold = Sales – gross profit
 $2,10,000 - (2,10,000 \times 25/125) = 1,68,000$
 COGS = O.S + Purchases – C.S
 $1,68,000 = 30,000 + 1,70,000 - C.S$
 C.S = 32,000

1.4 – Past Examination

A Company sold 20% of the goods on cash basis and the balance on credit basis. Debtors are allowed 1/2 month's credit and their balance as on 31-3-2015 is Rs. 1,25,000. Assume that the sale is uniform throughout the year. Calculate the credit sales and the total sales of the company for the year ended 31-3-2015

1.5 - December, 21 - 4 Marks

Calculate Gross Profit, cost of goods sold and closing stock from the following information:

Opening stock Rs. 20,000
 Cash Sales Rs. 60,000
 Credit Sales Rs. 40,000

Purchases Rs. 70,000

Rate of Gross profit on cost $33\frac{1}{3}\%$

Detailed Solution:

Gross profit rate on cost $33\frac{1}{3}\%$ i.e. 100/300 on cost or 1/3 on cost

If cost 3 profit would be 1 and sales 4

So rate of Profit on Sales will be 1/4

COGS = Sales - GP

= 1,00,000 - 1/4 of 1,00,000 = 75,000

COGS = OS + Purchases - CS

75,000 = 20,000 + 70,000 - x

X = 15,000

Section II - Conversion Method: Level - 1

2.1

Y commenced a business as a cloth merchant with Rs.40,000 on 1.1.2022. On the same day, he purchased furniture for Rs.12,000. The books are maintained on single entry system.

From the following particulars ascertain-

- cash in hand as on 31.12.2022
- prepare a trading and profit and loss account for the year ended 31.12.2022 and
- a balance sheet as on that date.

Sales [including cash sales of Rs.28,000]	68,000
Purchases [including cash purchases of Rs.16,000]	60,000
Y's drawings for personal use	5,600
Salaries to staff	8,000
Bad debts written off	2,000
Business expenses	2,800
Stock [as on 31.12.2022]	26,000
Sundry debtors [as on 31.12.2022]	20,800
Sundry creditors [as on 31.12.2022]	14,400

Y took cloth worth Rs 2,000 from the business for personal use but omitted to record these transactions in her books. Provide depreciation on furniture at 10% per annum.

Answers: cash in hand on 31.12.2022 Rs.11,200, Net profit Rs.22,000 and Balance Sheet Rs.68,800

Detailed Solution:

Debtor's a/c

Op balance	-	Cash received – bal Fig.	17,200
	40,000	Bad debts	2,000
		Closing bal c/d	20,800

Creditor's a/c

Cash – b.f.	29,600	Op. Bal.	-
Bal c/d	14,400	Credit sales	44,000

Cash a/c

Capital	40,000	Furniture	12,000
Sales (cash)	28,000	Cash purchases	16,000
Debtors	17,200	Drawings	5,600
		Salaries	8,000

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		Business expenses	2,800
		Drawings	800
		Sundry creditors -	29,600
		Closing bal c/d- b.f.	11,200

Furniture a/c

Cash	12,000	Depreciation	1,200
		Closing bal c/d b.f.	10,800

Trading and profit and loss a/c

Op stock	-	Credit sales	40,000
Credit purchases	16,000	Cash sales	28,000
Gross profit	36,000	Drawings of goods	2,000
		Closing stock	26,000
Salaries	8,000	Gross profit b/d	36,000
Bad debts	2,000		
Business expenses	2,800		
Depreciation	1,200		
Net profit	22,000		

Capital a/c

Drawings	5,600	Cash	40,000
Drawings of goods	2,000	Net profit	22,000
Bal c/d – b-f.	54,400		

Balance Sheet a/c

Closing creditors	14,400	Cash	11,200
Capital	54,400	Stock	26,000
		Drawings	20,800
		Furniture	10,800

2.2 – Examination Problem -

Mister Soft keeps books on single entry system. From the following information provided by him, prepare a trading and profit and loss account for the year ended 31.12.2023 and a balance sheet as on that date.

Details	31.12.2022	31.12.2023
Furniture	1,00,000	1,20,000
Stock	60,000	20,000
Debtors	1,20,000	1,40,000
Prepaid expenses	-	4,000
Creditors	40,000	?
Outstanding expenses	12,000	20,000
Cash	22,000	6,000

Receipt and payment during the year were as follows:

Receipts from debtors	4,20,000
Paid to creditors	2,00,000
Transportation of goods to the site	40,000
Drawings	1,20,000
Sundry expenses	1,40,000
Furniture purchased	20,000

Other information:

There were considerable amount of cash sales. Credit purchases during the year amounted to Rs.2,30,000. Provide a provision for doubtful debts to the extent of 10% on debtors.

Hint:

Transportation charges have been treated as direct expenses

Detailed Solution:

Debtor's a/c

b/d	1,20,000	Cash	4,20,000
Credit sales b.f.	4,40,000	Bal c/d	1,40,000

Creditor's a/c

Cash	2,00,000	b/d	40,000
Closing bal c/d	7,000	Credit purchases	2,30,000

Cash a/c

b/d	22,000	Creditors	200,000
Debtors	4,20,000	Drawings	120,000
Cash sales – bal. fig.	84,000	Carriage	4,000
		Sundry expenses	140,000
		Furniture	20,000
		Closing bal. c/d	6,000

Furniture a/c

b/d	1,00,000		
Cash	20,000	c/d - bal. fig.	1,20,000

Trading and profit and loss a/c

Opening stock	60,000	Credit sales	4,40,000
Credit purchases	2,30,000	Cash sales	84,000
Transportation	40,000	Closing stock	20,000
Gross Profit c/d	2,14,000		
	5,44,000		5,44,000
Expenses Paid : 140,000		Gross profit b/d	2,14,000
+ op prepaid : -			
- Closing prepaid : 4,000			
+ closing o/s : 20,000			
- op o/s : 12,000	1,44,000		
Provision for d/d	14,000		
Net profit t/f to capital a/c	56,000		
	2,14,000		2,14,000

Capital a/c

Drawings	1,20,000	Op. b/d	2,50,000
Bal c/d	1,86,000	Net Profit	56,000

Balance Sheet a/c

	31-12-22	31-12-23		31-12-22	31.12. 23
Creditors	40,000	70,000	Furniture	1,00,000	1,20,000
o/s expenses	12,000	20,000	Stock	60,000	20,000

Provision for d/d	-	14,000	Debtors	1,20,000	140,000
Capital	2,50,000	1,86,000	Prepaid expenses	-	4,000
			Cash	22,000	6,000
	3,02,000	2,90,000		3,02,000	2,90,000

Section III - Conversion Method: Level - 2

3.1 – Examination Problem –15 Marks - Modified

Following is the balance sheet of Mister Hello as at 31.03.21.

Details	Amount	Details	Amount
Capital	4,80,000	Buildings	3,25,000
Loan	1,50,000	Furniture	50,000
Trade Creditors	3,10,000	Motor car	90,000
		Stock	2,00,000
		Trade Debtors	1,70,000
		Cash in hand	20,000
		Cash at bank	85,000
	9,40,000		9,40,000

A fire occurred on the night of 31.03.2022, in which all books and records were lost. The cashier absconded with the available cash.

- a. Mr Hello however is able to provide you with following information:
His sales for the year ended **31.03.2022** were 20% higher than the previous years. He always sells his goods at cost plus 25%. 20% of the total sales for the year ended 31.03.22 was for cash.
There were no cash purchases.
- b. on April 1, 2021 the stock level was raised to Rs. 3,00,000 and maintained at this level throughout the year.
- c. Collections from debtors amounted to Rs. 14,00,000 of which 3,50,000 was received in cash.
Business Expenses amounted to Rs. 2,00,000 of which Rs. 50,000 was outstanding on March 31, 2022 and Rs. 60,000 paid by cheque.
- d. analysis of the pass book revealed the following :
Payment to creditors Rs. 13,75,000
Personal drawings Rs. 75,000
Cash deposited in bank Rs. 7,15,000
Cash withdrawn from bank Rs. 1,20,000
- e. Gross profit as per last Year's audited accounts was Rs. 3,00,000
- f. Provide depreciation on building and furniture at 5% and on Motor Car at 20%.
- h. The amount defalcated by the cashier may be treated as recoverable from him.

Answer:

Gross profit Rs. 3,60,000
 Net profit Rs.1,23,250
 Balance Sheet total Rs.12,03,250
 Credit sales Rs.14,40,000
 Credit Purchases- Rs.15,40,000
 Cash sales Rs.3,60,000
 Opening capital Rs.4,80,000
 Closing Capital Rs. 5,28,250

3.2 – Examination Problem –12 Marks - Modified

Mister Morning – a trader, who maintains books on single entry system basis, approaches you with the following details:

	1-4-2021	31-3-2022
Trade Creditors	1,57,700	1,24,000
Sundry Expenses outstanding	6,000	3,300
Sundry Fixed Assets (includes Machinery)	1,16,100	96,000
Stock in Trade	80,400	1,11,200
Cash in hand	29,600	12,000
Cash at Bank	40,000	69,200
Trade Debtors	1,65,300	1,78,700

Details of the years transactions are as follows:

Discount allowed to trade debtors	15,000
Returns from debtors	14,500
Bad debts	4,200
Discount allowed by creditors	7,000
Returns to creditors	4,000
Additional Capital introduced by cheque	85,000
Collections from debtors (Deposited into Bank after receiving cash)	625,000
Cash Purchases	10,300
Expenses paid by cash	95,700
Household expenses paid by Cheque	31,800
Machinery acquired by Cheque	3,900
Cash deposited into Bank	50,000
Cash withdrawn from Bank	92,400
Payment to creditors by cheque	6,02,700

Answer:

Gross profit Rs. 1,48,100

Net profit Rs.18,900

Balance Sheet total Rs.4,67,100

Credit sales Rs.6,72,100

Credit Purchases- Rs.5,80,000

Cash sales Rs.46,000

Opening capital Rs.2,67,700

Closing Capital Rs. 3,39,800

3.3 - Examination Problem –

The statement of affairs of Mister Night – a trader, on 31st March, 2022 is as follows:

Liabilities	Rs.	Assets	Rs.
Capital	50,000	Fixed Assets	30,000
Sundry Creditors	10,000	Stock	10,000
Liability for expenses	1,000	Debtors	15,000
		Bank	5,000
		Cash	1,000
	61,000		61,000

Mister Night does not maintain his books on double entry system. He furnishes you following information:

- Every week he draws Rs. 200.
- After meeting his weekly sundry expenses (Rs. 100 on an average) and drawings, the balance of weekly collection is banked at the commencement of next week.
- No cash purchase is made and creditors are paid by cheques.
- Sales are at fixed price and include 20% profit on sales.

- e. Credit sales are few and are noted in a diary. Payments are received in cheques only from such parties
- f. Expenses other than sundries and other special drawings are made in cheques.
- g. All unpaid bills are kept in a file carefully.

The following are his bank transactions for 13 weeks:

Balance on Jan. 1	5,000	Creditors paid	40,000
Cheques deposited	2,000	Rent paid	600
Cash deposited	42,000	Expenses other than sundry expenses	3,000
		Balance on April 1	5,400
	49,000		49,000

After 13 weeks on 1st April the entire cash was missing when it was to be deposited in the bank. The following further facts are ascertained:

Stock on that day was valued at Rs. 4,000

Sundry debtors amounted to Rs. 20,000 as per diary

Sundry creditors were Rs. 8,000 as per unpaid bills file.

Find out the amount of cash missing.

Answer:

Gross profit Rs. 11,000

Net profit Rs.4,000

Credit sales Rs.7,000

Credit Purchases- Rs.38,000

Cash sales Rs.48,000 that is total sales 55,000 less credit sales 7,000

Opening capital Rs.50,000

Closing Capital Rs. 51,400

3.4 - Professional Examination Problem -

The following information relates to the business of K-99 enterprises. You are requested to prepare Trading and Profit and Loss a/c and a balance sheet for the year ended 31.03.22

a. Assets and liabilities as at

Particulars	01.04.21	31.03.22
Furniture	60,000	63,500
Stock	80,000	70,000
Sundry Debtors	1,60,000	?
Sundry Creditors	1,10,000	1,50,000
Prepaid Expenses	6,000	7,000
Outstanding Expenses	20,000	18,000
Cash in hand and at Bank	12,000	26,250

b. Cash Transactions during the year :

- Collection from debtors, after allowing discount of Rs. 15,000 amounted to Rs. 5,85,000.
- Collection on discounting of bills of exchange, after deduction of discount of Rs. 1,250 by Bank, totalled to Rs. 61,250
- Creditors of Rs. 4,00,000 were paid Rs. 3,92,000 in full settlement of their dues
- Payment of freight inwards of Rs. 30,000
- Amount withdrawn for personal use Rs. 70,000
- Payment for office furniture Rs. 10,000
- Investments carrying annual interest of 6% were purchased at Rs. 95 (200 shares of face value of Rs. 100 each) on 1.October, 2021 and payment made thereof
- Expenses including salaries paid Rs. 95,000

- Miscellaneous receipts of Rs. 5,000
- c. Bills of Exchange drawn on and accepted by customers during the year amounted to Rs. 1,00,000. Of these, B/E of Rs. 20,000 were endorsed in favour of creditors. An endorsed B/E of Rs. 4,000 was dishonoured
- d. Goods costing Rs. 9,000 were used as advertising
- e. Goods are invariably sold to show a gross profit of 20% on sales
- f. Difference in cash book, if any, is to be treated as further drawings or introduction of capital
- g. Provide at 2 for doubtful debts on closing debtors

Detailed Solution Hints

Gross profit Rs. 1,21,750

Net profit Rs.10,145

Amount of total Sales i.e. balancing figure of trading account Rs. 6,08,750

(considered credit sales)

Closing balance of Debtors Rs. 72,750

Closing balance of B/R :Rs. 17,500

Balance figure of Cash a/c treated as additional drawings Rs. 21,000

Credit Purchases- Rs.4,56,000 (considered as credit)

Sundry expenses to be shown in P/L :Rs. 92,000

Opening capital Rs.1,88,000

Closing Capital Rs. 1,07,145

3.5 - Examination Problem -Mister Y keeps books under single entry system. On 31st March, 2016 his Balance Sheet was as follows:

Liabilities	Amount	Assets	Amount
Capital of Mister Y	4,50,000	Fixed assets	2,25,000
Creditors	8,70,000	Stock	9,15,000
Bills Payable	1,87,500	Debtors	2,22,000
Expenses outstanding	67,500	Bills receivable	90,000
		Prepaid Insurance	3,000
		Cash at bank balance	1,20,000
	15,75,000		15,75,000

[ii] Following are the summary of cash and bank transactions for the year ended 31st March, 2017:

Cash sales	1,10,70,000
Collection from debtors	22,65,000
Payment to creditors	1,12,60,500
Paid for bills payable	12,22,500
Sundry expenses paid	9,31,050
Drawings for domestic expenses by Mister Y	3,60,000
Cash and Bank Balance as on 31-3-2017	1,90,950

[iii] Following further details are available:

Gross profit on sales @	10%-
Bills receivable from debtors during the year	6,52,500
Discount allowed to debtors	54,000
Discount received from creditors	42,000
Bills receivable endorsed to creditors	22,500
Annual fire insurance premium paid – Paid on 1 st of August every year	9,000
Depreciation on fixed assets to be provide at the rate of	10%

[iv] Balances as on 31-3-2017 are given below;

Stock in hand	9,75,000

Debtors	2,28,000
Bills receivable	2,10,000
Bills payable	2,10,000
Outstanding expenses	7,500

Prepare Trading and Profit and Loss Account for the year ended on 31st March, 2017 and Balance Sheet on that date.

Detailed Solution

Bills Receivable a/c

Bal. b/d	90,000	Cash – bal. fig.	5,10,000
Debtors	6,52,500	Creditors - bills endorsed	22,500
		Balance c/d	2,10,000

Debtor's a/c

Bal b/d	2,22,000	Cash	22,65,000
Credit sales – bal fig	29,77,500	Discount allowed	54,000
		Bills receivable	6,52,500
		Bal. c/d	2,28,000

Bills Payable a/c

Bank	12,22,500	Op bal b/d	1,87,500
Bal c/d	2,10,000	Creditors bal fig ;that is bills accepted	12,45,000

Creditor's a/c

Cash	1,12,60,500	Op. bal b/d	8,70,000
Discount	42,000	Credit purchases - from trading a/c	1,27,02,750
B/R endorsed	22,500		
B/P	12,45,000		
Balance c/d – bal. fig.	10,02,750		

Cash and Bank a/c

Op bal b/d	1,20,000	BP	12,22,500
BR	5,10,000	Creditors	1,12,60,500
Debtors	22,65,000	Expenses	99,31,050
Cash sales	1,10,70,000	Drawings	3,60,000
		Bal c/d	190,950

Fixed Asset a/c

Opening balance b/d	2,25,000	Depreciation	22,500
		c/d	2,02,500

Trading and profit and loss a/c

Op stock	9,15,000	Sales	
Purchases – bal. fig.	1,27,02,750	Cash : 1,10,70,000	
Gross profit	14,04,750	Credit : 29,77,500	1,40,47,500
		Closing stock	9,75,000
Expenses : paid : 9,31,050		Gross profit	14,04,750
Add closing o/s : 7,500		Discount received	42,000
Less opening o/s : 67,500			
Add op. prepaid : 3,000			

Less cl. Prepaid : 3,000	8,71,050		
Discount allowed	54,000		
Depreciation	22,500		
Net profit	4,99,200		

Capital a/c

Drawings	3,60,000	Bal b/d	4,50,000
Bal c/d	5,89,200	Net profit	4,99,200

Balance Sheet a/c

Capital	5,89,200	Fixed asset	2,02,500
		Stock	9,75,000
Bills payable	2,10,000	Debtors	2,28,000
Creditors	10,02,750	Bills receivable	2,10,000
Outstanding expenses	7,500	Prepaid insurance	3,000
		Cash in hand at bank	1,90,950

3.6- Examination Problem

Alpana Enterprises maintain their books of accounts under a single entry system. The balance sheet on 31st March, 2022 was as follows::

Liabilities	Amount	Assets	Amount
Capital	6,75,000	Furniture and fixtures	1,50,000
Creditors	7,57,500	Stock	9,15,000
Expenses outstanding	67,500	Debtors	3,12,000
		Prepaid Insurance	3,000
		Cash at bank balance	1,20,000
	15,00,000		15,00,000

b. Following are the summary of cash and bank transactions for the year ended 31st March, 2023:

Receipts :	
Cash in hand and at the bank on 1.4.22	1,20,000
Cash sales	1,10,70,000
Collection from debtors	27,75,000
Payments:	
Payment to creditors	1,24,83,000
Sundry expenses paid	9,31,050
Drawings	3,60,000
Cash and Bank Balance as on 31-3-2023	1,90,950

c. Following further details are available:

Discount allowed to debtors	54,000
Discount received from creditors	42,500
Annual fire insurance premium paid – Paid on 1 st of August every year	9,000
Depreciation on fixed assets to be provide at the rate of	15% p.a. on WDV

d. Balances as on 31-3-2023 are given below;

Stock in hand	9,75,000
Debtors	3,43,000
Outstanding expenses	55,200

e.

- Gross profit of 10% on sales is maintained throughout the year. From the the above information find out:
- Amount of credit sales
- Amount of credit purchases
- Amount of closing balance of creditors
- Amount of sundry expenses to be charged to Profit and loss account
- Amount of net profit
- Amount of closing capital

Answers and Hints:

- Credit Sales 28,60,000
- Credit purchases 1,25,97,000
- Closing balance of creditors 8,29,000
- Gross profit 13,93,000
- Sundry Expenses debited to P/L 9,18,750
- Net Profit 4,40,000
- Closing capital 7,55,250

Sanjay Welkins' Classes

Chapter 12

Accounting for Bills of Exchange

1. Meaning

In case of credit transaction, the supplier normally gets a promise from the customer that he will settle the payment at a future date as agreed. It could either be a promissory note or bill of exchange. The promissory note is written by the customer as an undertaking to pay the money, whereas the bill of exchange is a note drawn by the seller and accepted by the buyer. In India, the Negotiable Instruments Act 1981 governs the provisions for bills of exchange. As per this act, the bill of exchange is defined as “an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain sum of money only to the order of the certain person or to the bearer of the instrument”

2. Features

Based on this definition the following features of a bill of exchange are noticed:

- (a) It's an instrument in writing.
- (b) It contains an unconditional order.
- (c) It's signed by the drawer.
- (d) It's drawn on a specific person.
- (e) There is an order to pay a specific sum of money.
- (f) It must be dated.
- (g) It specifies to whom the payment is to be made e.g. to the maker or to person mentioned by him or to the bearer.
- (h) The amount of money to be paid must be certain.
- (i) It must be properly stamped.
- (j) It may be made payable on demand, or after a definite period of time.

Whereas, a bill of exchange is drawn by seller and accepted by buyer; a promissory note, on the other hand, is created by the buyer as an undertaking to pay to the seller.

3. Specimen of a bill of exchange:

Rs.50,00,000

Two months after date, pay to me or my order, the sum of
Stamp Rupees fifty Lac only, for value received.

Accepted
(Signed)
Y9
City Two

Hudson Lines
City One
1st August, 2021

(Signed)
X9
SW 505, Hill View,
City One

4. Parties to Bill of Exchange

The parties involved in transaction that uses bill of exchange as a mode of settlement are:

- (a) **Drawer:** He is a person who draws the bill. Typically, he is the seller or a creditor.
- (b) **Drawee:** He is the person on whom the bill is drawn. Normally, he is the buyer or debtor. He has to pay the amount of the bill to the drawer on the due date.
- (c) **Payee:** He is the person to whom the amount of bill is payable. He may be the drawer himself or the creditor of the drawer.
- (d) **Endorsee:** He is the person in whose favour the bill is endorsed by the drawer. He is usually the creditor of the drawer.
- (e) **Drawee in case of need:** Sometimes the name of another person is mentioned as the person who will accept the bill if the original drawee does not accept it: such a person is called the 'Drawee in case of need'.

Suppose, 'A' sells goods to 'B' for Rs. 5,00,000. 'A' draws a bill on 'B' who accepts the same to pay this amount after 90 days. Here, 'A' is the drawer and 'B' is the drawee. If 'A' specifies that the amount will be paid to 'C', then 'C' will be the payee.

It is necessary that the bill is accepted by the drawee. Only then it becomes a valid negotiable instrument. Such accepted and signed bill of exchange is usually 'noted' with 'notary public'. Such noting is usually done when the bill is dishonoured.

5. How to Calculate of Due Date

Date of Maturity is also known as Due Date. The date on which the amount of the bill becomes payable is called 'Due Date' or 'Date of Maturity'. The period between the date of drawing of the bill and the due date is called Tenure of the Bill. To compute due date, three days (called Grace Period) are included to the date of maturity of the period of the bill.

The date of maturity of the period of bills depends on whether the bill is payable on date or bill is payable on sight. If the bill is payable on date, the date of maturity is computed by including tenure of bill to the making of the bill.

Date of maturity can be understood with the help of the following example:

Date of Drawing 12.12.2023

Tenure + 3 Months

12.03.2023

However, If the bill becomes due at sight, the date of maturity is counted by including tenure of the bill to the date of acceptance of the bill. In that case, the due date of the bill is calculated as follows:

Date of Acceptance 16.12.2023

Tenure + 3 months

16.3.2023

The due date of the bill after including grace period of 3 days is 15.3.2023 if the bill is payable at date and 19.3.2023 if the bill is payable at sight.

6. Important points for computing date of maturity

For computing the date of maturity, following points should be noted:

1. Days of grace are allowed on bills payable on maturity of a fixed period. In case of bills payable on demand, amount is required to be paid on presentation and no grace period is allowed.
2. If period of the bill matures on a date which is not there in the month in question, then the due date is taken as the last date of the month. For example, if a bill is drawn on 31.1.2013 and the period of the bill is 3 months, the period bill becomes payable on 30.4.2013 and after including grace days, due date is 3.5.2013.
3. In case the expiry date of a bill falls on a holiday, the bill becomes payable on the preceding day. But when the maturity date is a bank holiday or a Sunday and the second day of grace is also a holiday, the bill is payable on the next working day.

4. The tenure of the bill can be explained in months or in days. The due date of bill should be computed considering this fact in mind. Hence, if S draws bill on A on 31.1.2023 of one month, the maturity date of the bill is computed as follows :

Date of Drawing	31.1.2023
Tenure	<u>+1 month</u>
	28.2.2023
Days of Grace	<u>+ 3 days</u>
	03.03.2023

However, if tenure of the bill is 30 days, the expiry date of the bill is computed as follows:

Date of Drawing	31.1.2023
Tenure	<u>+ 30 days</u>
	02.03.2017
Days of Grace	<u>+ 3 days</u>
	5.3.2023

Hence, tenure of one month and 30 days is different

7. Explain Acceptance of a bill of exchange

When the drawee puts his signature across the face of a bill of exchange with or without the words "accepted", it is called acceptance.

A bill, except in certain special cases, requires acceptance; otherwise the liability of the drawee cannot be established thereon.

Acceptance may be General or Qualified. When the drawee accepts liability to pay the amount mentioned in the bill in full, without any condition or limitation, it is a case of general acceptance. When the drawee accepts subject to some qualifications as regards amount, tenor, domicile etc. it is a case of qualified acceptance.

8. What do you mean by an Endorsement of a Bill?

Endorsement is the act of signing a negotiable instrument by the maker or holder thereof for the purpose of transferring his rights to somebody else. The person making the endorsement is called the 'endorser', the person to whom it is endorsed is called the 'endorsee'.

A negotiable instrument payable to order may be transferred only by endorsement and delivery, but a negotiable instrument payable to bearer can be transferred by delivery only.

9. Explain discounting a Bill?

If the holder of a bill wants to get the money of the bill before its due date, he can do so by selling the bill to a bank or a Discounting House who in consideration of a charge called discount, provides him with ready cash. This is known as discounting the bill. Discount charged by the bank is the interest at a certain rate per cent per annum on the amount of the bill for its unexpired period, i.e., the period from the date of discounting upto the date of maturity. This discount has no connection with the cash discount and must not be confused therewith.

10. Explain Dishonour of Bill

Dishonour of a Bill means that the acceptor refuses to honour his commitment on due date and for this, payment of the bill on presentation does not take place. At the time of dishonour of a bill, original relationship between the parties is restored, that is, the drawee again becomes the debtor of the drawer in his books and drawer is treated then as a creditor in the books of drawee. Moreover, the drawer becomes liable here to compensate the bank (or for that matter endorsee) if the bill is not retained by the drawer till date of the maturity.

To provide a legal evidence of dishonour, the fact of dishonour is to be noted on the bill by 'Notary Public'. The fact of dishonour which he is recording is called 'noting' and the amount charged by him for his services are called 'noting charges'. These charges are to be paid by the holder of the bill on the date of default. Actually the acceptor of the bill is liable for the dishonour, the noting charges paid by the holder are to be reimbursed by the acceptor.

11. Explain the meaning of Renewal of Bills

Sometimes the drawee of a bill is not able to meet the bill on due date. He may request the drawer to draw a new Bill for the amount due. Sometimes he pays a certain amount out and accepts a first bill for the balance for which he has to pay a certain amount of interest which is either paid in cash or is included with the fresh bill. This bill is known as Renewal of Bills. That, the amount of the new bill will be face value of the original bill minus cash payment, if any, plus interest for the renewed period.

12. Explain Retirement of Bill

Sometimes the drawee pays the bill before the date of maturity. Under the circumstances, the drawer allows certain amount of rebate or discount which is calculated on certain percentage p.a. basis. The rebate is calculated from the date of payment to the date of maturity.

13. What is noting of a bill of exchange?

When the payee presents the bill of exchange to the drawee upon maturity of bill of exchange and when the drawee fails to make the payment, it is said that the bill is dishonoured, despite its due presentation. When the bill of exchange is dishonoured, it must be *noted* by the Notary public. The authentication by the notary of dishonouring of the bill of exchange is called as Noting.

14. Meaning of rebate.

The bill of exchange might retire before meeting the maturity date, when the holder of the bill of exchange and payee mutually agree to do so. To encourage such early retirement of the bill, the holder allows some discount called *Rebate on bills* for the period between the date of retirement and maturity. This rebate is computed at a specific rate of interest

15. Accounting entries

For the convenience of accounting, bills are classified into (i) Bills Receivable and (ii) Bills Payable. All bills are –

- (i) Bills Receivable to those who receive the bills, and
- (ii) Bills Payable to those who accept the bills,

Thus, the same bill is both a Bill Receivable and a Bill Payable.

Holder, of the bill, however, has following four options available to him :

- (a) He may retain the bill till the date of maturity
- (b) He may get the bill discounted
- (c) He may endorse it to a third party in settlement of a debt
- (d) He may send it to his banker for collection

15. Explain Various Types of Bills of Exchange

(a) Trade bill: This bill is drawn to settle a trade transaction.

(b) Accommodation bill: This bill is used without a trade transaction and is for mutual benefit. If Mr. X is in need of money, he draws a bill on his friend Mr. Y who accepts it. This bill is then discounted with bank (bank will pay money before due date) and the money is shared between X and Y. On the due date, Y will pay to the bank and X will pay Y his share.

Law generally does not recognise such bills.

16. Promissory Note

A person, by whom any amount is payable himself prepares and signs a written undertaking to pay. Here the credit document is called a 'Promissory Note'. It's a written document and contains an undertaking or promise to pay. As per Indian Negotiable Instrument Act, a 'Promissory Note' is "an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker to pay a certain sum of money to, or to the order of, a certain person." The person to whom the amount is payable is called Promisee or Payee.

17. A specimen of Promissory Note which is prepared by Mr. Eleven in favour of Mr. Twenty is as follows:

1,50,000

18-05-2025

Hudson Lines,
New Delhi

I, promise to pay Mr. 009 after 3 months on order, the sum of Rs. 1,50,000 (Rupees one lakhs fifty Thousand) for value Received.

Place: Sd/-

Date : 22/05/2025

Mr. Eleven

18. Purpose and advantages of Bills Receivable Book:

When the business has a huge number of bills that are drawn and accepted, recording each of their entry in the journal becomes cumbersome and time consuming exercise. The purpose of maintaining a separate Bills receivable subsidiary books is to separate the recording of the transactions related to these bills and maintain them separately.

Advantages:

- This will bring in quick, efficient and accurate recording of business transactions.
- As bills of exchange are of repetitive transactions in nature they can be easily recorded in the specialized bills payable books.
- They also prove economical and make the division of labour possible in accounting work.
- The format of the Bills Receivable Book is such that all the details of the bill of exchange like the amount, maturity date, drawee, payee etc are maintained at one place and provide a quick reference of all the details pertaining to a specific bill of exchange when required.
- As all the details of the bills of exchange are recorded at one place, the system is not prone to any fraudulent activities.

The accountants responsible for maintaining the bills of exchange gain specialized expertise in maintaining them and can easily detect any errors or missing entries easily. This also creates more accountability on the person responsible.

19. Proforma of a Bills Receivable Book

The following is the proforma of a Bills Receivable Book.

Bills Receivable Book

1	2	3	4	5	6	7	8	9	10	11	12

1. No. of Bill Date Received
2. Date of Bill
3. From Whom Received
4. Drawer
5. Acceptor
6. Where payable
7. Term
8. Due date
9. Ledger Folio
10. Amount
11. Cash Book Folio
12. Remarks

20. Benefits of maintaining a Bills Payable Book and state how its posting is done in the ledger.

- It results in efficient and accurate recording of business transactions.

- As bills of exchange transactions are of repetitive nature they can be easily recorded in the specialized bills payable books.
- They also prove economical and make the division of labour possible in accounting work.
- The format of the Bills Payable Book is such that all the details of the bill of exchange like the amount, maturity date, drawee, payee etc are maintained at one place and provide a quick reference of all the details pertaining to a specific bill of exchange when required.
- As all the details of the bills of exchange are recorded at one place, the system is not prone to any fraudulent activities.
- The accountants responsible for maintaining the bills of exchange gain specialized expertise in maintaining them and can easily detect any errors or missing entries easily. This also creates more accountability on the person responsible.

21. Procedure to post the entries from the Bills Receivable Books to the Ledger: The recordings from the Bills Payable Book are posted to the accounts of the creditors to whom acceptance has been. These books are totalled periodically and the totals are credited to the Bills Payable Account in the ledger. As the bills payable accounts represent the liability of the acceptor with respect to the bills accepted by him/her, they always end up with a credit balance, if any. This credit balance on any particular date must be same as the total worth of all the bills that are yet to be payable and yet to be presented for payment as recorded in the bills payable book.

22. Proforma of a Bills Payable Book

The following is the proforma of a Bills Payable Book.

Bills Payable Book

[illegible]

1. No. of Bill
2. Date of Bill
3. To Whom Given
4. Drawer
5. Payee
6. Where payable
7. Term
8. Due date
9. Ledger Folio
10. Amount paid
11. Date
12. Cash Book Folio
13. Remarks

Accounting for Bills of Exchange

1.1 When the Bill is retained by the drawer in his own possession till the date of maturity

In such a case, the drawer will himself receive the payment of the bill on the date of maturity. The following entries are passed in the books of both the parties :—

Transaction		Journal Entries it Drawer (Say X9)	the hooks of :— Drawee or Acceptor (Say Y9)
1.	When X9 sold goods to Y9	Y 9 Dr.	Purchases A/c Dr.
2.		To Sales A/c (Goods sold on Credit)	To X9
3.			(Goods purchased on Credit)
	When X9 receives the bill duly accepted by Y9	Bills Receivable A/c Dr. To Y9	X9 Dr. To Bills Payable A/c

	(Acceptance received)	(Acceptance given)
When the bill is retained by X9 till the date of maturity and Y9 pays the amount of bill on maturity	Bank A/c Dr. To Bills Receivable A/c (The amount of bill received on maturity)	Bills Payable A/c Dr. To Bank A/c (The amount of bill paid on maturity)

1.2 When the bill is discounted from the bank :

Following entries are passed to record these transactions :—

	Transaction	Journal Entries in the books of:—	
		Drawer (X9)	Drawee or Acceptor (Y9)
1.	When X9 discounts the bill from the bank	Bank A/c Dr. Discounting Charges A/c Dr. To Bills Receivable A/c (Bill discounted)	No Entry (No entry will be passed in the books of Y9 for the discounting of the bill, as he is not affected by the discounting of the bill)
2.	When Y9 pays the amount of the bill on the due date	No Entry (Bank will receive the payment on the due date and as such no entry will be passed in the books of X9 because he has already received cash while discounting the bill.)	Bills Payable A/c Dr. To Bank A/c (The amount of the bill paid to bank)

Key Note

When a bill is discounted, it is more appropriate to debit bank account instead of cash because the banker does not make the payment in cash, rather the amount is credited in the party's account and as such the amount is deemed to be deposited with the banker.

1.3 When Bill is Endorsed

	Transaction	Journal of X	Journal of Y (Drawee)	Journal of Z
1	If X9 endorses a bill in favour of Z10	Z 10 Dr. To B/R A/c (B/R endorsed to Z10)	No Entry	B/R A/c Dr. To X9 (B/R received)
2.	Y9 pays the amount of the bill on due date	No Entry	B/P A/c Dr. To Bank A/c (The amount of the bill paid on due date)	Bank A/c Dr. To B/R A/c (The amount of the bill received)

1.4 When the Bill is sent to the Bank for Collection

Often, instead of discounting the bill, it is sent to the bank with the instructions to keep the bill till maturity and collect its amount from the acceptor on that date. Banks offer such services. In such a case, bank will not credit the Customers' A/c until the amount of the bill is actually realised by it.

When the bills are sent for collection, the sender of the bills opens a new account in its books named "Bills sent for Collection A/c." This is a personal account and is debited when the bills are sent for collection and is credited when the intimation of actual realisation is received from the bank. Following entries are passed :

- When bill is sent for collection :—

Bills sent for Collection A/c Dr.
 To B/R A/c
 (B/R sent to bank for collection)
- On the due date, when the intimation of actual realisation of the bill is received from the bank :—

Bank A/c
To Bills sent for Collection A/c

Dr.

(Bill collected by bank)

Illustrative Case Study - 1.1

A bill for Rs. 10,000 is drawn by A10 on B10 which is duly accepted by the latter. The bill is duly met by B on its due date. Show what entries would be passed in the books of A10 and B10 under each of the following circumstances :

- (i) If A retains the bill till the due date.
- (ii) If he discounts it with his bankers for Rs.9,750.
- (iii) If he endorses it to his creditor C, in full settlement of his debt of Rs. 10,200.
- (iv) If he sends it to his bankers for collection.

Answer:

Journal of A10

Date	Particulars		L.F.	Dr. Amount	Cr. Amount
				Rs.	Rs.
	When bill is drawn :				
	B/R A/c	Dr.		10,000	
	To B10				10,000
	(Acceptance received)				
Case (i)	When bill is retained and is met on maturity :				
	Bank A/c	Dr.		10,000	
	To B/R A/c				10,000
	(Amount of the bill received on maturity)				
Case (ii)	When bill is discounted :				
	Bank A/c	Dr.		9,750	
	Discounting Charges A/c	Dr.		250	
	To B/R A/c				10,000
	(Bill discounted from bank)				
Case (iii)	When bill is endorsed :				
	C10	Dr.		10,200	
	To B/R A/c				10,000
	To Discount Received A/c				200
	(Bill endorsed to C10 in full settlement of his account)				
Case (iv) (a)	When bill is sent for collection :				
	Bills sent for Collection A/c	Dr.		10,000	
	To B/R A/c				10,000
	(Bill sent to Bank for collection)				
(b)	Bank A/c	Dr.		10,000	
	To Bills sent for Collection A/c				10,000
	(The amount of bill collected by the Bank)				

Journal of B10

Date	Particulars		L.F.	Dr. Amount	Cr. Amount

Date	Particulars		L.F.	Dr. Amount Rs.	Cr. Amount Rs.
	When bill is accepted :				
	A10	Dr.		10,000	
	To B/P A/c				10,000
	(Bill accepted)				
Case (i), (ii), (iii) and (iv)	When bill is met on maturity :				
	B/P A/c	Dr.		10,000	
	To Bank A/c				10,000
	(The amount of bill paid on its due date)				

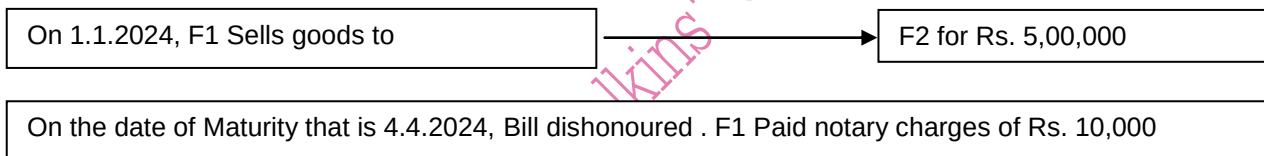
Sanjay Welkins' Classes

2. Dishonour of a Bill

2.1 When bill is retained till maturity by the drawer .

	Transaction	Journal Entries in the books of:	
		Drawer (F1)	Drawee (F2)
1.	When F2 the acceptor of the bill dishonours the bill on the due date	F2 Dr. To B/R A/c (Bill dishonoured cancelled)	B/P A/c Dr. To F1 (Bill dishonoured / cancelled)
2.	When 'F1' pays noting charges	F2 Dr. To Cash A/c (Noting charges paid)	Noting Charges A/c Dr. To F1 (Noting charges payable)
3.	Generally , a combined entry is passed for the aforementioned two entries .	OR	OR
		F2 Dr. To B/R A/c To Cash A/c (Bill dishonoured and noting charges paid)	B/P A/c Dr. Noting Charges A/c Dr. To F1 (Bill dishonoured and noting charges paid by F1)

Illustrative Case Study - 2.1



Answer:

Journal Entries In The Books of F1

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
2024			Rs.	Rs.
Jan. 1	F1	Dr.	5,00,000	
	To Sales A/c (Goods sold to F2)			5,00,000
Jan, 1	B/R A/c	Dr.	5,00,000	
	To F2 (Acceptance received for 2 months)			5,00,000
March 4	F2	Dr.	5,10,000	
	To B/R A/c			5,10,000
	To Cash A/c (Bill dishonoured and noting charges paid)			10,000

Journal Entries In The Books of F2

Date	Particulars	L.F.	Dr. Amount	Cr. Amount
24			Rs.	Rs.
Jan. 1	Purchases A/c	Dr.	5,00,000	

	To F1				5,00,000
	(Goods purchased from F1)				
Jan. 1	F1	Dr.		5,00,000	
	To B/P A/c				5,00,000
	(Acceptance given for 2 months)				
March 4	B/P A/c	Dr.		5,00,000	
	Noting Charges A/c	Dr.		10,000	
	To F1				5,10,000
	(Bill dishonoured and noting charges paid by F1)				

2.2 When bill discounted from the bank and is dishonoured

Journal of X -Drawer		Journal of Y -Drawee	
Y	Dr.	B/P A/c	Dr.
(Amount of bill + noting charges)		Noting Charges A/c	Dr.
To Bank A/c		To A	
(Bill dishonoured and noting charges paid by bank)		(Bill dishonoured and noting charges payable)	

Illustrative Case Study - 2.2

On 1.1.2024, F1 Sells goods to

F2 for Rs. 5,00,000

F1 Draws a Bill which was accepted by F2 . On the same date F1 Gets the bill discounted. Discounting charges amounted to Rs. 10,000. On the date of Maturity that is 4.4.2024, F2 failed to honour the bill. Bank Paid notary charges of Rs. 10,000.

Journal Entries In The Books of F1

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
2024				
Jan. 1	F1	Dr.	5,00,000	
	To Sales A/c			5,00,000
	(Goods sold to F2)			
Jan, 1	B/R A/c	Dr.	5,00,000	
	To F2			5,00,000
	(Acceptance received for 2 months)			
	Bank a/c	Dr.	4,90,000	
	Discount charges a/c	Dr.	10,000	
	To BR a/c			5,00,000
	BR Discounted			
March 4	F2	Dr.	5,10,000	
	To Bank A/c			5,10,000
	(Bill dishonoured)			

Journal Entries In The Books of F2

Date	Particulars	L.F.	Dr.	Cr.

				Amount	Amount
24				Rs.	Rs.
Jan. 1	Purchases A/c	Dr.		5,00,000	
	To F1				5,00,000
	(Goods purchased from F1)				
Jan. 1	F1	Dr.		5,00,000	
	To B/P A/c				5,00,000
	(Acceptance given for 2 months)				
March 4	B/P A/c	Dr.		5,00,000	
	Noting Charges A/c	Dr.		10,000	
	To F1				5,10,000
	(Bill dishonoured and noting charges paid by F1)				

2.3 When the bill endorsed to a third party is dishonoured

Transaction	Drawer - F1	Drawee - F2	Endorsee - F3
Say, a bill is received by F1 from F2, and endorsed to F3, is dishonoured on the due date.	F2 Dr. (Amount of bill + noting charges) To F3 (Bill dishonoured and the amount of bill + noting charges receivable from Y9 and payable to Z9)	B/P A/c Dr. Noting charges A/c Dr. To F1 (Bill dishonoured and noting charges payable to X9)	F1 Dr. To B/R A/c To Cash A/c (Bill dishonoured and noting charges paid in cash)

Key Notes :—

- One may need to keep in mind that in case of dishonour of a bill, the drawer shall always debit the acceptor's account and **credit** the B/R A/c if he himself retains the bill; or credit the bank's account if he has discounted it with his bank; or credits the endorsee's account if he has endorsed the bill.
- On the other hand , In case of dishonour of a bill, the acceptor shall always pass the same entry irrespective of the fact that bill is presented for payment by the drawer himself or by the bank or by the third party. Acceptor shall always debit the B/P A/c and credit the Drawer's A/c when bill is dishonoured.

Illustrative Case Study - 2.3

On 1.1.2024, F1 Sells goods to

F2 for Rs. 5,00,000

F1 Draws a Bill which was accepted by F2 . On the same date F1 endorses the bill to his Creditor F3.. On the date of Maturity that is 4.4.2024, F2 failed to honour the bill. F3 Paid notary charges of Rs. 10,000.

Journal Entries In The Books of F1

Date	Particulars		L.F.	Dr. Amount	Cr. Amount
2024				Rs.	Rs.
Jan. 1	F1	Dr.		5,00,000	
	To Sales A/c				5,00,000
	(Goods sold to F2)				
Jan, 1	B/R A/c	Dr.		5,00,000	

	To F2			5,00,000
	(Acceptance received for 2 months)			
	F3 (Endorsee)	Dr.	5,00,000	
	To BR a/c			5,00,000
	BR Endorsed			
March 4	F2	Dr.	5,10,000	
	To F3 A/c			5,10,000
	(Bill dishonoured)			

Journal Entries In The Books of F2

Date	Particulars		L.F.	Dr. Amount	Cr. Amount
24				Rs.	Rs.
Jan. 1	Purchases A/c	Dr.		5,00,000	
	To F1				5,00,000
	(Goods purchased from F1)				
Jan. 1	F1	Dr.		5,00,000	
	To B/P A/c				5,00,000
	(Acceptance given for 2 months)				
March 4	B/P A/c	Dr.		5,00,000	
	Noting Charges A/c	Dr.		10,000	
	To F1				5,10,000
	(Bill dishonoured and noting charges paid by F1)				

Topic 3 : Cancellation / Renewal / New Bill

Following entries are usually passed in case of renewal of bills :

	Transaction	Journal Entries in the books of :—	
		Drawer (F1)	Drawee (F2)
1.	First of all, an entry is passed for the cancellation of the old bill.	F2 To B/R A/c (Bill cancelled)	B/P A/c To F1 (Bill cancelled)
2.	When F2 pays the amount of interest in cash.	Cash A/c To Interest A/c (The amount of interest received in Cash)	Interest A/c To Cash A/c (The amount of interest paid in Cash)
3.	When F2 does not pay the amount of interest in cash.	F2 To Interest A/c (Interest receivable)	Interest A/c To F1 (Interest payable)
4.	When a new bill is received from F2.	B/R A/c To F2 (New acceptance received)	F2 Dr. To B/P A/c (New acceptance given)

Illustrative Case Study- Renewal of Bill - 3.1

On 1st April, 2021, F2 accepts a bill drawn by F1 for two months for Rs.50,000, in payment of debt. On the due date the bill is dishonoured and F1 had to pay Rs.200 as noting charges. On 4th June 2021, F2 requested F1 to draw a new bill for the amount due. F1 agreed to draw a new bill for 73 days but he charged 18% p.a. interest in cash. This bill is duly met on its maturity.

Pass Journal entries in the books of both the parties.

Analysis:

	1.04.21	
+	02	
	1.06.21	
+	3	
Maturity date	4.06.21	
	dishonoured	
	Noting charges Rs. 200	
	Requests for New Bill	Tenure of new bill 73 Days
	4.6.21	
	26	26
	30.6.21	
	31	31
	31.07.21	
	16	16
	16.08.21	
	03	
	19.09.21 maturity date of new bill	

Solution :

Journal of F1

Date	Particulars		L.F.	Dr. Amount	Cr. Amount
2021				Rs.	Rs.
April 1	Bills Receivable A/c	Dr.		50,000	
	To F2				50,000
	(Acceptance received)				
June 4	F2	Dr.		50,200	
	To Bills Receivable A/c				50,000
	To Cash A/c				200
	(Bill dishonoured and noting charges paid)				
June 4	Cash A/c	Dr.		1,807	
	To Interest A/c				1,807
	(Interest received in cash, i.e., $50,200 \times \frac{18}{100} \times \frac{73}{365} =$ Rs. 1,807)				
June 4	Bills Receivable A/c	Dr.		50,200	
	To F2				50,200
	(New acceptance received)				
Aug. 19	Bank A/c	Dr.		50,200	50,200
	To Bills Receivable A/c				
	(The amount of the bill received on due date)				

Journal of F2

Date	Particulars		L.F.	Dr. Amount	Cr. Amount
2021				Rs.	Rs.
April 1	F1	Dr.		50,000	
	To Bills Payable A/c				50,000
	(Acceptance given)				
June 4	Bills Payable A/c	Dr.		50,000	
	Noting Charges A/c	Dr.		200	
	To F1				50,200
	(Bill dishonoured and noting charges paid by F1)				
June 4	Interest A/c	Dr.		1,807	
	To Cash A/c				1,807
	(Interest paid in cash)				
June 4	F1	Dr.		50,200	
	To Bills Payable A/c				50,200
	(New acceptance given)				
Aug. 19	Bills Payable A/c	Dr.		50,200	
	To Bank A/c				50,200
	(The amount of the Bill paid on due date)				

Illustrative Case Study - 3.2

On 1st August 2025, F1 sold goods of the value of Rs.2,00,000 to F2. F2 pays Rs. 36,000 in cash and accepted a bill for the balance amount for two months. On the due date, F2 expressed his inability to meet the bill and offered to pay Rs.80,000 in cash and accepted a new bill for the balance plus interest at 15% p.a. for three months. F1 agreed to this proposal. On maturity this bill was duly met by F2.

Pass entries in the books of F and F2.

Maturity date of original bill : 1.8.25
 + 2 months
 3 grace days
 = 4..10.25

Maturity date of new bill :
 4.10.25
 3 months and 3 grace days
 = .7.01.26

Detailed Solution :

Journal of A4

Date	Particulars		L.F.	Amount Dr.	Amount Cr.
2025				Rs.	Rs.
Aug. 1	F2	Dr.		2,00,000	
	To Sales A/c				2,00,000
	(Goods sold)				
Aug. 1	Cash A/c	Dr.		36,000	
	Bills Receivable A/c	Dr.		1,64,000	
	To F2				2,00,000
	(Cash and Acceptance received)				
Oct. 4	F2	Dr.		20,000	

	To Bills Receivable A/c				20,000
	(Bill cancelled)				
Oct. 4	Cash A/c	Dr.		80,000	
	To F2				80,000
	(Cash received)				
Oct. 4	F2	Dr.		4,500	
	To Interest A/c				4,500
	(Interest receivable)				
	$120,000 \times \frac{15}{100} \times \frac{3}{12}$				
Oct. 4	Bills Receivable A/c	Dr.		88,500	
	To F2				88,500
	(New acceptance received)				
2022					
Jan. 7	Bank A/c	Dr.		88,500	
	To Bills Receivable A/c				88,500
	(Amount of the bill received)				

Journal of F2

Date	Particulars		L.F.	Amount Dr. Rs.	Amount Cr. Rs.
2025					
Aug. 1	Purchases A/c	Dr.		2,00,000	
	To F1				2,00,000
	(Goods purchased)				
Aug. 1	F1	Dr.		2,00,000	
	To Cash A/c				36,000
mm	To Bills Payable A/c				1,64,000
	(Cash and Acceptance given)				
Oct. 4	Bills Payable A/c	Dr.		2,00,000	
	To F1				2,00,000
	(Bill cancelled)				
Oct. 4	F1	Dr.		80,000	
	To Cash A/c				80,000
	(Cash paid)				
Oct. 4	Interest A/c	Dr.		4,500	
	To F1				4,500
	(Interest payable for 3 months)				
Oct. 4	F1	Dr.		88,500	
	To Bills Payable A/c				88,500
	(New acceptance given)				
2022					
Jan. 7	Bills Payable A/c	Dr.		88,500	
	To Bank A/c				88,500
	(Acceptance met)				

Illustrative Case Study - 3.3

On 1.1.2024, F1 Sells goods to

F2 for Rs. 4,00,000

F1 Draws a Bill at 3 months which was accepted by F2 . On 4.1.2024, F1 got the bill Discounted at 6% per annum ($4,00,000 \times 6/100 \times 3/12 = 6,000$). On the maturity date of 4.04.2024, Bill got dishonoured. Bank paid Noting charges @ Rs. 2,000. F2 accepts a new bill for 3 months. New bill amount will be (Rs. 4,00,000 + NC 2,000 + Interest @ 12% for 3 months i.e. 12,060 = 4,14,060)
Pass entries in the books of F1 and F2.

Detailed Solution :

Journal of F1

Date	Particulars		L.F.	Amount Dr.	Amount Cr.
2024				Rs.	Rs.
Jan. 1	F2	Dr.		4,00,000	
	To Sales A/c				4,00,000
	(Goods sold)				
Jan. 1	Bills Receivable A/c	Dr.		4,00,000	
	To F2				4,00,000
	(Acceptance received)				
Apr. 4	Bank a/c	Dr.		3,94,000	
	Discount a/c	Dr.		6,000	
	To BR a/c				4,00,000
	BR Discounted				
Apr. 4	F2	Dr.		4,02,000	
	To Bank a/c				4,02,000
	(Bill Dishonoured and cancelled)				
Apr. 4	F2	Dr.		12,060	
	To Interest A/c				12,060
	(Interest receivable)				
Apr. 4	Bills Receivable A/c	Dr.		4,14,060	
	To F2				4,14,060
	(New acceptance received)				
July. 7	Bank A/c	Dr.		4,14,060	
	To Bills Receivable A/c				4,14,060
	(Amount of the bill received)				

Journal of F2

Date	Particulars		L.F.	Amount Dr.	Amount Cr.

2024				Rs.	Rs.
Jan. 1	Purchases A/c	Dr.		4,00,000	
	To F1				4,00,000
	(Goods purchased)				
Jan. 1	F1	Dr.		4,00,000	
	To Bills Payable A/c				4,00,000
	(Cash and Acceptance given)				
Apr 4	Bills Payable A/c	Dr.		2,00,000	
	To F1				2,00,000
	(Bill Dishonoured and cancelled)				
Apr 4	Interest A/c	Dr.		12,060	
	To F1				12,060
	(Interest payable for 3 months)				
Apr 4	F1	Dr.		4,14,060	
	To Bills Payable A/c				4,14,060
	(New acceptance given)				
2022					
July 7	Bills Payable A/c	Dr.		4,14,060	
	To Bank A/c				4,14,060
	(Acceptance met)				

Topic :4: Meaning of Accommodation Bill:

Accommodation Bills are drawn and accepted with no consideration passed or received. The Bill, which is drawn just to oblige a friend, who is in need of money, of course without any trading activities, with sole intention of raising funds required for ready cash is known as Accommodation Bill.

The accommodating party, i.e., the drawee accepts the Bill drawn by the accommodated party (drawer). That is the Drawer of the accommodation bill can be called accommodated party and drawee can be called accommodating party. After the Bill is accepted, the drawer discounts it with a bank and obtains the cash.

Before the due date of the Bill, Drawer provides funds to the Acceptor, who honours the Bill. Since the acceptance is given without consideration and to help the accommodated party to raise the funds, the accommodated party has to discharge the Bill by himself or provide funds to accommodating party.

Thus, there is always a mutual understanding between the parties and hence, these bills are called Accommodation Bills. The language of an Accommodation Bill is the same as that of an ordinary Trade Bill. The modes of drawing, accepting, discounting, honoring etc. are similar to that of any Trade Bills. A banker cannot make distinction between a genuine Trade Bill and Accommodation bill. These Bills are also called "Kites" or "Finance Bills".

Following is the difference between the trade and accommodation bills:

1. These bills are drawn by creditors and accepted by debtors.	1. These are not drawn by creditors.
2. These are drawn against proper consideration.	2. These are drawn without any consideration.
3. Trade bill is a proof of debts.	3. An accommodation bill is not a proof of debts.

Following situations may arise with respect to accommodation Bills

Situation one- When one party accepts a Bill to accommodate the drawer only.

Say F4, who is in urgent need of cash, approaches a friend - G4 and mutually decided to raise funds through a bill of exchange. In such situation, the party - F4, who needs cash, draws a Bill which is accepted by his

friend - G4. The drawer -F4 can discount the Bill with a bank and the proceeds are used by him alone. At the time of maturity, the drawer- F4 pays the amount to the Acceptor - G4, who honours the Bill.

Illustrative Case Study - 4.1

Mr. A9 accepted a bill for Rs 20,000 drawn by B9 to enable the latter to raise funds at three months on 1st October 2021. The bill was duly discounted by B9 at their Bank at 6% per annum. On the due date B9 remitted the amount to the acceptor and the Bill was duly met. Pass journal entries in the books of both the parties

Journal of B9				Journal of A9			
Date		Amount	Amount	Date		Amount	Amount
Year 2021	B/R Dr.	20,000		Year 2021	B9 A/c Dr.	20,000	
	To A9 a/c		20,000		To B/P a/c		20,000
	Bill drawn on A9 for 3 months				Acceptance of bill		
2. oct.	Cash a/c Dr.	19,700			No Entry		
	Disc. on Bills a/c Dr.	300					
	To B/R a/c		20,000				
Year 2022	A9 a/c Dr.	20,000					
Jan. 4	To Cash a/c		20,000		Cash a/c Dr.	20,000	
	Amount paid to A9 to meet the bill				To B9 a/c		20,000
					Cash received from B9		
Jan 4	No Entry				B/P a/c Dr.	20,000	
					To Cash A/c		20,000
					Bill honoured on maturity		

Situation -2 - For Mutual Benefit

Often an accommodation Bill is drawn and accepted for mutual benefit of the Drawer and Drawee. The Drawer draws a Bill and Drawee accepts it. The same Bill is discounted by the Drawer and an agreed portion of the proceeds is remitted to the Acceptor.

The discounting charge is also shared by both the parties in the same proportion in which the collection proceeds of the Bill were shared. Prior to the due date, the Drawer pays his share to the Acceptor, who meets the Bill by adding his share of money.

Illustrative Case Study: 4.2

Mr. F-4 draws a Bill for Rs 1,50,000 on Mr. K4 on 1st January 2021 payable three months after the date. The Bill after acceptance is discounted by F4 at 6% p.a. and he remits 1/3 of the proceeds to K4. On the due date, F4 sends the necessary amount to K4 who meets the Bill. Pass Entries in the books of F4 and K4

Answer:

Journal of F4				Journal of K4			
Date		Amount	Amount	Date		Amount	Amount
Year 2021				Year 2021			

Journal of F4				Journal of K4			
Date		Amount	Amount	Date		Amount	Amount
1. Jan.	B/R Dr.	1,50,000		1. Jan	F4 A/c Dr.	1,50,000	
	To K4 a/c		1,50,000		To B/P a/c		1,50,000
	Bill drawn on K4 for 3 months acceptance received				Acceptance of bill		
1. Jan	Cash a/c Dr.	1,47,750		1. Jan	No Entry		
	Disc. on Bills a/c Dr.	2,250					
	To B/R a/c		1,50,000				
	Bill discounted at 6% for 3 months						
1. Jan.	K4 a/c Dr.	50,000		1. Jan	Cash a/c Dr.	49,250	
	To Disc. on bills a/c		750		Disc. on bills a/c Dr.	750	
	To Cash a/c		49,250		To F4 a/c		50,000
	1/3 of the proceeds and 1/3 rd of disc charges t/f				1/3 of the proceeds received and 1/3 of discount charged		
4th April	K4 a/c Dr.	1,00,000		4. April	Cash A/c Dr.	1,00,000	
	To Cash a/c		1,00,000		To F4		1,00,000
	2/3 amount sent to K4 for meeting the bill				2/3rd contribution received from F4		
				4. April	B/P a/c Dr.	1,50,000	
					To Cash a/c		1,50,000
					Bill met on maturity		

Situation - 3 - Where there are two parties and each draws a Bill upon the other one

In such a situation Both the parties are in need of money and as such draw bill upon each other For mutual accommodation . Say, Mr. F5 draws a Bill on Mr. F6 for Rs 10,00,000 and Mr. F6 draws a Bill on Mr. F5 for Rs 10,00,000. Both F5 and F6 shall discount their Bills with a Bank to meet their financial needs and shall bear Discount charges of their Bills. Both the parties shall honour their acceptances on the due date.

Illustrative Case Study 4.3

Mr. K2 drew a Bill on K4 on November 1st, 2021 for an amount Rs 4,00,000 payable three months after that date. On the same date Mr. K2 accepted a Bill for Rs 4,00,000 drawn by K4 for a period of three months. Both the parties discounted their Bills at 12% p.a. On the due date both the Bills were honoured. Make journal entries in the books of both the parties.

Journal of K2				Journal of K4			
Date		Amount	Amount	Date		Amount	Amount
Year 2021				Year 2021			

Journal of K2				Journal of K4			
Date		Amount	Amount	Date		Amount	Amount
1. Nov.	B/R Dr.	4,00,000		1. Nov.	K2 A/c Dr.	4,00,000	
	To K4 a/c		4,00,000		To B/P a/c		4,00,000
	Bill drawn on K4 for 3 months acceptance received				Acceptance of bill		
1. Nov.	K4 A/c Dr.	4,00,000		1. Nov.	B/R a/c Dr.	4,00,000	
	To B/P		4,00,000		To, K2 a/c		4,00,000
1. Nov.	Cash a/c Dr.	3,88,000		1. Jan	No Entry		
	Disc. on Bills a/c Dr.	12,000					
	To B/R a/c		4,00,000				
	Bill discounted at 12% for 3 months						
1. Nov	No Entry				Cash a/c Dr.	3,88,000	
					Disc. on bills a/c Dr.	12,000	
					To K2 a/c		4,00,000
					Bill Discounted at 12% for 3 months		
4. Feb. 22	B/P a/c Dr.	4,00,000		4. Feb. 22	B/P a/c Dr.	4,00,000	
	To Cash a/c		4,00,000		To Cash a/c		4,00,000
	Bill met on maturity				Bill met on maturity		

4.4

P draws a bill for Rs. 60,000 and R accepts the same for the mutual accommodation of both of them to the extent of P 2/3 and R 1/3. P discounts the same for Rs. 56,400 and remits 1/3 of the proceeds to R. Before the due date R draws another bill for Rs. 84,000 on P in order to provide funds to meet first bill. The second bill is discounted for 81,600 with the help of which, the first bill is met and Rs. 14,400 are remitted to P. before the due date of the second bill, P became bankrupt and R received a dividend of 50 paise in the Rupee in full settlement.

Make the necessary Journal entries in the books of both the parties.

Answer

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

	1st Bill		2nd Bill	
	Proceeds (Rs.)	Discount (Rs.)	Proceeds (Rs.)	Discount (Rs.)
P (2/3rd)	37,600	2,400	54,400	1,600

Sanjay Welkins Classes	Bills of Exchange - Revisionary Material

R (1/3rd)	18,800	1,200	27,200	800
Total	56,400	3,600	81,600	2,400

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

**In the Books of P
Journal Entries**

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

R's Account			
Particulars	Amount RS.	Particulars	Amount RS.
To, Bank A/c	18,800	By B/R A/c	60,000
To, Discount A/c	1,200	By Bank A/c	14,400
To, B/P A/c	84,000	By Discount A/c	1,600
By B/P A/c			84,000
To, Bank A/c			28,000
To, Deficiency A/c			28,000
	1,60,000		1,60,000

Chapter 13

Rectification of Errors

1

Question : State various types of Errors

Answer : Trial balance should not be regarded as a conclusive proof of the correctness of the books of account, that is if the trial balance does not agree, there are errors or mistakes but even if the trial balance agrees, there may be errors in the accounts.

Types of Errors

- A- Clerical Errors
 - 1. Errors of Omission
 - Complete Omission
 - Partial Omission
 - 2. Errors of Commission
 - 3. Compensating Errors
- B- Errors of Principle

2

Question : Explain Clerical Errors

Answer:

Errors other than errors of principle are called clerical errors. The following are the types of clerical errors.

1. Errors of Omission: These errors arise as a result of some act of omission on the part of the person responsible for the maintenance of books of account. It refers to the omission of a transaction at the time of recording in subsidiary books or posting to ledger. Omission may be complete or partial.

(a) Complete Omission: When any particular transaction has not at all been entered in the journal or in the book of original entry, it cannot be posted into the ledger at all and complete error of omission will occur. The trial balance is not affected at all by such errors e.g. failure to record completely credit sales in sales book. However, the trial balance will agree, if debit side as well as credit side of a journal entry is not posted to ledger.

(b) Partial Omission: This means that the transaction is entered in the subsidiary book, but is not posted to the ledger, such errors affect the agreement of trial balance e.g. omitting to post the discount columns of the cash book.

2. Errors of Commission: These mistakes are committed because of ignorance, lack of proper accounting knowledge and carelessness of the accounting staff.

They are committed while recording transactions. These errors may or may not affect the agreement of trial balance.

For example:

- Mistake in balancing an account.
- Mistake in posting amount. for example, is to transpose figures - to write Rs. 359 instead of Rs. 395.
- Making an entry on the wrong side. For example, if instead of debiting an account it is credited
- A mistake in the casting of subsidiary books.

3. Compensating Errors: They are group of errors, the total effect of which is not reflected in the trial balance. These errors are neutralizing in nature, hence one error is compensated by other error or errors of opposite nature. For example, an extra debit in purchase account may be compensated by an extra credit in sales account. Thus, compensating errors do not affect the agreement of trial balance.

3. Question - Explain Errors of Principle

Answer : These errors arise because of the failure to differentiate between capital expenditure and revenue expenditure and capital receipts and revenue receipts. The distinction between capital and revenue is of relevance because any incorrect adjustment or allocation in this respect would falsify the final results shown by the profit and loss account and the balance sheet. These errors do not affect the agreement of trial balance. For example, debiting purchase of furniture to office expenses account, crediting sale of furniture to sales account, etc.

4. Question - Explain various errors which are Disclosed By Trial Balance

Answer: Trial balance in general, discloses any error which affects one side of the account. These errors are disclosed by the trial balance as both sides of trial balance do not agree.

Examples:

- Error in casting subsidiary books.
- Error in carrying forward the total of one page the next page.
- Error in posting from book of subsidiary record to ledger.
- Error in balancing an account.
- Omission of casting etc.
- Posting an amount on the wrong side of a ledger account.
- Double posting to an account.
- Error in carrying a balance of an account to the trial balance.

The Trial balance may not agree also become

- Trial balance has a mistake in itself, or

Schedule of debtors or schedule of creditors is wrong

5. Question - State and Explain Errors Not Disclosed By Trial Balance

Answer - The agreement of a trial balance is only a check of arithmetical accuracy of the ledger but it is not a conclusive proof as to the absolute accuracy of the books. The following errors will not affect the agreement of trial balance and hence are not disclosed by the trial balance:

- (i) *Errors of Complete Omission:* If a transaction was not recorded at all, the agreement of the trial balance will not be affected. For example, if goods worth Rs. 12,000 have been received back from a customer and the entry has not at all been made in the Returns Inwards Book then, the Customer's Account will not be credited and the Returns Inwards Account also will not be debited. Thus, there will be no debit and credit, and the trial balance will agree even though there is a mistake.
- (ii) *Errors of Commission:* If a transaction was debited or credited to a wrong account with correct amount and on the correct side in the books of original entry or in the ledger, trial balance will remain unaffected.
- (iii) *Compensatory Errors:* These are errors which are neutralized by the commission of another error or errors of the same magnitude but of opposite nature, which makes the trial balance to agree. For instance, the over-casting of a sales book by (say) Rs. 10,000 and thereby the excess credit to the sales account, will be arithmetically off-set either by over debiting or under crediting a single account or several accounts with a total sum of Rs. 10,000.
- (iv) *Errors of Principle:* Errors of principle like furniture purchased debited to purchase account, building sold credited to sales account, commission paid for purchase of land debited to commission account etc. will not affect trial balance as they are related to allocation of amount received or spent between revenue and capital. There will be no effect on trial balance because double entry will be passed and one account will be debited and other credited. So the debit and credit side of trial balance will definitely agree.
- (v) *Recording Wrong Amount in Subsidiary Book:* If a wrong amount is written in subsidiary books, then entries on both the debit and credit sides will be on the basis of the wrong amount and then the trial balance will naturally agree.
- (vi) *Errors of Duplication:* This is the error of entering a transaction more than once in the subsidiary books.

6. Question - Explain the Classification of Errors from the point of view of 'Rectification of Errors'

Answer - On the basis of rectification of errors, we can classify the errors into the following two broad categories:

1. Errors not affecting the Trial Balance
2. Errors affecting the Trial Balance

The errors need to be categorized in these categories because we can usually rectify the errors not affecting

7. Question - Explain Rectification of Errors not affecting the Trial Balance

Answer - These errors affect two or more accounts simultaneously. Thus, these are two-sided errors. We can rectify these by passing a journal entry giving the correct debit and credit to the accounts. In order to rectify an error, we need to cancel the effect of wrong debit or credit by reversing it and restore the effect of correct debit or credit.

When there is short debit or excess credit in an account we need to debit the concerned account. Whereas, when there is short credit or excess debit in an account we need to credit the concerned account.

Complete omission to record an entry in the journal or the subsidiary books, incorrect recording of transactions in the books, complete omission of posting and errors of principle are the examples of these errors.

8. Question - Rectification of Errors affecting the Trial Balance

Answer - These errors affect only one account. Thus, these are one-sided errors. We can rectify these errors by giving an explanatory note in the account or by passing a journal entry with the help of Suspense A/c.

When we detect an error before posting to the ledger, we can correct it by simply crossing the wrong amount, writing the correct amount above it and initializing it. Similarly, we can also correct an error in the ledger account.

Errors of casting, errors of carrying forward the balances, errors of balancing the accounts, errors of posting the wrong amount in the correct account, error of posting in the correct account on the wrong side, omitting to show an account in the trial balance, posting in wrong side with wrong amount are the examples of errors affecting the Trial Balance.

9. Question - Explain the meaning of Suspense Account

Answer - When the trial balance does not tally due to the one-sided errors in the books, an accountant puts the difference between the debit and credit side of the trial balance on the shorter side as the Suspense A/c. As and when we locate and rectify the errors, the balance in the Suspense A/c reduces and consequently becomes zero. Thus, we cannot categorize the Suspense A/c. It is a temporary account and can have debit or credit balance depending upon the situation.

10. Question - Explain Rectification of Errors in the Next Accounting Year

Answer - When we cannot locate and rectify the errors before the final accounts, we need to carry forward the balance of the Suspense A/c to the next financial year. When we rectify the errors of the previous accounting year, we need to route them through the Profit and Loss Adjustment A/c for the items of expenses, losses, incomes and gains. This avoids their impact on the current income statement.

11. Question - Explain the steps for locating Errors

Answer - Whenever there is a difference in the trial balance even by a small amount, the mistakes involved must be located. A small amount may be the net result of a number of mistakes and it is not safe to ignore a difference in trial balance howsoever small it may be. The following steps are suggested to find out errors:

- (i) Total the debit and credit columns of the trial balance again. If one amount has been shown for a group of accounts (for example, in place of all customers individually, only one amount against "Sundry Debtors" may be shown), recheck the total of the list of such accounts.
- (ii) See that the balances of all accounts including the cash, bank balances have been written in the trial balance.

- (iii) See that there is no mistake in the balancing of the various accounts.
- (iv) Find out the exact difference in the trial balance. Look for such accounts which show the same amount. It is possible that the balance of the particular account has been omitted from the trial balance. Accounts showing a balance equal to half the difference should also be checked; the amount may have been written on the wrong side of the trial balance
- (v) Recheck the totals of the subsidiary books.
- (vi) If the difference is a large one, compare the figures with the trial balance of the corresponding date of the previous year. Any account showing a rather large difference over the figures of the corresponding trial balance of the previous year should be rechecked.
- (vii) Posting of all the amounts corresponding to the difference or half the difference should be checked.
- (viii) If the difference is still not traced, posting of the accounts will have to be checked. For this, it is better, first of all, to check the posting of the totals of subsidiary books such as sales book, purchases book, returns books etc. The subsidiary books should then be gone through to see if any items have not been posted. It should also be checked whether the various accounts have been opened with correct balances. Nominal accounts should be checked first, then real accounts and then personal accounts should be taken up.

12. Accounting for Rectification Of Errors

It is better to rectify errors always through journal entries. However, if an error is located immediately after it has been entered, the accountant may neatly cross out the wrong amount and initial the rectification. There should not be any overwriting. If however, some time has elapsed between the commission of the error and its detection, the error should be rectified by making suitable journal entries only.

13. Need for Rectification of Errors:

- To present the correct accounting information.
- To show the accurate profit or loss made during the year by preparing the profit & loss account.
- To disclose the true financial position by preparing the balance sheet.

Illustrative Question Bank

Section - I : Rectification before the preparation of Final Accounts

1.1

Pass journal entries necessary to rectify the following errors:

1. An amount of Rs. 10,000 withdrawn by the proprietor for his personal use has been debited to Trade Expenses Account.
2. A purchase of goods from N amounting to Rs. 15,000 has been wrongly entered in the Sales Book.
3. A credit sale of Rs. 5,000 to S has been wrongly passed through the Purchases Book.
4. Rs. 7,500 received from M1 have been credited to M2.

Solution:

Journal Entries

1. Drawings Account Dr. 10,000

To Trade Expenses Account 10,000

(For the amount withdrawn for personal use wrongly charged to the trade expenses account)

2. (a) Sales Account Dr. 15,000

To N 15,000

(Being the cancellation of the entry passed through the Sales Book)

- (b) Purchases Account Dr. 15,000

To S 15,000

(To record the credit purchases from N)

3. S Dr. 10,000

To Purchases Account 5,000

To Sales Account 5,000

(Rectification of the mistake caused by entering sale for 5 1,000 to S in the Purchases Book)

4. M2 Dr. 7,500

To M17,500

(Being the rectification of wrong credit given to M2 instead of M1)

1.2

Pass Rectifying Journal Entries for the following:

- Rs. 18,750 paid on account of salary to the cashier D stands debited to his personal account.
- A contractor's bill for extension of premises amounting to Rs. 13,75,000 has been debited to Building Repairs Account.
- On 25th March, goods of the value of Rs. 5,000 were returned by A and were taken into stock but the returns were entered in the books under date 3rd April, i.e.; after the expiration of the financial year on 31st March.
- A bill of Rs. 10,000 for old office furniture sold to S were entered in the Sales Day Book.
- An amount of Rs. 4,000 received on account of interest was credited to Commission Account.

Solution:

Journal Entries

1. Salaries Account Dr. 18,750

To D 18,750

(Being the adjustment of salary wrongly debited to the personal account of the cashier)

2. Building Account Dr. 13,75,000

To Building Repairs Account 13,75,000

(Being the adjustment of amount wrongly debited to the building account for building repairs)

3. Returns Inwards Account Dr. 5,000

To A 5,000

(Being the entry necessary to record the return inwards within the financial year)

Entry in the books of next accounting year's A Dr. 5,000

To Return Inwards Account 5,000

(Cancellation of unwanted entry)

4. Sales Account Dr. 10,000

To Office Furniture Account 10,000

(Being the sale of old office furniture wrongly passed through the sales book)

5. Commission Account Dr. 800

To Interest Account 800

(Being the adjustment of amount wrongly credited to the commission account for interest received)

Section - II : Rectification after the Preparation of Trial Balance but before the Preparation of Final Accounts

2.1

The trial balance of Mister K-5 did not tally on 31.3.2019. The following errors were detected afterwards.

Pass the necessary journal entries to rectify the errors and find out the difference in trial balance assuming that all errors have been rectified.

- A sum of Rs.2,400 received from M on 31.3.2019 was entered in the cash book on 2.4.2019.
- Returns inwards book was under cast by Rs. 1,200.

- (iii) The purchase of Laptop for Rs.1,00,000 was entered in the purchases day book.
- (iv) Wages of workmen engaged in the construction of building amounting Rs. 1,40,000 were debited to wages account.
- (v) A purchase of Rs. 10,684 had been posted to the debit of supplier's account as Rs. 10,468.
- (vi) Goods amounting to Rs. 4,000 had been returned by S and were taken into stock, but no entry was passed in the books for the transaction.
- (vii) Rs. 56,000 paid for purchase of T.V. for proprietors own use had been charged to miscellaneous expense account.
- (viii) A sale of Rs. 2,400 to Y was credited to his account with Rs. 240.
- (ix) A sale of Rs. 8,000 has been passed through the purchases journal.
- (x) Rs. 300 paid for repairs to furniture had been entered in the total column of petty cash book, but not entered in the appropriate analysis column, the total of which has been posted.

Answer

- (i) No further entry required as receipt has already been recorded
- (ii) Returns Inwards A/c Dr. 1,200
To Suspense A/c 1,200
(Returns inward book was under cast by Rs. 1,200, error now rectified)
- (iii) Laptop A/c Dr. 1,00,000
To Purchases A/c 1,00,000
(Typewriter purchased was wrongly passed through purchases day book, error now rectified)
- (iv) Building A/c Dr. 1,40,000
To Wages A/c 1,40,000
(Wages paid for construction of building was wrongly debited to wages account, error now rectified)
- (v) Suspense A/c Dr. 20,912
To Supplier's A/c 10,684 + 10,468) 20,912
(Purchase of Rs. 10,684 from supplier wrongly debited to his account by Rs. 10,468, error now rectified)
- (vi) Returns Inwards A/c Dr. 4,000
To S a/c 4,000
(Goods returned by S not entered in the books of account, now entered)
- (vii) Drawings A/c Dr. 56,000
To Miscellaneous Expenses A/c 56,000
(Purchase of T.V. for owner earlier charged to miscellaneous expenses account, error now rectified)
- (viii) Y (2,400 + 240) Dr. 2,640
To Suspense A/c 2,640
(Being goods of Rs. 2,400 sold to Y wrongly credited to his account for Rs. 240, error now rectified)
- (ix) Suspense A/c Dr. 16,000
To Purchases A/c Dr. 8,000
To Sales A/c 8,000
(Being a sale of Rs. 8,000 wrongly passed through purchases journal, error now rectified)
- (x) Repairs to Furniture A/c Dr. 300
To Suspense A/c 300
(Being repairs for furniture earlier not posted from petty cash book, error now rectified)

Section - III : Rectification after the preparation of Final Accounts

The method of rectification of errors in the next accounting period depends upon the fact whether the account affected was part of the trading and profit & loss account. If the account affected is not part of the trading and profit & loss account, the rectification is done in the usual manner. However, if error involves an account

having its impact on the profit, a Profit & Loss Adjustment Account is opened. While rectifying errors, all nominal accounts are replaced by Profit & Loss Adjustment Account. Profit and Loss Adjustment Account is transferred to capital account of the sole proprietor or partners capital accounts in the case of partnership; In the case of a joint stock company the account is transferred to Profit and Loss Appropriation Account.

Examples:

(a) Wages of Rs. 10,000 paid for the installation of machinery charged to wages account. In the same accounting period, the rectifying entry would be:

Machinery Account Dr. 10,000

To Wages Account 10,000

But if the final accounts have been prepared, the wages account has been closed by transfer to trading account, so the rectifying entry will be:

Machinery Account Dr. 10,000

To Profit and Loss Adjustment Account 10,000

3.1

While closing his books of account, Mister F-9 finds that the Trial Balance on that date, i.e. 31st March, 2019 is out by Rs. 1,814 excess debit. He places the difference in a newly opened Suspense Account and prepares his final accounts which reveal a profit of Rs. 29,560 for the year ended 31st March, 2019. In April 2019, the following errors were detected in the accounts for the year 2018-19;

- (i) Purchases book was under cast by Rs. 2,000.
- (ii) Cash received from Mister F Rs.1,374 was posted to the debit of Mister G as Rs.1,356.
- (iii) Discount received Rs.15,260 and discount allowed Rs.13,746, the totals of the appropriate columns in cash book were not posted to the ledger.
- (iv) Schedule of debtors was totalled Rs.2,32,560 instead of Rs.2,32,760. Mister F-9 maintains a provision for bad debts @ 5%.
- (v) Bank charges and interest, Rs.230 remained un-posted to the debit side of the nominal account.
- (vi) Depreciation on furniture Rs.5,940 was wrongly recorded as Rs.5,580.

Pass journal entries to rectify the above-mentioned errors, prepare Suspense Account and Profit and Loss Adjustment Account and ascertain the correct amount of profit for the year ended 31st March, 2019.

Solution:

Journal

- (i) Profit and Loss Adjustment Account Dr. 2,000

To Suspense Account 2,000

(Being rectification of error caused by under-casting of Purchases Book for the year 2018-19 by Rs. 1,000)

- (ii) Suspense Account Dr. 2,730

To F a/c 1,374

To G a/c 1,356

(Being rectification of wrong debit of Rs. 1,356 to G and omission of credit of Rs. 1,374 to F, in 2018-19 books)

- (iii) Suspense Account Dr. 1,514

To Profit and Loss Adjustment Account 1,514

(Being rectification of omission of posting of discount received Rs. 15,260 and discount allowed Rs. 13,746 in 2018-19)

- (iv) Schedule of Debtors Account Dr. 200

Profit and Loss Adjustment Account Dr. 10

To Suspense Account 200

To Provision for Bad Debts Account 10

(Being rectification of schedule of debtors and also rectification of Provision for bad debts account due to wrong basis on which the amount of bad debts was calculated in 2018-19)

- (v) Profit and Loss Adjustment Account Dr. 230
 To Suspense Account 230
(Rectification of omission of posting to bank charges and interest account)
- (vi) Profit and Loss Adjustment Account Dr. 360
 To Furniture Account 360
(Being rectification of wrong entry for depreciation on furniture)

Sanjay Welkins' Classes

Chapter 14

Partnership - Part - A

- Admission of a partner
- Retirement of a Partner
- Retirement cum Admission of a Partner
- Death of a Partner

Admission of a Partner

When the existing partners of a firm allow a new person to become a partner in the firm, it is called admission of a partner. Following matters require adjustment at the time of admission of a new partner are-

1. Adjustment in the profit sharing ratio
2. Adjustment for goodwill
3. Adjustment of profit and losses arising from the revaluation of assets and liabilities
4. Adjustment of accumulated profits, reserves and losses
5. Adjustment of capital the ratio in which all partners including the incoming partner share the future profits and losses is known as the new profit sharing ratio.

The ratio on which old partners have agreed to sacrifice their share in profits in favour of an incoming partner is called the sacrificing ratio.

1. Goodwill

Goodwill is the benefit and advantage of the good name, reputation and connection of a business

Goodwill is an invisible force that helps a business to earn more than the normal return on investment enjoyed by similar businesses. It is the sum total of the reputation and other favourable attributes built up by a business. Goodwill results into larger number of customers, higher turnover and more profits for a business. The additional profits earned by the business or its "super profits" indicate that it has goodwill. Thus goodwill is a real but intangible asset.

When the amount paid for the purchase of a business is in excess of its net assets, such excess payment is treated as "Goodwill at Cost" or "Purchased Goodwill".

Where there is no purchase or sale but a change of constitution takes place like admission of a new partner etc., the value of goodwill may be recognised as "Inherent/Potential" Goodwill. Accounting Treatment of Goodwill as Read with the Relevant Accounting Standard issued by the ICAI.

(A) Accounting Standard 10 (AS—10) related is 'Accounting for Property, Plant and Equipments.

(B) Paragraph 16 of this standard stipulates that "Goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is excess of the value of the net assets of the business taken over the excess is to be termed as 'goodwill'."

1.1 Methods of valuation of goodwill

Goodwill is valued as per any of the following methods :

1.1.1. Average profit method

Step one calculation of future maintainable profits

Total profits of past years	xxx
Add abnormal losses	xxx
Less abnormal gains	xxx
Total adjusted profits	xxx
÷	
Total number of years of past profits	<u>xxx</u>
= average adjusted profits	xxx
+ Future gains	xxx
- Future losses	<u>xxx</u>
= future maintainable profits	<u>xxx</u>

Step two

Calculation of goodwill -

Future maintainable profits x No. of years of purchase

1.1.2. Super profits method

- * Calculate future maintainable profits [FMP]
- * Calculate capital employed that is assets – liabilities
- * Calculate normal profits/ reasonable profits that is- capital employed x normal rate of return/ 100
- * Compute super profits = FMP – Normal profits
- * Compute goodwill = super profits x no. of years of purchase.

1.1.3. Capitalisation of super profits

Goodwill = super profits / normal rate of return

1.1.4. Annuity Method -

It is a derivative of super profit concept. If super profit is expected to be earned uniformly over a number of years, Goodwill is computed with the help of Annuity Table.
 Calculate Super Profit as discussed before
 Goodwill=Annual Super Profit x Present Value of Annuity of Rs.1.

2. Accounting treatment of goodwill

When new partner brings his share of goodwill in cash	1. Cash a/c Dr. To, premium a/c 2. Premium a/c dr. To, old partners capital a/c [for crediting the amount of goodwill in sacrificing ratio] 3. old partners capital a/c Dr. To, cash a/c [for withdrawal of goodwill]
When new partner fails to bring in his share of goodwill in cash	New partners capital or current account Dr. To, Old partners capital account [in sacrificing ratio]

3. Adjustment Regarding Valuation of Assets and Liabilities:

The Book values of assets as shown in the Balance Sheet may not reflect their current realizable values. Similarly the liabilities included in the Balance Sheet may not exhibit their actual position. Whenever a change takes place in a partnership business in the form of admission or retirement or death of a partner or due to change in profit sharing ratio, revaluation of assets or liabilities become necessary.

The effect of Revaluation are given in two ways :

- (a) **By incorporation the changes of the Balance Sheet Values** and
- (b) **Without changing the Balance Sheet values.**

3.1 By Incorporating Changes in the Balance sheet values

Prepare: Revaluation Account

- (i) For decrease in the value of assets, increase in the value of liabilities, provision for unrecorded liabilities:

Revaluation A/c Dr

To Assets A/c (with the decrease in value)

To Liabilities A/c (with the increase in value)

- (ii) For increase in the value of assets, decrease in the value of liabilities, unrecorded assets

Assets A/c Dr (with the increase in value)

Liabilities A/c Dr (with the decrease in value)

To Revaluation A/c

- (iii) For profit on revaluation :

Revaluation A/c Dr

To old partners capital A/c (in their old profit sharing ratio) [For loss on revaluation, the reverse entry should be made]

Specimen of :

Revaluation Account

Dr.		Cr.	
Particulars	Rs.	Particulars	Rs.
To Assets (Decrease)	x xx	By Assets (Increase)	x xx
To Liabilities (Increase)	x xx	By Liabilities (Decrease)	x xx
To Partners Capital A/c (Share of Revaluation Profit)	x xx	By Partners Capital A/c (Share of Revaluation loss)	x xx
	x xx		xx x

3.2 Without changing the Balance sheet Values

Prepare: Memorandum Revaluation Account

- (i) Record increase/decrease in the value of assets and liabilities as discussed.
- (ii) Share the profit or loss on Revaluation amongst the old partners in their old profit sharing Ratio.
- (iii) Reverse the increase/decrease in the value of assets and liabilities.
- (iv) After reversal, calculate profit or loss.
- (v) Share the profit/loss, after reversal amongst all the partners (including the new partner) in their new profit sharing ratio.

Memorandum Revaluation Account

Dr.		Cr.	
Particulars	Rs.	Particulars	Rs.

To Assets (Decrease)	xx x	By Assets (Increase)	xx x
To Liabilities (Increase)	xx x	By Liabilities (Decrease)	xx x
To Partners Capital A/c	xx x	By Partners Capital A/c	xx x
(Share of Revaluation Profit)	xx x	(Share of Revaluation loss)	
[Old Partners in old Profit sharing Ratio]		[Old Partners in their Old profit sharing ratio]	
	xxx		
To Reversal of Items b/d	xx x	By Reversal of Items b/d	xx x
To Partners Capital A/c	xx x	By Partners capital A/c	xx x
(Revaluation Profit amount- all partners in new profit sharing Ratio)		(Revaluation loss amount - all partners in their new Profit sharing (Ratio))	
	xxx		

4. Accumulated Profits/Losses or Reserve & Surplus

If there are any accumulated profits or losses or other surpluses, the same should be transferred to old partner's Capital or Current Account as per old profit sharing ratio before the admission of new partner:

Entries

(a) For transferring accumulated profits

Profit & Loss A/c (Cr.) Dr.

General Reserve A/c Dr.

Any other Surpluses A/c Dr.

To Old Partner's Capital A/c

(as per old profit sharing ratio)

(b) For transferring accumulated losses

Old Partner's Capital A/c Dr.

To Accumulated Losses A/c

5. Adjustment of capital

On the basis of new partners capital-

- Step one- calculate the capital of the firm
- Step two- determine the new capital of each partner
- Step three- find the present capital of the partner
- Step four -now find out the surplus or deficit

6. Determination of new partner's capital

- Step one – determine the balances of the old partners after taking into account all the adjustments and total them up. This shall deliver the combined capital of the old partners in the new firm.
- Step two – now divide the combined capital by the remaining profit [1 – new partner's profit sharing ratio]. This shall provide the New capital of entire firm.
- Step three- now multiply the capital of the New Firm with profit sharing ratio of new partner.

Section – 1 – Calculation of new profit sharing ratio, Sacrificing Ratio and treatment of goodwill

1.1

P and Q are partners sharing results of the business in the ratio of 2:1- R is admitted as a new partner and as per terms he shall have to bring in Rs.20,000 as capital and Rs.9,000 as goodwill- half of which is to be withdrawn by the partners. Pass entries.

1.2

Tom and Dom are partners sharing results in the agreed ratio of 7:3-On this date they admit Harry into the firm for $\frac{3}{7}$ th share which he acquired in the ratio of 2:1- and for the same Harry is to bring in rupees 100,000 as capital and 60,000 as premium for goodwill- however he could bring in only 30,000 as premium. Pass entries.

Section – 2 – Comprehensive Questions

2.1

Adapted:

A1 and A2 were carrying on business in partnership sharing profits and losses in the ratio of 3:2. On December 31, 2022 their balance Sheet was as follows:

Capital		L/B	40,000
A1	30,200	F/F	10,600
A2	35,400	Stock	38,500
Bank loan	20,000	Debtors	19,000
Sundry creditors & BP	30,800	Cash	20,300
Workmen Compensation Fund	12,000		
	1,28,400		1,28,400

On January 1, 2023 A3 was admitted to partnership on the following conditions:

- A3 would be entitled to $\frac{1}{3}$ rd share in profits.
- A3 would bring Rs.30,000 as his capital.
- He would not be able to bring his share of Goodwill in cash for Rs.10,000.
- The book value of land and building will be increased by Rs.10,000, that of furniture would be reduced to Rs.10,000 and stock would be reduced by 10%.
- A provision for bad debts @ 5% of sundry debtors would be created
- The actual liability of workmen compensation fund is estimated at Rs.2,000.
- Bank loan would be paid off.

Prepare Revaluation Account, Partners Capital Accounts and the Balance sheet of the new firm.

Answers:

Revaluation Profit: 4,600 = A1: 2,760 , A2 : 1,840

Workmen Compensation fund directly adjusted in capital accounts

Capital Account balances – A1 44,960 , A2 45,240 & A3 20,000

Balance Sheet total:1,43,000

2.2 - Adapted - modified

F1 and F2 were are sharing profits and losses in the ratio of 3:2. On 31.03.21 their position is as follows:

Balance sheet 31.03.21

F1 Capital	12,000	L/B	8,000
F2 Capital	10,000	P/M	10,000
General Reserve	12,000	Stock	12,000
WCF	4,000	Debtors	11,000
Sundry Creditors	12,000	Cash at bank	9,000
	50,000		50,000

They decided to admit F3 for a 20% profit on the following terms :

- (a) The liability on Workmen's Compensation Fund is to be determined at Rs. 2,000;
- (b) F3 to bring in Rs. 3,000 as premium out of his share of Rs. 3,600. He is also to bring in Rs. 20,000 as his capital;
- (c) General Reserve is to be maintained at its original value;
- (d) Rs. 2,000 out of creditors to be paid at 5% discount.

Pass the necessary journal entries to give effect to the above arrangement; to show the capital accounts and prepare the Balance Sheet of the new firm.

Hints :

1. F3 pays premium Rs. 3,000. This should be shared by F1 and F2 in their sacrifice ratio, which is eventually the old ratio 3 : 2.

For the unpaid Premium [Rs. 3,600 — Rs. 3,000 = Rs. 600].

F3 Capital Account to be debited and F1 and F2 capital a/c should be credited in old ratio.

2. For General Reserve to be maintained, the following adjustment will be required.

Credited in Old Ratio between old partners(12,000 as 3 : 2)

Debited in New Ratio (12 : 8 : 5)

3. WCF Gain should be taken straight to the partners capital account

Detailed Solution:

Revaluation a/c			
Profit t/f to :		Discount received from creditors	100
F1	60		
F2	40		
	100		100

Partner's Capital accounts							
	F1	F2	F3		F1	F2	F3
GR	5,760	3,840	2,400	Bal. b/d	12,000	10,000	-
Bal. c/d	16,860	13,240	17,600	GR	7,200	4,800	-
				WCF	1,200	800	
				Cash	-	-	20,000
				Premium	1,800	1,200	-
				F1 current a/c	360	240	
				R/L profit	60	40	

Balance sheet			
Capitals : F1	17,360	Cash : 9,000 + 20,000 + 3,000 - 1,900	30,800
F2	13,240	Debtors	11,000
F3	17,600	Stock	12,000

GR	12,000	P/M	10,000
WCF - Liability Portion	2,000	L/B	8,000
		F's Current a/c	600
	71,700		71,700

2.3

Brick, Sand and Cement are partner in a firm sharing profit and losses in the ratio of 3:2:1. Their Balance Sheet as on 31st March 2022

Balance sheet			
Capitals :		L/B	50,000
Brick	30,000	F/F	15,000
Sand	20,000	Stock	20,000
Cement	10,000	B/R	5,000
Reserves	30,000	Debtors	7,500
Creditors	6,000	Cash in hand and at bank	2,500
Bills Payable	4,000		
	1,00,000		1,00,000

Lime is to be admitted as a partner with effect from 1st January, 2023 on the following terms

- Lime will bring in Rs. 15,000 as Capital and Rs. 12,000 as premium for goodwill. Half of the premium will be withdrawn by the partners.
- Lime will be entitled to : 1/6th share in the profits of the firm.
- The assets will be revalued as follows Land and Building— Rs. 56,000; Furniture — Rs. 12,000; Stock— Rs. 16,000; Debtors — Rs. 7,000
- The claim of a creditor for Rs. 2,300 is paid at Rs. 2,000.
- Half of the Reserve is to be withdrawn by the partners.

Record the Journal entries (including cash transactions) in the books of the firm and show the opening Balance Sheet of the new firm.

Answers :

Revaluation Loss : 6,000 -3,000 -4,000 - 500 + 300 = Rs. 1,200 [600/ 400 / 200]

Cash balance – 2,500 +15,000 + 12,000 - 2,000 - 6,000 - 15,000 = 6,500

Balance Sheet : 1,02,500

Capital Accounts

		Brick	Sand	Cement	Lime
	Balance b/d	30,000	20,000	10,000	-
+	Reserves	15,000	10,000	5,000	
-	Half Reserves withdrawn	7,500	5,000	2,500	
+	Cash - capital				15,000
+	Premium credited	6,000	4,000	2,000	
-	half premium withdrawn	3,000	2,000	1,000	
-	R/L Loss	600	400	200	
	Balance c/d	39,900	26,600	13,300	15,000

Balance sheet :

Assets: L/B 56,000 + F/F 12,000 + stock 16,000 + BR 5,000 + Debtor 7,000 + Cash 6,500 = 1,02,500

Liability: Capitals 39,900 + 26,600 + 13,300 + 15,000 + Creditors 3,700 + BP 4,000 = 1,02,500

Section 3: Questions Related to Capital Adjustments

3.1

On 31st December, 2019 the balance sheet of Bottle and Glass, who are partners in firm sharing profits in the ratio of 3:2 was as follows:

Liabilities	Rs.	Assets	Rs.
Capitals –		Plant and Machinery	10,000
Bottle	10,000	Land and buildings	8,000
Glass	8,000	Debtors	12,000
General reserve	15,000	Provision for doubtful debts (1,000)	11,000
Workmen compensation fund	5,000	Stock	12,000
Creditors	12,000	Cash	9,000
	50,000		50,000

They agreed to admit Wine into the firm for 1/5th share of its profits on the following terms:

- Provision for doubtful debts would be increased by Rs. 2,000
- The value of land and building would be increased to Rs. 18,000
- The value of stock would be increased by Rs. 4,000
- The liability against workmen's compensation fund is determined at Rs 2,000
- Wine brought in as his share of goodwill Rs. 10,000 in cash
- Wine would bring in further cash as would make his capital equal to 20% of the total capital of the new firm, after the above revaluation and adjustments are carried out.

Prepare revaluation account, partners' capital accounts and the Balance sheet of the firm after the admission of Wine.

Answer

Balances in capital accounts – 34,000 /24,000 /14,500

Balance sheet total Rs. 86,500.

Revaluation a/c			
Provision for D/D	2,000	Land and buildings	10,000
Profit t/f to Partner's capital a/c:		Stock	4,000
B 7,200			
G 4,800	12,000		

Partner's Capital accounts

	B	G	W		B	G	W
GW as per balance Sheet		-		Bal b/d	10,000	8,000	-
Suspense a/c as per b/s	-	-		G.R.	9,000	6,000	-
c/d	34,000	24,000	14,800	WCF 5,000-3,000	1,800	1,200	-
				Cash #	-	-	14,500
				Premium#	6,000	4,000	-
				R /L Profit	7,200	4,800	-
Balances after all adjustments of :							
			B			34,000	
			G			24,000	

	Total	58,000
Remaining profit of B & G in the new firm	$1 - 1/5 = 4/5$	
Capital of new firm	Combined capital / Remaining Profit	$58,000 / 4/5$ $= 58,000 \times 5 / 4 = 72,500$
Therefore W shall bring 20% of 72,500		14,500

Balance sheet			
Capitals : B 34,000		P/M	10,000
G 24,000		L/B	18,000
W 14,500	72,500	Debtors 12,000 less provision for D/D 3,000	9,000
WCF (liability Portion)	2,000	Stock	16,000
Creditors	12,000	Cash op bal 9,000 + capital of W 14,500 + premium 10,000	33,500
	86,500		86,500

Since new ratio separately is not given, old ratio shall be the sacrificing ratio

3.2

Dettol and Sevlon are partners sharing results in the ratio of 7:3. Their balance sheet as at 31.3.2023 is as follows:

Liabilities	Rs.	Assets	Rs.
Sundry suppliers	40,000	Cash in hand and at bank	36,000
Bills due	20,000	Debtors 46,000	
General reserve	10,000	Less provision for D/D <u>2,000</u>	44,000
Capital of Dettol	50,000	Stock	50,000
Capital of Sevlon	40,000	Patents, copyrights and designs	30,000
	160,000		160,000

On First April 2023, Revlon joins the firm as a third partner for $1/4^{\text{th}}$ share of the future profits on the following terms and conditions:

- Goodwill is valued at Rs. 40,000 and Revlon is to bring in necessary amount in cash as premium for goodwill.
- 20 per cent of the reserve is to remain as a provision against bad and doubtful debts.
- Stock in trade is to be reduced by 40%.
- Dettol is to pay off the bills due.
- Revlon is to introduce Rs. 30,000 as his share of capital to which amount other partner's capitals shall have to be adjusted.

Prepare necessary accounts and frame revised balance sheet.

Answers

Capital balances- 63,000 / 27,000 / 30,000

Balance sheet total Rs. 1,60,000

Cash balance Rs. 58,000

	Dettol	Sevlon	Revlon (new partner)
Ratios as given	7/10	3/10	1/4
New ratio not given	therefore Sacrificing ratio shall be old ratio i.e. 7:3		

Entries :

For capital contribution by new partner

- Cash 30,000
- To Revlon 30,000

For Premium contribution by new partner

- Cash 10,000
- To premium 10,000

For Distribution of Premium

- Premium 10,000
- To Dettol 7,000
- To Sevlon 3,000

Distribution of General Reserve

- General reserve 10,000
- To prov. D/D 2,000
- To D (8,000 x 7 /10) 5,600
- To S (8,000 x 3 /10) 2,400

Bills taken over by Dettol

- Bills due 20,000
- To Dettol 20,000

Revaluation a/c			
Stock	20,000	Loss t/f	
		Dettol	14,000
		Sevlon	6,000

Partner's Capital accounts							
	Dettol	Sevlon	Revlon		Dettol	Sevlon	Revlon
R/l loss	14,000	6,000	-	b/d	50,000	40,000	-
c/d	68,600	39,400	30,000	GR	5,600	2,400	-
				Cash	-	-	30,000
				Premium	7,000	3,000	-
				Bills a/c	20,000	-	-
Cash *	5,600	12,400	-	b/d	68,600	39,400	30,000
c/d #	63,000	27,000	30,000				

New Firm Capital on the basis of R's capital	$30,000 \div 1/4 = 1,20,000$	
Less R's Capital	30,000	
Remaining capital	90,000	

New capital of :		
Dettol	90,000 x 7/10 = 63,000	
Sevlon	90,000 x 3/10 = 27,000	

Balance sheet			
Sundry Creditors	40,000	Cash 36,000 + cap 30,000 + premium 10,000- surplus 5,600 less surplus 12,400	58,000
Bills	-	Debtors 46,000 less Provision for D/D 2,000 + 2,000)	42,000
GR -	-	Stock 50,000 – 20,000	30,000
Capitals : D	63,000	Patents copyrights and designs	30,000
S	27,000		
R	30,000		
	1,60,000		1,60,000

Section 4 : Entry Based Questions

Q.4.1

- Plant of book value worth Rs. 600,000 was under-valued by Rs. 1,00,000
- Equipments worth Rs. 5,00,000 was found overvalued by Rs. 50,000
- Book value of stock was Rs. 1,00,000 out of which Rs. 10,000 worth of stock was to be discarded and 20,000 worth of stock was found obsolete.
- Unrecorded investments were worth Rs. 1,00,000
- Unrecorded liability towards electricity bill and damages were Rs. 30,000

1	Plant a/c	1,00,000	
	To revaluation a/c		1,00,000
2	Revaluation a/c	50,000	
	To Equipment a/c		50,000
3	Revaluation a/c	3,0000	
	To stock – discarded		10,000
	To stock – obsolete		20,000
4	U /R investment	1,00,000	
	To R/L		1,00,000
5	R/L	30,000	
	To U / R liab. For electric bill and damages		30,000

Section 5: Questions Related to Rectifications

Q.5.1 - Past Rectifications / Module

Quick and Slow are partners in firm sharing profits and losses in the ratio of 3:2. the Balance Sheet of the firm as on 31st March 2023 is as follows -

Quick capital a/c	1,20,000	Furniture and fixtures	60,000
Slow capital a/c	77,000	Office equipments	30,000
General reserve	30,000	Motor car	75,000
Sundry creditors	96,000	Stock	50,000
		Sundry debtors	90,000
		Cash at bank	18,000

1. Smooth was admitted as new partner with effect from 1.4.2023 and it was agreed that he would bring some private furniture worth Rs.10,000 and private stock costing Rs.8,000 and in addition contribute Rs.50,000 cash towards capital.

2. He would also bring proportionate share of goodwill which is to be valued at two year's purchase of the average profits of the last three years.

3. The profits of last three years were:

22-23	52,000
21-22	32,000
20-21	28,000

4. However on checking of past records, it was noticed that on 1.4.2021 a new furniture costing Rs.8,000 was purchased but wrongly debited to revenue and in 22-23 a purchase invoice of Rs.4,000 dated 25.3.2023 has been omitted in the books. The firm charges depreciation on furniture at the rate of 10% per annum.

4. Goodwill is to be computed on the basis of correct profits.

5. On revaluation, value of stock is to be reduced by 5% and motor car is worth Rs.85,000.

6. Smooth duly paid the required amount for goodwill and cash towards capital.

7. It was decided that the future profits of the firm would be shared as;

Quick - 50%

Slow - 30%

Smooth - 20%

Prepare capital accounts and balance sheet of the firm.

Detailed Solution:

Profit and Loss Adjustment a/c			
Furniture and Fixtures :	1,520	Furniture and fixture	8,000
Dep.800 +720			
S/C : Purchase Invoice	4,000		
Profit T/F			
Q 1,488			
SL 992	2,480		
	8,000		8,000

Revaluation a/c			
Stock	2,500	Motor Car	10,000
Profit T/F			

Q 4,500			
SL 3,000	7,500		
	10,000		10,000

Partner's Capital accounts							
	Q	S _L	S _M		Q	S _L	S _M
Balance c/d -B.F.	1,51,620	1,00,624	68,000	Balance b/d	1,20,000	77,000	-
				GR	18,000	12,000	-
				P&L Adj. a/c	1,488	992	-
				R/L a/c	4,500	3,000	-
				Cash - cap.	-	-	50,000
				F/F	-	-	10,000
				Stock	-	-	8,000
				Premium	7,632	7,632	-
	1,51,620	1,00,624	68,000		1,51,620	1,00,624	68,000

Post Admission Balance sheet				
Capitals Quick	1,51,620		F/F see Note	76,480
Slow	1,00,624		Motor Car	85,000
Smooth	68,000	3,20,244	O/Equipment	30,000
S/C 96,000 + 4,000		1,00,000	Stock See note	55,500
			Debtors	90,000
			Cash at bank See Note	83,264
		4,20,244		4,20,244

P/L adjustment account is prepared to rectify the past mistakes .

Goodwill : $52,000 + 32,000 + 28,000 + 2,480$ (Adjusted profits of earlier years) / 3×2 years purchase = 76,320

and Smooth's share 20% i.e. Rs. 15,264 , S.R 1:1 i.e. OR - NR

Stock : op. Balance 50,000 + brought in by S_m 8,000 - R/L 2,500 = 55,500

F/F: op. Balance 60,000 - Depreciation of earlier years [800 +720] i.e. 1,520 + F/F wrongly debited to Revenue now capitalised 8,000 + brought in by S_m 10,000 = 46,480

Cash: op. Bal. 18,000 + Sm capital 50,000 + Premium 15,264 = 83,264

Important entries:

Cash a/c Dr. 50,000 F/F Dr. 10,000 Stock Dr. 8,000 To Smooth Cap. a/c 68,000	Cash a/c Dr. 15,264 To Premium 15,264	Premium a/c Dr. 15,264 To Quick 7,632 To Slow 7,632

Section 6:

Memorandum Revaluation that is When partners decide to not to alter the book values of assets and liabilities

6.1 - Module Adapted

A and B are partners sharing profits and losses in proportion to their capitals. Their Balance Sheet as on 31st March, 2021 is given below :

Liabilities	Rs.	Assets	Rs.
Creditors	15,000	Freehold Premises	10,000
General Reserve	2,100	Machinery	3,500
Capitals :		Furniture	1,750
A	20,000	Office Equipments	550
B	15,000	Stock	14,100
		Bill Receivable	3,060
		Debtors	17,500
		Bank	1,590
		Cash	50
	52,100		52,100

On 1st April, 2021 they admit C on the following conditions :

- (i) C should bring in Rs. 10,000 as capital and to pay Rs. 3,500 for goodwill as she will get 1/4th share in profits.
- (ii) A provision of 2% to be raised against debtors, stock to be reduced by 5%, Freehold Premises to be revalued at Rs. 12,650, Machinery at Rs. 2,800, Furniture at Rs.1,540 and Office equipments at Rs. 495.
- (iii) Partners agreed that the values of assets and liabilities should remain unaltered.

Show the necessary accounts and prepare the opening Balance Sheet of the new firm.

Detailed Solution

1. The Partners have decided not to alter the book values of the assets and liabilities. The effects of revaluation may be ascertained by preparing a Memorandum Revaluation Account as follows.

Revaluation a/c

Provision for D/D 2% of 17,500	350	Freehold Premises	2,650
Stock	705		
Machinery	700		
F/F	210		
O/Equipments	55		
Profit T/F to :			
A	360		
B	270		
	2,650		2,650
Reversal of items	2,650	Reversal of items	2,020
		Reversal Result T/F to :	
		A	270
		B	203
		C	157
	2,650		2,650

Capital Accounts

Particulars	A	B	C	Particulars	A	B	C
To General Reserve	900	675	525	By Balance b/d	20000	15000	-
To M. Rev. A./c	270	203	157	By General Reserve	1,200	900	-
To Balance c/d	22,390	16,792	9,318	By Bank A/c	360	270	-
				By M. Rev. A/c	2000	1500	-
				By Bank A/c (Premium) In-4:3.			
	23,560	17,670	10,000		23,560	17,670	10,000

Balance Sheet as at 1.4.2019

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.
Capitals:	22,390		Freehold Premises	10,000
A	16,792		Machinery	3,500
B	<u>9,318</u>		Furniture	1,750
C		48,500	Office Equipments	550
General Reserve		2,100	Stock	14,100
Sundry Creditors		15,000	Bill Receivable	3,060
			Debtors	17,500
			Bank	15,090
			[1,590 + 10,000 + 3,500]	
			Cash	50
		65,600		65,600

Section 7: Negative Sacrificing Ratio

7.1 - Module

A and B are partner in a firm sharing profit and losses in the ratio of 4 : 1. Their Balance Sheet as on 31st March 2022

stood as follows :

Balance sheet			
Capitals :		Furniture	20,000
A	25,000	Stock	40,000
B	65,000	B/R	10,000
Reserves	25,000	Debtors	30,000
Bills Payables	5,000	Cash at bank	40,000
Sundry Creditors	20,000		
	1,40,000		1,40,000

They agreed to take C as a partner with effect from 1st April 2023 on the following terms :

- (a) A, B and C will share profit and losses in the ratio of 5 : 3 : 2.
- (b) C will bring Rs. 20,000 as premium for goodwill and Rs. 30,000 as capital.

- (c) Half of the Reserve is to be withdrawn by the partners.
- (d) The asset will be revalued as follows : Furniture Rs. 30,000; Stock Rs. 39,500; Debtors Rs. 28,500.
- (e) A creditor of Rs. 12,000 has agreed to forgo his claim by Rs. 2,000.
- (f) After making the above adjustments, the capital accounts of A and B should be adjusted on the basis of C's capital, by bringing cash or withdrawing cash as the case may be.

Show Revaluation Account, Partners' Capital Account and the Balance Sheet of the new firm

Answers :

Revaluation Profit Rs. 10,000 [8,000 / 2,000]

Balance Sheet : 1,73,000

Capital Accounts

Credit		A	B	C
	Balance b/d	25,000	65,000	-
+	Reserves	20,000	5,000	-
+	Revaluation - Profit	8,000	2,000	-
+	Cash - capital	-	-	30,000
+	Premium credited	20,000	-	-
+	B's Capital a/c: GW in proportion to gain of B	10,000	-	-
	Total	83,000	72,000	30,000
Debit Side	Cash - half reserves withdrawn	10,000	2,500	-
	A's Capital : GW in proportion to gain of B	-	10,000	-
	Balance c/d	73,000	59,500	30,000
Credit side	Balance b/f	73,000	59,500	30,000
	Capitals in proportion to NPSR - as per workings	75,000	45,000	30,000
	Deficiency : by Cash	2,000	-	-
	Surplus : to Cash	-	14,500	

Cash account

Opening balance	40,000
+ C's capital a/c - capital contribution	30,000
+ Premium	20,000
+ A's deficiency	2,000
- A & B - reserves withdrawn	12,500
- Surplus capital of B	14,500
= Balance c/d	65,000

7.2 : Adapted : Negative Sacrificing Ratio

K and L are two partners sharing profits and losses in the ratio of 5:3. Their Balance Sheet as at 30th June, 2023 is as follows :

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Creditors		30,000	Furniture		40,000
Reserve		14,000	Patent		10,000
Capital Account :			Debtors	44,000	
K	40,000		Less : Reserve for Bad Debts	<u>5,000</u>	
L	<u>50,000</u>	90,000	Stock		39,000

			Cash in hand		20,000
					25,000
		1,34,000			1,34,000

On 1st July, 2023, they take M into partnership. M brings Rs. 25,000 as his capital and brings Rs. 3,600 as his share of goodwill. The new profit sharing ratio of K, L and M is 2:4:1. Patent is written off from the books and a reserve for Bad Debt is created at 5%. Reserve appears in the books of new firm at its original figure.

Show the necessary Journal entries to carry out the above transactions and prepare a Balance

Sheet of the new firm as at 1st July, 2023.

Date	Particulars	Debit Rs.	Credit Rs.
2023	Bank A/c Dr.	28,600	
July 1	To M's Capital A/c		25,000
	To Premium A/c		3,600
	<i>Cash to be brought in by M As capital</i>		
	Premium A/c Dr.	3,600*	
	To K's Capital A/c		3,600
	<i>Value of goodwill credited to K's Capital only</i>		
	L's capital a/c Dr.*	4,950	
	To, K's capital a/c		4,950
	<i>Goodwill in proportion of Gain to L is credited to K</i>		
	Reserve A/c Dr.	14,000	
	To K's Capital A/c		8,750
	To L's Capital A/c		5,250
	<i>Reserve credited to old partners capital accounts in 5:3</i>		
	K : Capital A/c Dr.	4,000	
	L : Capital A/c Dr.	8,000	
	M : Capital A/c Dr.	2,000	
	To Reserve A/c		14,000
	<i>Reserve shown at its original value</i>		
	Revaluation A/c Dr.	10,000	
	To Patents A/c		10,000
	<i>(Patent eliminated from the book)</i>		
	Reserve for Bad Debts A/c Dr.	2,800	
	To Revaluation A/c		2,800
	<i>Excess provision written back</i>		
	K's Capital A/c Dr.	4,500	
	L's Capital A/c Dr.	2,700	
	To Revaluation A/c		7,200
	<i>Loss on revaluation transferred</i>		

Capital Account

Particulars	K Rs.	L Rs.	M Rs.	Particulars	K Rs.	L Rs.	M Rs.

To Reserve A/c	4,000	8,000	2,000	By Balance b/d	40,000	50,000	—
" Revaluation A/c	4,500	2,700	—	" Premium A/c	3,600	—	—
— Loss	—	4,950*	—	" Reserve A/c	8,750	5,250	—
" K's Capital A/c	48,800	39,600	23,000	" L's Capital A/c	4,950*	—	—
" Balance c/d				" Bank	—	—	25,000
	56,850	55,250	25,000		57,300	55,250	25,000

Balance Sheet as on July 1, 2019

Liabilities	Amount Rs.	Amount Rs.	Assets	Amount Rs.	Amount Rs.
Capitals:			Furniture		40,000
K	48,800		Debtors	44,000	
L	39,600		Less : R/B/Debts	<u>2,200</u>	41,800
M	<u>23,000</u>	1,11,400	Stock		20,000
Reserve		14,000	Cash & Bank		53,600
Creditors		30,000	(25,000 + 28,600)		
		1,55,400			1,55,400

*Goodwill

	K	L	M
OPSR	5/8	3/8	
NPSR	2/7	4/7	1/7
	19/56 : sacrifice	11/56 : gain	

∴ Entire goodwill should be credited to K's Capital only.

Since L is gaining 11/56 from K, he must have to pay in proportionate amount to K as under, i.e., if M brings for 1/7th share Rs. 3,600 for goodwill, then full value of goodwill will be = $3,600 \times \frac{7}{1} = 25,200$.

Thus L should pay (which he will not pay - rather shall be adjusted through his capital account) for $\frac{11}{56} \times 25,200 = \text{Rs. } 4,950$

Section 8: Advance level

8.1

A and B are partners in a firm sharing profits and losses in the ratio 3 : 2. Their Balance Sheet as on 31.12.2020 stood as follows :

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Sundry Creditors		20,000	Goodwill		12,000
Capital Account			Cash in hand		15,000
A	12,000		Sundry Debtors	21,000	
B	<u>30,000</u>	42,000	Less : Reserve for Bad Debts	<u>1,000</u>	20,000
			Stock-in-trade		10,750
			Fixture & Fittings		250
			Profit and Loss Account		4,000
		62,000			62,000

On 1.1.2021 they admit C as a partner on the following terms:

- (a) The new profit sharing ratio of A, B and C becomes 5:3:2.
- (b) Agreed value of Goodwill is Rs. 20,000 and C brings the necessary premium for Goodwill in cash, half of which is retained in the business. **Book value of Goodwill should remain undisturbed.**
- (c) The Reserve for bad debts is to be raised to 10% of Sundry Debtors.
- (d) Stock-in-trade is to be revalued at Rs. 12,000 but the effect is not to be shown in the books.**
- (e) Fixture & Fittings are to be reduced to Rs. 150.
- (f) C should bring further sum in cash in order to make his capital equal to $\frac{1}{5}^{\text{th}}$ of the combined adjusted capital of A and B.

Show the necessary journal entries and the Capital Accounts of the partners and also prepare the Balance Sheet of the new firm as at 1.1.2021.

In the books of A, B and C
Journal

Date	Particulars	Debit Rs.	Credit Rs.
2021 Jan. 1	Bank A/c Dr. To Premium / Goodwill A/c (Goodwill and capital to be brought in by C in cash) Firms GW On admission is Rs. 20,000 - 12,000 = 8,000 C's share of GW will be Rs. 8,000 x $\frac{1}{5}$ = 1,600	1,600	1,600
	Premium/Goodwill A/c Dr. To A's Capital A/c To B's Capital A/c (Goodwill to be credited to A and B's capital account in sacrificing ratio of 1:1)	1,600	800 800
	A's Capital A/c Dr. B's Capital A/c Dr. To Bank A/c (Half of the goodwill withdrawn)	400 400	800
	A's Capital A/c Dr. B's Capital A/c Dr. To Profit and Loss A/c (Debit balance of P&L A/c transferred to A and B's capital in 3 : 2)	2,400 1,600	4,000
	Profit and Loss Adjustment A/c Dr. To Reserve for Bad Debts A/c To Fixture and Fitting A/c (Value of assets is reduced on revaluation before C's admission)	1,200	1,100 100
	A's Capital A/c Dr. B's Capital A/c Dr. To Profit and Loss Adjustment A/c (Loss on revaluation transferred to A and B's capital in 3 : 2)	720 480	1,200

Date	Particulars	Debit Rs.	Credit Rs.
	Stock (12,000 – 10,750) Dr. To A's Capital A/c To B's Capital A/c (Effect of stock on revaluation given on C's admission)	1250	750 500
	A's Capital A/c Dr. B's Capital A/c Dr. C's Capital A/c Dr. To Stock A/c (Effect of stock on revaluation given now reverted)	625 375 250	1,250

Capital Accounts

Credit		A	B	C
	Balance b/d	12,000	30,000	-
+	Cash - capital	-	-	7,820
+	Premium credited	800	800	-
+	Stock	750	500	-
	Total	13,550	31,300	7,820
Debit Side	Cash - GW	400	400	-
	R/L Loss	720	480	-
	Stock	625	375	250
	P/L Dr. Balance	2,400	1,600	
	Balance c/d - b.f	9,405	28,445	7,570
		13,550	31,300	7,820

Cash account

Opening balance	15,000
+ C's capital a/c - capital contribution	7,820
+ Premium	1,600
- A & B - GW withdrawn	800
= Balance c/d	23,620

Balance Sheet

Assets	GW 12,000 + Cash 23,620 + Debtors 18,900 + Stock 10,750 + F/F 150 = 65,420
Liabilities	Capitals : 9,405 + 28,445 + 7,570 , S/C + 20,000 = 65,420

Working :

1. Goodwill to be brought in by C :

Agreed value of goodwill	20,000
Less : as per Balance Sheet	12,000
Under valuation	8,000

∴ C is to bring Rs. 8,000 x 1/5 = 1,600

2. Sacrificing ratio :

A $\frac{3}{5}$ - $\frac{5}{10}$ = $\frac{(6-5)}{10}$ = $\frac{1}{10}$

B $\frac{2}{5}$ - $\frac{3}{10}$ = $\frac{(4-3)}{10}$ = $\frac{1}{10}$

C $\frac{1}{10}$ + $\frac{1}{10}$ = $\frac{2}{10}$

Goodwill to be shared between A and

B equally i.e. (1 : 1)

3.Capital to be brought in By C

Balances after all adjustments of

A 9,405 Revaluation a/c

Provision for D/D 2% of 17,500	350	Freehold Premises	2,650
Stock	705		
Machinery	700		
F/F	210		
O/Equipments	55		
Profit T/F to :			
A	360		
B	270		
	2,650		2,650
Reversal of items	2,650	Reversal of items	2,020
		Reversal Result T/F to :	
		A	270
		B	203
		C	157
	2,650		2,650

B 28,445

= 37,850

C is to bring:

Rs. $37,850 \times 1/5$

= Rs. 7,570 + Rs. 250 (for stock) = Rs. 7,820.

Retirement of A Partner**Chapter Crux**

When a partner decides to retire from a partnership firm because of old age, illness, mutual disputes or any other reason, it is called retirement of a partner. At the time of retirement of a partner, the few accounting problems arise and settled example, calculation of the new profit- sharing ratio and gaining ratio, revaluation of assets and liabilities, treatment of goodwill, accumulated profits, reserves and losses, share of the partner in profits or losses up to the date of retirement.

When a partner retires or dies his share of profits is taken over by the remaining partners. The remaining partners then compensate the retiring or deceased partner in the form of goodwill in their gaining ratio. The following entry is recorded for this purpose:

Remaining Partners capital a/c [gaining ratio]

Retiring partners' capital a/c [retiring Partner's share of Goodwill]

At the time of retirement of a partner, assets are revalued and liabilities are reassessed; the difference is recorded in the revaluation Account. The balance in the revaluation account is transferred to the capital accounts of all the partners [including the outgoing partner] in their old profit-sharing ratio.

For the past profits or reserves, the amount is credited to all the partners in the old profit sharing ratio.

The total amount due to a retiring partner may include-

Capital on the date of the last balance sheet / Interest or salary, if any, payable to him / Share of profits or losses till the date of retirement / share in the profits or losses on revaluation of assets and liabilities/ share in

the goodwill of the firm / share in the general reserve or profits and losses account appearing in the balance sheet. The final net amount payable will be settled by paying him cash/ through bank or by transferring it to a separate Loan Account.

1. Explain the treatment of Goodwill at the time of Retirement

At the time of retirement the retiring partner is also eligible for share of goodwill of the firm.

Alternative One:

i) Raising of goodwill :

Goodwill account Dr (Value of goodwill – existing goodwill in the balance sheet)

To all partners capital account (Old P.S.R)

ii) Write off goodwill

Existing partners Capital A/c Dr.

To Goodwill A/c (In NPSR)

or

Alternative Two

Remaining/Continuing Partners Capital Account Debit

To Retiring Partner's Capital account

The Net Effect of the above entries under alternative one shall be equal to alternative two.

2. How dues of Retiring Partner are settled

The retiring partner becomes entitled to get back his dues from the firm which consists of the following :

- (i) Balance of his capital and current account at the time of retirement.
- (ii) Share of goodwill, undistributed profit or loss, reserves and profit or loss on revaluation of assets and liabilities.
- (iii) Salary, commission, interest on capital, if any and all other dues till the date of retirement.
- (iv) Any adjustment in drawings and interest thereon.

i) Payment at a point of time.

Journal entry:

Retiring Partner's Capital A/c Dr

To Bank A/c

ii) If part payment be made by giving assets:

Retiring Partner's Capital A/c Dr

To Assets A/c

iii) If the dues are transferred to Loan account.

Retiring Partner's Capital A/c Dr

To Retiring partners' Loan A/c

iv) If the existing partners bring in cash for making payment :

Bank / Cash account Dr

To Existing Partners' Capital A/c

v) For interest due on Retiring Partners Loan Account.

Interest on Retiring partner's loan account Dr

To Retiring Partner's Loan account.

3. Explain Sec-37 - Rights to Share of Profits after Retirement

According to Sec. 37 of the Indian Partnership Act, "where any member of a firm has died or otherwise ceased to be a partner and the surviving or continuing partners carry on the business of the firm with the

property of the firm without any final settlement of accounts as between them and the outgoing partner or his estate, then, in the absence of a contract to the contrary. The outgoing partners or his estate is entitled at the option of himself or his representatives to such share of the profits made since he ceased to be a partner as may be attributable to the use of his share of the property of the firm or interest @ 6% p.a. on the amount of his share in the property of the firm.”

In short, if any partners retires from a firm and if the final and if the final settlement of accounts is not made (i.e. if he is not paid in full) and if the continuing partner carry on the business after his retirement, the outgoing partner or his legal representatives is entitled to get share of profits or 6% p.a. of his share of property of the firm.

Under the circumstances, the share of profit of the outgoing partner should be ascertained as under:

(a) Computes the average profits of the last year at first.

(b) Ascertain the amount of profit on proportionate basis.

i.e. $\text{Average profit} \times \text{Period after retirement} / 12$

(c) On the basis of computed figure of (b), ascertain retiring partners' share.

The Share of Profit so ascertained should be transferred to Profit & Loss suspense Account by passing the following entry:

Profit & Loss Suspense A/c Dr.
To Retiring Partners Capital A/c

Section 1: Calculation of New Profit Sharing Ratio and Gaining Ratio

1.1

One, Two and Three are partners sharing profits in the ratio 5/10 : 4/10 : 1/10 . Find out the new ratio of the remaining partners –

- If One retires
- If Two retires
- If Three retires

Answer

- 4:1
- 5:1
- 5:4

1.2

Eleven , Twelve and Thirteen are partners sharing profits in the ratio of 1/5 : 1/3 : and 7/15 respectively. Thirteen retires and his share was taken by Eleven and Twelve in the ratio of 3:2. Find out the new ratio.

Answer – 12:13

1.3

Breakfast, Brunch and Lunch are partners sharing profits and losses in the ratio of 4:3:1. Brunch retired, selling his share of profits to Breakfast and Lunch for Rs. 8,100, Rs 3,600 paid be Breakfast and Rs. 4,500 by Lunch.

Compute new and gaining ratio and also pass entry.

New ratio 2:1

Gaining ratio 4:5

Break fast sells his share	3 / 8	
In the ratio of	3,600 / 8,100 to break fast that is 4/9	

And	4,500 / 8,100 to Lunch that is 5 / 9	
Shares given/ sold to breakfast	$4/9 \times 3/8 = 12/72$	
Shares given to sold to Lunch	$5/9 \times 3/8 = 15/72$	
New ratio of Break fast	$4/9 + 12/72 = 48/72$	
Lunch	$1/8 + 15/72 = 24/72$	
	2:1	
Gaining ratio	4/9 : 5/9	

Section – 2: Treatment of Goodwill

2.1

Din, Raat and Subhah are equal partners in a firm. Goodwill has been valued at Rs. 36,000 on Subhah's retirement from the firm. Din and Raat agree to share in the ratio of 3:2. Pass entries for Adjustment of Goodwill.

2.2

Aloo, Kulche and Chhole are partners. Goodwill has been valued at Rs. 48,000. On Chhole's retirement Aloo and Kulche agree to share profits in the ratio of 5:3. Pass entries for Chhole's share of goodwill.

Section - 3: Preparation of Revaluation A/C, Capital A/C and Balance Sheet

3.1

The Balance Sheet of Baichung, Tausif and Vijayan who shared profits and losses in the ratio 3:3:2 respectively was as follows on 31st December, 2023 :

Balance sheet			
Baichung	24,000	Machinery	31,600
Tausif	10,000	Furniture	6,400
Vijayan	8,000	Stock	8,500
Reserve	4,800	Debtors	4,300
Creditors	8,700	Cash at Bank	4,700
	55,500		55,500

Baichung retired from the business on 1st January, 2023.

Revaluation of assets were made as : Machinery Rs. 34,000,

Furniture Rs. 5,000, Stock Rs. 9,600, Debtors Rs. 4,000 and Goodwill Rs. 10,000.

Baichung was paid Rs. 4,225 immediately and the balance was transferred to a Loan Account for payment in 4 equal half-yearly installments together with interest @ 6% p.a.

Show the necessary accounts, the Balance Sheet of the firm immediately after Baichung's retirement and his Loan

Account till finally paid off.

Hints :

Revaluation Result : Profit – 1,800

Capital Balances : T : $10,000 + 1,800 + 675 + 3,750 - 6,000 = 10,225$

V : $8,000 + 1,800 + 450 + 2,500 - 4,000 = 8,750$.

B's Loan a/c : 26,000

Balance sheet : 53,675

Goodwill raised and written off

3.2

A, B and C were in partnership sharing profits in the proportion of 5:4:3. The Balance Sheet of the firm as on 31st March, 2023 was as under :

Balance sheet			
Capitals		Goodwill	40,000
A	1,35,930	Furniture	8,200
B	95,120	Stock	1,57,300
C	61,170	Debtors	93,500
Creditors	41,690	Cash at Bank	34,910
	3,33,910		3,33,910

A had been suffering from ill-health and gave notice that he wished to retire. An agreement was, therefore entered into as on 31st March, 2023, the terms of which were as follows:

- (i) The Profit & Loss Account for the year ended 31st March, 2023, which showed a net profit of Rs. 48,000 was to be reopened. B was to be credited with Rs. 4,000 as bonus, in consideration of the extra work which had devolved upon him during the year. The profit sharing ratio was to be revised as from 1st April, 2022 to 3:4:4.
- (ii) Goodwill was to be valued at two years' purchase of the average profits of the preceding five years. The Fixtures were to be revalued by an independent valuer. A provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book values.
- (iii) The valuations arising out of the above agreement were Goodwill Rs. 56,800 and Fixture Rs. 10,980.
- (iv) B and C agreed, as between themselves, to continue the business, sharing profits in the ratio of 3:2 and decided to eliminate Goodwill from the Balance Sheet, to retain the Fixtures on the books at revised value, and to increase the provision for doubtful debts to 6%.

You are required to submit the Journal Entries necessary to give effect to the above arrangement and to draw up the Capital Accounts of the partners after carrying out all adjustment entries as stated above.

Detailed Solution:

1. A's Capital A/c [5/12 of Rs. 48,000] Dr.20,000

B's Capital A/c [4/12 of Rs. 48,000] Dr.16,000

C's Capital A/c [3/12 of Rs. 48,000] Dr.12,000

To Profit & Loss A/c 48,000

Profits of Rs. 48,000 already shared by A, B & C as 5 : 4 : 3 written back

2. Profit & Loss Adjustment A/c Dr. 4,000

To B's Capital A/c 4,000

B Credited with bonus of Rs. 4,000 for his extra work

3. Profit & Loss Adjustment A/c Dr. 44,000

To A's Capital A/c [3/11 of Rs. 44,000] 12,000

To B's Capital A/c [4/11 of Rs. 44,000] 16,000

To C's Capital A/c [4/11 of Rs. 44,000] 16,000

The remaining profits re-distributed as 3 : 4 : 4

4. Goodwill A/c Dr. 56,800

To A's Capital A/c [3/11 of Rs. 56,800] 15,490

To B's Capital A/c [4/11 of Rs. 56,800] 20,655

To C's Capital A/c [4/11 of Rs. 56,800] 20,655

5.

Fixtures A/c Dr. 2,780

To Revaluation A/c 2,780

Values of assets increased on revaluation

6. Revaluation A/c Dr. 1,870

To Provision for doubtful debts A/c 1,870

Provision created @ 2% on Debtors

7. Revaluation A/c Dr. 910

To A's Capital A/c 248

To B's Capital A/c 331

To C's Capital A/c 331

Profit on Revaluation shared among all partners as 3 : 4 : 4

7. A's Capital A/c Dr. 1,32,760

To A's Loan A/c 1,32,760

Transfer of A's dues to his Loan A/c

8. B's Capital A/c [3/5] Dr. 34,080

C's Capital A/c [2/5] Dr. 22,720

To Goodwill A/c 56,800

Goodwill Account written off

9.

Revaluation a/c Dr. 3,740

To Provision for doubtful debts A/c 3,740

Provision on debtors increased by 4% further on Rs. 93,500

10.

B's Capital A/c [3/5] Dr. 2,244

C's Capital A/c [2/5] Dr. 1,496

To Revaluation A/c 3,740

Loss on Revaluation

Section - 4 : Questions Related to Capital Adjustments

4.1

The Balance Sheet of Red, White and Yellow – sharing results in the ratio of their capitals is as follows:

Suppliers a/c	21,000	Buildings	1,00,000
General reserve	20,000	Plant and tools	50,000
Capitals :		Stock of inventory	18,000
Red	80,000	Debtors	20,000
White	40,000	Provision for doubtful debts	(1,000)
Yellow	40,000	Cash at bank	14,000

On that date White decided to retire from the firm and was paid for his share in the firm subject to the following:

1. Value of the building is estimated at Rs.1,20,000
2. Provision for doubtful debts is to be increased to 15% on total debtors.
3. An unrecorded bill of Rs.15,000 was settled for Rs.10,000
4. Goodwill of the firm was estimated at Rs.72,000.
5. Suppliers account was settled in full.
6. The capital of the firm was fixed at Rs.1,20,000

Prepare relevant accounts.

Solution:

Balance sheet			
Suppliers	-	Buildings 1,00,000 + 20,000	1,20,000
General reserve	-	Plant and tools	50,000
Capitals : R	80,000	Stock of inventory	18,000
Y	40,000	Debtors 20,000 less PFDD 1,000 + 2,000	17,000
W's loan a/c	65,000	Cash at bank	-
Bank overdraft	10,000		

4.2

The balance sheet of X,Y and Z sharing profits and losses in the ratio of 5:3:2 stood as follows as on 31.12.2021:

Capitals :		Cash at bank	40,000
X	40,000	Customers debts	80,000
Y	62,000	Stock	1,00,000
Z	33,000	Fixed assets	50,000
Undistributed profits	85,000	Advertisement expenditure	10,000
Employees provident fund	10,000		
Sundry creditors	50,000		

On this date X retired and Y and Z decide to share profits in the ratio of 2:3 hence forth.

It was decided to make the following adjustments at the time of retirement:

1. Goodwill is to be computed on the basis of two years purchase of last three years profits and losses. Profits of last three years were Rs.60,000, [25,000] and 85,000.
2. Fixed assets to shed down by 5%.
3. There are indications that some customers might not pay the amount. A five per cent margin is therefore needed.
4. A liability of 10,000 is settled at rupees 8,000 and this liability is included in the creditors.

5. Yet another liability in the form of an unrecorded bill of Rs.3,000 is settled at Rs.1,000.
6. In order to pay X, Y and Z are supposed to bring in such amount so that X is paid out his dues and at the same time their capitals become proportionate to their Profit sharing ratio and simultaneously a balance of Rs.15,000 finds place in the bank account.

Provide necessary accounting treatment for the above through ledger accounts.

Answer: loss 5500, final capital balances- Y:71,800, Z :107700 ,amount paid to X:89750

Capital adjustment –

Balances after adjustments Y 74,850 + Z 14,900 + amount required to pay X 89,750 = 1,79,500

New capital of Y = $1,79,500 \times 2 / 5 = 71,800$ and of Z $1,79,500 \times 3 / 5 = 1,07,700$

Amount paid to Y 3,050 and amount brought in by Z 92,800

Revaluation a/c			
Fixed Assets	2,500	Sundry creditors (Liab. of 10,000 settled at 8,000)	2,000
Margin for Customers debts	4,000		
U/R Liability	1,000		
		R/L Loss:	5,500
	7,500		7,500

Partner's Capital accounts							
	X	Y	Z		X	Y	Z
Adv. Exp.	5,000	3,000	2,000	Bal. b/d	40,000	62,000	33,000
R/L Loss	2,750	1,650	1,100	U. Profits	42,500	25,500	17,000
GW 2:3	-	32,000	48,000	GW 80,000	40,000	24,000	16,000
Balance c/d	1,14,750	74,850	14,900				
Cash	1,14,750	-		Bal. b/f	1,14,750	74,850	14,900
Cash - B.F	-	3,050	-	Cash - B.F	-	-	92,800
Bal. c/d - WN	-	71,800	1,07,700				

Balance sheet			
Capitals : Y	71,800	Cash 40,000 + 92,800 - 3,050 - 1,14,750	15,000
Z	1,07,700	Customers debts	76,000
EPF	10,000	Stock	1,00,000
S/C 50,000 - 2,000	48,000	Fixed Assets	47,500
U/R Liability	1,000		

Section – 5: Past Adjustments

5.1

The following is the Balance Sheet of A, B and C who were equal partners. On 31.12.2021 their position statement stood as follows:

A' capital	33,600	Plant and machinery at cost	49,000
B' capital	25,200	Furniture	4,800

C' capital	12,000	Stock in trade	22,800
10% Mortgage loan	12,000	Sundry debtors	21,600
Sundry creditors	16,600	Cash in hand	1,200

On 1.1.2022, C retired from the business and claimed his share in the secret reserve/profit arising out of the following-

1. During the year 2020, purchase of Machinery at cost of Rs.5,000 was charged to Purchases account, the installation charges of Rs.300 to erect the machinery, being charged to machinery repairs account.
2. Rs.1,200 received from a debtor towards rent of property sublet, was credited to his personal account, instead of rent account, so as to reduce his debit balance from Rs.1,600 to Rs.400 debit
3. Interest on loan was paid up to 31.12.2021, and the whole amount was charged to interest account in 2020.
4. After rectifying the above, it was decided –
5. The goodwill of the firm be valued at three times the average profits of the last three years .Such profits should be the correct profits and not the book profits. The book profits for the last three years were: 2019- Rs. 13,830, 2020- Rs. 32,000 and 2021- Rs. 12,010.
6. Machinery be depreciated by 10% and the provision for doubtful debts be made at 5% on debtors.
7. The goodwill account should appear in the books to the extent of retiring partner's share therein.
8. C should be paid half of his dues in cash which shall be brought in by A and B in their profit sharing ratio and the other half shall be left in the business as C's loan fetching 15% interest.

Prepare C's capital account, Profit and Loss Adjustment A/c and the Balance Sheet of A and B after C's retirement.

Detailed Solution:

Step one

Rectification Entries

1	A :	Correct	Machinery a/c	5,000
			To bank	5,000
		Wrong	Purchases a/c	5,000
			To bank a/c	5,000
		Rectifying	Machinery	5,000
			To Purchases (P&L)	5,000
1.	B	Correct	Machinery	300
			To bank	300
		Wrong	Repair	300
			To bank	300
		Rectifying	Machinery	300
			To repair - P&L	300
2.		Correct	Cash	1,200

			To rent	1,200
		Wrong	Cash	1,200
			To Debtors	1,200
		Rectifying	Debtors	1,200
			To P&L a/c	1,200
3.		Correct	Interest (2020)	1,200
			Prepaid interest (2021)	1,200
			To bank	2,400
		Wrong	Interest (05)	1,200
			Interest (06)	1,200
			To bank	2,400
		Rectifying	Prepaid Interest	1,200
			Interest –P&L	1,200

Step two

Profit and loss adjustment account

Profit t/f to		Machinery	5,000
A : 2,567, B: 2,567, C: 2,566	7,700	Machinery	300
		Debtors a/c	1,200
		Prepaid Interest	1,200

Step Three

Revaluation account

Depreciation on machinery 10% of 49,000 + 5,300	5,430	Loss transferred to :	
Provision for D/D : 5% of 21,600 + 1,200	1,140	A 2,190	
		B 2,190	
		C 2,190	6,570

Step four :

Goodwill valuation :

$$\frac{13,830 + 32,000 + 12,010 + 7,700}{3} \times 3 = 65,540$$

$$C's \text{ share} = 65,540 \times \frac{1}{3} = 21,847$$

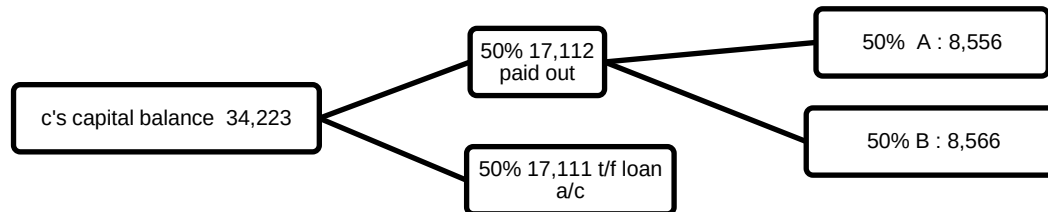
Entry :

Goodwill a/c 21,847

To C a/c 21,847

Step : five

Partner's Capital accounts							
	A	B	C		A	B	C
R/L	2,190	2,190	2,190	b/d	33,600	25,200	12,000
Loan	-	-	17,111 #	P&L adj.	2,567	2,567	2,566
Cash	-	-	17,112 #	G.W.	-	-	21,847
c/d	42,533	34,133	-	Cash #	8,550	8,556	



Balance sheet			
Capital A	42,533	Plant and machinery	49,000 + 5,300 – 5,430
Capital B	34,133	Furniture	4,800
C's loan @ 15%	17,111	Stock in trade	22,800
10% M. loan	12,000	Debtors	21,600 + 1,200 - 1,140
Sundry creditors	16,600	Cash	1,200 + 8,556 + 8,556 - 17,112
		Goodwill	21,847

Section – 6: Retirement cum Admission of a Partner

6.1

X, Y, & Z were equal partners. Their Balance Sheet as on 31.12.22 was as follows :

Balance sheet			
Partners' Capital		L/B	1,00,000
X	1,00,000	P/M	2,00,000
Y	1,00,000	F/E	50,000
Z	2,00,000	SIT	1,00,000
Partner's Current A/c :		Sundry Debtors	1,00,000
X	50,000	Bank Balance	1,50,000
Y	75,000		
Z	25,000		
Sundry Creditors	1,50,000		
	7,00,000		7,00,000

On 1.1.23 X retired and it was agreed that he should be paid all his dues in full on that date. For this purpose, goodwill was to be calculated on the basis of 3 years purchase of past 3 years profits which amounted to Rs. 1,00,000, Rs. 1,40,000 and Rs. 1,20,000 respectively.

In order to meet his obligation, a bank loan was arranged on 1.1.23 for Rs. 2,00,000 pledging the fixed assets as security.

Further, to compensate a loyal manager Q, it was agreed between Y and Z that Q should be admitted as a partner, who should bring in, over and above a capital of Rs. 1,00,000, his share of Goodwill in cash to serve as working capital.

Y and Z agreed to forego 1/3rd of their individual share of profits to Q.

Prepare the opening Balance Sheet of the firm as on 1.1.23.

Solution:

Working Notes:

(1) Valuation of Goodwill

Average Annual Profits =

1,00,000 1,40,000 1,20,000

3

= Rs. 1,20,000

Goodwill = 3 × 1,20,000 = Rs. 3,60,000

Journal Entries

a. GW a/c Dr. 3,60,000

X 'Current A/c Dr. 1,20,000

Y's Current A/c Dr. 1,20,000

Z's Current A/c Dr. 1,20,000

(Being goodwill credited against existing partners Y & Z in their gaining ratio 1:1:1)

b. Y's Current A/c Dr. 1,80,000

Z's Current A/c Dr. 1,80,000

To GW 3,60,000

NR 1:1

c. Bank a/c Dr. 2,00,000

To Loan a/c 2,00,000

Loan raised on security of FA

d. Cash A/c Dr. 1,00,000

To Q's Capital A/c 1,00,000

Capital contributed by C

e. Cash A/c Dr. 1,20,000

To Premium for goodwill a/c 1,20,000

f. Premium for GW a/c Dr. 1,20,000

To Y's Current A/c 60,000

To Z's Current A/c 60,000

Being Q's share of premium for goodwill share between Y & Z in their sacrificing ratio

Capital Accounts

	X	Y	Z	Q
By Balance b/d	1,00,000	1,00,000	2,00,000	-
By X's Current a/c	1,70,000	*-	-	-
Cash – capital introduced				1,00,000
Total	2,70,000	1,00,000	2,00,000	1,00,000
To cash – Final Settlement	2,70,000			

To balance c/d	-	1,00,000	2,00,000	1,00,000
Total	2,70,000	1,00,000	2,00,000	1,00,000

Current Accounts

Credit	X	Y	Z
By Balance b/d	50,000	75,000	25,000
By GW	1,20,000	1,20,000	1,20,000
By PFGW	-	60,000	60,000
Total	1,70,000	2,55,000	2,05,000
GW	-	1,80,000	1,80,000
X's Capital a/c	1,70,000	-	-
Bal. c/d - B.F.	-	75,000	25,000
Total	1,70,000	2,55,000	2,05,000

Bank a/c

Bal b/d	1,50,000	X's Capital a/c	2,70,000
Bank Loan a/c	2,00,000	Bal. c/d	3,00,000
Cash a/c – premium for GW	1,20,000		
Q's Capital a/c	1,00,000		
	6,70,000		6,70,000

Balance sheet

Capitals		L/B	1,00,000
Y	1,00,000	P/M	2,00,000
Z	2,00,000	F / Equipments	50,000
Q	1,00,000	Stock	1,00,000
Current A/c:		Debtors	1,00,000
Y	75,000	Bank balance	3,00,000
Z	25,000		
Bank Loan (secured)	2,00,000		
Sundry Creditors	1,50,000		
	8,50,000		8,50,000

6.2

X,Y and Z are partners sharing profits and losses in the proportion to 3:2:2, respectively. The Balance Sheet of the firm as on 01.01.2023 was as follows:

Capitals		P/M	72,000
X	1,00,000	F/F	28,000
Y	80,000		
Z	70,000	Stock	1,12,000
Bank overdraft	20,000	Debtors	96,000
S/ Creditors	56,000	Cash at bank	18,000
	3,26,000		3,26,000

X retired on 01.01.2023 on which date R is admitted as new partner. For the purpose of adjusting the rights as on partners' goodwill to be valued at Rs. 84,000 and Sundry Debtors and Stock to be reduced by Rs. 16,000 to Rs. 1,00,000 respectively.

X is to receive Rs. 44,000 in cash on the date of retirement and the balance due to him is to remain as loan at 8% p.a.

Repayment of loan to be made at the end of each year by annual installments representing 25% of the future profit before charging interest on loan.

R is to bring in Rs. 1,00,000 in cash as his capital on the date of admission. The new partners are to share profits and losses equally after paying the interest on X's Loan.

The net profit for the year ended 31st December 2023, is Rs. 64,000 before taking into account the installment payable

X.

You are required to show:

- (a) Profit and Loss Appropriation Account for the year ended 31st December, 2022.
- (b) Capital Accounts of the new partners; and
- (c) X's Loan Account as on 31st Dec, 2023.

Detailed Solution :

Entries:

a.	Goodwill a/c	84,000	
	To X		36,000
	To Y		24,000
	To Z		24,000
	3:2:2		
b.	Y	28,000	
	Z	28,000	
	R	28,000	
	To GW		84,000
	1:1:1		
		28,000	
c.	RL		16,000
	To Debtors		12,000
	To Stock		
	Loss on R/L		
d.	X	12,000	
	Y	8,000	
	Z	8,000	
	To RL		28,000
	3:2:2		
e.	X	44,000	
	To Cash		44,000

Profit and Loss Appropriation a/c as at 31.12.23

Loan Fund 25% x 64,000	16,000	Net Profit	64,000
Interest 8% on 80,000	6,400		
To Profit :			
Y 13,867			
Z 13,867			

R 13,866	41,600	
	64,000	64,000

Capital Accounts

	X	Y	Z		X	Y	Z
GW	-	28,000	28,000	Bal. b/d	1,00,000	80,000	70,000
RL Loss	12,000	8,000	8,000	GW	36,000	24,000	24,000
Cash	44,000						
X loan B.F	80,000						
Bal. c/d : B. F	-	68,000	58,000				
				Bal. b/d		68,000	58,000
Bal. c/d - B.F.		81,867	71,867	PL Appropriation a/c		13,867	13,867

R Capital a/c

RL	28,000	Cash	1,00,000
Bal. c/d - BF	85,866	PL Appropriation a/c	13,866

X' Loan Account

Bank : 16,000 + 6,400	22,400	Bal. b/d	80,000
Bal. c/d - BF	64,000	PL Appropriation a/c - Interest	6,400

6.3

Gita and Mita are equal partners. Gita , by agreement, retires and Lata joins the firm on the basis of one third share of profits on 01.04.2013. The balances of the books as on 31st March 2013 were:

Capitals		GW	10,000
Gita	1,04,000	Fixed assets at cost	1,20,000
Mita	1,02,000	Current Assets:	
Provision for Depreciation	12,000	Stock	60,000
Creditors	20,000	Debtors	40,000
		Cash at bank	8000
	2,38,000		2,38,000

Goodwill and Fixed Assets valued at Rs. 30,000 and Rs. 1,40,000 respectively and it was agreed to be written up accordingly before admission of Lata as partner. Sufficient money is to be introduced so as to enable Gita to be paid off and leave Rs. 5,000 cash at Bank; Mita and Lata are to provide such sum as to make their Capitals proportionate to their share of profit. Assuming the agreement was carried out, show the journal entries required and prepare the Balance Sheet after admission of Lata.

All working should form part of your answer.

Detailed Hints

Entries:

a.	Goodwill a/c	30,000	
	To		15,000
	M		15,000

	SR 1:1		
b.	M	20,000	
	L	10,000	
	To GW		30,000
c.	Fixed Asset	32,000	
	To RL		32,000
	1,20,000 - 12,000 = 1,08,000 -----1,40,000		
d.	R/L	32,000	
	To G		16,000
	To M		16,000

Capital Accounts

	G	M	L		G	M	L
GW as per BS	5,000	5,000	-	Bal. b/d	1,04,000	1,02,000	-
GW	-	20,000	10,000	GW	15,000	15,000	-
Bal. c/d	1,30,000	1,08,000	-	RL	16,000	16,000	-
				Bal. c/d	-	-	10,000
bal. b/d	-	-	10,000	Bal. b/d	1,30,000	1,08,000	-
cash BF	1,30,000	-	-	Cash - BF	-	42,000	85,000
Bal. c/d : WN	-	1,50,000	75,000				

Capital Adjustments :

New Firm Capital :

GW	-	
FA	1,20,000 - Prov. For Dep. 12,000 + appreciation 32,000	1,40,000
Stock		60,000
Debtors		40,000
Cash at bank		5,000
		2,45,000
Less:	Creditors	20,000
		2,25,000
M Capital	2,25,000 x 2/3	1,50,000
L Capital	2,25,000 x 1/3	75,000

Section – 7 : App. of Section - 37

7.1

X, Y and Z are partners sharing profits and losses equally. On 1.12.2020, Z retired from the partnership firm. The capitals of the partners, after all necessary adjustments stood at Rs. 45,000, Rs. 75,000 and Rs. 50,000 respectively.

X and Y continued to carry on the business without settling the accounts of Z. final payment to Z made on 1st March, 2020. The partnership firm made profits amounting to Rs. 30,000 during the period from 1st 12. 2020 to 29th Feb, 2020.

What are the rights of Z to share subsequent profit as per provisions of section 37 of the Indian Partnership Act?

Solution:

Unsettled capital of C Rs.50,000 (Date of retirement : 1.12.19).

Net Profit earned by the firm after C's retirement Rs.30,000.

Capitals of X:Rs.45,000 and Y Rs.75,000

C is entitled to the maximum of the following :

(i) interest on unsettled capital = $\text{Rs.}50,000 \times 6\% \times 2 \text{ months} = \text{Rs.}1,560$

(ii) Profit earned out of unsettled capital = $\text{Profit} \times \frac{\text{Retired or Deceased Partner's unsettled Dues}}{\text{Total Capital of the firm (including the amount due to the retired or deceased partner)}}$

$= \text{Rs. } 30,000 \times \frac{50,000}{\text{Rs.}45,000 + 75,000 + 50,000}$

$\text{Rs.}45,000 + 75,000 + 50,000 = \text{Rs.}8,823$

Sanjay Welkins' Classes

Death of Partner

Chapter Crux:

Accounting problems which arise on the death of a partner are similar to those arising on retirement of a partner. Only difference is that death being a natural phenomena could take place at any point of time where as in case of retirement, retiring partner could be persuaded to retire on the accounting date. On the date of death, deceased partner's capital account is prepared and it is credited with his capital balance existing as per last balance sheet, share of reserve fund, general reserve, profit and loss a/c credit balance and debited with any Goodwill and deferred expenditure appearing on the assets side of the balance sheet. Further if any revaluation is made on the date of balance sheet then result of such revaluation is also posted to the deceased partner's capital account. If partnership deed provides for any Interest on capital, salary, commission the such dues shall also be posted to the credit side of deceased partner's capital account. If any drawings had been made between last balance sheet date to the date of death then same is also, along with interest on drawings if any, shall be debited to the deceased partner's capital account. Since death could occur any time during the accounting year, main problem arises with respect to determination of profits earned by the Firm during the inter-alia period that is between date of last balance sheet and date of death. In order to determine such profits, either average of profits of earlier years is taken as base or simply profits of last year is taken as the base.

1. Total Amount Payable

If a partner dies, the partnership is usually dissolved. But if the surviving partners desire so, they may purchase the share of the deceased partner and carry on the business. In that case they have to decide (1) the total amount payable to the legal representative or executor of the deceased partner and (2) the mode of such payment.

Total Amount Payable includes:

- (i) The deceased partner's Capital and / Current Accounts last Balance.
- (ii) His share of undistributed profit/loss.
- (iii) His share of revaluation profit/loss (iv) his share of goodwill.
- (v) His share of Joint Life Policy, if any and
- (vi) His share of profit/loss made by the firm between the last year ending and the date of his death.

2. The Accounting Procedure

The accounting procedure involved is similar to that followed in case of retirement of a partner.

The mode of payment depends on the agreement between the partners. It may be:

(i) Lump Sum Payment : If the firm has sufficient funds, the total amount payable on account of the deceased partner is transferred to his Representative's Account (or Executor).

Such Representative's Account is debited and Bank Account is credited on payment of the dues.

(ii) Instalment Payment/Loan Payment : The firm may not have enough funds to make prompt payment. In such a case, the total amount payable is transferred to a loan account in the name of the legal representative or executor. The loan is paid off gradually by instalments after considering interest on unpaid balance. The word "Loan" may or may not be appended with the Account. But its gradual payment will definitely resemble the payment of loan.

3. Joint Life Policy and its Treatment

The partners of a firm may have a Joint Life Policy covering the lives of all the partners. It helps to realize money from the Insurance Company in case of death of a partner. The dues of the deceased partner can be paid off without affecting the working capital of the firm.

The policy matures when a partner dies. The money realized from the Insurance Company is distributed among all the partners, including the deceased partner.

Section - 1 Preparation of Deceased Partners Executor 's Account

1.1

Friday, Saturday and Sunday were partners in a firm sharing profits and losses in the ratio of 5:3:2. On 31.3.2020 their balance sheet was as under:

Liabilities	Rs.	Assets	Rs.
Sundry creditors	1,55,000	Goodwill	25,000
Workmen compensation reserve	10,000	Leaseholds	1,00,000
Reserve fund	20,000	Patents	30,000
Capital A/cs		Machinery	1,50,000
Friday	1,50,000	Stock	50,000
Saturday	1,25,000	Sundry debtors	1,40,000
Sunday	75,000	Cash at bank	40,000
	5,35,000		5,35,000

Sunday died on 1.8.2020 and partnership deed provided the following:

1. Goodwill to be valued at 2.5 years' purchase of the average profits of the previous 4 years, which were Rs. 65,000, Rs. 60,000, Rs. 80,000 and Rs. 75,000
2. Patents be valued at Rs. 40,000, machinery at Rs. 1,40,000, leaseholds at Rs. 1,25,000
3. For the purpose of computing Sunday's share in the profits 2017-18, the profits in 2019-20 should be taken as base.
4. A sum of Rs. 21,000 to be paid immediately to the executors of Sunday and the balance to be paid in four equal half- yearly instalments together with interest @ 10 per cent per annum.

Find out the amount payable to the executors of deceased partner's executors.

Answer – balance in Sunday capital a/c - 121,000 and amount due to Sunday's executor's a/c as on 1.8.2017 Rs. 1,00,000

Solution :

Basic analysis :

Last balance sheet date 31.3.17

Date of death 1.8.17

Current year period 1.4.17 -1.8.3.17 that is 4 months

Note one : Goodwill = $\frac{65,000 + 60,000 + 80,000 + 75,000}{4 \text{ years}} \times 2.5 \text{ years} = 1,75,000$

Note two :

Calculation of Revaluation Result ;

Patents + 10,000

Machinery – 10,000

Leaseholds +25,000

= net gain 25,000

Note three:

Calculation of current period's profit :

Profits for last year 75,000

Therefore current 4 month's profits = $75,000 \times 4/12 = 25,000$

Note four :

Calculation of amount payable to deceased partners executors :

Sunday's Capital account

G.W. of B. Sheet $25,000 \times 2/10$	5,000	b/d	75,000
Balance t/f to Sunday's Executor's a/c	1,21,000	WCR $10,000 \times 2/10$	2,000
		Reserve fund $20,000 \times 2/10$	4,000
		G. W $1,75,000 \times 2/10$	35,000
		Revaluation profit $25,000 \times 2/10$	5,000
		Profit and loss suspense a/c that is share in current year's profit : $25,000 \times 2/10$	5,000

Sunday's Executor's a/c

Cash	21,000	Capital a/c	1,21,000
Balance c/d	1,00,000		

Section – 2 – Comprehensive Questions

2.1

River, Canal and Sea are partners sharing profits equally. Sea died on 31.3.2020. The balance sheet of the firm on 31.12.2019 stood as follows -

Liabilities	Rs.	Assets	Rs.
Sundry creditors	33,250	Cash	2,500
Contingency reserve	9,000	Bank	10,000
Investment fluctuation fund	3,000	Debtors 25,000	
Capital A/cs		Less provision for D/D <u>2,000</u>	23,000
River	75,000	Stock	25,000
Canal	50,000	Investments at cost	12,500
Sea	50,000	Land and buildings	1,00,000
		Goodwill	47,250
	2,20,250		2,20,250

In order to arrive at the balance due to Sea it was mutually agreed that:

1. Land and buildings be valued at Rs. 1,25,000
2. Investment fluctuation fund be brought up to Rs. 1,350
3. Debtors were all good, no provision is required
4. Stocks are valued at Rs. 23,500
5. Goodwill to be valued at one year's purchase of the average profits of the past five years.
6. Sea's share of profits to the date of death to be calculated on the basis of average profits of the preceding five years.
7. The profits of the last preceding five years were as under

28,750
35,000
22,500
20,000
25,000

Prepare revaluation a/c, partner's capital account and the balance sheet of the new firm as on 31.3.2007.

Answers-

hints- transfer provision for D/D to the credit side of Revaluation a/c ; transfer gain on IFF to partners capital account ; Sea's share of profit in the current year's profit up to the date of death – $26,250 \times \frac{3}{12} = 6,562.50$ x $\frac{1}{3} = 2,187.50$; firm's goodwill 26,250

Profit on revaluation Rs. 25,500

Capital balances – 66,925 / 41,925

Amount due to executor's of Sea – Rs. 57,237.50

Balance sheet total – Rs. 2,00,687.50

Revaluation a/c

Stock	1,500	Land	25,000
Profit :		Provision for D/D*	2,000
R : 8,500			
C : 8,500			
S : 8,500	25,500		

* alternatively can be credited directly to partners capital a/c

Capital accounts

	R	C	S		R	C	S
G.W. B/S	15,750	15,750	15,750	b/d	75,000	50,000	50,000
G.W. W/off	13,125	13,125	-	Cap. Reserve	3,000	3,000	3,000
c/d	66,925	41,925		I.F.F : 1,650	550	550	550
Exec. a/c	-	-	57,237.50	R/L	8,500	8,500	8,500
				G.W.	8,750	8,750	8,750
				P&L Susp. a/c	-	-	2,187.50

Balance sheet

I.F.F [Remaining Balance]	1,350	Cash	2,500
Sundry creditors	33,250	Bank	10,000
Capital of R	66,925	Debtors	25,000
Capital of C	41,925	Stock	23,500
S's Executor's a/c	57,237.50	Investments	12,500
		Land and buildings	1,25,000
		P&L Suspense a/c	2,187.50

Goodwill of firm = 26,250

Calculation of Sea's Share of Current Year's profit

Average profits of last 5 years = 26,250

3 months profits :

$26,250 \times \frac{3}{12} = 6,562.50$

Sea,s share $6562.50 \times \frac{1}{3} = 2,187.50$

Profit and loss suspense a/c

To Sea's a/c a/c

2.2

A, B and C were partners of a firm sharing profits and losses in the ratio of 3:4:3. The Balance Sheet of the firm as on 31.3.2020 was as under –

Capital accounts-		Fixed assets –	100,000
A	48,000	Current assets-	-
B	64,000	Stock	30,000
C	48,000	Debtors	60,000
Reserve	20,000	Balance at bank	30,000
creditors	40,000		

Partner C died on 30th September, 2020.

It was agreed between the surviving partners and the legal representatives of C that:

Goodwill of the firm will be taken at Rs. 60,000.

Fixed assets will be written down by Rs.20,000.

In lieu of profits, C should be paid at the rate of 25% per annum on his capital as on 31.3.2020.

The profits for the year ended 31.3.2021 after charging depreciation of Rs.10,000 [depreciation up to 30.9.2020 was agreed to be Rs.6,000] were Rs.48,000.

Policy money was received and the legal heirs were paid off.

Drawings accounts of the partners reflected following balances as under-

- a. A 18,000 drawn evenly over the year
- b. B 24,000 drawn evenly over the year
- c. C 20,000 up to the date of death

On the basis of the above figures please indicate the entitlement of the legal heirs of C.

Answers- capital balances after six months : A-64286 / B- 85714 / C- 52000, option exercised u/s 37 Rs.6,436

Section – 3 – Applicability of Section 37

3.1

Discuss the applicability of Section 37 of the Partnership Act :

In case of retirement, the retiring partner or in case of death, the executor of the deceased partner, if the dues are not settled, then such retired partner or the executor is entitled to the following :

Maximum of :

Interest @ 6% p.a. on the amount due to them(i.e. if the amount is unsettled, like, rate of interest on loan to be allowed to the retired partner or the executor is not mentioned)

Or

The share of profit earned for the amount due to the partner

Conditions:

- (a) The surviving partners/continuing partners continue to carry on the business of the firm.
- (b) The business is carried on without any final settlement of accounts between the continuing partners and the outgoing partners or his estate.
- (c) There is no contract to the contrary of the options contained in Section 37 i.e. share in the profits or

interest @ 6% p.a. on the unsettled capital.

Example: Unsettled capital of C Rs.52,000 (Date of retirement : 30.9.18, financial year 2018-19). Net Profit earned by the firm after C's retirement Rs.25,000. Capitals of A:Rs.57,000 and B Rs.76,000)

C is entitled to the maximum of the following :

(i) interest on unsettled capital = Rs.52,000 x 6% x 6 months = Rs.1,560

(ii) Profit earned out of unsettled capital = Profit x Retired or Deceased Partner's unsettled Dues/Total Capital of the firm(including the amount due to the retired or deceased partner)

= Rs.(25,000 x 52,000) / (Rs.52,000 + 57,000 + 76,000) = Rs.7,027.

Sanjay Welkins' Classes

Chapter - 14: Part - B

Partnership - Part - II

Dissolution of Partnership Firms

1. Preface

It's the last stage of partnership firm. In this case business of the firm comes to an end and relationship between or among the partners gets ceased.

2. Circumstances in which firm gets dissolved

1. On account of agreement- firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners.
2. Dissolution by notice- A firm may get dissolved if any partner gives notice in writing to all the other partners of his intention to dissolve the firm provided partnership is at will.
3. Compulsory dissolution – a firm gets compulsorily dissolved if a) all the partners except one are insolvent or b) the business of partnership has become illegal.

4. Dissolution by court-

firm may get closed down on account any of the following reasons, if any partner moves court

- When a partner has become of unsound mind or has become insane
- When a partner has become permanently incapable of performing his duties or carrying out his responsibilities.
- When a partner is found guilty of misconduct
- When a partner will fully and persistently commits breach of agreement regarding management of the affairs of the firm
- When a partner has transferred whole of his interest to a third party.
- When the business of the firm cannot be carried on except at a loss.
- When in the opinion of the court any such ground which may render it just and equitable that firm should ordered down to close the business.

5. Other reasons

A firm may get dissolved if term for which the firm was formed gets expired. Further a firm a firm gets closed also when purpose for which it was formed gets completed. Likewise, firm could get closed when a partner dies or when a particular partner is declared as insolvent.

3. Difference between dissolution of partnership and dissolution of firm

Dissolution of partnership	Dissolution of a firm
A partnership gets dissolved when a new partner is admitted or when a partner dies or when a partner retires.	A firm is dissolved by the partnership mutually or by the court.
In this case business of the firm continues – that is it does not get terminated.	In this case all activities come to an end that is business gets terminated.
In this revaluation of assets and liabilities is done and a new balance sheet is drawn.	In this case assets are realised and liabilities are paid off along with amount due to partners.
	Under this case Realisation account is prepared to

Under it Revaluation account is prepared to arrive at net profit or loss. It results in a new partnership.	know the result of dissolution. It will not result in any new partnership.

4. Provisions of section 48

This section deals with settlement of various accounts at the time of dissolution- it provides that-

1. Losses including deficiencies of capital are to be paid in the following manner:

- Firstly out of profits
- Then out of capital
- Finally by partners individually in their profit sharing ratio.

2. The assets of the firm including any sum contributed by the partners to make up the deficiency of capital shall be applied in the following manner and order-

- In paying the debts of the firm to a third party
- In paying to each partner rateably what is due to him on account of advances
- In paying to each partner rateably what is due to him on account of capital
- The balance, if any, shall be divided among the partners in their profit sharing ratio.

5. Accounting treatment

5.1. Open

- Realisation account
- Capital accounts of the partners
- Cash/ bank account.

5.2. Transfer all assets to the debit side of realisation account. However any debit balance of profit and loss account or partner's capital account or current account or any suspense account should be transferred to the debit side of partner's capital account. Any debit balance of partners loan account should be transferred to the debit side of cash account.

5.3. After having transferred the entire Assets side properly now move the Liabilities side. Transfer all real liabilities [sundry creditors, bills payable, outstanding expenses, bank overdraft, advance income, provision for tax, provident fund, gratuity, workmen profit sharing fund bank loan, partners wife's loan etc.] to the credit side of realisation account.

5.4. Transfer all specific reserves [provision for doubtful debts, provision for depreciation, joint life policy reserve or fund, stock reserve, investment fluctuation fund, assets revaluation reserve etc.] to the credit side of realisation account

5.5. Transfer all free reserve [profit and loss account credit balance, general reserve a/c, reserve fund a/c, workmen compensation fund to the extent which is free] to the credit side of partner's capital account.

5.6. Transfer partner's capital account, current account, drawings account to the credit side of partner's capital account.

(there is no point in opening current separately as ultimately balances in these accounts shall have to be transferred to capital accounts)

5.7. Transfer partner's loan account to the credit side of cash account.

5.8. After having posted all the items of the balance sheet at proper places next step is to realise the assets:

When assets are sold for cash- entry will be

Cash account debit

To, realisation account

When assets are taken away by any partner then entry will be-

Partner's capital account debit

To realisation account

When any asset is given to settle the claim of a liability then no entry shall be made.

5.9. After realising the assets next step is to repay the liabilities [only real liabilities- specific reserves are not liabilities].

When liability is discharge by Firm then entry shall be

Realisation account debit

To Cash account

When any partner agrees to discharge the liability then entry will be

Realisation account debit

To partner's capital account

5.10. When Dissolution Expenses are paid by Firm then entry shall be

Realisation account debit

To cash account

When partner agrees to bear the realisation expenses then entry will be

Realisation account debit

To partners capital account

Often a partner is bestowed upon with task of dissolution process against some agreed remuneration or salary or commission in that case entry shall be

Realisation account debit [with the amount of salary/commission/ remuneration]

To partners capital account

Actual expenses in this case should be either ignored or may be treated with following entry

Partner's capital account debit

To cash account

5.11. If there is any unrecorded asset then realise it as per step four. Likewise if there is any unrecorded liability then repay it as per step five.

5.12. Now close the realisation account and transfer the loss or profit to the partner's capital account.

Now close the partner's capital account.

Now balance cash/ bank account. It shall automatically get tallied.

6. Garner versus Murray

When a partner is not in a position to pay his debts due to firm he is said to be insolvent. In this case deficiency arising shall be borne in accordance with famous English case of Garner versus Murray. Salient features of this case are as follows-

1. loss due to deficiency is a capital loss
2. Such loss shall have to borne by solvent partners [only those solvent partners whose initial capital balances are credit balances].
3. Before bearing the deficiency the solvent partners shall bring in their share of realisation losses.

Note:

Since this is mere a paper entry questions in this book have been solved without considering this point.

7. Dissolution before expiry of a fixed term

A partner who, on admission, pays a premium to the other partners with a stipulation that the firm will not be dissolved before the expiry of a certain term, will be entitled to a suitable refund of premium or of such part as may be reasonable, if the firm is dissolved before the term has expired.

No claim in this respect will arise if:

- (1) the firm is dissolved due to the death of a partner;
- (2) the dissolution is mainly due to the partner's (claiming refund) own misconduct; and
- (3) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

The amount to be repaid will be such as is reasonable having regard to the terms upon which the admission was made and to the length of period agreed upon and that already expired. Any amount that becomes due will be borne by other partners in their profit-sharing ratio.

8. Insolvency of a Partner

If the capital account of a partner is in debit, after his share of loss or profit has been adjusted therein, the firm will not have sufficient cash or assets to pay off the amounts due to the other partners, until the amount is repaid by the partner whose account is in debit. If however, the partner is insolvent, the amount will not be realised. In such a case, the deficiency may be borne by the solvent partners in their profit-sharing ratio or according to the principle settled in the well known case of Garner vs. Murray. In the latter case, the deficiency would be borne by the solvent partners in proportion to their capitals and not in the proportion in which they share profits and losses. If a partner goes insolvent then the following are the consequences:

1. The partner adjudicated as insolvent ceases to be a partner on the date on which the order of adjudication is made.
2. The firm is dissolved on the date of the order of adjudication unless there is a contract to the contrary.
3. The estate of the insolvent partner is not liable for any act of the firm after the date of the order of adjudication, and
4. The firm cannot be held liable for any acts of the insolvent partner after the date of the order of adjudication.

9. Loss Arising From Insolvency Of A Partner

When a partner is unable to pay his debt due to the firm he is said to be insolvent and the share of loss is to be borne by other solvent partners in accordance with the decision in the English case of Garner vs. Murray.

According to this decision, solvent partners have to bear the loss due to insolvency of a partner loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.

9.1. Capital Ratio

If they are maintaining capitals at fixed amounts then all adjustments regarding their share of profits, interest on capitals, drawings, interest on drawings, salary etc. are done through Current Accounts, which may have debit or credit balances and insolvency loss is distributed in the ratio of fixed capitals.

9.2. But if capitals are not fixed and all transactions relating to drawings, profits, interest, etc., are passed through Capital Accounts then Balance Sheet of the business should not exhibit Current Accounts of the partners and capital ratio will be determined after adjusting all the reserves and accumulated profits to the date of dissolution, all drawings to the date of dissolution, all interest on capitals and on drawings to the date of dissolution but before adjusting profit or loss on Realisation Account.

9.3 If some partner is having a debit balance in his Capital Account and is not insolvent then he cannot be called upon to bear loss on account of the insolvency of other partner.

10. Insolvency of all Partners

Clear Insolvency : When all partners are insolvent

Unclear Insolvency: When all, but one partner, are insolvent

10.1 Clear Insolvency

Prepare

Realisation account

Cash account

Sundry liabilities account

Partners capital account

Deficiency account

And close in the aforementioned order.

Deficiency account shall automatically get closed

10.2 Unclear Insolvency

Prepare

Realisation account

Cash account

Partners capital accounts

Deficiency account

Creditors should be paid only the amount available including the amount contributed by the partners

Illustrative Question Bank

Section – 1 - Simple Dissolution

1.1 - Examination Problem

A, B, and C are in partnership and sharing profits and losses in the ratio of 7:7:4. On 31.03.2021, it was found that some frauds were committed by C during the year 2020-21, so, it was decided to dissolve the partnership on 31st March 2021 when their balance sheet was as under:

Details	Amount	
Capitals :		
A	1,80,000	
B	1,80,000	
C	-	
General Reserve	36,000	
Trade creditors	80,000	
Bills payable	30,000	
	5,06,000	
Assets:		
Buildings	1,90,000	
Inventory	1,30,000	
Investments	50,000	
Debtors	70,000	
Cash and Bank	26,000	
C' Capital Account	40,000	
	5,06,000	

1. Following frauds were committed by C:

- A cheque for Rs. 7,000 received from debtor was not recorded in books and was misappropriated by C

- Investments costing Rs. 8,000 were sold by C at Rs. 11,000 and the funds transferred to his personal account. This sale was omitted from the firm's books.
2. A creditor agreed to take over investments of the book value of Rs. 9,000 at Rs. 13,000. The rest of the creditors were paid off at a discount of 10%.
3. The other assets realised as follows:
- Building: 110 % of book value
 - Inventory: Rs. 1,20,000
 - Investments: the rest of investments were sold at a profit of Rs. 7,000
 - Debtors: the rest of the debtors were realised at a discount of 10%
 - The bills payable were settled at a discount of Rs. 500
 - The expenses of dissolution amounted Rs. 8,060
 - It was found out that realisation from C,s private assets would only be Rs. 7,000

Prepare the necessary ledger accounts.

Answers: Profit Rs. 15,840 : 6,160, 6,160 & 3,520

Deficiency of C = Rs. 39,480 (19,740, 19,740)

Final payments to A 1,80,420 B 1,80,420

Hints :

C's Capital a/c Dr. 18,000

Realisation a/c 18,000

For Investments and Debtors

Assets Realised 4,25,700

Amount paid to creditors (80,000 - 13,000) x 90% = 60,300

1.2 - Examination Problem

A, and B are in partnership and sharing profits and losses equally. On 31.03.2024 their balance sheet was as under:

Liabilities	Amount	
Capitals :		
A	1,10,000	
B	90,000	
Employees Provident Fund - EPF	30,000	
Investment Fluctuation Fund - IFF	10,000	
Creditors	1,00,000	
Bank's Loan	50,000	
	3,90,000	
Assets		
Machinery	1,10,000	
L/B	40,000	
Investments	90,000	
Stock	60,000	
Debtors 80,000 - Provision 2,000	78,000	
Bank	12,000	
	3,90,000	

The firm was dissolved on the above date and the assets and liabilities were settled as follows: Stock was sold at 25% less than the book value and the machinery realised 20% more than the book value/ Debtors of Rs. 10,000 proved bad and rest paid the amount due. A typewriter , which was fully depreciated , is now valued at Rs. 3,000 and is taken over by A at this value. B took over 40% of the investments at 15% discount

and the remaining investments were handed over to a creditor of Rs. 60,000, the Balance payment to the creditor was made in cash. A was appointed to realise the assets and pay off the liabilities for which he was to be paid a commission of Rs. 2,500. L/B were valued at Rs. 70,000. Bank took over the L/B to settle the loan and paid the balance amount of Rs. 20,000 to the firm. Prepare: Realisation account, Partners' Capital account and the bank a/c.

Answers and Hints:

Realisation Profit : Rs. 40,100 (20,500 / 20,500)

Final settlement : 1,29,500 / 79,450

Bank total : 2,79,000

Payment in cash to creditors 1,00,000 less Investment taken over Rs. 60,000 = 40,000

Treatment of Bank loan Bank loan 50,000 - Less L/B taken over 70,000 = bank will return 20,000 to the firm

Bank a/c Dr. 20,000 To Realisation a/c 20,000 (Excess Payment returned by bank)

Total Realisation 45,000 + 1,32,000 + 70,000 + 20,000 returned by Bank = 2,67,000

Investments taken over by B = 90,000 x 40% less 15% = 30,600

Entry for A,s Commission : Realisation a/c dr. To A's capital a/c 2,500

1.6 Examination Problem

Following is the balance sheet of A and B as at 31.12.22.

Liabilities	Amount Rs.	Assets	Amount Rs.
Sundry Creditors	38,000	Cash at bank	12,500
Mrs A Loan	20,000	Sundry Debtors	55,000
Mrs B loan	30,000	Stock	44,000
Reserve Fund	6,000	B/R	19,000
Provision for doubtful debts	4,000	Machinery	52,000
Capital Accounts: A	90,000	Investments	38,500
B	60,000	Fixtures	27,000
	2,48,000		2,48,000

The firm was dissolved on this date and the assets realised and settlements made as follows;

The realisation of the assets was as follows: Sundry Debtors Rs. 52,000, Stock Rs. 42,000, B/R Rs. 16,000, Machinery Rs. 49,000

Investments was taken over by A at an agreed value of Rs. 36,000 and also agreed to pay Mrs. A loan.

The sundry creditors were paid off less 3% discount

The realisation expenses incurred amounted to Rs. 1,200.

Prepare: Realisation account, Partners' Capital account and the bank a/c.

Answers and Hints:

Loss on Realisation : A 18,280, B 18,280 = 36,560

Final payments A 58,720, B 44,720

Bank account total 1,71,500

Assets Realised 1,59,000

Liabilities paid off : Creditors 36,860 + Mrs B loan 30,000 = 66,860

1.7 Examination Problem

A, B and C are partners in a firm - M/s ABC brothers sharing results in the ratio of 3:2:1. Partners were also entitled to interest on loan @ 10% p.a., but not interest on capital. The partners decided to dissolve the firm on 30.06.22. The following is their balance sheet as at 31.03.22.

Liabilities	Amount Rs.	Assets	Amount Rs.
Capitals: A	1,68,000	Building	2,10,000
B	1,15,500	Furniture	35,000
A's Loan	77,000	Motor cycle	1,40,000
Sundry Creditors	2,80,000	Stock	1,92,500
Bank overdraft	1,05,000	Sundry Debtors	1,40,000
		C's Capital a/c	28,000
	7,45,500		7,45,500

Between the Balance sheet date and the date of dissolution, purchases amounted to Rs. 1,05,000 and Sales Rs. 1,57,500. In addition to payments made to creditors, a sum of Rs. 42,000 and Rs. 21,000 were paid on account of salaries and general expenses.

Each Partner withdrew Rs. 2,800 per month. On 30.06.22 Debtors , creditors and stock amounted to Rs. 2,10,000, Rs. 2,45,500 and Rs. 1,57,500 respectively.

During course of proceedings the partners decided to transfer the entire business to a private limited company with all assets, liabilities and partners' loan for a consideration of Rs. 3,15,000. Dissolution Expenses amounted to Rs. 9,800 and were borne by A.

Prepare necessary ledger Accounts, profit and loss account, partners Capital Account and the balance sheet as at 30.06.22.

Detailed Solution:

Profit and Loss account for the period 1.4.22 to till 30.6.22

Liabilities	Amount Rs.	Assets	Amount Rs.
Opening Stock	1,92,500	Sales	1,57,500
Purchases	1,05,000	Closing Stock	1,57,500
Salaries	42,000	Net Loss c/d	45,500
General Expenses	21,000		
	3,60,500		3,60,500
Net Loss b/d	45,500	Loss T/F to Capital accounts	47,425
Interest on Loan - A = $77,000 \times 10\% \times \frac{3}{12}$	1,925		
	47,425		47,425

Debtors Account

Details	Amount Rs.	Details	Amount Rs.
Balance b/d	1,40,000	Bank - bal. Fig.	67,500
Sales	1,57,500	Balance c/d	2,10,000
	2,97,500		2,97,500

Creditors Account

Details	Amount Rs.	Details	Amount Rs.
Bank - bal. Fig.	1,39,500	Balance b/d	2,80,000
Balance c/d	2,45,500	Purchases	1,05,000
	3,85,000		3,85,000

Bank Overdraft Account

Details	Amount Rs.	Details	Amount Rs.
Sundry Debtors	87,500	Balance b/d	1,05,000

Balance c/d	2,45,200	Sundry Creditors	1,39,500
		Salaries	42,000
		General Expenses	21,000
		Drawings 2,800 x 3 months x 3 partners	25,200
	3,32,700		3,32,700

Partners' Capital Accounts

Details	A	B	C
By balance b/d	1,68,000	1,15,500	-
By balance c/d balancing figure	-	-	44,305
To Balance b/d	-	-	28,000
To Profit and loss a/c : share of loss	23,712	15,808	7,905
To Drawings	8,400	8,400	8,400
To Balance c/d balancing figure	1,35,888	91,292	-

Balance sheet

Details	Amount Rs.	Details	Amount Rs.
Capitals: A 1,35,888 + B 91,292	2,27,180	Buildings	2,10,000
Sundry Creditors	2,45,500	Furniture	35,000
Bank overdraft	2,45,200	Motor cycle	1,40,000
A's Loan a/c 77,000 + Interest 1,925	78,925	Stock in Trade	1,57,500
		Sundry Debtors	2,10,000
	3,32,700	C's Capital	44,300
	7,96,805		7,96,805

1.8 - Past Examination Problem

A and B are partners - sharing results in the ratio of 1:2. On 1.4.2024, they decide to dissolve the partnership and on that date the balance sheet of the firm is as under:

Balance sheet 31.03.24

Details	Amount Rs.	Details	Amount Rs.
Capitals: A 1,50,000 + 1,00,000	2,50,000	Land and Buildings	1,20,000
Sundry Creditors	50,000	Plant and Machinery	80,000
General Reserve	60,000	Furniture	30,000
B's Loan a/c	30,000	Stock in Trade	1,02,000
		Sundry Debtors 50,000 - Provision 2,000	48,000
		Cash at bank	10,000
	3,90,000		3,90,000

The sales of firm's properties realised Rs. 1,00,000 from stock, Rs. 34,000 from furniture and Rs. 1,00,000 from land buildings, Rs. 45,000 were collected from Debtors and creditors were paid off at a discount of Rs. 1,000/ P/M were taken over by A at their book value. The expenses of realisation amounted to Rs. 4,000.

Prepare: Realisation account, Partners' Capital account and the bank a/c.

Answers and hints:

Loss on realisation 20,000 / A 8,000, B16,000

Final Payments A 82,000, B 1,24,000

Cash at bank total Rs. 2,89,000

1.9 - Past Examination Problem

A, B and C - partners of a firm and sharing result in the ratio of 2:2:1. On 31.03.24 they dissolved the firm.

Balance sheet 31.03.24

Details	Amount Rs.	Details	Amount Rs.
Capitals : A	30,000	P/M	30,000
B	10,000	F/F	2,000
C	2,000	Stock in Trade	10,400
Sundry Creditors	17,800	Sundry Debtors 18,400 - Provision 400	18,000
Loan on Hypothecation of Stock	6,200	Joint Life Policy	15,000
Joint life policy Reserve	12,400	Patents and trade marks	10,000
		Cash at bank	8,000
	93,400		93,400

Other Information:

- C had taken a loan from insurers for Rs. 5,000 on the security of JLP. The policy was surrendered and insurers paid a sum of Rs. 10,200 after deducting Rs. 5,000 for C's loan and Rs. 300 as interest thereon.
- One of the creditors took some of the patents whose book value was Rs. 6,000 at a valuation of Rs. 4,500. The balance due to that creditors was paid in cash.
- The firm has previously purchased some shares in a Joint Stock company and had written them off. The shares were now found to be worth Rs. 3,000 and the loan creditors agreed to accept the shares at this value.
- The remaining assets realised as follows: P/M 17,000, F/F 1,000, Stock 9,000, Debtors 16,500 and patents and trademarks 50% of their book value.
- The liabilities were paid and a total discount of Rs. 500 was allowed by the creditors.
- The expenses of realisation amounted to Rs. 2,300.

Prepare - Realisation, Partners' capital and bank account.

Hints and answers:

Transfer joint Life policy reserve to partners capital account as JLP will be surrendered and this amount will become free.

Point a:

Bank a/c Dr. 10,200

C's Capital a/c Dr. 5,300

To Realisation a/c 15,500

Point b. S/C 17,800 less 4,500 = balance 13,300 less discount of 500 as per point e = 12,800

Real a/c dr. To cash 12,800

Point c. Loan 6,200 less unrecorded asset shares taken over 3,000 = 3,200

Real Dr to cash 3,200

Realisation Loss 18,700 / A 7,480, B 7,480 and C 3,740

Assets Realised : P/M 17,000 + F/F 1,000 + Stock 9,000 + Debtors 16,500 + Patents 50% of 4,000 i.e. 2,000 = 45,500

Final Payments A 27,480 , B 7,480

Amount brought in by C 4,560

Bank account total 68,260

1.10: Examination Problem

A,B and C are partners of the firm ABC brothers and sharing profits and losses in the ratio of 4:3:2. Following is the balance sheet of the firm as at 31st March 2024

Balance sheet 31.03.24

Details	Amount Rs.	Details	Amount Rs.
Capitals : A	4,00,000	Fixed Assets	5,00,000
B	3,00,000	Stock in trade	3,00,000
C	2,00,000	Sundry Debtors	5,00,000
General Reserve	90,000	Cash in hand	10,000
Sundry Creditors	3,20,000		
	13,10,000		13,10,000

Partners of the firm decided to dissolve the firm on the above date. It was found that a credit purchase of Rs. 20,000 in March, 24 had not been recorded in the books of the firm.

Fixed assets realised Rs. 5,20,000 and book debts Rs. 4,40,000

Stock were valued at Rs. 2,50,000 and it was taken over by Partner B

Creditors allowed discount of 5% and the expenses of realisation amounted to Rs. 6,000.

Prepare - Realisation, Partners' capital and bank account.

Hints and answers:

Treatment and Payment to creditors :

First of all , simply Transfer Balance sheet balance of S/C 3,20,000 to the credit side of Realisation and then towards debit side make the payment as follows :

S/C 3,20,000 + UR Creditors for Purchases 20,000 = 3,40,000 - less 5% discount = 3,23,000

Loss on Realisation Rs. 99,000 (44,000/ 33,000 / 22,000)

Final payments : A 3,96,000 / 47,000 / 1,98,000

Cash account total 9,70,000

Section – 2 - Partners' Insolvency

2.1 – RTP - Modified

A, B and C are partners sharing profits and losses in the ratio of 4:3:2. Their balance sheet as on 31.12.2023 stood as follows-

Sundry creditors	20,000	Cash	2,000
bank overdraft [secured against stock]	15,000	Debtors	18,000
loan [against the mortgage of machinery]	25,000	[reserve for doubtful debts]	[1,000]
capitals	20,000	Stock	25,000
A	10,000	Machinery	40,000
B	3,000	Profit and loss account	9,000
C			

The firm was dissolved on that date. Stock was taken over by the banker and it realized Rs.20,000. bank paid back Rs.4,000 after recovering its overdraft and interest due there on.

Machinery was disposed of for Rs.24,000 and debtors realised Rs.14,000 only. Loan was fully paid off along with interest due Rs.1,000.

Sundry creditors were discharged at 10% discount. Expenses amounted to Rs.300 which were paid by A. C became insolvent and only Rs.950 could be recovered from his private assets.

Prepare necessary ledger accounts to close the books of the firm assuming that the required cash brought in by the partners to make the final payment

Detailed Solution:

Realisation account

Debtors 18,000 - 1,000	17,000	S/C	20,000
Machinery	40,000	Loan	25,000
Stock:	25,000	BOD	15,000
Cash: Loan 25,000 + interest 1,000 + S/C 20,000 - 2,000	44,000	Cash : Machinery 24,000+ Debtors 14,000 + 4,000 surplus Recovery from Bank	42,000
A's Capital : expenses	300	Loss B.F	24,300

Capital Accounts

	A	B	C		A	B	C
P&L	4,000	3,000	2,000	Bal b/d	20,000	10,000	3,000
Real.	10,800	8,100	5,400	Real.	300	-	-
Def.	2,400	1,050	-	Cash	-	-	950
Cash BF	3,100	-	-	Cash BF.	-	2,150	-
				Def. t/F To A&B- BF	-	-	3,450

Cash Account

Bal b/d	2,000	Real.	44,000
Real.	42,000	A	3,100
C	950		
D	2,150		

Note (2) Loss on C's insolvency Rs. 3,450 is borne by A and B in the ratio of their capitals just before the start of dissolution, i.e.,

	A	B
	Rs.	Rs.
Capitals as per Balance Sheet	20,000	10,000
Less : Dr. Balance of P & L A/c	<u>4,000</u>	<u>3,000</u>
Capital Ratio	<u>16,000</u>	<u>7,000</u>
	Or 16	: 7

2.2 - Past Examination Problem

N, J, V and P are partners and had been carrying on business in partnership business in an agreed ratio of 3:2:1:1. They decide to dissolve the partnership on the basis of the following Balance Sheet as on 30.4.2023.

Capital accounts:		Premises	120,000
N	100,000	Furniture	40,000
J	60,000	Stock	100,000
General reserve	56,000	Debtors	40,000
Capital reserve	14,000	Cash	8,000
Sundry creditors	20,000	Capital overdrawn	
Mortgage loan	80,000	V	10,000
		P	12,000

- The assets realised as follows-
 1. Debtors – 24,000

2. Stock – 60,000
3. Furniture – 16,000
4. Premises – 90,000

- Expenses of dissolution came to Rs.4000.
- Further creditors of Rs.12,000 had to be met by the firm.

You are required to draw up the realisation account capital and cash accounts assuming V became insolvent and nothing could be realised from his private estate. Use Garner versus Murray rule.

Detailed Solution:

Realisation account

Premises	1,20,000	S. Crs	20,000
Furniture	40,000	M. loan	80,000
Stock	1,00,000	Cash : Assets Realised	1,90,000
Debtors	40,000		
Cash : creditors 20,000 + M.L : 80,000 + expenses 4,000 + further Creditors: 12,000	1,16,000	Loss on realisation:	1,26,000

Capital Accounts

	N	J	V	P		N	J	V	P
b/d			10,000	12,000	b/d	1,00,000	60,000	-	-
Real. loss	54,000	36,000	18,000	18,000	GR	24,000	16,000	8,000	8,000
Deficiency borne by N & J adjusted Cap. Ratio of 130: 80	11,143	6,857			CR	6,000	4,000	2,000	2,000
Cash final payments	64,857	37,143	-	-	Deficiency	-	-	18,000	-
					Cash – final amt. brought in				20,000

Cash Account

b/d	8,000	Real.	1,16,000
Real.	1,90,000	N	64,857
P	20,000	J	37,143
	2,18,000		2,18,000

P is solvent but having Debit balance and therefore shall not bear the deficiency.

2.3 - Past Examination Problem

A, B, C and D are partners in a firm sharing profits and losses in the ratio of 4:3:2:1. the following is their Balance Sheet as at 31st March, 2023.

Creditors	125,000	Cash in hand	43,000
Reserve	10,000	Debtors	
Capital :		1,20,000	110,000

A	136,000	Less: Provision for D/D	102,000
B	57,000	<u>10,000</u>	
		Other assets	42,000
		Capitals:	31,000
		C	
		D	

On 31.3.2006, the firm is dissolved. The partnership agreement provides that the deficiency of an insolvent partner will be borne by the solvent partners as per Garner Vs Murray rule.

A is to take over 60% of the book debts at Rs.56,000 and B is to take over 40% of the book debts at Rs.36,000. other assets realised at a loss of 2% on net collection and creditors are paid at a discount of 20%. Realisation expenses amounted to Rs.5,000. D is insolvent and a dividend of 20% is realised from his estate.

Prepare necessary ledger accounts to close the books of the firm.

Detailed Solution:

Realisation account

Debtors	1,20,000	Creditors	1,25,000
Other assets	1,02,000	Provision for D/D	10,000
Cash : creditors 1,25,000- 20% discount = 1,00,000 + expenses 5,000	1,05,000	A's Capital ; Debtors	56,000
		B's Capital ; Debtors	36,000
		Cash : Other Assets 1,02,000 x 100 / 102	1,00,000
		Loss on realisation	Nil
	3,27,000		3,27,000

Capital Accounts

	A	B	C	D		A	B	C	D
b/d	-	-	42,000	31,000	b/d	1,36,000	57,000	-	-
Real.	56,000	36,000	-	-	GR	4,000	3,000	2,000	1,000
Real. loss	Nil	Nil	Nil	Nil	Cash: 20% of 30,000				6,000
Deficiency borne by A & B adjusted Cap. Ratio of 140: 60	16,800	7,200	-	-	Deficiency	-	-	-	24,000
Cash final payments	67,200	16,800	-	-	Cash – final amt. brought in	-	-	40,000	

Cash Account

b/d	43,000	Realisation	1,05,000
Real.	1,00,000	A	67,200
D	6,000	B	16,800
C	40,000		
	1,89,000		1,89,000

Note: Other assets realised 2% on net collection means,
if Net collection amount is 100 then book value must be 102

	Net collection	Book value
	100	102
Other Assets	?	1,02,000
	$1,02,000 \times 100 / 102 = 1,00,000$	

2.4 - Past Examination Problem

P, Q, R and S are partners and had been carrying on business in partnership business in an agreed ratio of 3:2:1:1. They decide to dissolve the partnership on the basis of the following Balance Sheet as on 31.03.2024.

Capital accounts:		Land and Buildings	2,46,000
P	1,68,000	Furniture & Fixtures	65,000
Q	1,08,000	Stock	1,00,000
General reserve	95,000	Debtors	72,500
Capital reserve	25,000	Cash in hand	15,500
Sundry creditors	36,000	Capital overdrawn	
Mortgage loan	1,10,000	R	25,000
		S	18,000
	5,42,000		5,42,000

The assets realised as follows-

Debtors – 65,000

Stock – 72,000

F/F – 42,000

L/B – 2,30,000

Expenses of dissolution came to Rs.7,800.

Further creditors of Rs.18,000 had to be met by the firm.

R became insolvent and nothing could be realised from his private estate

You are required to draw up the realisation account capital and cash accounts. Use Garner versus Murray rule.

Realisation account

Land and buildings	2,46,000	Sundry Creditors	36,000
Furniture	65,000	Mortgage loan	1,10,000
Stock	1,00,000	Cash : Assets Realised	
Debtors	72,500	2,30,000 + 42,000 +72,000 +85,000	4,09,000
Cash : creditors 36,000 + Mortgage loan 1,10,000 + expenses 7,800 + further Creditors: 18,000	1,71,800	Loss on realisation: P 40,120 , Q 30,090 , R 20,060 ,S 10,030	1,00,300
	6,55,300		6,55,300

Capital Accounts

	P	Q	R	S		P	Q	R	S
b/d	-	-	25,000	18,000	b/d	1,68,000	1,06,000	-	-
Real. loss	40,120	30,090	20,060	10,030	Gen. Res.	38,000	28,500	19,000	9,500
Deficiency borne by P & Q	12,636	6,424	-	-	Cap. Res.	10,000	7,500	5,000	2,500

adjusted Cap. Ratio of 216: 144									
Cash final payments	1,63,24 4	1,05,486	-	-	Deficiency	-	-	21,06 0	-
					Cash – final amt. brought in				16,030

Cash Account

b/d	15,500	Real.	1,71,800
Real.	4,09,000	P	1,63,244
S	16,030	Q	1,05,486
	4,40,530		4,40,530

S is solvent but having Debit balance and therefore shall not bear the deficiency.

Section – 3 - Firm's Insolvency

3.1

All Partners Are Insolvent - Self Attempt

X, Y and Z are partners in a business. Their balance sheet as on 31.3.2023 was as follows:

Capitals		Properties	400,000
X	160,000	Fixture	160,000
Z	100,000	Machine	400,000
X' s loan	200,000	Book debts	200,000
Creditors	10,00,000	Stock	160000
		Cash	10,000
		Y's capital	130,000

Due to bad financial position of the partners, the firm was dissolved and all partners were declared bankrupt.

The assets were realised as follows-

Book debts- 45% less	Machine- 200,000
Properties- 160,000	Fixture- 40,000
Stock - 100,000	

The private financial position of the partners was as follows:

Private assets	Private liabilities
X 250,000	250,000
Y 200,000	180,000
Z 230,000	250,000

Expenses of realisation amounted to Rs. 10,000. only Rs. 20,000 were recovered from Y's private estate.

Prepare realisation, Bank, creditors, capital and deficiency account.

Net Answer: Loss 7,20,000

Section - 4 – Sale / Conversion of Partnership Firm

Theoretical Discussion:

Accounting Treatment under Sale/ Conversion of Partnership Firm :

Step 1	Close Asset side	T /F Assets taken over or not	Debit side of Realisation a/c
		Treatment of cash/ Bank ; • Taken over by Company • Not taken over by Company	• T/f to realisation a/c • T/f to Cash / Bank a/c
		Value less assets	Debit side of partners cap. a/c
Step 2	Close Liab. side	Liabilities taken over or not	Credit side of Realisation a/c
		Specific reserves	Credit side of realisation a/c
		Capital accounts, current a/c, drawings a/c, advance a/c, loan a/c	Capital a/c
		Free reserves	Credit of partners capital a/c
Step 3	Purchase consideration	Entry One	Purchasing co a/c To Realisation a/c
		Entry Two	Cash a/c Shares a/c Debentures To Purchasing Co, a/c
Step 4	Realise assets not taken over by Company		Cash a/c To realisation a/c
Step 5	Pay- off liabilities not taken over		Realisation a/c To cash a/c
Step 6	Pay off expenses borne by Firm		Same as above
Step 6	Close realisation a/c – T/f Result to Partners' Capital Account		
Step 7	Close partner's capital accounts... settle the balances in cash		
Step 8	Tally cash account		

4.1 - Recent Examination Question

A and B are partners on equal footing. The firm's balance sheet as on 31.12.22 was as follows:

Capital:		Fixed Assets:	
A	1,38,000	Leasehold buildings	80,000
B	1,52,000	Plant and Machinery	1,80,000
Bank Loan	40,000	Furniture	20,000
Current Liabilities:		Current Assets:	
Sundry Creditors	70,000	Stock	60,000
Bills Payable	10,000	Book Debts	68,000
		Cash/Bank	2,000

The business was carried on till 30.6.2023. The partners withdrew in equal amounts half the amount of profits made during the period of six months [Jan to June] after charging depreciation on:

- Leasehold buildings-10%per annum
- Plant and machinery-10%per annum
- Furniture-10% per annum

Meanwhile sundry creditors were reduced by Rs.15,000, Bills payable by Rs.2,500 and Bank loan by Rs.20,000.

On 30th June Stock was valued at Rs.70,000, Book debts were Rs.75,000 and Cash at bank was Rs.2,500.

On 30th June 2023 the firm sold the business to Limited Company for Rs.400,000 payable in Equity shares of Rs.10 each.

The partners decided to take over shares in profit sharing ratio, any difference to be settled in cash.

You are required to prepare-

- Statement of Net Assets as on 30th June 2023
- Statement of profits earned during the period six months ended on 30.6.2023.
- Realisation account
- Capital accounts of the partners

Detailed Hints

- Net assets as on 30.6.2023- 3,31,000
- Profit earned during the six months period - 82,000
- Realisation profit-69,000
- Settlement in cash-,7000

a. Net Assets as at 30.06.23

Sanjay Welkins' Classes

Land and buildings	80,000 - dep @ 10% for 6 months	76,000
P/M	1,80,000 - dep @ 10% for 6 months	1,71,000
F/F	20,000 - dep @ 10% for 6 months	19,000
Stock		70,000
Book debts		75,000
Cash at bank		2,500
		4,13,500
Less:		
Bank loan	40,000 - 20,000	20,000
Sundry Creditors	70,000 - 15,000	55,000
Bills payable	10,000 - 2,500	7,500
		3,31,000

b. Statement of Profits 1.1.23 - 30.6.23

Net Assets / Capital		
As at	30.6.23	3,31,000
As at	1.1.23	2,90,000
Profits after drawings		41,000
Drawings		41,000
Net profits before drawings		82,000

c. Balance sheet as at 30.6.23

Capitals			L/B	76,000
A	1,38,000 + share of profit 41,000 - share of drawings 20,500	1,58,500	P/M	1,71,000
B	1,52,000 + share of profit 41,000 - share of drawings 20,500	1,72,500	F/F	19,000
Bank loan		20,000	Stock	70,000
S/C		55,000	Book debts	75,000
B/P		7,500	Cash at bank	2,500
		4,13,500		4,13,500

Sale of Business

Realisation account

L/B	76,000	Bank loan	20,000
P/M	1,71,000	S/C	55,000
F/F	19,000	B/P	7,500
Stock	70,000	Purchasing Company a/c	4,00,000
Book Debts	75,000		
Cash at bank	2,500		
Profit T/f to partners cap.a/c	69,000		

Partners' Capital Account

	A	B		A	B
Shares in Purchasing company	2,00,000	2,00,000	Balance b/d	1,58,500	1,72,500
Cash - b.f		7,000	Real. Profits	34,500	34,500
			Cash - b.f	7,000	-

Entries in the books of Purchasing Company

1.	Business purchase a/c	4,00,000	
	To firm a/c		4,00,000
2.	Assets Taken over	4,13,500	
	Goodwill - b.f	69,000	
	To Liabilities taken over		82,500
	To business purchase a/c		4,00,000
3.	Firm account	4,00,000	
	To Share Capital account		4,00,000

4.2

A and B are partners on equal footing. The firm's balance sheet as on 31.12.2022 was as follows:

Capital:			
A	1,50,000	P/M	1,60,000
B	1,30,000	Buildings	48,000
Current Liabilities:		Debtors	75,000
Sundry Creditors	80,000	Stock	70,000
Bank Overdraft	45,000	Joint Life Policy	6,000
		Profit and loss A/c	30,000
		Drawings a/c : A	9,000
		B	7,000
	4,05,000		4,05,000

The operations of the business were carried on till 30.6.2023. The partners withdrew in equal amounts half the amount of profits made during the period of six months [Jan to June] after charging depreciation on:

- P/M - 10% per annum
- Buildings - 10 % per annum

Mean while sundry creditors were reduced by Rs.20,000 and Bank Overdraft by Rs.5,000.

Joint life policy was surrendered for Rs. 6,000 before on 30th June 2023. Stock was valued at Rs. 84,000, debtors at Rs. 68,000. The other items remained same.

On 30th June 2023 the firm sold the business to TQM Limited. The value of goodwill was estimated at Rs. 1,30,000 and remaining assets were valued on the basis of the balance sheet as on 30.06.2023 .

Company paid the purchase consideration in equity shares of Rs. 10 each.

You are required to prepare-

- Statement of Net Assets as on 30th June 2023
- Statement of profits earned during the period six months ended on 30.6.2023.
- Realisation account
- Capital accounts of the partners

Detailed Hints:

Net assets as on 30.6.2023 - 2,49,600

Capitals as on 30th June 2019 A = Rs. 1,33,800, B = Rs. 1,15,800

Profit earned during the six months period :- net asset as on 30th June , 23 : 2,49,600 – net assets as on 31.12.22 that is 2,34,000 = 15,600 after drawings add drawings 15,600 = profits before drawings = 31,200

Purchase consideration = 3,79,600

Realisation Profit - 1,30,000

Settlement In Shares – A = 1,98,800, B = 1,80,800

a. Net Assets as at 30.06.23P/M	1,60,000 - dep @ 10% for 6 months	1,52,000
Buildings	48,000 - dep @ 10% for 6 months	45,600
Stock		84,000
Debtors		68,000
JLP		-
		3,49,600
Less:		
Sundry Creditors	80,000 - 20,000	60,000
Bank Overdraft	45,000 - 5,000	40,000
		2,49,600

b. Statement of Profits 1.1.23 - 30.6.23

Net Assets / Capital		
As at	30.6.23	2,49,600
As at	1.1.23	
	A : 1,50,000 - 15,000 - 9,000 = 1,26,000	
	B : 1,30,000 - 15,000 - 7,000 = 1,08,000	2,34,000
Profits after drawings		15,600
Drawings		15,600
Net profits before drawings		31,200

c. Balance sheet as at 30.6.23

Capitals			P/M	1,52,000
A	1,26,000 + share of profit 15,600 - share of drawings 7,800	1,33,800	Buildings	45,000
B	1,08,000 + share of profit 15,600 - share of drawings 7,800	1,15,800	Stock	84,000
S/C		60,000	Debtors	68,000
B.O.D		40,000		
		3,49,600		3,49,600

Sale of Business

a.

Goodwill a/c Dr. 1,30,000

To A 65,000

To B 65,000

b. Real. A/c Dr. 1,30,000

To GW a/c 1,30,000

Realisation account

GW	1,30,000	S/C	60,000
P/M	1,52,000	BOD	40,000
Buildings	45,600	Purchasing Company a/c	3,79,600
Stock	84,000	PC = Assets T/O = 4,79,600 Less Liab. T/o 1,00,000 = 3,79,600	
Debtors	68,000	Loss	-
Profit	-		
	4,79,600		4,79,600

Partners' Capital Account

	A	B		A	B
Shares in Purchasing company	1,89,800	1,89,800	Balance b/d	1,33,800	1,15,800
Cash - b.f	9,000		GW	65,000	65,000
			Cash - b.f		9,000

Entries in the books of Purchasing Company

1.	Business purchase a/c	3,79,600	
	To firm a/c		4,00,000
2.	Assets Taken over including GW	4,79,600	
	To Liabilities taken over		1,00,000
	To business purchase a/c		3,79,600
3.	Firm account	3,79,600	
	To Share Capital account		3,79,600

Section - 5 : Amalgamation of Firms

Accounting Treatment : in the Books of Vendor entities

Step 1	Close Asset side	Assets taken over by new Firm	Debit side of New Firm A/c Note : Any Loss or Gain shall be transferred to Revaluation A/c
		Assets not Taken over by New Firm (that is Taken over by partners)	Debit side of partners' Capital a/c Note : Any Loss or Gain shall be transferred to Revaluation A/c
		Value less assets	Debit side of partners cap. a/c
		Treatment of Unrecorded Asset • Taken over new Firm • Not taken over new firm	• T/F to the debit side of New Firm a/c • t/f to the debit side of Partners' Capital a/c Note : it's a Gain- shall also be transferred to the credit side of Revaluation A/c
		Treatment of Goodwill Valued by the New Firm	Entry one : Goodwill a/c Dr. To, Partners' Capital a/c Entry Two; New Firm A/c Dr. To, Goodwill a/c

Step 2	Close Liab. side	Liabilities taken over	Credit side of New Firm a/c Note : Any Loss or Gain shall be transferred to Revaluation A/c
		Liabilities Not taken over by New firm	Credit side of partners' Capital a/c Note : Any Loss or Gain shall be transferred to Revaluation A/c
		Specific reserves	Credit side of realisation a/c
		Capital accounts, current a/c, drawings a/c, advance a/c, loan a/c	Capital a/c
		Free reserves	Credit of partners capital a/c
		Treatment of Unrecorded Asset • Taken over new Firm Not taken over new firm	• T/f to the Credit side of New Firm a/c • T/f to the Credit side of Partners' Capital a/c Note : Since it's a Loss, shall also be transferred to the debit side of Revaluation A/c
Step 3	Close Revaluation Account and T/f Result to Partners' Capital Account		
Step 4	Close partner's capital accounts... T/f the balances to New Firm account		
Step 5	Tally New Firm Account		

Accounting treatment In the books of Purchasing entity

Write off Goodwill	Goodwill a/c Dr. To All partners Capital A/c
Prepare Partners Capital Account and adjust capitals if Required	
Prepare balance sheet	

5.1

B and S are partners of S & Co. sharing profits and losses in the ratio of 3:1. S and T are partners of T & Co. sharing profits and losses in the ratio of 2:1.

On 31st October, 2022, they decided to amalgamate and form a new firm M/s. BST & Co. wherein B, S and T would be partners sharing profits and losses in the ratio of 3:2:1.

Their balance sheets on that date were as under :

Liabilities	S & Co.	T & Co.	Assets	S & Co.	T & Co.
Due to X & Co.	40,000	-	Cash in hand	10,000	5,000
Due to S & Co.	-	50,000	Cash at bank	15,000	20,000
Other Creditors	60,000	58,000	Due from T & Co.	50,000	-
Reserves	25,000	50,000	Due from X & Co.	-	30,000
Capitals			Other Debtors	80,000	1,00,000
B	1,20,000	-	Stock	60,000	70,000
S	80,000	1,00,000	Furniture	10,000	3,000
T	-	50,000	Vehicles	-	80,000
			Machinery	75,000	-
			Building	25,000	
	3,25,000	3,08,000		3,25,000	3,08,000

The amalgamated firm took over the business on the following terms :

- (a) Goodwill of S & Co. was worth Rs. 60,000 and that of T & Co. Rs. 50,000. Goodwill account was not to be opened in the books of the new firm, the adjustments being recorded through capital accounts of the partners.
- (b) Building, machinery and vehicles were taken over at Rs. 50,000, Rs. 90,000 and Rs. 1,00,000 respectively.

- (c) Provision for doubtful debts has to be carried forward at Rs. 4,000 in respect of debtors of S & Co. and Rs. 5,000 in respect of debtors of T & Co.

You are required to:

- (i) Compute the adjustments necessary for goodwill.
- (ii) Pass the journal entries in the books of BST & Co. assuming that excess/deficit capital (taking T's Capital as base) with reference to share in profits are to be transferred to current accounts.

Detailed Solution:

Books of S & Co.
Revaluation a/c

	Rs.		Rs.
To Provision for D/D	4,000	By Machinery	15,000
To Profit t/f to B and S	36,000	By Buildings	25,000
	40,000		40,000

Partners' Capital Accounts

	B	B		B	B
	Rs.	Rs.		Rs.	Rs.
To Balance t/f to New Firm a/c	2,10,750	1,10,250	By Balance b/d	1,20,000	80,000
			By General Reserve	18,750	6,250
			By GW	45,000	15,000
			R/L : Profit 3:1	27,000	9,000

New Firm a/c

	Rs.		Rs.
Cash in hand	10,000	Creditors	60,000
Cash at bank	15,000	Due from X & Co.	40,000
Due from T & Company	50,000	B's Capital account	2,10,750
Other debtors 80,000- Provision 4,000	76,000	C's Capital account	1,10,250
Stock	60,000		
F/F	10,000		
Machinery	90,000		
Buildings	50,000		
Goodwill	60,000		

Note: Treatment of Goodwill

- a. first credited to partners and then b. Debited to New Firm

Books of T & Co.
Revaluation a/c

	Rs.		Rs.
To Provision for D/D	5,000	Vehicles a/c	20,000
To Profit t/f to S and T	15,000		
	40,000		

Partners' Capital Accounts

	S	t		S	T
	Rs.	Rs.		Rs.	Rs.
To Balance t/f to New Firm a/c	1,76,667	88,333	By Balance b/d	1,00,000	80,000
			By General Reserve	33,333	16,667
			By GW	33,334	16,666
			R/L : Profit 3:1	10,000	5,000

New Firm a/c

	Rs.		Rs.
Cash in hand	5,000	Creditors	58,000
Cash at bank	20,000	Due to S & Co.	50,000
Due from X & Company	30,000	S's Capital account	1,76,667
Other debtors 1,00,000- Provision 5,000	95,000	T's Capital account	88,333
Stock	10,000		
F/F	3,000		
Vehicles	1,00,000		
Goodwill	50,000		
	3,73,000		3,73,000

Books of New Firm

1st Step

Writing off of Goodwill

B Dr 55,000

S Dr. 36,667

S Dr. 18,333

To GW a/c 1,10,000

2. Step:

Capital Accounts

	B	S	T		B	S	T
GW	55,000	36,667	18,333	Bal. b/d	2,10,750	1,76,667	88,333
Bal. c/d	1,55,750	2,50,250	70,000			1,10,250	
				Bal. b/d	1,55,750	2,50,250	70,000
Balance c/d :	2,10,000	1,40,000	70,000	Current a/c	54,250		
New firms Capital				b.f.			
4,20,000/ 3:2:1							
Current a/c - b.f	-	1,10,250	-				

New Firms Capital = 70,000 divided by 1/6

Balance sheet

Assets :	
Cash 10,000 + 5,000	15,000
Bank 15,000 + 20,000	35,000
Due from T & Co. 50,000 less 50,000	-
Debtors Net: 76,000 + 95,000	1,71,000
Stock 60,000 + 70,000	1,30,000
F/F 10,000 + 3,000	13,000
Machinery	90,000
Buildings	50,000
Vehicles	1,00,000
B's Current account	54,250
Liabilities:	
Capitals : B 2,10,000 + S 1,40,000 + T 70,000	4,20,000
S' Current Account	1,10,750

Creditors : 60,000 + 58,000	1,18,000
Due to X & Co.	40,000

5.2

Firm X & Co. consists of partners A and B sharing Profits and Losses in the ratio of 3: 2. The firm Y & Co. consists of partners B and C sharing Profits and Losses in the ratio of 5: 3.

On 31st March, 2022 it was decided to amalgamate both the firms and form a new firm XY & Co., wherein A, B and C would be partners sharing Profits and Losses in the ratio of 4:5:1.

Balance Sheet as at 31.3.2022

Liabilities	X & Co.	Y & Co.	Assets	X & Co.	Y & Co.
	Rs.	Rs.		Rs.	Rs.
Capital:			Cash in hand/bank	40,000	30,000
A	1,50,000	—	Debtors	60,000	80,000
B	1,00,000	75,000	Stock	50,000	20,000
C	—	50,000	Vehicles	—	90,000
Reserve	50,000	40,000	Machinery	1,20,000	—
Creditors	1,20,000	55,000	Building	1,50,000	
	4,20,000	2,20,000		4,20,000	2,20,000

The following were the terms of amalgamation:

- (i) Goodwill of X & Co., was valued at Rs. 75,000. Goodwill of Y & Co. was valued at Rs. 40,000. Goodwill account not to be opened in the books of the new firm but adjusted through the Capital accounts of the partners.
- (ii) Building, Machinery and Vehicles are to be taken over at Rs. 2,00,000, Rs. 1,00,000 and Rs. 74,000 respectively.
- (iii) Provision for doubtful debts at Rs. 5,000 in respect of X & Co. and Rs. 4,000 in respect of Y & Co. are to be provided.

You are required to:

- (i) Show, how the Goodwill value is adjusted amongst the partners.
- (ii) Prepare the Balance Sheet of XY & Co. as at 31.3.2022 by keeping partners capital in their profit sharing ratio by taking capital of 'B' as the basis. The excess or deficiency is to be kept in the respective Partners' Current accounts.

Detailed Solution:

Books of X & Co.
Revaluation a/c

	Rs.		Rs.
Machinery	20,000	Buildings	50,000
Prov. For d/d	5,000		
Loss t/f to A 15,000, B 10,000	25,000		

Partners' Capital Accounts

	A	B		A	B
	Rs.	Rs.		Rs.	Rs.
To Balance t/f to New Firm a/c	2,40,000	1,60,000	By Balance b/d	1,50,000	1,00,000
			By General Reserve	30,000	20,00
			By GW	45,000	30,000
			R/L : Profit 3:2	15,000	10,000

New Firm a/c

	Rs.		Rs.
Cash / Bank	40,000	Creditors	1,20,000

Debtors 60,000- Provision 5,000	55,000	A	2,40,000
Stock	50,000	B	1,60,000
Machinery	1,00,000		
Buildings	2,00,000		
Goodwill	75,000		
	5,20,00		5,20,000

Note: Treatment of Goodwill

a. first credited to partners and then b. Debited to New Firm

Books of Y & Co.

Revaluation a/c

	Rs.		Rs.
To Provision for D/D	4,000	Loss t/f to B 12,500 , C 7,500	20,000
To Vehicles	16,000		

Partners' Capital Accounts

	B	C		B	C
	Rs.	Rs.		Rs.	Rs.
R/L Loss	12,500	7,500	By Balance b/d	75,000	50,000
To Balance t/f to New Firm a/c	1,12,500	72,500	By General Reserve	25,000	15,000
			By GW	25,000	15,000

New Firm a/c

	Rs.		Rs.
Cash / Bank	30,000	Creditors	55,000
Debtors 80,000- Provision 4,000	76,000	B	1,12,500
Stock	20,000	C	72,500
Vehicles	74,000		
Goodwill	40,000		
	2,40,000		2,40,000

Books of New Firm

1st Step

Writing off of Goodwill

A Dr 46,000

B Dr. 57,500

C Dr. 11,500

To GW a/c 1,15,000

2. Step:

Capital Accounts

	A	B	C		A	B	C
GW	46,000	57,500	11,500	Bal. b/d	2,40,000	1,60,000	72,500
Bal. c/d	1,94,000	2,15,000	61,000			1,12,500	
				Bal. b/d	1,94,000	2,15,000	61,000
Balance c/d : New firms Capital 4,30,000/ 4:5:1	1,72,000	2,15,000	43,000				
Current a/c - b.f	22,000	-	18,000				

New Firms Capital = 2,15,000 divided by 5/10 = 4,30,000

Balance sheet

Assets :	
Cash / Bank 40,000 + 30,000	70,000
Debtors Net: 55,000 + 76,000	1,31,000
Stock 50,000 + 20,000	70,000
Machinery	1,00,000
Buildings	2,00,000
Vehicles	74,000
Liabilities:	
Capitals : A 1,72,000 + B 2,15,000 + C 43,000	4,30,000
Current Accounts: A 22,000 + C 18,000	40,000
Creditors : 1,20,000 + 55,000	1,75,000

Section - 6: Piecemeal Distribution

1. Piecemeal Distribution /Payments

As a matter of fact, on the dissolution of a partnership, assets are sometimes realized gradually over a period of time.

In such a case it may be agreed that different parties are to be paid in order of preference as and when assets are realized without unnecessarily waiting for the final realization of all the assets.

The order of the payment will be as follows :

- (i) Realisation expenses
- (ii) For provision for expenses that are to be made
- (iii) Preferential creditors (say, Income Tax or any payment made to the Government)

- (iv) Secured creditors – upto the amount realized from the disposal of assets by which they are secured and for the balance, if any, to be paid to unsecured creditors
- (v) Unsecured creditors – in proportion to the amount of debts, if more than one creditor
- (vi) Partners' loan – if there is more than one partner – in that case, in proportion to the amount of loan
- (vii) Partners' capital – the order of payment may be made by any one of the following two methods:
 - (a) Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method
 - (b) Maximum Possible Loss Method

2. Maximum Loss Method

Each instalment realised is considered to be the final payment i.e., outstanding assets and claims are considered worthless and partners' accounts are adjusted on that basis each time when a distribution is made, following either Garner vs. Murray Rule or the profit-sharing ratio rule.

Steps

- (1) Prepare a statement showing distribution of cash (2) Pay off the external Liabilities
- (3) After all the payment is made for the external liabilities, the partners will be paid off.

Total Due of Partners xxx

Less : Net/Balance of Realisation

(x) Maximum Loss xxx

(4) The maximum loss shall be shared amongst the partners in their profit sharing ratio, as if, there will be no further realisation.

(5) If any of the partner capitals, after step (4) is negative, that partner shall be treated like an insolvent partner.

(6) The deficiency of the insolvent partner as per step (5) shall be shared by the other solvent partners (i.e. those partners who has positive capital balances) in their capital contribution ratio as per Garner vs. Murray Rule.

(7) Repeat the steps (3) to (6) till final realisation.

3. Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method

Under this method, actual capital of the partners on the date of dissolution is compared with their proportionate capital (determined on the basis of minimum capital per unit of profit) to determine surplus capital of the partners.

Surplus capital is paid first and any balance left thereafter is distributed in the profit sharing ratio.

This ensures that final balances of partners show their share of realisation profit/loss and thus, no settlement need to be done at that point of time

6.1 - Maximum Possible loss Method

The following is the Balance Sheet of A, B, C on 31st December, 2019 when they decided to dissolve the partnership:

Liabilities	Rs.	Assets	Rs.
Creditors	2,000	Sundry Assets	48,500
A's Loan	5,000	Cash	500
Capital Accounts:			
A	15,000		
B	18,000		
C	9,000		
	49,000		49,000

The assets realised the following sums in instalments:

I	1,000
II	3,000
III	3,900
IV	6,000

V	20,100 ¹
	34000

The expenses of realisation were expected to be Rs. 500 but ultimately amounted to Rs. 400 only.

¹ includes saving in expenses i.e. Rs.100 (Rs.500 - Rs.400).

Show how at each stage the cash received should be distributed between partners. They share profits in the ratio of 2:2:1.

Detailed Solution:

Statement showing Realisation and Distribution of Cash Payments

	Realisation	Creditors	Partners'	Partners'
			Loan	Capitals
	Rs.	Rs.	Rs.	Rs.
1. After taking into account cash balance and amount set aside for expenses	1,000	1,000	-	-
2.	3,000	1,000	2,000	-
3.	3,900	-	3,000	900
4.	6,000	-	-	6,000
Including saving in expenses	20,100	-	-	20,100
	34,000	2,000	5,000	27,000

To ascertain the amount distributable out of each instalment realised among the partners, the following table will be constructed:

Statement of Distribution on Capital Account

(1) Calculation to determine the mode of distribution of Rs. 900

	Total	A	B	C
	Rs.	Rs.	Rs.	Rs.
Balance	42,000	15,000	18,000	9,000
Less: Possible loss, should remaining assets prove to be worthless (in their profit sharing ratio)	(41,100)	(16,440)	(16,440)	(8,220)
	+ 900	- 1,440	+ 1,560	+ 780
Deficiency of A's capital written off against those of B and C in the ratio of their capital, 18,000 : 9,000 (Garner vs. Murray)			(960)	(480)
Manner in which the first Rs. 900 should be distributed			+ 600	+ 300

(2) Distribution of Rs. 6,000

Balance after making payment of amount shown in step (1)	41,100	15,000	17,400	8,700
Less : Possible Loss assuming remaining asset to be valueless (in their profit sharing ratio)	(35,100)	(14,040)	(14,040)	(7,020)
Balance available and to be distributed	6,000	960	3,360	1,680

(3) Distribution of Rs. 20,100

Balance after making payment of amount shown in step (2)	35,100	14,040	14,040	7,020
Less : Possible loss, assuming remaining assets to be valueless (in their profit sharing ratio)	(15,000)	(6,000)	(6,000)	(3,000)
Manner of distribution of Rs. 20,100	20,100	8,040	8,040	4,020

Summary :				
Balance	42,000	15,000	18,000	9,000
Total amounts paid	27,000	9,000	12,000	6,000
Loss	15,000	6,000	6,000	3,000

6.2 - Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method

Solve the previous case problem using Highest Relative Capital Method

Detailed Solution:

a. Determination of Surplus Capital

	A	B	C
Capital	Rs. 15,000	18,000	9,000
Profit-sharing ratio	2	2	1
Capital divided by the profit-sharing ratio	7,500	9,000	9,000
Proportionate Capital of B and C, taking			
A's capital as the base	Rs. 15,000	15,000	7,500
Excess of actual over proportionate capital	Rs. nil	3,000	1,500

This indicates that A should not get anything till Rs. 3,000 is paid to B and Rs. 1,500 is paid to C. Since capital of B and C are already according to their mutual profit-sharing ratio (2:1), they will share the available cash in this ratio.

b. After paying off creditors and A's loan, the available amount will be distributed as below in this method:

	Total	A	B	C
	Rs.	Rs.	Rs.	Rs.
Third Instalment	900	-	600	300
Fourth Instalment (i)	3,600	-	2,400	1,200
(ii)	2,400	960	960	480
Fifth Instalment	20,100	8,040	8,040	4,020
Total	27,000	9,000	12,000	6,000

Total payment made to each partner will, of course be same under both the methods.

Section - 7 - Limited Liability Partnerships

1. What Is A Limited Liability Partnership

Means a partnership formed and registered under this Act;

As per section 3 of the Act, a Limited Liability Partnership has the following characteristics:

- A limited liability partnership is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
- A limited liability partnership shall have perpetual succession.

Any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

2. Distinction between an ordinary partnership firm and an LLP

	Points	Partnerships	LLPs
1	Applicable Law	Indian Partnership Act 1932	The Limited Liability Partnerships Act, 2008
2	Registration	Optional	Compulsory with ROC
3	Creation	Created by an Agreement	Created by Law
4	Body Corporate	No	Yes
5	Separate Legal	No	Yes

	Entity		
6	Perpetual Succession	Partnerships do not have perpetual succession	It has perpetual succession and individual partners may come and go
7	Number of Partners	Minimum 2 and Maximum 20 (subject to 10 for banks)	Minimum 2 but no maximum limit
8	Ownership of Assets	Firm cannot own any assets. The partners own the assets of the firm	The LLP as an independent entity can own assets
9	Liability of Partners / Members	Unlimited: Partners are severally and jointly liable for actions of other partners and the firm and their liability extends to personal assets	Limited to the extent of their contribution towards LLP except in case of intentional fraud or wrongful act of omission or commission by a partner.
10	Principal Agent Relationship	Partners are the agents of the firm and of each other	Partners are agents of the firm only and not of other partners

Sanjay Welkins' Classes

Chapter 15

Accounting - Meaning, Scope and Significance, Cycle

Terms

Transaction

It is an event which involves exchange of some value between two or more entities. It can be purchase of stationery, receipt of money, payment to a supplier, incurring expenses, etc. It can be a cash transaction or a credit transaction.

Purchases

This term is used for goods to be dealt-in i.e. goods are purchased for resale or for producing the finished products which are meant for sale. Goods purchased may be

Cash Purchases or Credit Purchases.

Thus, Purchase of goods is the sum of cash purchases and credit purchases.

Sundry Creditors

Creditors are persons who have to be paid by an enterprise an amount for providing goods and services on credit.

Sales

Sales are total revenues from goods or services provided to customers. Sales may be in cash or in credit.

Sundry Debtors

Persons who have to pay for goods sold or services rendered or in respect of contractual obligations. It is also termed as debtor, trade debtor, and accounts receivable.

Revenue (Sales)

Sales revenue is the amount by selling products or providing services to customers. Other items of revenue common to many businesses are: Commission, Interest, Dividends, Royalties, and Rent received, etc.

Expenses

Costs incurred by a business in the process of earning revenue are called expenses. In general, expenses are measured by the cost of assets consumed or services used during the accounting period. The common items of expenses are: Depreciation, Rent, Wages, Salaries, Interest, Cost of Heating, Light and water and Telephone, etc.

Income

The difference between revenue and expense is called income. For example, goods costing ` 50,000 are sold for ` 70,000, the cost of goods sold, i.e. ` 50,000 is expense, the sale of goods, i.e. ` 70,000 is revenue and the difference, i.e. ` 20,000 is income. In other words, we can state that $\text{Income} = \text{Revenue} - \text{Expense}$

Gain

Usually this term is used for profit of an irregular nature, for example, capital gain.

Loss

It means something against which the firm receives no benefit. It is a fact that expenses lead to revenue but losses do not, such as theft.

Profit

It is the excess of revenue of a business over its costs. It may be gross profit and net profit.

Gross profit

is the difference between sales revenue or the proceeds of goods sold and/or services provided over its direct cost of the goods sold.

Net profit

is the profit made after allowing for all types of expenses. There may be a net loss if the expenses exceed the revenue.

Expenditure

Spending money or incurring a liability for some benefit, service or property received is called expenditure. Payment of rent, salary, purchase of goods, purchase of machinery, etc. are some examples of expenditure. If the benefit of expenditure is exhausted within a year, it is treated as revenue expenditure. In case the benefit of expenditure lasts for more than one year, it is treated as an asset and also known as capital expenditure.

Expenditure is usually the amount spent for the purchase of assets. It increases the profit earning capacity of the business. Expense, on the other hand, is an amount to earn revenue. Expenditure is considered as capital expenditure unless it is qualified with words like revenue expenditure on rent, salaries etc., while expense is always considered as a revenue expense because it is always incurred to earn revenue.

Drawings

It is the amount of money or the value of goods which the proprietor takes away from business for his/her household or private use.

Capital

It is the amount invested in an enterprise by its owners e.g. paid up share capital in a corporate enterprise. It also refers to the interest of owners in the assets of an enterprise. It is the claim against the assets of the business. Any amount contributed by the owner towards the business unit is a liability for the business enterprise. This liability is also termed as capital which may be brought in the form of cash or assets by the owner

Assets

These are tangible objects or intangible rights owned by the enterprise and carrying probable future benefits. Tangible items are those which can be touched and their physical presence can be noted/felt e.g. furniture, machine etc. Intangible rights are those rights which one possesses but cannot see e.g. patent rights, copyrights, goodwill etc. Assets are purchased for business use and are not for sale. They raise the profit earning capacity of the business enterprise. Assets are broadly categorized as current assets and non-current assets/fixed assets.

Current assets are those assets which are held for a short period generally one year's time. The balance of such items goes on fluctuating i.e. it keeps on changing throughout the year. The balance of cash in hand may change so many times in a day. Various current assets are cash in hand/at bank, debtors, bills receivable, stock, pre-paid expenses.

Non-current assets : Those assets are acquired for long term use in the business. Such assets raise the profit earning capacity of the business enterprise. Expenditure on such assets is non-recurring and of capital nature. Expenses incurred on acquiring these assets are added to the value of the assets.

Liability

It is the financial obligation of an enterprise other than owners' funds. Liabilities mean the amount which the business owes to outsiders, that is, except the proprietors. In the words of Finny and Miller, "Liabilities are debts, they are amounts owed to creditors." Thus, the claims of those who are not owners are called Liabilities.

This can be expressed as : $\text{Liabilities} = \text{Assets} - \text{Capital}$

In business, transactions are recorded taking business to be an entity distinct from its owners. Thus, capital invested by the proprietors is a liability but an internal liability. On the other hand, external liability is a liability that is payable to outsiders, i.e., other than the proprietors.

External liability arises because of credit transactions or loans raised. Examples of external liabilities are creditors, bank overdraft, bills payable, outstanding liabilities. Liabilities can be classified into the following :

- i. Long-Term Liabilities : These are those liabilities which are payable after a long term, (generally more than a year). Examples of Long-Term Liabilities are long term loans, debentures, etc.
- ii. Short-Term/Current Liabilities : These are liabilities which are payable in the near future (generally within a year). Examples of Current Liabilities are creditors, bank overdrafts, bills payable, short-term loans, etc.

Account :

Account is a summarised record of relevant transactions at one place relating to a particular head. It records not only the amount of transactions but also their effect and direction.

Stock or Inventory : Stock is the tangible property held by an enterprise for the purpose of sale in the ordinary course of business or for the purpose of using it in the production of goods meant for sale or services to be rendered.

Stock may be opening stock or closing stock. In case of a manufacturing concern, Closing Stock comprises raw materials, Work-in-Progress (i.e., semi-finished goods) and finished goods in hand on the closing date. Similarly, Opening Stock (beginning inventory) is the amount of stock at the beginning of the accounting period.

Goods : They refer to items forming part of the Stock-in-Trade of an enterprise, which are purchased or manufactured with a purpose of selling. In other words, they refer to the products in which an enterprise is dealing. For an enterprise dealing in home appliances such as T.V., fridge, A.C., etc., these are goods. Similarly, for a stationer, stationery is goods, whereas for others, it is an item of expense (not purchases). An enterprise may purchase assets for use in furtherance of business or stationery for use in the business, but they are not purchases of 'goods' but fixed asset and expense respectively.

Receivables :

The term 'Receivables' includes the outstanding amount due from others. Sometimes, a debtor may accept a Bill of Exchange, which is payable after a certain period. Such a bill is known as Bill Receivable. Sometimes, a debtor promises to pay the specific amount in writing after a specified period. Such a promise is known as a Promissory Note and is recorded as note receivable. The term – accounts receivable includes trade debtors as well as bills receivable and promissory notes receivable. The term receivable includes all the amounts due from others.

Payables : The term 'Payables' include the amounts due to other. Accounts Payable includes trade creditors as well as bills payable and promissory notes payable. The term payable includes all the amounts due to others.

Bill Receivable : Bill Receivable means a Bill of Exchange accepted by a debtor the amount of which will be received on the specified date.

Bill Payable : Bill Payable means a Bill of Exchange, the amount of which will be payable on the specified date.

Event : Any transactions in an organisation can be called as an event. Transactions in an organisation have documentary evidence and will create a change in revenue, expense, assets, liabilities and capital.

Cost : It is the amount of expenditure incurred on or is attributed to a specified article; product or activity.

Voucher : It is proof of a business transaction. Cash Memo, Bill/Invoice, Credit/Debit notes etc. are examples of voucher.

Discount : Some customers are allowed reduction in the price of goods by the business. It is called a Discount.

Trade Discount : It is the reduction allowed by the seller to the buyer at the time of sale on the list price of goods. Trade discount is allowed on bulk purchases. Normally, trade discount is deducted from the list price and only the balance is accounted for. Therefore, trade discount will not be shown in the books of accounts.

Cash Discount : It is the deduction allowed by the creditor to the debtor on the amount due by the latter. This concession is given only to those who settle their accounts within a stipulated period. Therefore, cash

discount encourage prompt settlement of accounts. For the debtor who pays the amount, it is an income. For creditor, cash discount is an expense.

Accounting - Meaning and Definition :

Accounting involves not only book keeping but also many other activities. The American Institute of Certified Public Accountants (AICPA) defined accounting as "The art of recording, classifying, summarising, analysing and interpreting the business transactions systematically and communicating business results to interested users in accounting"

Nature of Accounting

Economic events : It is the occurring of the consequence to a business organisation which consists of transactions that are measurable in monetary terms. Purchase of a Machinery, installing and keeping it ready for manufacturing is an economic event which consists of a number of financial transactions. These transactions are (a) buying the machine, (b) transporting the same, (c) preparing the site for its installation and (d) incurring expenditure on installing the same.

Identification: Identification implies determining what transactions are to be recorded i.e. items of financial character are to be recorded. For example, goods purchased for cash or on credit will be recorded. Items of non-financial character such as changes in managerial policies, etc. are not recorded in the books of accounts.

Measurement means quantification of business transactions into financial terms by using monetary unit. If an event cannot be quantified in monetary terms, it is not considered fit for recording in the books of the firm. That is why important items like appointment, signing of contracts, etc. are not shown in the books of accounts.

Recording : Having identified and measured the economic events in financial terms, these are recorded in the books of accounts in monetary terms date wise. The recording of the business transactions is done in such a manner that the necessary financial information is summarized according to well established accounting practices.

Communication : The economic events are identified, measured and recorded in such a manner that the necessary relevant information is generated and communicated in a certain form to the management and other internal and external users of information. The financial information is regularly communicated through accounting reports.

Organisation : refers to a business enterprise whether for profit or not for profit motive. Interested users of information. Many users need financial information to make important decisions. These users can be investors, creditors, labour unions, Trade Associations, etc.

Branches of Accounting

The changing requirements of the business over the centuries have given rise to specialized branches of accounting and these are :

Financial Accounting It is concerned with recording the transactions of financial character, summarising and interpreting them and communicating the results to the users. It ascertains profit earned or loss incurred during a period (usually one year as accounting year) and the financial position as on the date when the accounting period ends. It can provide financial information required by the management and other parties. The word accounting and financial accounting are used interchangeably. At present we are concerned with financial accounting only.

Cost Accounting It analyses the expenditure so as to ascertain the cost of various products manufactured by the firm and fix the prices. It also helps in controlling the costs and providing necessary costing information to management for decision making.

Management Accounting It is concerned with generating information relating to funds, cost and profits etc. This enables the management in decision making. Basically, it is meant to assist the management in taking rational policy decisions and to evaluate the impact of its decisions and actions and the performance of various departments.

Tax Accounting This branch of accounting has grown in response to the difficult tax laws such as relating to income tax, sales tax etc. An accountant is required to be fully aware of various tax legislations.

Social Accounting This branch of accounting is also known as social reporting or social responsibility accounting. It discloses the social benefits created and the costs incurred by the enterprise. Social benefits include such facilities as medical, housing, education, canteen, provident fund and so on while the social costs may include such matters as exploitation of employees, industrial interest, environment pollution, unreasonable terminations, social evils resulting from setting up industries etc.

Objectives

The main objectives of financial accounting are as under :

To track the Balances

Systematic recording of business transactions provides vital information about various balances like cash balance, bank balance, etc.

Providing Details of Transactions

Systematic maintenance of books provides the details of every transactions. Ascertaining Net Profit or Loss Summarisation in form of Profit and Loss Account provides business income over a period of time.

Reflecting Financial Position

Balance sheet is prepared to depict financial position of business means what the business owns and what it owes to others. Information to All Interested Users After analysis and interpretation, business performance and position are communicated to the interested users.

Legal Obligations

Vital accounting information helps in fulfilling legal obligations e.g. sales tax, income tax etc. Functions of Accounting The function of accounting is to provide quantitative information primarily financial in nature about economic entities, which is intended to be useful in making economic decisions.

Functions of Financial Accounting

Maintaining Systematic Records Business transactions are properly recorded, classified under appropriate accounts and summarized into financial statements.

Communicating the financial results It is used to communicate financial information in respect of net profits (or loss), assets, liabilities etc. to the interested parties.

Complying Legal Requirements

The provisions of various Laws such as Companies Act, 2013, Income Tax and GST Acts, require the submission of various statements i.e. Annual accounts, Income Tax returns, Returns for GST etc

Fixing responsibility- It helps in computation of profits of different departments of an enterprise. This facilitates the fixing of the responsibility of departmental heads.

Decision making- It provides the users the relevant data to enable them make appropriate decisions in respect of investment in the capital of the business enterprise or to supply goods on credit or lend money etc.

Advantages of Accounting

1. **Financial Information about Business :** Financial performance during the accounting period, i.e., profit or loss and also the financial position at the end of the accounting period is known through accounting.
2. **Assistance to Management :** The management makes business plans, takes decision and exercise control on affairs on the basis of accounting information.
3. **Replacement for Memory :** A systematic and timely recording of transactions obviates the necessity to remember the transactions. The accounting record provides this necessary information.
4. **Facilitates Comparative Study :** A systematic record enables a businessman to compare one year's results with those of other years and locate significant factors leading to the change, if any.

5. **Facilitates Settlement of Tax Liabilities :** A systematic accounting record immensely helps settlement of income tax, sales tax, VAT and excise duty liabilities since it is a good evidence of the correctness of transactions.
6. **Facilitates Loans :** Loan is granted by the banks and financial institutions on the basis of growth potential which is supported by the performance. Accounting makes available the information with respect to performance.
7. **Works as Evidence in Court :** Systematic record of transactions is often accepted by the Courts as good evidence.
8. **Facilitates Sale of Business :** If someone desires to sell his business, the accounts maintained by him will enable the ascertainment of the proper purchase price.
9. **Assistance in the Event of Insolvency :** Insolvency proceedings involve explaining many transactions that have taken place in the past. Systematic accounting records assist a great deal in such a situation.
10. **Helpful in Partnership Accounts :** At the time of admission of a partner, retirement or death of a partner and dissolution of the firm, accounting records are of vital importance and use. It is so because such records provide the basis to reach a settlement.

Limitations of Accounting

1. Accounting information is expressed in terms of Money : Non-monetary events or transactions are completely omitted.
2. Fixed assets are recorded in the accounting records at the original cost : Actual amount spent on the assets like building, machinery, plus all incidental charges is recorded. In this way the effect of rise in prices is not taken into consideration. As a result the Balance Sheet does not represent the true financial position of the business.
3. Accounting information is sometimes based on estimates: Estimates are often inaccurate. For example, it is not possible to predict the actual life of an asset for the purpose of depreciation.
4. Accounting information cannot be used as the only test of managerial performance on the basis of mere profits : Profit for a period of one year can readily be manipulated by omitting certain expenses such as advertisement, research and development, depreciation etc. i.e. window dressing is possible.
5. Accounting information is not neutral or unbiased : Accountants ascertain income as excess of revenue over expenses. But they consider selected revenue and expenses for calculating profit of the concern. They also do not include cost of such items as water, noise or air pollution i.e. social cost, they may also use different methods of valuation of stock or depreciations.

Accounting as an Information System and its Users

Accounting is the common language used to communicate financial information to individuals, organisations, government agencies about various aspects of business such as financial position, operating results (i.e. Profit or loss) and cash flows.

Users, both inside and outside the business, have to make decisions concerning the allocation of limited economic resources. In order to ensure that resources are allocated in an efficient and effective manner, users require financial information for the purpose of making decisions.

Accounting provides information that is useful in making business and economic decisions. It is the primary means of communicating financial information to owners, lenders, managers, Government and its regulatory agencies 'and -others- who have interest in an enterprise.

It helps the users in taking better decisions by providing relevant, reliable and timely information on the financial and operational position of an enterprise.

It is observed that almost all business enterprises maintain detailed accounting records.

Even the most intelligent manager with a sharp memory would find it difficult to remember the daily transactions simply by observing them. So he/she must rely upon the accounting process which begins with the recording of business transactions and ends up with the preparation of summarized financial statements.

Thus, Accounting as an information system is necessitated by great complexity of modern business organisations.

Accounting as a Source of Information

“Accounting is a service activity. Its function is to provide qualitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions.”

As an information system, accounting collects data and communicates economic information about the organisation to a number of users whose decisions and actions are related to its performance.

Accounting begins with the identification of transactions of financial nature and ends with the preparation of financial statements (i.e., Income Statement and Balance Sheet).

Each step in the process of accounting generates information. Generation of information is not an end in itself, it is a way to facilitate the dissemination of information among users of accounting information.

Accounting information is used for predicting, comparing and evaluating the earning power and financial position of a business enterprise. Therefore, dissemination of information is an essential function of accounting.

State whether the following statements are True or False :

- i. Systematic record of transactions is often accepted by the Courts as good evidence.
- ii. The balance sheet makes available the information about the financial health of the enterprises.
- iii. Creditors are internal users of accounting information

Users of Accounting Information

Users of Accounting Information may be categorised into Internal Users and External Users.

Internal Users

- i. Owners : Owners contribute capital in the business and thus, are exposed to maximum risk. Naturally, they are interested in knowing the profit earned or loss suffered by the business besides the safety of their capital. The financial statements give the information about profit or loss and financial position of the business.
- ii. Management :The management makes extensive use of accounting information to arrive at informed decisions such as determination of selling price, cost controls and reduction, investment into new projects, etc.
- iii. Employees and Workers : Employees and workers are entitled to bonus at the year end, which is linked to the profit earned by an enterprise. Therefore, the employees and workers are interested in financial statements. Besides, the financial statements also reflect whether the enterprise has deposited its dues into the provident fund and employees state insurance accounts, etc., or not.

External Users

- i. Banks and Financial Institutions :Banks and financial institutions are an essential part of any business as they provide loans to the businesses. Naturally, they watch the performance of the business to know, whether it is making progress as projected to ensure the safety and recovery of the loan advanced. They assess it by analysing the accounting information.
- ii. Investors and Potential Investors :Investment involves risk and also the investors do not have direct control over the business affairs. Therefore, they rely on the accounting information available to them and seek answers to the questions such as - what is the earning capacity of the enterprise and how safe is their investment?
- iii. Creditors : Creditors are those parties who supply goods or services on credit. Before granting credit, creditors satisfy themselves about the credit worthiness of the business. The financial statements help them immensely in making such an assessment.
- iv. Government and Its Authorities : The government makes use of financial statements to compile national income accounts and other informations. The information so available to it enables them to take policy decisions. Government levies varied taxes such as Excise Duty, VAT, Service Tax and Income Tax. These government authorities assess the correct tax dues from an analysis of financial statements.
- v. Researchers : Researchers use accounting information in their research work.

- vi. Consumers : Consumers require accounting information for establishing good accounting control so that cost of production may be reduced with the resultant reduction of the prices of products they buy. Sometimes, prices of some products are fixed by the government, so it needs accounting information to fix fair prices so that consumers and producers are not exploited.
- vii. Public : They want to see the business running since it makes substantial contribution to the economy in many ways, e.g., employment of people, patronage to suppliers, etc. Thus, financial accounting provides useful financial information to various user groups for decision-making.

Qualitative Characteristics of Accounting Information

Two fundamental characteristics of financial statements are their truth and fairness. An auditor of the enterprise has to make a statement in his report whether, in his opinion, the financial statements give a true and fair view. It means that the Balance Sheet should give a true and fair view of the state of affairs and the Profit and Loss Account should give the true and correct profit or loss for the period.

Besides the above fundamental characteristics, there are other qualitative characteristics (attributes) that make the information content of the financial statements meaningful to its users.

These are:

1. Reliability;
2. Relevance;
3. Understandability and
4. Comparability.

1. Reliability : Accounting information must be reliable. the foremost factors that make it reliable are that

- i. it should be verifiable. It means, transactions should be evidenced by documents. For example, purchases be evidenced by bills of purchases, sales be evidenced by sales bills, etc.
- ii. it should be free from personal bias. It means, where personal judgement is to be exercised, it should be independent and free from bias.

Reliability of the accounting information depends on:

- i. Neutrality : Neutrality means that the accounting information made available does not suffer from bias.
- ii. Prudence : The accounting information prepared on the principle of prudence (conservatism) means that the accounting information is prepared by providing all prospective losses while leaving all prospective profits.
- iii. Completeness : The accounting information given should be complete in all respects as incomplete information may lead to wrong interpretation.
- iv. Substance Over Form : The accounting information to be meaningful, should be governed by the substance of the information and not by its legal form alone.

2. Relevance : The accounting information, besides disclosing statutorily required disclosures, should disclose other information, after judging its relevance to the decision-making need of its users. For example, interest on borrowings is disclosed without stating the rate of interest. Users, therefore, cannot link interest cost to different types of borrowed funds. In the process, they fail to appreciate the rationality of financing decisions. Generally, only the statutory (legal) required information is disclosed.

3. Understandability : Understandability means that the information provided through the financial statements be presented in a manner that the users are able to understand it in the manner it should be. However, if an information is considered relevant for the users' decision-making it must be disclosed even if the information is complex and not readily understandable by common users. The information disclosure requirement of law must be fulfilled howsoever complex such information may be.

4. Comparability : Comparability means that the users should be able to compare the accounting information of an enterprise of the period either with that of other periods, known as intra-firm comparison or with the accounting information of other enterprises, known as inter-firm comparison. It is, therefore, necessary to follow standardised accounting policies consistently to the extent possible.

Accounting information to be useful should have all the above characteristics. The accounting information produced in the light of Reliability and Relevance Qualitative Characteristics can be useful but its usefulness shall be limited if it lacks understandability and comparability.

Role of an Accountant in Society

The accountants' role in the society can be summarised as follows :

- To maintain the proper books of accounts which portray the true and fair view of the results of the business.
- To provide information and reports to management to enable them to discharge their duties more effectively
- To act as auditor for attestation of accounts as per the requirement of law.
- To act as an internal auditor to assist and strengthen the hands of the management. To act as tax consultant to handle the tax matters of the business.
- To act as management consultant to provide services regarding financial planning of the business to their clients.

Accounting Process

Following are the two approaches for deciding which account to debit and which to credit:

A. American Approach or the Modern Approach

Under this approach, we divide the transactions into the following five categories:

1. Transactions relating the owner, e.g. Capital and drawings. These are in the nature of Personal Accounts.
2. Transactions relating to the other liabilities, e.g. Suppliers of goods. These are also usually in the nature of Personal Accounts.
3. Asset-related transactions, e.g. land, building, plant, and machinery, cash, bank, stock, bills receivable, etc. These are in the nature of Real Accounts.
4. Transactions relating to the expenses, e.g. salary, wages, rent, commission, freight, cartage, etc. These are in the nature of Nominal Accounts.
5. Transactions relating to the revenues or incomes, e.g. interest, dividend, sale of goods, etc. These are also in the nature of Nominal Accounts.

Thus, as per this approach, we need to follow the following rules in order to decide which account to debit and which to credit:

I. For Assets Accounts

Debit Increase in Assets

Credit Decrease in Assets

II. For Liabilities Accounts

Debit Decrease in Liabilities

Credit Increase in Liabilities

III. For Capital Account

Debit Decrease in Capital

Credit Increase in Capital

IV. For Income Accounts

Debit Decrease in Income

Credit Increase in Income

V. For Expenses Accounts

Debit Increase in Expenses

Credit Decrease in Expenses

VI. For Stock Account

Debit Increase in Stock

Credit Decrease in Stock

B. British Approach or the Traditional Approach or the Double Entry System

Under this approach, we need to first identify the account that is getting affected by a transaction. After identifying the type of account, the next step is the application of the rules to decide which account to debit and credit.

These rules of Double-entry are known as the Golden rules. These are as follows:

I. Real Accounts

Debit what comes in

Credit what goes out

II. Personal Accounts

Debit the receiver

Credit the giver

III. Nominal Accounts

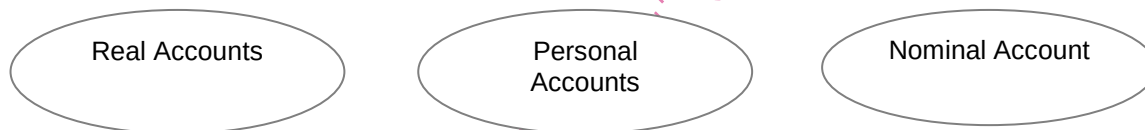
Debit all expenses and losses

Credit all incomes and gains

Types of Accounts

Different types of accounts in accounting are Real, Personal and Nominal Account. Real account is then classified in two subcategories – Intangible real account, Tangible real account. Also, three different sub-types of Personal account are Natural, Representative and Artificial. Let's begin.

Types of Accounts –



Personal Account

These accounts types are related to persons. These persons may be natural persons like A's account, B 's account, C's account, D's account, etc.

These persons can also be artificial persons like partnership firms, companies, bodies corporate, an association of persons, etc.

For example – X and Y trading Co., Charitable trusts, Axis Bank Ltd, Telco Ltd, etc.

Rule for this Account



For Example – Goods sold to Mister F. In this transaction, Mister F is a personal account as being a natural person. His account will be debited in the entry as the receiver.

Real Accounts

These account types are related to assets or properties. They are further classified as Tangible real account and Intangible real accounts.

Tangible Real Accounts

These include assets that have a physical existence and can be touched. For example – Building A/c, cash A/c, stationery A/c, inventory A/c, etc.

Intangible Real Accounts

These assets do not have any physical existence and cannot be touched. However, these can be measured in terms of money and have value. For Example – Goodwill, Patent, Copyright, Trademark, etc.

Rules

Debit what comes
into the business.

Credit what goes out
of business

For Example – Furniture purchased by an entity in cash. Debit furniture A/c and credit cash A/c.

Nominal Account

These accounts types are related to income or gains and expenses or losses. For example: – Rent A/c, commission received A/c, salary A/c, wages A/c, conveyance A/c, etc.

Rules

Debit all the
expenses and losses
of the business.

Credit the incomes
and gains of
business.

For Example – Salary paid to employees of the entity. Salary A/c will be debited when the expenses are incurred. Whereas, when an entity receives any interest, discount, etc these are credited whenever these are received by the entity.

Accounting Cycle

1. Preparation of Journal
2. Preparation of Ledger
3. Preparation of Trial balance
4. Preparation of Final Accounts

Steps involved in an accounting cycle are as given below

Recording of transactions

As soon as the transaction occurs it is the responsibility of an accountant to record such a transaction in subsidiary books. Accounting transaction should be recorded in the books according to the accounting policies, principles followed by such entity.

Journal

Next step in this accounting cycle is to record the financial transactions in the journal. Financial transactions are recorded in Journal chronologically.

Ledger

All the journal entries prepared in the earlier step are posted into respected ledgers chronologically. A ledger shows the summary of all the financial transactions related to such account. For example: – In cash ledger, we find a summary of all the cash transactions.

Trial balance

After completion of the posting of entries to ledgers, one need to prepare a trial balance.

Adjusted Trial Balance

After preparation of trial balance and making adjustment entries (if any), an adjusted trial balance may also be prepared. An accountant shall also check that the debit and credits on the trial balance match.

Financial Statements

After having completed aforementioned steps, one can prepare financial statements easily. Financial statements will show the true financial position and operating results of the entity's business.

Accrual Basis and Cash Basis

Cash Basis Accounting

As per cash basis of accounting, we record revenues on receipt of cash, and expenses on their payment. Cash basis of accounting does not recognize accounts receivable or accounts payable.

All transactions related to revenues, costs, assets, and liabilities are reflected in the accounts for the period in which actual receipts or actual payments are made.

Many small enterprises opt to use the cash basis of accounting. It is simple to maintain. We can easily find out when a transaction has occurred and there is no need to track receivables or payables.

The cash method also helps to determine how much cash the business actually has at any given time. We can look at our bank balance and understand the exact resources at our disposal.

Accrual Basis Accounting

As per accrual basis, we record revenues and expenses when they accrue, regardless of the actual receipt or payment of the amount. This basis is more commonly in use than the cash basis.

The accrual basis provides a more realistic idea of income and expenses during a period of time. This method provides a long-term picture of the business that cash accounting cannot provide.

The downside of this method is that accrual accounting does not give any awareness of cash flow. An enterprise can appear to be more profitable while in reality, it has no balances in bank accounts.

Accrual basis accounting without careful monitoring of cash flow can have potentially adverse consequences.

Chapter 17

Accounting Concepts & Conventions

Accounting Concepts :

Are defined as Basic assumptions or rules or procedures on the basis of which Financial Statements of a Business Entity is prepared.

Meaning of Accounting Concept

Following are the various accounting concepts:

- ✍ Business entity concept
- ✍ Money measurement concept
- ✍ Going concern concept
- ✍ Accounting period concept
- ✍ Accounting cost concept
- ✍ Duality aspect concept
- ✍ Realisation concept
- ✍ Accrual concept
- ✍ Matching concept

Business Entity Concept

Is also known as Separate Entity concept and some times as economic entity concept.

As per this concept Business and owners are considered as separate entities.

Transactions of owners are not mixed with the Business Transactions.

That is the reason amount invested by owner into the business is recorded towards Liability side as Capital i.e. amount owed by business to owners

Significance

This concept helps in ascertaining the profit of the business as only the business expenses and revenues are recorded and all the private and personal expenses are ignored.

Money Measurement Concept

As per this concept only such transactions that can be measured in monetary terms are recorded. It is also means transactions or events should not be recorded in physical units rather in value of money.

Also this concept implies, transactions and events that cannot be measured in money terms should not be recorded.

Going Concern Concept

Means that business will continue to operate in foreseeable future. On account of this concept business Expenditures can be deferred.

In the absence of this concept, the cost of a fixed asset will be treated as an expense in the year of its purchase.

Accounting Period Concept

It is customary that life of a business is divided into appropriate parts or segments for analysing the results shown by the business.

Each part or segment is known as an accounting period. Normally , accounting period comprises of 12 months.

This concept is extremely vital to assess and analyse results and for complying with legal formalities.

Accounting Cost Concept

As per this concept assets of the business should be recorded on the basis of actual cost.

Cost means :

Purchase price + All direct expenses incurred in bringing the asset to the present location + Installation Expenses .

Assets are recorded at historical cost. For a new asset Historical cost basically means actual cost. However, for an Used asset, Historical Cost means Cost Less Depreciation.

This concept requires asset to be shown at the price at which it has been acquired, which can be verified from the supporting documents. It helps in calculating depreciation on fixed assets.

Dual Aspect Concept

This concept simply implies that every transaction has two aspects. On account of this concept at any point of time:

Assets must be equal to Capital + Liabilities

Realisation Concept

As per this concept Revenue should be recognised when sale has been made either in cash or on credit and right to receive cash has been established

Accrual Concept

As per this concept, all expenses and incomes relating to the accounting period only should be recorded irrespective of actual cash receipts or payments.

Matching Concept

This concept is based upon accounting period concept. As per this concept, expenses of a particular period should be charged against the income of the same period.

It guides how the expenses should be matched with revenue for determining exact profit or loss for a particular period. It is very helpful for the investors/shareholders to know the exact amount of profit or loss of the business.

Accounting Conventions

Simply means customs or traditions based on general agreements between or among accounting bodies.

The most important conventions which have been used for a long period are :

- ✍ Convention of consistency.
- ✍ Convention of full disclosure.
- ✍ Convention of materiality.
- ✍ Convention of conservatism.

Convention of Consistency

The convention of consistency means that same accounting principles should be used for preparing financial statements year after year. A meaningful conclusion can be drawn from financial statements of the same enterprise when there is a comparison between them over a period of time. But this can be possible only when accounting policies and practices followed by the enterprise are uniform and consistent over a period of time. If different accounting procedures and practices are used for preparing financial statements of different years, then the result will not be comparable.

Therefore, as per this convention the same accounting methods should be adopted every year in preparing financial statements. But it does not mean that a particular method of accounting once adopted can never be changed. Whenever a change in method is necessary, it should be disclosed by way of footnotes in the financial statements of that year. Significance It facilitates comparative analysis of the financial statements

Convention of Full Disclosure

Full disclosure principle refers to the concept that suggests that a business should report all the necessary information in their financial statements, so that the users who are able to read the financial information are in a better position to make important decisions regarding the company.

Since, the external users of financial information lack any kind of information on how business is run, the full disclosure principle makes it easier to determine how a company is functioning.

Following are some of the information that can be disclosed in the financial statements:

1. Acknowledging any change in accounting standards or principles.
2. Accounting policies that are followed
3. Presenting all financial statements in detail
4. Details on the level of inventory of the business.
5. The nature of relationship between the business and related party/parties of the organisation.
6. Disclosing the nature of non-monetary transactions.
7. Circumstances that lead to the impairment of goodwill.

Convention of Materiality

As per this convention all significant material information and policies must be disclosed by way of note. Further, as per materiality concept, all information that is considered as material should be recorded and presented while immaterial transactions should be ignored while preparing the financial statements

Convention of Conservatism

As per this concept all anticipated losses should provided for while all anticipated gains should be ignored. On account of this convention provision for doubtful debts, provision for decline in value of Investments etc. are made.

MCQs

Q.1 The correct form of Accounting equation is

- (a) Assets – Receivable = Equity
- (b) Assets + Receivable = Equity
- (c) Assets – Liabilities = Equity
- (d) Assets + Liabilities = Equity

Answer: c

Q.1 GAAP stands for:

- (a) Generally Accepted Accounting Provisions
- (b) Generally Accepted Accounting Policies
- (c) Generally Accepted Accounting Principles
- (d) None of these

Answer: c

Q.2 Which accounting principle states that companies and owners should be treated as separate entities.

- (a) Monetary Unit Assumption
- (b) Business Entity Concept
- (c) Periodicity Assumption
- (d) Going Concern Concept

Answer: b

Q.3 Cost or expenses must be recorded at the same time as the revenue to which they correspond is specified by which principle?

- (a) Matching Principle
- (b) Going Concern Principle
- (c) Consistency Principle
- (d) Prudence Principle

Answer: a

Q.4 Which concept states that “for every debit, there is a credit”?

- (a) Money Measurement Concept
- (b) Accounting Period Concept
- (c) Separate Entity Concept
- (d) Dual Aspect Concept

Answer: d

Q.5 For measuring income, the most acceptable method is?

- (a) To apply normal rate of return on capital invested
- (b) To apply the average return in industry on capital
- (c) To match the cost with revenue
- (d) To find out the difference in net worth as on two dates

Answer: c

Q.7 As per revenue recognition principle, sales revenues should be recognized at the time when?

- (a) Order is taken for merchandise
- (b) Ownership of goods gets transferred from the seller to the buyer
- (c) Cash is received
- (d) All of the above

Answer: b

Q.8 Due to which concept, accounting does not record non-financial transactions?

- (a) Going concern concept
- (b) Money measurement concept
- (c) Accrual concept
- (d) Cost concept

Answer: b

Q.9 The owner of the business is treated as a creditor of the business according to which of the following concept?

- (a) Entity concept
- (b) Materiality concept
- (c) Consistency concept
- (d) Periodicity concept

Answer: a

Q.10 As per the accrual concept of accounting, any financial or business transaction should be recorded:

- (a) when profit is computed
- (b) when balance sheet is prepared
- (c) when cash is received or paid
- (d) when transaction occurs

Answer: d

Q.11 According to which concept, the proprietor of the business is treated as the creditor to the extent of his capital?

- (a) Business Entity Concept
- (b) Accounting period concept
- (c) Cost Concept
- (d) Money measurement concept

Answer : Business Entity Concept

Q-12 Which of the following accounting concept says that asset is to be recorded at their original cost and depreciated in a systematic manner without reference to its market value?

- (a) Going Concern concept
- (b) Cost Concept
- (c) Accrual Assumption
- (d) Consistency Concept

Answer : Going Concern concept

Sanjay Welkins' Classes

Chapter 18

Capital and Revenue Expenditures

1. Question - Explain the meaning of Capital Expenditure

Response: Capital expenditure is one that results in acquisition of an asset or which results in an increase in the earning capacity of a business. The benefit of such expenditure lasts for a long period of time.

Examples:

Purchases of land, buildings, machinery, furniture, patents, etc. All these assets stay in business and are used again and again.

Other examples are money paid for goodwill (like the right to use the established name of an outgoing firm) since it will attract the old firm's customers and thus will result in higher sales and profits; money spent to reduce working expenses like conversion of hand-driven machinery to power-driven machinery and expenditure enabling a firm to produce a large quantity of goods.

Expenditure which does not result in an increase in capacity or in reduction of day-to-day expenses is not capital expenditure, unless there is a tangible asset to show for it.

All sums spent up to the point an asset is ready for use should also be treated as capital expenditure.

Examples are: fees paid to lawyer for drawing a purchase deed of land, overhauling expenses of second hand machinery, cartage paid for bringing machinery to the factory from supplier's premises and money spent to install a machinery; and even interest on loans taken to acquire fixed assets only for the period before the asset becomes operational.

2. Question Explain the meaning of Revenue Expenditure

Response: Expenses whose benefit expires within the year of expenditure and which are incurred to maintain the earning capacity of existing assets are termed as revenue expenditure.

Amounts paid for wages, salary, carriage of goods, repairs, rent and interest, etc., are examples of revenue expenditure.

Depreciation on fixed assets is also a revenue expenditure. To the extent the materials are used up, they will be revenue expenditure.

Similarly, cost of goods sold is revenue expenditure.

Costs incurred to acquire an asset are capital but costs incurred to keep them in working condition or to defend their ownership are revenue.

Fee paid to a lawyer for checking whether all the papers are in order before land is purchased is capital expenditure. But if later a suit is filed against the purchaser, the legal costs will be of revenue type.

3. Question : State the Difference Between Capital And Revenue Expenditure

Response: The following are the points of distinction between capital expenditure and revenue expenditure:

- (i) Capital expenditure is incurred in acquiring or improving permanent assets which are not meant for resale. But revenue expenditure is a routine expenditure incurred in the normal course of business and includes cost of sales as also the upkeep of fixed assets etc.
- (ii) Capital expenditure seeks to improve the earning capacity of the business whereas revenue expenditure is incurred to maintain the earning capacity of the business.
- (iii) Capital expenditure is normally a non-recurring outlay but revenue expenditure is usually a recurring features.
- (iv) Capital expenditure produces benefits over several years. Hence, only a small part is charged as depreciation to income statement and the rest appears in the balance sheet. But revenue expenditure is consumed within an accounting year and the entire amount is charged to the (current year's) income statement. Hence, it does not appear in the balance sheet. Deferred revenue expenditure is however an exception to this rule.

4. Question : Explain Deferred Revenue Expenditure

Response: There are certain expenses which may be in the nature of revenue but their benefit may not be consumed in the year in which such expenditure has been incurred; rather the benefit may extend over a number of years, for example, heavy advertising expenditure incurred in introducing a new line or developing a new market.

Charges of these expenses are deferred because such expenses benefit more than one accounting period. The matching principle demands this. The basis of charge is usually proportionate to the benefit consumed/reaped.

The practice which varies considerably is to write off the amount over the period of years in which the benefit is expected to accrue say 3 to 5 years. If the expenditure can be ear-marked as being in respect of a specified object, the expenditure should be written off during the life of that object.

Example: Heavy advertising expenses on a new product, accidental losses like loss arising from a fire or an earthquake; the loss may be spread over a few years. The deferred revenue expenditure not yet written off is shown on the assets side of the balance sheet. In the case of joint stock companies, it is deducted from reserves.

Thus, deferred revenue expenditure is revenue in character but —

- (i) The benefit of which is not exhausted in the year of expenditure, or
- (ii) is applicable either wholly or in part to the future years, or
- (iii) is accidental with heavy amount and it is not prudent to charge it against the profit of one year.

5.Question - Explain the sub-classification of Deferred Revenue Expenditures

Response: The deferred revenue expenditure may be classified into the following three categories:

- (i) Expenditure partly paid in advance, where a portion of the benefit has been derived within the accounting period and the balance will be reaped in a number of future years. Therefore, the benefit to be reaped in future is shown in the balance sheet as an asset e.g. special advertising expenditure for a new product.
- (ii) Expenditure in respect of service rendered which for any sound reason is considered as an asset or more properly not considered to be allocable to the one accounting period e.g. cost of experiments, discount on issue of debentures etc.
- (iii) Amounts representing loss of an exceptional nature e.g. property confiscated in a foreign country, loss on uninsured assets, etc.

6. Question : Write a note on Comparison Between Capital And Deferred Revenue Expenditure

Response: The main feature of capital expenditure is that it results in a benefit which will accrue to the business enterprise for a long time, say 10 or 15 years. Deferred revenue expenditure also results in a benefit which will accrue in future period but generally for 3 to 5 years.

The capital expenditure or the resulting asset is usually capable of being reconverted into cash though may be at a loss. This is not possible in the case of deferred revenue expenditure. At times, heavy loss such as loss due to earthquake is treated as deferred revenue expenditure in the sense that they are written off over a period of 3 to 5 years. Such a loss cannot be treated as a capital expenditure.

7. Question Explain Capital And Revenue Receipts

Response: - Capital receipts comprise of payments or contributions into the business by the proprietor, partners or companies towards the capital of the firm and also any sum received from debenture-holders, any loans and the proceeds of sale of any fixed assets of a business enterprise.

Revenue receipts are the outcome of a firm's activity in the accounting period, part of its rewards for offering goods or services to the public e.g. sales, commission, fees received for services, interest on investment, etc.

Revenue receipts must be set off against the revenue expenses in order to calculate the profit or loss of the business in an accounting period. Capital receipts and expenditure have no bearing on the profit or loss for the accounting period. The distinction between capital receipts and revenue receipts can be drawn as follows:

8. Question State any five differences between Capital Receipts Revenue Receipts

Response: (i) Amount realised by the sale of fixed assets or by issue of shares or debentures is a capital receipt.

Amount realised by sale of goods or rendering services is always a revenue receipt.

(ii) A receipt in substitution of a source of income is a capital receipt.

A receipt in substitution of an income is a revenue receipt.

(iii) Amount received for surrender of certain rights under an agreement is a capital receipt, because a capital asset is being given up in the form of these rights.

Amount received as compensation under an agreement for the loss of future profits is a revenue receipt.

(iv) Instead of lump sum payment if the payment is received in installments, it is a capital receipt.

If an income is received in a lump sum it is a revenue receipt.

(v) Amount realised from the sale of a capital asset or investment is capital receipt.

Amount realised from the sale of an asset kept for sale is revenue receipt.

9. Question - Explain Capital And Revenue Profits

Response: - While preparing the final accounts, distinction has to be made between capital profits and revenue profits.

Revenue profits are earned in the ordinary course of business. They appear in the profit and loss account and are available for distribution as profit, or for creating reserves and funds, or for being used in the business.

However, capital profits are those which are earned as a result of selling some fixed assets, or in connection with raising capital for the firm. For instance, a building purchased for Rs. 7,00,000 was subsequently sold for Rs. 7,50,000, then Rs. 50,000 will be profit of capital nature. Similarly, when a company issues its shares of the face value Rs. 100 for Rs. 150 each, it is said that shares have been issued at a premium, the amount of premium being a capital profit.

Capital profits are either capitalized i.e. transferred to capital account or transferred to capital reserve account which may be utilized for meeting capital losses.

10. Question - Explain the meaning of Capital And Revenue Losses

Response: - Revenue losses are the losses which arise during the normal course of business whereas capital losses are those which occur when selling fixed assets or raising share capital. If a building purchased for Rs. 40,00,000 is sold for Rs. 33,50,000, there will be capital loss of Rs. 6,50,000.

Treatment of capital losses is not different from that of capital profits. Just as capital profits are not shown in the profit and loss account, similarly capital losses are not shown in the profit and loss account. They are shown in the balance sheet on the assets side.

As and when capital profits arise, capital losses are gradually written off against them.

If however, capital losses are huge, the common practice is to spread them over a number of years and charge a part thereof to profit and loss account of each such year.

But if they are negligible, they are debited to profit and loss account of the year in which they occur.

Illustrative Question Bank**1. Illustrative Case**

State whether the following are capital, revenue or deferred revenue expenditure.

- (i) Carriage of Rs 7,500 spent on machinery purchased and installed.
- (ii) Heavy advertising costs of Rs 20,000 spent on the launching of a company's new product.
- (iii) Rs 200 paid for servicing the company vehicle, including Rs 50 paid for changing the oil.
- (iv) Construction of basement costing Rs 1, 95,000 at the factory premises.

Solution :

- (i) Carriage of Rs 7,500 paid for machinery purchased and installed should be treated as a Capital Expenditure.

- (ii) Advertising expenses for launching a new product of the company should be treated as a Deferred Revenue Expenditure.
- (iii) Rs 250 paid for servicing and oil change should be treated as a Revenue Expenditure.
- (iv) Construction cost of basement should be treated as a Capital Expenditure.

2.Illustrative Case

State whether the following are capital or revenue expenditure.

- (i) Paid a bill of Rs 10,000 of Mr. F1, who was engaged as the erection engineer to set up a new automatic machine costing Rs 20,000 at the new factory site.
- (ii) Incurred Rs 26,000 expenditure on varied advertisement campaigns under taken yearly, on a regular basis, during the peak festival season.
- (iii) In accordance with the long-term plan of providing a well- equipped Labour Welfare Centre, spent Rs 90,000 being the budgeted allocation for the year.

Solution

- (i) Expenses incurred for erecting a new machine should be treated as a Capital Expenditure.
- (ii) Advertisement expenses during peak festival season should be treated as a Revenue Expenditure.
- (iii) Expenses incurred for Labour Welfare Centre should be treated as a Capital Expenditure.

3Illustrative Case

Classify the following items as capital or revenue expenditure:

- (i) An extension of railway tracks in the factory area;
- (ii) Wages paid to machine operators;
- (iii) Installation costs of new production machine;
- (iv) Materials for extensions to foremen's offices in the factory;
- (v) Rent paid for the factory;
- (vi) Payment for computer time to operate a new stores control system,
- (vii) Wages paid to own employees for building the foremen's offices. Give reasons for your classification.

Solution

- (i) Expenses incurred for extension of railway tracks in the factory area should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (ii) Wages paid to machine operators should be treated as a Revenue Expenditure because it will benefit only the current period.
- (iii) Installation costs of new production machine should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (iv) Materials for extensions to foremen's offices in the factory should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.
- (v) Rent paid for the factory should be treated as a Revenue Expenditure because it will benefit only the current period.
- (vi) Payment for computer time to operate a new stores control system should be treated as Revenue Expenditure because it has been incurred to carry on the normal business.
- (vii) Wages paid for building foremen's offices should be treated as a Capital Expenditure because it will benefit the business for more than one accounting period.

4.Illustrative Case

For each of the cases numbered below, indicate whether the income/expenditure is capital or revenue.

- (i) Payment of wages to one's own employees for building a new office extension.
- (ii) Regular hiring of computer time for the preparation of the firm's accounts.
- (iii) The purchase of a new computer for use in the business.
- (iv) The use of motor vehicle, hired for five 'years, but paid at every six months.

Solution

- (i) Payment of wages for building a new office extension should be treated as a Capital Expenditure.
- (ii) Computer hire charges should be treated as a Revenue Expenditure.
- (iii) Purchase of computer for use in the business should be treated as a Capital Expenditure.
- (iv) Hire charges of motor vehicle should be treated as a Revenue Expenditure.

5.Illustrative Case

State with reasons whether the following are capital or revenue expenditure:

- (1) Freight and cartage on the new machine Rs 150, and erection charges Rs 500.
- (2) Fixtures of the book value of Rs 2,500 sold off at Rs 1,600 and new fixtures of the value of Rs 4,000 were acquired cartage on purchase Rs 5.
- (3) A sum of Rs 400 was spent on painting the factory.
- (4) Rs 8,200 spent on repairs before using a second hand car purchased recently, to put it in usable condition.

Answer -

- Freight and cartage totaling Rs 650 should be treated as a Capital Expenditure because it is directly associated with acquisition of Machine
- Loss on sale of fixtures Rs (2,500 -1,600) = Rs 900 should be treated as a Capital Loss. The cost of new fixtures and carriage thereon should be treated as a Capital Expenditure because the fixture will be used for a long period.
- Painting of the factory should be treated as a Revenue Expenditure because it has been incurred to maintain the factory building.

Repairing cost of second hand car should be treated as a Capital Expenditure because it will benefit the business for more than one accounting year.

7.Illustrative Case

State the nature (capital or revenue) of the following expenditure which were incurred by

509 Limited during the year ending 31.3 2019:

- (i) Rs 10,000 was spent on repairing a second hand machine which was purchased and Rs 1,000 was paid on carriage and freight in connection with its acquisition.
- (ii) A sum of Rs 8,000 was paid as compensation to two employees who were retrenched.
- (iii) Rs 300 was paid in connection with carriage on goods purchased.
- (iv) Rs 50,000 customs duty is paid on import of a machinery for modernization of the factory production during the current year and Rs 10,000 is paid on import duty for purchase of raw materials.
- (v) Rs 25,000 interest had accrued during the year on term loan obtained and utilised for the construction of factory building and purchase of machineries; however, the production has not commenced till the last date of the accounting year.

Solution

- (i) Repairing and carriage totaling Rs 11,000 for second hand machine should be treated as a Capital Expenditure.
- (ii) Compensation paid to employees shall be treated as a Revenue Expenditure.
- (iii) Carriage paid for goods purchased should be treated as a Revenue Expenditure.
- (iv) Customs duty paid on import of machinery to be treated as a Capital Expenditure. However, import duty paid for raw materials should be treated as a Revenue Expenditure.
- (v) Interest paid during pre-construction period to be treated as a Capital Expenditure.

8.Illustrative Case

State with reasons whether the following items relating to F555 Ltd. are capital or revenue:

- 1. Rs 50,000 received from issue of shares including Rs 10,000 by way of premium.
- 2. Purchased agricultural land for the mill for Rs 60,000. Rs 500 also paid for land revenue.

3. Rs 5,000 paid as contribution to PWD for improving roads of sugar producing area.
4. Rs 40,000 paid for excise duty on sugar manufactured.
5. Rs 70,000 spent for constructing railway siding.

Solution

- (1) Rs 40,000 (Rs 50,000 - Rs 10,000) received from issue of shares will be treated as a Capital Receipt. The premium of Rs 10,000 should be treated as a Capital Profit.
- (2) Cost of land Rs 60,000 to be treated as Capital Expenditure and land revenue of Rs 500 to be treated as Revenue Expenditure.
- (3) Contribution paid to PWD should be treated as a Revenue Expenditure.
- (4) Excise duty of Rs 40,000 should be treated as a Revenue Expenditure.
- (5) Rs 70,000 spent for constructing railway siding to be treated as a Capital Expenditure.

9. Illustrative Case

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

- (i) Expenses incurred in connection with obtaining a licence for starting the factory were Rs 10,000.
- (ii) Rs 1,000 paid for removal of stock to a new site.
- (iii) Rings and Pistons of an engine were changed at a cost of Rs 5,000 to get full efficiency.
- (iv) Rs 2,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the Plaintiff. The suit was not successful.
- (v) Rs 10,000 were spent on advertising the introduction of a new product in the market, the benefit of which will be effective during four years.
- (vi) A factory shed was constructed at a cost of Rs 1,00,000. A sum of Rs 5,000 had been incurred for the construction of the temporary huts for storing building materials.

Solution

- (i) Rs 10,000 incurred in connection with obtaining a license for starting the factory is a Capital Expenditure. It is incurred for acquiring a right to carry on business for a long period.
- (ii) Rs 1,000 incurred for removal of stock to a new site is treated as a Revenue Expenditure because it is not enhancing the value of the asset and it is also required for starting the business on the new site.
- (iii) Rs 5,000 incurred for changing Rings and Pistons of an engine is a Revenue Expenditure because, the change of rings and piston will restore the efficiency of the engine only and it will not add anything to the capacity of the engine.
- (iv) Rs 2,000 incurred for defending the title to the firm's assets is a Revenue Expenditure.
- (v) Rs 10,000 incurred on advertising is to be treated as a Deferred Revenue Expenditure because the benefit of advertisement is available for 4 years, Rs 2,500 is to be written off every year.
- (vi) Cost of construction of Factory shed of Rs 1,00,000 is a Capital Expenditure, similarly cost of construction of small huts for storing building materials is also a Capital Expenditure.

10. Illustrative Case

Following expenses were incurred by 520 Limited- a company which deals in Entertainments and Theater. Categorise the expenses into Revenue and Capital nature.

- (i) The redecoration expenses Rs 6,000.
- (ii) The installation of a new wine bar for Rs 10,000.
- (iii) The building of an extension of the club dressing room for Rs 15,000.
- (iv) The purchase of wines and spirits Rs 2,000.
- (v) The purchase of V.C.R. and T.V. for the use in the club lounge for Rs 15,000.

Solution

- (i) The redecoration expenses of Rs 6,000 shall be treated as a Deferred Revenue Expenditure.
- (ii) The installation of a new wine bar is a Capital Expenditure because it is the acquisition of an asset.
- (iii) Rs 15,000 spent for the extension of club dressing room is a Capital Expenditure because it creates an asset of a permanent nature.

- (iv) The purchase of wines and spirits of Rs 2,000 is a Revenue Expenditure.
- (v) The purchase of V.C.R. and T.V. for Rs 15,000 is a Capital Expenditure, because it is the acquisition of assets.

Multiple Choice Question

1. -----is that expenditure that results in the acquisition of an asset or which results in an increase in the earning capacity of a business.
- (A) Capital expenditure
 - (B) Revenue expenditure
 - (C) Deferred revenue expenditure
 - (D) None of the above

Answer:

- (A) Capital expenditure
2. Expenses whose benefit expires within the year of expenditure and which are incurred to maintain the earning capacity of existing assets are termed as
- (A) Capital expenditure
 - (B) Revenue expenditure
 - (C) Deferred revenue expenditure
 - (D) None of the above

Answer:

- (B) Revenue expenditure
3. There are certain expenses that may be in the nature of revenue but their benefit may not be consumed in the year in which such expenditure has been incurred; rather the benefit may extend over a number of years are termed as
- (A) Capital expenditure
 - (B) Revenue expenditure
 - (C) Deferred revenue expenditure
 - (D) None of the above

Answer:

- (C) Deferred revenue expenditure
4. Which of the following is/are examples of capital expenditure?
- (A) Purchases of land & buildings by the property dealer
 - (B) Purchases of machinery by machinery dealer
 - (C) Expenses incurred for getting patents
 - (D) All of the above

Answer:

- (C) Expenses incurred for getting patents
5. Which of the following is/are examples of capital expenditure?
- (A) Fees paid to a lawyer for drawing a purchase deed of land
 - (B) Overhauling expenses of second-hand machinery
 - (C) Cartage paid for bringing machinery to the factory from the supplier's premises
 - (D) All of the above

Answer:

- (D) All of the above
6. Amounts paid for wages, salary, carriage of goods, repairs, rent, and interest, etc. are items of
- (A) Capital expenditure
 - (B) Revenue expenditure

- (C) Deferred revenue expenditure
- (D) None of the above

Answer:

- (B) Revenue expenditure

7. Costs incurred to acquire an asset are but costs incurred to keep them in working condition or to defend their ownership are

- (A) Capital expenditure, Revenue expenditure
- (B) Revenue expenditure, Revenue expenditure
- (C) Deferred revenue expenditure. Revenue expenditure
- (D) Revenue expenditure, Capital expenditure

Answer:

- (A) Capital expenditure, Revenue expenditure

8. Which of the following is/are not an example of capital expenditure

- (A) Money spent to reduce working expenses like conversion of hand-driven machinery to power-driven machinery
- (B) Money paid for goodwill (like the right to use the established name of an outgoing firm)
- (C) Expenditure which does not result in an increase in capacity or in reduction of day-to-day expenses
- (D) All of the above

Answer:

- (C) Expenditure which does not result in an increase in capacity or in reduction of day-to-day expenses

9 Depreciation on fixed assets is

- (A) Capital expenditure
- (B) Revenue expenditure
- (C) Deferred revenue expenditure
- (D) None of the above

Answer:

- (B) Revenue expenditure

10. All sums spent up to the point an asset is ready for use should also be treated as

- (A) Capital expenditure
- (B) Revenue expenditure
- (C) Deferred revenue expenditure
- (D) None of the above

Answer:

- (A) Capital expenditure

11. Amounts paid for wages, salary, carriage of goods, repairs, rent, and interest, etc. are items of

- (A) Capital expenditure
- (B) Revenue expenditure
- (C) Deferred revenue expenditure
- (D) None of the above

Answer:

- (B) Revenue expenditure

12. The fee paid to a lawyer for checking whether all the papers are in order before the land is purchased is ----- But if later a suit is filed against the purchaser, the legal costs will be _____

- (A) Capital expenditure, Revenue expenditure
- (B) Revenue expenditure, Revenue expenditure
- (C) Deferred revenue expenditure, Revenue expenditure
- (D) Revenue expenditure, Capital expenditure

Answer:

(A) Capital expenditure, Revenue expenditure

Sanjay Welkins' Classes

Chapter 19

Four Framework of Accounting

Accounting Framework provides common set of rules and guidelines that is used to measure, recognise, present and disclose information

Four Frameworks of Accounting

1. Conceptual Framework

A conceptual framework is

Is like constitution

Sets out

Objective

Qualitative characteristics

Definition of asset/ Liabilities and Income and expenses

Recognition criteria

Measurement bases

2. Legal Framework

Partnership : Indian Partnership Act 1932

LLP : LLP Act of 2008

Co-operative - Co-operative Society Act 1912

Banking Companies : Banking Regulations Act 1949

Insurance Companies : Insurance Act 1938 and IRDA Guidelines

3. Institutional Framework

Guidelines and pronouncements by :

ICAI

ICMAI

4. Regulatory Framework

Money Market : RBI

Capital Market : SEBI

Insurance Sector : IRDA

Pension Funds : PFRDA

Telecommunication : TRAI

Competition: Competition Commission

MCQs

1. Which of the following is not true concerning a conceptual framework in accounting?
 - a. It should be a basis for standard-setting.
 - b. It should allow practical problems to be solved more quickly by reference to it.
 - c. **It should be based on fundamental truths that are derived from the laws of nature.**
 - d. All of these answer choices are true.

2. What is a purpose of having a conceptual framework?
- a. To make sure that economic activity can be identified with a particular legal entity.
 - b. To segregate activities among different companies.
 - c. To provide comparable information for different companies.
 - d. To enable the profession to more quickly solve emerging practical problems and to provide a foundation from which to build more useful standards.**
3. In the conceptual framework for financial reporting, what provides "the why"--the purpose of accounting?
- a. Recognition, measurement, and disclosure concepts such as assumptions, principles, and constraints
 - b. Qualitative characteristics of accounting information
 - c. Elements of financial statements
 - d. Objective of financial reporting**
4. The objective of general-purpose financial reporting is to provide financial information about a reporting entity to each of the following except
- a. potential equity investors.
 - b. potential lenders.
 - c. present investors.
 - d. All of these answers are correct.**
5. The underlying theme of the conceptual framework is
- a. decision usefulness.**
 - b. understand-ability.
 - c. faithful representation.
 - d. comparability.

Sanjay Welkins' Classes

Financial Accounting : Division B

Accounting Standards

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Chapter 1

Overview Accounting Standards

Q - 1: How Many Accounting Standards Have been Issued so Far and how many have been notified?

Response : The Council of ICAI, so far, issued twenty nine Accounting Standards.

However, AS 6 on 'Depreciation Accounting' has been withdrawn on revision of AS 10 'Property, Plant and Equipment' and AS 8 on 'Accounting for Research and Development' has been withdrawn consequent to the issuance of AS 26 on 'Intangible Assets'.

Thus effectively, there are 27 Accounting Standards at present.

The 'Accounting Standards' issued by the Accounting Standards Board establish standards which have to be complied by the business entities so that the financial statements are prepared in accordance with generally accepted accounting principles

Q - 2: Give a detailed list Accounting standards

Response: The following is the list of Accounting Standards with their respective date of applicability:

AS No.	Title of the Accounting Standard	Date
1	Disclosure of Accounting Policies	01/04/1993
2	Valuation of Inventories (Revised)	01/04/1999
3	Cash Flow Statement	01/04/2001
4	Contingencies and Events Occurring after the Balance Sheet Date (Revised)	01/04/1998
5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies	01/04/1996
6	Depreciation Accounting	Withdrawn w.e.f 1.4.2016 after issuance of revised AS 10 on PPE
7	Construction Contracts	01/04/2002
8	Research & Development	Now included in AS 26
9	Revenue Recognition	01/04/1993
10	Property, Plant and Equipment (Revised)#	01/04/2016
11	The Effects of Changes in Foreign Exchange Rates	01/04/2004
12	Accounting for Government Grants	01/04/1994
13	Accounting for Investments (Revised)	01/04/1995
14	Accounting for Amalgamations (Revised)	01/04/1995
15	Employee Benefits	01/04/2006
16	Borrowing Costs	01/04/2000
17	Segment Reporting	01/04/2001
18	Related Party Disclosures	01/04/2001
19	Leases	01/04/2001
20	Earnings Per Share	01/04/2001
21	Consolidated Financial Statements (Revised)	01/04/2001
22	Accounting for Taxes on Income	01/04/2006
23	Accounting for Investments in Associates in Consolidated Financial Statements	01/04/2002
24	Discontinuing Operations	01/04/2004
25	Interim Financial Reporting	01/04/2002

Sanjay Welkins' Classes	Overview of AS / Ind AS/ Acc. Standards

26	Intangible Assets	01/04/2003
27	Financial Reporting of Interests in Joint Ventures	01/04/2002
28	Impairment of Assets	01/04/2008
29	Provisions, Contingent Liabilities and Contingent Assets (Revised)	01/04/2004

Earlier AS 10 was on 'Accounting for Fixed Assets'.

Q :3 - Explain the Applicability of Accounting Standards

Response -

1. For the purpose of compliance of the accounting Standards, the council of ICAI, at its 400th meeting held on 18-19, March, 2021, considered matter relating to applicability of Accounting standards issued by ICAI, to Non-company entities (Enterprises). The scheme for applicability of Accounting Standards to Non-company entities shall come into effect in respect of accounting periods commencing on or after 1.4.2020

2. As per the announcement, entities were classified into three levels. Level I, Level II ,Level III and Level IV entities.

3. Level I entities are large size entities while Level II are medium size entities ,Level III entities are small size and level IV are Micro entities. As per the said Announcement Level IV, III and II shall be referred to as Micro, Small and Medium size entities (MSMEs).

3. Level I entities are required to comply in full with all the accounting standards.

4. Certain relaxations/exemptions have been provided to Level , II, III and IV non-company entities.

Q - 4 - Explain The Criteria for classification of Non-Corporate Entities as decided by the Institute of Chartered Accountants of India

Response:

Level I Entities

Non-company entities which fall in any one or more of the following categories, at the end of the relevant accounting period, are classified as Level I entities:

(i) Entities whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

(ii) Banks (including co-operative banks), financial institutions or entities carrying on insurance business.

(iii) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds **250** crore in the immediately preceding accounting year.

(iv) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees **50** crore at any time during the immediately preceding accounting year.

(v) Holding and subsidiary entities of any one of the above

Level II Entities (Medium Sized)

Non-corporate entities which are not Level I entities but fall in any one or more of the following categories are classified as Level II entities:

(i) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees 50 crore* but does not exceed 250 crore in the immediately preceding accounting year.

(ii) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees 10 crores but not in excess of rupees 50 crore at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above

Level III Entities (Small sized)

Non-corporate entities which are not covered under Level I and II but fall in any one or more of the following categories are classified as Level III entities:

(i) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees 10 crore* but does not exceed 50 crore in the immediately preceding accounting year.

(ii) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees 2 crore but not in excess of rupees 10 crore at any time during the immediately preceding accounting year.

Sanjay Welkins' Classes	Overview of AS / Ind AS/ Acc. Standards

(iii) Holding and subsidiary entities of any one of the above

Level IV Entities (Micro sized)

Non-corporate entities which are not covered under Level I ,II , and Level III are considered as Level IV entities.

Q - 5 - Explain the Criteria for classification of Companies under the Companies (Accounting Standards) Rules, 2021

Response:

Small and Medium-Sized Company (SMC) as defined in Clause 2(f) of the Companies (Accounting Standards) Rules, 2021:

"Small and Medium Sized Company" (SMC) means, a company-

- (i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
- (ii) which is not a bank, financial institution or an insurance company;
- (iii) whose turnover (excluding other income) does not exceed 250 crore in the immediately preceding accounting year;
- (iv) which does not have borrowings (including public deposits) in excess of rupees 50 crore at any time during the immediately preceding accounting year; and
- (v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Explanation : For the purposes of clause 2(f), a company should qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

Non-SMCs

Companies not falling within the definition of SMC are considered as Non- SMCs.

Chapter 2

Overview Accounting Standards

Q – 1 - Explain - Explain Indian Accounting Standards (Ind AS).

Response -

- Indian Accounting Standards (Ind AS) are IFRS converged standards issued by the Central Government of India under the supervision and control of Accounting Standards Board (ASB) of ICAI and in consultation with National Advisory Committee on Accounting Standards (NACAS).
- ASB is a committee under Institute of Chartered Accountants of India (ICAI) which consists of representatives from government department, academicians, other professional bodies viz. ICSI, ICAI, representatives from ASSOCHAM, CII, FICCI, etc
- National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA)
- MCA has to spell out the Accounting Standards applicable for companies in India.
- Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS).

Core Crux of Ind AS

- Globalization and Liberalization
- Transparency of financial statements
- Comparability of financial statements

Enhanced Disclosure requirements

Q – 2 – Explain the Benefits of Convergence With IFRS

Response - There are many beneficiaries of convergence with IFRS such as the economy, investors, industry, etc.

The Economy:

When the markets expand globally the need for convergence increases since the convergence benefits the economy by increasing growth of its international business.

It facilitates maintenance of orderly and efficient capital markets and also helps to increase the capital formation and thereby economic growth.

It encourages international investing and thereby leads to more foreign capital flows to the country.

Investors:

A strong case for convergence can be made from the viewpoint of the investors who wish to invest outside their own country.

Investors want the information that is more relevant, reliable, timely and comparable across the jurisdictions.

Financial statements prepared using a common set of Accounting Standards help investors better understand investment opportunities as opposed to financial statements prepared using a different set of national Accounting Standards.

Investors' confidence is strong when Accounting Standards used are globally accepted. Convergence with IFRS contributes to investors' understanding and confidence in high quality financial statements.

The Industry:

The industry is able to raise capital from foreign markets at lower cost if it can create confidence in the minds of foreign investors that their financial statements comply with globally accepted Accounting Standards.

With the diversity in Accounting Standards from country to country, enterprises which operate in different countries face a multitude of accounting requirements prevailing in the countries

The burden of financial reporting is lessened with convergence of Accounting Standards because it simplifies the process of preparing the individual and group financial statements and thereby reduces the costs of preparing the financial statements using different sets of Accounting Standards.

Sanjay Welkins' Classes	Overview of AS / Ind AS/ Acc. Standards

In the scenario of globalization, India cannot insulate itself from the developments taking place worldwide.

In India, so far as the ICAI and the Government authorities such as the National Advisory Committee on Accounting Standards established under the Companies Act, 1956, and various regulators such as Securities and Exchange Board of India and Reserve Bank of India are concerned, the aim has always been to comply with the IFRS to the extent possible with the objective to formulate sound financial reporting standards.

Q – 3 - List out various Ind ASs

Response - The following is the list of Ind AS vis-a-vis IFRS and AS:

Ind AS	IFRS	Title of Ind AS/IFRS
101	1	First Time Adoption of Indian Accounting Standards
102	2	Share Based Payment
103	3	Business Combinations
104	4	Insurance Contracts
105	5	Non-current Assets Held for Sale and Discontinued Operations
106	6	Exploration for and Evaluation of Mineral Resources
107	7	Financial Instruments: Disclosures
108	8	Operating Segments
109	9	Financial Instruments
110	10	Consolidated Financial Statements
111	11	Joint Arrangements
112	12	Disclosure of Interests in Other Entities
113	13	Fair Value Measurement
114	14	Regulatory Deferral Accounts
115	15	Revenue from contracts with Customers
116	16	Leases
1	1	Presentation of Financial Statements
2	2	Inventories
7	7	Statement of Cash Flows
8	8	Accounting Policies, Changes in Accounting Estimates and Errors
10	10	Events after the Reporting Period
11	11	Construction Contracts (Now Replaced by Ind AS 115)
12	12	Income Taxes
16	16	Property, Plant and Equipment
17	17	Leases (replaced by Ind AS 116)
18	18	Revenue (Now Replaced by Ind AS 115)
19	19	Employee Benefits
20	20	Accounting for Government Grants and Disclosure of Government Assistance
21	21	The Effects of Changes in Foreign Exchange Rates
23	23	Borrowing Costs
24	24	Related Party Disclosures
27	27	Separate Financial Statements
28	28	Investment in Associates and Joint Ventures
29	29	Financial Reporting in Hyperinflationary Economies
32	32	Financial Instruments: Presentation
33	33	Earnings per Share
34	34	Interim Financial Reporting
36	36	Impairment of Assets

Sanjay Welkins' Classes	Overview of AS / Ind AS/ Acc. Standards

37	37	Provisions, Contingent Liabilities and Contingent Assets
38	38	Intangible Assets
40	40	Investment Property
41	41	Agriculture

Q - 3 : Explain - Implementation of Indian Accounting Standards (IND AS):

1. For Companies other than banks, NBFCs and Insurance Companies:

- a) All companies which are listed/or in process of listing inside or outside India on Stock Exchanges (other than companies listed on SME Exchanges)
- b) Unlisted companies having net worth* of ₹ 250 crore or more
- c) Parent, Subsidiary, Associate and Joint venture of above

Notes:

- ✎ Companies listed on SME exchange not required to apply Ind AS.
- ✎ Once Ind AS are applicable, an entity shall be required to follow the Ind AS for all the subsequent financial statements.
- ✎ Companies not covered above shall continue to apply existing Accounting Standards notified in **Companies (Accounting Standards) Rules, 2006**.

*Net worth shall have the same meaning as defined under section 2(57) of the Companies Act, 2013.

Net worth means the

- ⊕ aggregate value of the paid-up share capital and
- ⊕ all reserves created out of the profits and
- ⊕ securities premium account,

after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

2. For Scheduled Commercial Banks (Excluding RRBs), Insurers/Insurance Companies and Non-Banking Financial Companies (NBFC's):

Non-Banking Financial Companies (NBFC's):

- ✎ NBFCs whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India.
- ✎ NBFCs that are unlisted having net worth ₹ 250 crore or more.
- ✎ Holding, Subsidiary, JV and Associate companies of above.

Notes:

- ⊕ Applicable for both Consolidated and Individual Financial Statements
- ⊕ NBFC having net worth below ₹ 250 crore shall not apply Ind AS.
- ⊕ Voluntary adoption of Ind AS is not allowed.

Scheduled Commercial banks (excluding RRB's):

- ✎ Scheduled Commercial Banks (SCBs) excluding Regional Rural Banks (RRBs) were initially required to implement Indian Accounting Standards (Ind AS) from 1 April 2018.
- ✎ RBI vide a press release dated 5 April 2018, deferred the implementation of Ind AS by one year i.e. from 1 April 2019.
- ✎ However, later on it **deferred** the Ind AS implementation **till further** notice RBI through a notification dated 22 March 2019.

Regional Rural Banks (RRBs):

- ⊕ RRBs are Indian Scheduled Commercial Banks (Government Banks) operating at regional level in different States of India. They have been created with a view of serving primarily the rural areas of India with basic banking and financial services.
- ⊕ Each Regional Rural Bank is sponsored by a Public Sector Bank.
- ⊕ Shareholders in a RRB are: Central Government (50%); Sponsored Bank (35%); and State Governments (15%).
- ⊕ Few RRB namely; Andhra PragathiGrameena Bank, Baroda Gujarat Gramin Bank etc.

Sanjay Welkins' Classes	Overview of AS / Ind AS/ Acc. Standards

Insurers/Insurance companies:

Implementation from 1st April, 2021 (with comparatives):

Notes:

- ⊕ Holding, subsidiary, JV and Associates companies of insurers/insurance companies shall also apply from the said date irrespective of it being covered under corporate roadmap.
- ⊕ Applicable for both Consolidated and individual Financial Statements.

Division of Schedule III to the Companies Act, 2013:

As per the Companies Act, 2013, Schedule III, there are **three divisions** namely-

- 1. Division I**, which is applicable to a company whose financial statements are required to **comply with the accounting standards**.
- 2. Division II**, which is applicable to a company whose financial statements are drawn up in **compliance with Ind AS**. (MCA Notification dated 6th April, 2016)
- 3. Division III**, which is applicable to **Non-Banking Finance Companies** whose financial statements are drawn up in **compliance with Ind AS**. (MCA Notification in March, 2018)

Points which merits consideration:

- ✎ The requirements of Ind AS Schedule III, do not apply to companies as referred to in the proviso to Section 129(1) of the Act, i.e., any insurance or banking company, or any company engaged in the generation or supply of electricity or to any other class of company for which a form of Balance Sheet and Statement of Profit and Loss has been specified in or under any other Act governing such class of company
- ✎ It may, **however**, be **clarified** that for **companies engaged in the generation and supply of electricity**, neither the Electricity Act, 2003, nor the rules framed there under, prescribe any specific format for presentation of Financial Statements by an electricity company. Section 1(4) of the Act states that the Act will apply to electricity companies, to the extent it is not inconsistent with the provisions of the Electricity Act. **Keeping this in view, Ind AS Schedule III as applicable may be followed by such companies till the time any other format is prescribed by the relevant statute.**
- ✎ The Ind AS Schedule III requires that if the compliance with the requirements of the Act including Ind AS as applicable to the companies, require any change in presentation or disclosure in the Financial Statements, the requirements of **Ind AS Schedule III will stand modified accordingly**.
- ✎ Disclosure requirements specified in Schedule III would be in addition to and not in substitution of the disclosure requirements specified in Ind AS. In situations where an accounting treatment or disclosure in an **Ind AS is in conflict with the requirements of Schedule III**, companies are required to **comply with the relevant Ind AS**.
- ✎ Where any Act or Regulation (e.g. SEBI Guidelines for listed entities) requires specific disclosures to be made in the Financial Statements of a company, the said disclosures shall be made in addition to those required under Ind AS Schedule III.

Chapter – 3 :

Accounting Standards

AS – 1

Disclosure of Accounting Policies

Summary

All significant accounting policies used in the preparation and presentation of financial statements should be disclosed.

The disclosure should form part of the financial statements, normally in one place.

Any change in the accounting policies which has a material effect in the current period or is expected to have a material effect in later periods should be disclosed.

In case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected should also be disclosed to the extent it can be calculated. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

If the fundamental accounting assumptions of Going Concern, Consistency, and Accrual are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

Illustrative Case Studies Vault

1.

Which one is the correct one? Fundamental accounting assumptions as per AS 1 are:

- (a) Going Concern, Matching and Consistency;
- (b) Money Measurement, Going Concern and Prudence;
- (c) Accounting Period, Going Concern and Entity Concept; and
- (d) Going Concern, Consistency and Accruals.

Response

As per AS 1, the fundamental accounting assumptions are: Going Concern, Consistency and Accruals.

2.

Explain, in short, the relevant Disclosures of Accounting Policies as per AS 1.

Response :

As per AS 1, the Disclosures of Accounting Policies are: All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place. Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policies which has a material effect in the current period, the amount by which any item in the financial statements is affected by such change should also be

Sanjay Welkins' Classes	Overview of AS / Ind AS/ Acc. Standards

disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

If the fundamental accounting assumptions, viz, Going Concern, Consistency and Accruals, are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

3.

Explain the methods/criteria for the selection and application of Accounting Policies.

Response :

Certain assumptions are used in the preparation of financial statements. They are usually not specifically stated because they are assumed to be followed. Disclosure is necessary only if they are not followed. The following have been generally accepted as fundamental accounting assumptions:

Going Concern: The organisation is normally viewed as a going concern, that is to say, it will be in continuing operations for the foreseeable future. It is assumed that the organisation has neither the intention nor the necessity of shutting down or reducing the scale of operations.

Consistency: It is assumed that accounting policies are consistently followed from one period to another. No frequent changes are expected.

Accrual: Revenues and costs are recorded when they are earned or incurred (and not as money is received or paid) in the periods to which they relate.

4.

Exercise of prudence does not permit creation of hidden reserve by understating profits and assets or by overstating liabilities and losses. Comment

Response:

Suppose a company is facing a damage suit. No provision for damages should be recognised by a charge against profit, unless the probability of outflow funds is there.

5.

A simple disclosure that an accounting policy has been changed is not of much use for a reader of a financial statement. Comment .

Response:

The effect of change should therefore be disclosed wherever ascertainable. Suppose a company has switched over to weighted average formula for ascertaining cost of inventory, from the earlier practice of using FIFO to WA.

If the closing inventory by FIFO is Rs. 2 lakh and that by weighted average formula is Rs. 1.8 lakh, the change in accounting policy pulls down profit and value of inventory by Rs. 20,000. The company must disclose the change in accounting policy in the following manner:

' In the present year the company has changed to weighted average formula, for ascertaining inventory costs from the earlier practice of using FIFO for the purpose. The change in policy has reduced profit and value of inventory by Rs. 20,000.

6.

S. No.	IND AS 1	AS 1
1	Deals with Presentation of Financial Statements	Deals with Disclosure of Accounting Policies

Sanjay Welkins' Classes	Overview of AS / Ind AS/ Acc. Standards

2	The Indian accounting standard is wider when compared with AS-1.	Comparatively scope is narrower.
3	An explicit statement of compliance is required.	There is no such requirement in AS-1 to provide explicit compliance statement.
4	Indian AS-1 provides criteria for the classification of Current and Non- Current assets along with liabilities. Moreover, such information shall be presented as per IND AS-1.	AS-1 does not provide any bifurcation of current asses and non-current assets.
5	The enterprise cannot present any item as extraordinary Item either in the profit and loss statement or in the notes.	The enterprise can represent an extraordinary item in both the P&L statement and notes to accounts.
6	As per IND AS-1, the expenses shall be classified based on the nature of expenses.	No specific restriction.
7	In case of any retrospective amendment an enterprise is required to prepare a balance sheet at the beginning of the year in addition to the normal balance sheet.	There is no such requirement to create an opening balance sheet for retrospective change.
8	In Ind AS-1 there are two parts of the profit and loss statement. The first part shows the normal profit or loss account for the period. Whereas, the 2nd part shows "Other comprehensive Income" component	There is no such requirement to present profit and loss statement in two in AS-1.

AS 10

Property, Plant and Equipment

Summary Notes :

AS 10 Property, Plant and Equipment prescribe the accounting treatment for properties, P&E (Plant and Equipment) so that the users of financial statements could recognize and appreciate the information about the investment made by any enterprise in property, P&E and the also understand the changes made in such investments.

It is also important to note that AS 6 – Accounting for Depreciation stands withdrawn and such matters related to depreciation is included in AS 10.

Applicability of AS 10 Property, Plant and Equipment

AS 10 is to be applied in accounting for property, P&E (Plant and Equipment) and this standard are not applicable to:

- (a) biological assets which are related to agricultural activities except for bearer plants. The Standard is applicable to bearer plants, however, it doesn't apply to the produce on bearer plants; and
- (b) wasting assets which include mineral rights, expenses related to exploration for and extraction of oil, minerals, natural gas and other non-regenerative resources.

Recognition of Asset under AS 10 Property, Plant and Equipment

The cost of property and P&E should be recognized as an asset only if:

- (i) it is apparent that the future economic benefits related to such asset would flow to the business; and
- (ii) the cost of such asset could be reliably measured.

Measurement of cost of the asset

An enterprise can select the revaluation model or the cost model as the accounting policy and employ the same to the entire class of its properties and P&E.

According to the cost model, after recognizing the asset as an item of property or plant and equipment, it should be carried at the cost less the accumulated depreciation and the accumulated impairment losses (if any).

As per revaluation model, once the asset is recognized and its fair value could be measured reliably, then it must be carried at the revalued amount, which is the fair value of such asset at the date of the revaluation as reduced any following accumulated depreciation and accumulated impairment losses (if any).

Revaluations must be done at regular intervals for ensuring that the carrying amount doesn't differ much from that which would be determined using the fair value at balance sheet date.

Depreciation under AS 10 Property, Plant and Equipment

As per the standard, depreciation charge for every period must be recognized in the P/L Statement unless it's included in carrying the amount of any another asset. Depreciable amount of any asset should be allocated on a methodical basis over the useful life of the asset.

Every part of property or P&E (Plant and Equipment) whose cost is substantial with respect to the overall cost of the item must be depreciated separately.

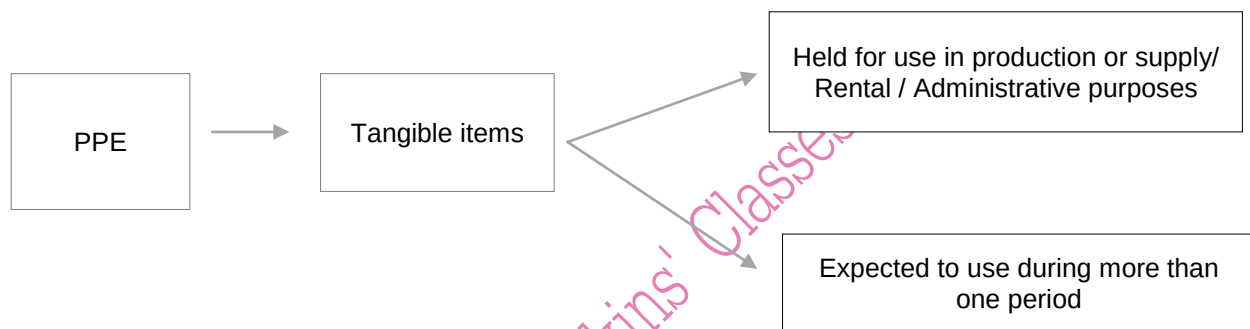
The standard also prescribes, that the residual value and useful life of an asset must be reviewed at the end of each financial year and, in case the expectations vary from the previous estimates, changes must be accounted for as changes in accounting estimate as per Accounting Standard 5 – Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.

The method of depreciation employed must reflect the pattern of future economic benefits of the asset consumed by an enterprise. Various depreciation methods could be used for allocating the depreciable amount of an asset on a methodical basis over the useful life of the asset. The methods include SLM (Straight-line Method), diminishing balance method or units of production method.

‘Property Plant and Equipment’ is :

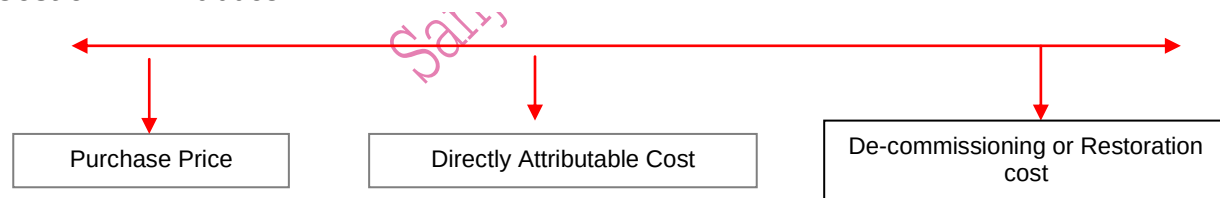
Property, plant and equipment are tangible items that:

- (a) are held for use in the production or supply of goods or services or for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period



Initial Recognition:

Cost of PPE Includes:



Shall include import duties, non-refundable taxes etc. Any trade discount or rebates allowed shall be subtracted.

Any cost directly attributable in bringing the asset to its present location and condition necessary for it to be capable of operating in a manner as intended by the management.

Examples:

Cost of site preparation
Initial delivery and handling charges
Installation and assembling cost
Testing cost (net proceeds after subtracting any related income)
Professional Fee etc.

Cost not included in the Carrying amount of PPE:

- i. Cost incurred while item is capable of operating as per desired intentions of the management but has not been brought to use or is operated at less than full capacity
- ii. Costs of conducting business in a new location or with a new class of customers
- iii. cost of introducing a new product or service including advertising and promotional activity
- iv. Administrative and other general costs

Case Study - 1 - Cost of PPE

R-89 Limited is installing a new plant at its production facility. It provides you the following information:

Cost of plant (cost as per suppliers' invoice)	31,25,000
GST paid	32,500
Estimated dismantling costs to be incurred after 5 Years	2,50,000
Initial operating losses before commercial production	3,75,000
Initial delivery and handling costs	1,85,000
Cost of site Preparation	4,50,000
Consultant used for advice on the acquisition of the plant	6,50,000

Please advice the Entity on the costs that can be capitalised for plant in accordance with this standard

Response:

Except initial Operating losses before commercial production, all other cost shall be capitalised.

Note : It has been now clarified that for computing cost of the asset GST shall be ignored . GST has to be accounted for separately.

Case Study - 3 - Cost of PPE

S-9 Limited constructed a fixed asset and incurred the following other expenses for construction:

Materials	16,00,000
Direct Expenses	3,00,000
Total direct Labour (1/15th of the total labour time was chargeable to the construction)	6,00,000
Total office and administrative expenses (4% is chargeable to construction)	9,00,000
Depreciation on assets used for installation	15,000

Response:

Materials	16,00,000
Direct Expenses	3,00,000
Total direct Labour (1/15th of the total labour time was chargeable to the construction)	40,000
Total office and administrative expenses (4% is chargeable to construction)	36,000
Depreciation on assets used for installation	15,000
	19,91,000

Case Study: 4 -

Entity A, a supermarket chain, is renovating one of its major stores. The store will have more available space for in store promotion outlets after the renovation and will include a restaurant. Management is preparing the budgets for the year after the store reopens, which include the cost of re-modelling and the expectation of a 15% increase in sales resulting from the store renovations, which will attract new customers. State whether the re-modelling cost will be capitalised or not.

Response:

The expenditure in re-modelling the store will create future economic benefits (in the form of 15% of increase in sales) and the cost of re-modelling can be measured reliably, therefore, it should be capitalised.

Case Study - 5

Entity A has an existing freehold factory property, which it intends to knock down and redevelop. During the redevelopment period the company will move its production facilities to another (temporary) site. The following incremental costs will be incurred:

1. Setup costs of Rs. 5,00,000 to install machinery in the new location.
2. Rent of Rs. 15,00,000
3. Removal costs of Rs. 3,00,000 to transport the machinery from the old location to the temporary location.

Can these costs be capitalised into the cost of the new building?

Response:

Constructing or acquiring a new asset may result in incremental costs that would have been avoided if the asset had not been constructed or acquired. These costs are not to be included in the cost of the asset if they are not directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The costs to be incurred by the company are in the nature of costs of relocating or re-organising operations of the company and do not meet the requirement of the Standard and therefore, cannot be capitalised.

Case Study - 6

Entity A, which operates a major chain of supermarkets, has acquired a new store location. The new location requires significant renovation expenditure. Management expects that the renovations will last for 3 months during which the supermarket will be closed. Management has prepared the budget for this period including expenditure related to construction and re-modelling costs, salaries of staff who will be preparing the store before its opening and related utilities costs. What will be the treatment of such expenditures?

Response:

Management should capitalise the costs of construction and re-modelling the supermarket, because they are necessary to bring the store to the condition necessary for it to be capable of operating in the manner intended by management. The supermarket cannot be opened without incurring the re-modelling expenditure, and thus the expenditure should be considered part of the asset.

Case Study : 7

F4 limited contracted with a supplier to purchase a specific machine to be installed in new plant in 4 months time.

Special foundations were required for the plant, which were to be prepared within this supply lead time.

The cost of site preparation and laying foundations were Rs. 2,10,000.

These activities were supervised by an Architect during the entire period, who is employed for this purpose at Rs. 35,000 per month.

The machine was purchased at Rs. 1,27,50,000.

A sum of Rs. 2,12,500 was incurred towards transportation charges to bring the machine to the factory.

An Engineer was engaged at a fee of Rs.37,500 to supervise machinery installation at the plant site.

Ascertain the amount at which the machine should be capitalised under Ind AS -16

Response:

Purchase price	1,27,50,000
Cost of preparation of site	2,10,000
Architect's Salary Rs. 35,000 x 4	1,40,000
Transportation charges	2,12,500
Professional fee for installation: Engineers fee	37,500
	1,33,50,000

Case Study - 8:

PLF Limited acquired a Standby Generator during current year for ₹ 100 lakhs and servicing equipment for ₹ 10 lakhs. Entity wants to capitalise these assets as PPE.

Response:

PPE are tangible assets/items that are - a. held for use in production or ii. For rentals or iii. For administrative purposes and are expected to be used for a period in excess of 12 months. Since these assets can satisfy the definition of PPE they can be recognised as PPE.

Case Study - 9:

A publishing company undertook repair and overhauling of its machinery at a cost of 250,00,000 to maintain them in good condition and capitalized the amount – as it is more than 25% of the original cost of the machinery.

Response:

Contention of the company is wrong. Unless expenditure would result in increasing the capacity it would be charged to revenue. Mere fact that expenditure is in excess of 25% of original cost does not qualify it to be considered as capital expenditure.

Case Study - 10 -

Cost of structural alterations amounting to Rs. 5,00,000 to self owned factory premises has been charged to Buildings repairs. Comment.

Response:

As per Standard, any subsequent expenditure on PPE/fixed assets which increases the future benefits arising from them beyond their previously assessed standards of performance, amounts to capital expenditure and these must form part of the cost of asset.

The words- structural alterations clearly suggests significant changes such as change in design of the buildings or expansion of the building etc and thus must be capitalized instead of being debited to repairs account

Case Study - 11

From the following information state the amount to be capitalised as per Ind-AS - 16. Give explanations for your answers:

Routine Repairs	5
Partial replacement of a part of machine	1
Replacement of machinery which will increase efficiency	10

Response:

According standard - Accounting for PPE, only expenditure that increases the future benefits from the existing assets beyond its previously assessed standard of performance is included in the gross book value i.e. an increase in capacity. Thus, in the present case, 'Repairs' amounting to Rs. 5 lakhs and partial replacement of machine should be charged to Profit and Loss Account as revenue expenditure. But the amount incurred for Replacement of machinery amounting to Rs. 10 lakhs which will increase efficiency should be treated as capital expenditure.

Case Study –12 -

A company has made additions to its factory buildings by its own workmen at a cost of 5,00,000 for wages and materials. The lowest estimate from an outside contractor to carry out the same work was for Rs. 6,00,000. The directors contend that as they were fully entitled to employ an outside contractor it is reasonable to debit the Factory Building a/c with Rs. 6,00,000.

Response:

Standard clearly states that gross book value of the asset- which is self constructed should be computed on the basis of actual cost incurred and not on the notional basis- and further no internal profits on such assets should be considered.

Therefore the contention of the company to show the asset at Rs. 6,00,000 is incorrect.

Case Study - 13 -

Aero India acquired an aircraft carrier for Rs. 500 crores. Engine cost is Rs. 300 crores included in 500 crores. Life of aircraft is 10 years while of engine is 5 years. Calculate the depreciation

Case Study- 14 -

Finley India limited has buildings and Machinery in its financial statements. The management of the company wants to follow the straight line method of depreciation for building and reducing balance method for machinery. Comment

Case Study - 15 -

G-500 limited has two cars. Usage and nature are same. Management wants to adopt different methods of depreciation. Comment

Case Study - 16 -

Y-555 limited acquired machinery for Rs. 1,20,000 having an useful life of 10 years with zero residual value. At the end of 3rd year, it was reassessed that machine is useful for only 5 more years. Calculate the depreciation for 4th year and onwards.

Case Study – 17 -

Z-2125 limited acquired machinery for Rs. 1,20,000 having an useful life of 10 years with zero residual value. At the end of 3rd year, due to price adjustments the cost of the machine increased by Rs. 6,000 also it was reassessed that machine is useful for further 9 more years after which it could fetch Rs. 9,000. Calculate the depreciation for 4th year and onwards.

Case Study – 18

T-45 limited is having a building costing Rs. 12,00,000. It is depreciated as per straight line method. Estimated working life is 10 years and residual value is Rs. 2,00,000. Entity adopts revaluation model and during the fourth year entity building was revalued upwards by Rs. 3,00,000 and residual value was reassessed at Rs. 3,00,000. Also remaining useful life was reassessed as 10 years. Find depreciation charge for 4th year and onwards.

Land and buildings are separable assets and are accounted for separately, even when they are acquired together.

Case Study - 19

As an auditor what would you do in the following situations? The method of depreciation on plant and machinery is to be changed from SLM basis to WDV basis from the current year.

Response:

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

Case Study - 20

State briefly the duty of an auditor with regard to the following—

No depreciation has been charged for the year ended 31.3.2023, in respect of a spare Bus purchased during the year and kept ready by the company for use as stand-by on the ground that it was not used during the year.

Response:

Dep. is measure of the wearing out consumption or other loss of value of a depreciable asset arising from—

1. Expected usage
2. Effluxion of time or
3. Obsolescence through change in technology or market trends.

Thus depreciation has to be charged even in case of those assets which are not used at all during the year as there is Effluxion of time.

Case Study - 21 - Depreciation - change of method

A company acquired a machine on 1.04.16 for Rs. 5,00,000. The company charged depreciation upto 2018-19 on SLM basis with estimated working life of 10 years and scrap value of Rs. 50,000.

From 2019-20, the company decided to change depreciation method at 20% reducing balance method.

Compute the amount of depreciation to be debited to Profit and loss account for the year 2019-20

Response:

Annual depreciation = $(5,00,000 - 50,000) / 10 = 45,000$

WDV at the end of 2018-19 = $5,00,000 - 45,000 \times 3 = 3,65,000$

Depreciation to be charged in 2019-20:

Book value as at 31.03.19 = 3,65,000

Depreciation = $3,65,000 \times 20\% = 73,000$

Case Study - 22 - Depreciation- reassessment of useful life

A computer costing Rs. 60,000 is depreciated on a straight line basis assuming 10 years working life and Nil Residual value, for three years. The estimate of remaining useful life after third year was reassessed at 5 years. Calculate depreciation as per provisions of Ind - AS-16.

Response:

Present Book value that is after 3 years $60,000 - (60,000 \times 3) = 42,000$

Revised Depreciable amount per annum = $42,000 / 5 = 8,400$

Case Study - 23 - Depreciation- Revaluation- Re-Estimated Useful Life - Sale/Disposal

V-7 limited purchased machinery on 1.4.18 for Rs. 15,00,000. The company charged straight line method of depreciation based on 15 years working life estimate and residual value of Rs. 3,00,000.

At the beginning of the 4th year, the company by way systematic evaluation revalued the machinery upward by 20% of the net book value as on date and also re-estimated the useful life as 7 years and scrap value as nil.

The increase in net book value was credited directly to revaluation reserve account.

Depreciation (on SLM) later on was charged to profit and loss account.

At the beginning of 8th year the company decided to dispose -off the machinery and estimated the realisable value to be of Rs. 2,00,000

You are required to ascertain the amount to be charged to profit and loss at the beginning of the 8th year with reference to this standard

Response:

Depreciation per year	$1,35,000 / 6$	22,500
Depreciation for 3 years	$22,500 \times 3$	67,500
WDV at the beginning of the 4th Year	$1,35,000 - 67,500$	82,500
Revised Depreciation:		
Depreciable amount	$82,500 - 1,50,000 \times 5\%$	
	$82,500 - 7,500$	75,000
Remaining Life		4 years
Depreciation for the 4th year and onwards		18,750

Case Study - 24 - Depreciation-Re-Estimated Useful Life -

Machinery with useful life of 6 years was purchased on 1.04.2016 for Rs. 1,50,000. Depreciation was provided on SLM for first three years considering a residual value of 10% of cost.

In the beginning of 4th year the company re-assessed the remaining useful life of the machinery at 4 years and residual value was estimated at 5% of the original cost.

The accountant re-calculated the revised depreciation historically and charged the difference to profit and loss account.

You are required to comment on the treatment by accountant and calculate the depreciation to be charged for the fourth year.

Response:

Depreciation per year	$1,35,000 / 6$	22,500
Depreciation for 3 years	$22,500 \times 3$	67,500
WDV at the beginning of the 4th Year	$1,35,000 - 67,500$	67,500
Revised Depreciation:		
Depreciable amount	$82,500 - 1,50,000 \times 5\%$	
	$82,500 - 7,500$	75,000
Remaining Life		4 years
Depreciation for the 4th year and onwards		18,750

Q - 25. Explain difference between Ind AS 16 and AS 10

Response: Ind AS 16 Vs. AS 10

Particulars	Ind AS 16 Property Plant Equipment	AS 10
Change in the methods of depreciation	Ind AS 16 considers such change as changes in the accounting estimate and is applied prospectively.	This change is considered as the changes in accounting policy.
Reviewing residual value	The residual value must be reviewed at the end of every financial year at least and, any change must be accounted for as changes in the accounting estimate.	No such requirement under AS 10
Reassessing the useful life	Ind AS 16 requires reviewing at the end of every financial year and applied prospectively.	AS 10 requires periodical review and prospective application.
Government grant received for PPE	Cannot be adjusted against the cost of the asset	AS 12 gives an option to reduce the grant so received from gross value of such asset
Cost of major Inspections	As per Ind AS 16, the cost of any major inspections must be recognized in carrying the amount of the PPE	As per AS 10, the cost of major inspections are usually expensed as and when they're incurred.

AS 11 (Revised)

Effects of Changes in Foreign Exchange Rates

1.

Initial Recording of All Foreign currency Transactions (FCT) should be done by applying the Exchange (ER) on prevailing on the date of transaction.

Case Study - 1

Shiners India limited - whose accounting year ends on 31st of March, made a sale on 1.1.19 of \$ 100,000 and on this date exchange rate was Rs. 47.

Entity shall record the transaction as follows

Date	Particulars	Debit	Credit
1.1.19	Foreign Debtors a/c \$ 1,00,000 x Rs. 47	47,00,000	
	To, Sales a/c		47,00,000

2. According to the standard, at the balance sheet date all Monetary Transactions should be reported using the closing rate and any loss or gain arising thereof should be recognised in statement of P&L

Case Study - 2 Shiners India limited - whose accounting year ends on 31st of March, made a sale on 1.1.19 of \$ 100,000 and on this date exchange rate was Rs. 47. Exchange rate as at 31.3.19 is 1\$ = Rs. 48

Entity shall record the transaction as follows

Date	Particulars	Debit	Credit
1.1.19	Foreign Debtors a/c \$ 1,00,000 x Rs. 47	47,00,000	
	To, Sales a/c		47,00,000
31.3.19	Foreign Debtors a/c \$ 1,00,000 x Re. 1	1,00,000	
	To, P/L a/c		1,00,000
	Gain = difference of \$ 1,00,000 x Rs. 47 and \$ 1,00,000 x Rs. 48 or \$ 1,00,000 x Rs. 1		

3. As per AS 11, exchange difference on Settlement of the Account should also be transferred to Profit and Loss account.

Case Study Shiners India limited - whose accounting year ends on 31st of March, made a sale on 1.1.19 of \$ 100,000 and on this date exchange rate was Rs. 47. Exchange rate as at 31.3.19 is 1\$ = Rs. 48. Say the amount of sale was receivable after 4 months that is 1.5.19 on this date rate of exchange is 49.

Entity shall record the transaction as follows

Date	Particulars	Debit - Rs.	Credit- Rs.
1.1.19	Foreign Debtors a/c \$ 1,00,000 x Rs. 47	47,00,000	
	To, Sales a/c		47,00,000
31.3.19	Foreign Debtors a/c \$ 1,00,000 x Re. 1	1,00,000	
	To, P/L a/c		1,00,000

	<i>Gain = difference of \$ 1,00,000 x Rs. 47 and \$ 1,00,000 x Rs. 48 or \$ 1,00,000 x Rs. 1</i>		
31.05.19	Bank a/c (\$ 1,00,000 x Rs. 49)	49,00,000	
	To, Foreign Debtors		48,00,000
	To, P/L a/c		1,00,000

Case Study - 4

Exchange rate per US \$

Goods purchased on 1-1-2025 of US dollar 10,000	Rs. 45
Exchange rate on 31-3-2025	Rs. 44
Date of actual payment 7-7-2025	Rs. 43

Ascertain the loss/gain for the financial years 2024-25 and 2025-26 and also give their treatment as per AS-11.

Response:

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 1.1.2024 and corresponding creditor would be recorded at Rs.4,50,000 (i.e. \$10,000 × Rs. 45)
According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate.

Thus, creditor of US \$10,000 on 31.3.2025 will be reported at Rs.4,40,000 (i.e. \$10,000 × Rs.44) and exchange profit of Rs.10,000 (i.e. 4,50,000 – 4,40,000) should be credited to Profit and Loss account in the year 2024-25.

On 7.7.2025, creditor of \$10,000 is paid at the rate of Rs.43. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, Rs.10,000 (i.e. 4,40,000 – 4,30,000) will be credited to Profit and Loss account in the year 2025-26.

Case Study 5. VX India Limited, imported materials worth US \$ 9,000 on 25th Feb. 2025, when exchange rate was Rs.44.

The transaction was recorded in the books at the above mentioned date. The payment for the transaction was made on 10th April, 2025, when the exchange rate was Rs.48 per dollar.

At the yearend 31.03.2025, the rate was Rs.49 per dollar.

Chief accountant of the company passed an entry on 31.3.2025 adjusting the cost of raw material consumed for the difference between Rs. 48 and Rs. 44 per US dollar.

Discuss whether this treatment is justified as per the provisions of AS- Revised.

Response:

As per AS 11 'The Effects of Changes in Foreign Exchange Rates', all foreign currency transactions should be recorded by applying the exchange rate on the date of transactions. Thus, goods purchased on 25.02.2025 and corresponding creditor would be recorded at Rs.3,96,000 (i.e. \$ 9,000 × Rs. 44)

According to the standard, at the balance sheet date all monetary transactions should be reported using the closing rate. Thus, creditor of US \$9,000 on 31.3.2025 will be reported at Rs.4,41,000 (i.e. \$ 9,000 × Rs.49) and exchange Loss of Rs.45,000 (i.e. 4,41,000 – 3,96,000) should be debited to Profit and Loss account in the year 2024-25.

On 10.4.2025, creditor of \$9,000 is paid at the rate of Rs.48. As per AS 11, exchange difference on settlement of the account should also be transferred to Profit and Loss account. Therefore, Rs.9,000 (i.e. 4,41,000 – 4,32,000) will be credited to Profit and Loss account in the year 2025-26.

Case Study - 6 GX India limited made a Purchase on 1.1.24 of \$ 100,000 and on this date exchange rate was Rs.47. The amount of was receivable after 4 months.

The exchange rate on 31.3.2024 was Rs. 48 and on 1.5.24 was Rs.49. Company closes its account on 31st of March of every year.

What will be the impacts of the above?

Response

On the date of transaction the Creditors shall be recorded in the books in Indian currency at-\$100,000 x 47= 47,00,000 while on 31.3.24 Creditors should be recorded at Rs.100,000 x 48= 48,00,000 Loss of Rs.100,000 should be debited to profit and loss a/c.

There will be another loss of Rs.100,000 on 1.5.24 when amount would be paid – which should be recognised in Profit and loss a/c of 04-05.

Case Study 7 - TTT limited of India has taken a loan of \$ 2,50,000 few years back. An amount \$1,50000 is still due for payment after 3 months. It enters into a forward cover for the period of 3 months at the rate Rs.47 while the spot rate on the date of contract was Rs.46. Show the proper treatment.

Response

Loss = 47 - 46.00 = 1 per dollar.

Total loss = 1,50,000 x 1 = Rs. 1,50,000

AS-11 states that the difference between the spot rate and forward rate should be recognized as income or expense and should be amortized over the period of the forward contract.

In this case loss Rupees 1,50,000 should be amortized over a period of 3 months.

Integral Foreign Operation

Is a Foreign operation whose activities and operations are similar to the reporting enterprise's operations.

Non-Integral Foreign Operation

Is a foreign operation whose activities are not similar to the activities and operation of the reporting enterprise.

Difference between :

Ind AS 21	AS 11
Ind AS 21 does not include the forward exchange contracts and similar other financial instruments from its scope which are covered under per Ind AS 39	AS 11 include accounting for such contracts
Ind AS 21 is based on the functional currency approach	AS 11 isn't based on such approach
Under Ind AS 21, the presentation currency could be different from the local currency and it prescribes a detailed guidance on the same	No such concept under AS 11

AS – 12

Accounting for Government Grants

1. Preface :

To help discharge this duty, the government undertakes promotional activities, provides incentives and grants to businesses. The grants received from the government are in various forms such as subsidy, incentives, duty drawbacks among others.

2. Exceptions

AS 12 deals with grants given by government but does not covers:

i) The accounting for grants which reflect the effect of price changes ii) Assistance by the government other than grants like tax exemption, etc iii) Participation of government in organisation's ownership

3. Meaning of Government Grant

Simply means the assistance was given by the government in cash or kind with certain specific conditions. These do not include such grants from the government which cannot be measured reasonably. Also, the transactions with the government which cannot be separately identified from normal trading of the organization are not considered as a grant. For e.g.: Receipt of cash on the sale of packaged drinking water to railways.

4. Methods of Accounting for Government Grants

There are two methods outlined by the AS to account for the government grants:

- * Capital approach
- * Income / Revenue approach

The method of accounting for any grant is always based on the nature of grant received. The grants are recognized only where a certainty exists for the fulfilment of conditions and ultimate collection of such grants.

Capital Approach

Such grants are treated as a part of capital or shareholder's funds. These are grants which are given as a proportion of total investment in a business. Ordinarily, the government does not expect a repayment of such grants. Due to this reason, such grants are credited to the capital or shareholder's funds. These grants are divided primarily into three types:

A) Non-monetary grants B) The proportion of capital in a business C) For specific fixed assets

A. Accounting of grants as a Proportion of total capital in a business The non-monetary grants are those which are given in form of resources such as land, building. These grants are usually given at a concessional rate or for free. These grants should be accounted for at the acquisition cost or nominal value (if given free of cost).

B. Accounting of grants as a Proportion of total capital in a business Where grants are of such nature that they are treated as a proportion to total capital in a business, they are treated as Capital Reserves and

shown as Capital Reserve in the Balance Sheet. This way the amount received will not have any effect on Income Statement or Fixed Assets carrying amount. This means that such amounts cannot be distributed as a dividend to shareholders. Also, they are not eligible to be considered as a deferred income.

C. Accounting of grants for Specific fixed assets These are such grants which have a primary condition attached to them:

- * The organization receiving such grants must either Construct, Acquire or Purchase such specific fixed assets for which such grant is given.
- * Other condition may also be imposed as the type of assets, location of assets, period of acquisition, etc.

Two methods are prescribed for recognition of grants in form of grants for specific fixed assets:

Method 1 – The amount of grant is reduced from the gross amount of the asset to calculate book value. This signifies that the grant is being recognized in profit and loss account as a reduced charge of depreciation over the life of such asset.

F1 Ltd. Purchases a machinery for Rs. 150 lakhs with a useful life of 5 years and 'Nil' salvage value. It gets Rs. 50 lakhs as a grant from the government for this machinery.

- a) The Machinery will be shown as Rs. 100 lakhs (150 lakhs – 50 lakhs) in the balance sheet
- b) Rs. 20 lakhs (100 lakhs / Useful life i.e. 5 years) will be charged to profit and loss account each year as a depreciation on this machinery.

Method 2 – The grants are treated as a deferred income in the financial statements. This income is recognized gradually in the profit and loss account over the useful life of an asset or say in the proportion of depreciation on such asset.

F2 Ltd. Purchases a machinery for Rs. 150 lakhs with a useful life of 5 years and 'Nil' salvage value. It gets Rs. 30 lakhs as a grant from the government for this machinery.

- a) The Machinery will be shown as Rs. 150 lakhs in the balance sheet along with Rs. 50 lakhs as 'Deferred Government Grant'.
- b) Rs. 30 lakhs (150 lakhs / Useful life i.e. 5 years) will be charged to profit and loss account each year as a depreciation while an income of Rs. 10 lakhs (50 lakhs / Useful life i.e. 5 years) shall; be recognised in SPL.

5. Income Approach

Grants which relate to revenue are credited to the profit and loss account as 'Other Income'. They can also be deducted from the related expenses in the profit and loss account. For example:- Grants for electricity expenses of a manufacturing entity.

6. Refund of grants related to Revenue –

- Adjust against unamortized grant
- Excess refund charged to profit and loss account.

7. Refund of Grant Related to Specific Asset

- If grant was deducted from gross value of asset – refundable amount should be recorded by increasing the book value of the asset and decreasing the value of Bank a/c. Depreciation should be provided on such increased value prospectively.
- If grant was treated as deferred income – adjust with unamortized deferred income. Excess refund to be charged to profit and loss account

- If grant was credited to capital reserve- adjust it with capital reserve.

Students are requested to note that, Government grants that become refundable should be accounted for as an extraordinary item (see Accounting Standard (AS) 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies)

8. Disclosures

The accounting policy adopted for grants and method of presentation in the financial statements.

The nature and extent of grants recognised in the financial statements- including grants of non-monetary assets given at a concessional rate or free of cost.

15. Ind AS 20 Vs. AS 12

Ind AS 20	AS 12
Requires disclosure of financial statements with indication on other forms of government assistance received	No requirement as it does not deal with other forms of government assistance
Recognition of grants directly to the shareholder's fund is prohibited	Grants for non-depreciable assets are required to be shown as a capital reserve under shareholder's funds
Government grants in the nature of capital contribution are not recognized	Specifically requires that government grants as capital contribution should be recognized
Requires the recognition of non-monetary grants at fair value	Requires recognition of non-monetary grants at acquisition cost or nominal value
The option to deduct the amount of grant from the book value of the asset is not available	The option to deduct the amount of grant from the book value of the asset is available

ILLUSTRATIVE CASE STUDIES VAULT

Q 1: As an auditor comment on the following:

A company received a subsidy of Rs. 1 crore for establishing an undertaking in the backward/notified area.

The company had received a subsidy of Rs. 1 crore, for establishing an undertaking in the backward/notified area.

Response: The accounting treatment of such subsidy shall depend upon the nature and purpose for which it has been given. As per AS-12 on "Accounting for Government Grants", the grant given for acquisition of fixed assets is in the nature of the promoter's contribution. In such cases, no payment is ordinarily expected and thus the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income. Accordingly, the amount of Rs. 1 crore should be kept in a Capital reserve account and treated as a part of shareholders' funds.

Q 2: X Ltd. received a grant of Rs. 2 crores from the Central Government for the purpose of special Machinery during 2021- 22. The cost of Machinery was Rs. 20 crores and had a useful life of 9 years. During 2015-16, the grant has become refundable due to non-fulfillment of certain conditions attached to it. Assuming the entire grant was deducted from the cost of Machinery in the year of acquisition. State with reasons the accounting treatment to be followed in the year 2026-27.

Response:

AS -12, on Accounting for Government Grants states that the amount refundable in respect of a government grant- related to a specific fixed asset, is recorded by increasing the book value of the asset. Depreciation on the revised book value is provided prospectively over the residual useful life of the asset. In the given case,

book value of machinery will be increased by Rs. 2 crores in the year 2026-27. The computations for the depreciation on machinery can be given as:

Cost of machinery	Rs. 20 crores
Less: Grant received	Rs. 2 crores
Cost of machinery	Rs. 18 crores
Useful life of machinery	9 years
Depreciation as per year as per straight line method	
(Assuming residual value to be zero) [Rs. 18 crores/9]	Rs. 2 crores
Total depreciation for 4 years (2021-22 to 2025-2026)	Rs. 8 crores
Book value as at 1.4.26	Rs. 10 crores
Add: Grant refunded	Rs. 2 crores
Revised book value	Rs. 12 crores
Remaining useful life	5 years
Revised annual depreciation [Rs. 12 crores/ 5]	2.4 crores

Thus, book value of machinery will be 12 crores as at 31.3.2026 and the depreciation amounting Rs. 2.4 crores will be charged on machinery on 31.3.17. Book value as at 31.3.2027 = 12 - 2.4 = 9.6 crores.

Q 3: On 1.4.2020 ABC Ltd. received Government grant of Rs. 300 lacs for acquisition of a machinery costing Rs.1,500 lakhs. The grant was credited to the cost of the asset. The life of the machinery is 5 years. The machinery is depreciated at 20% on WDV basis. The company had to refund the grant in May 2023 due to non- fulfillment of certain conditions.

How you would deal with the refund of grant in the books of ABC Ltd.?

According to AS 12 on accounting for Government Grants, the amount refundable in respect of a grant related to a specific fixed asset should be recorded by increasing the book value of the asset or by reducing the capital reserve or deferred income balance, as appropriate by the amount refundable. Where the book value is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of asset. The accounting treatment in both the alternative can be given as follows:

		Rs. (in lakhs)
1 st April, 2020	Acquisition cost of machinery (Rs. 1,500- 300)	1,200.00
31 st March, 2021	Less: Depreciation @ 20%	240.00
	Book value	960.00
31 st March, 2022	Less: Depreciation @ 20%	192.00
	Book value	768.00
31 st March, 2023	Less: Depreciation @ 20%	153.60
1 st April, 2023	Book value	614.40
May, 2023	Add: Refund of grant	300.00
	Revised book value	914.40

Depreciation @ 20% on the revised book value amounting to Rs. 914.40 lacs is to be provided prospectively over the Remaining useful life of the asset i.e. years ended 31st March, 2024 and 31st March, 2006. amount of

Q-4: 005 Ltd. presented the following information:

How will you treat the following in the Balance Sheet of 005 Ltd.?

005 Ltd. purchased a piece of land for Rs.10,00,000 for which it received a grant from the Govt. amounting to Rs.3,00,000.

Response:

As per AS 12, Accounting for Govt. Grants, grants related to non-depreciable (Land is a non-depreciable asset) assets should be credited to Capital Reserve.

Thus (i) When the land was purchased

Land A/c Dr. 10,00,000

To Bank A/c 10,00,000

(ii) When the Govt. grant received

Bank A/c Dr. 3,00,000

To Capital Reserve 3,00,000

Balance Sheet of 005 Ltd.:

Balance Sheet (extract) as at...

Liabilities Amount

Capital Reserve 3,00,000

Assets Amount

Rs. Land 10,00,000

Q-5: T501 Ltd presented the following particulars. How will you deal with the following:

T501 limited received some Govt. grant as the compensation for the payment of wages of 100 workers who were found surplus (not needed) by T 501 limited.

Response:

Government grants may become receivable by an enterprise as compensation for expenses or losses incurred in a previous accounting period. Such a grant is recognised in the income statement of the period in which it *becomes receivable*, as an extraordinary item if appropriate.

Thus, in this case, the Govt. grant which was received should be credited to income statement/Profit and Loss Account.

Q-6: Super India presented the following particulars; how will you deal with the following?

The selling price of a product of Z Ltd. is Rs.15, the same can be sold in the open market for Rs.10 per unit provided a Govt. grant of Rs.5 is received.

Response: Grants related to revenue are sometimes presented as a credit in the profit and loss statement, either separately or under a general heading such as 'Other Income'. Alternatively, they are deducted in reporting the related expense.

Q-7: F-777 Ltd. presented the following particulars. F-777 Ltd. Applied for a Govt. grant to set up a new factory premises amounting to Rs. 20,00,000 which has been sanctioned/approved. The amount had not been received by F-777 Ltd. But the factory premise was completed within the year. How will you deal with it?

Response:

Mere receipt of a grant is not necessarily a conclusive evidence that conditions attaching to the grant have been or will be fulfilled.

An appropriate amount in respect of such earned benefits, estimated on a prudent basis, is credited to income for the year even though the actual amount of such benefits may be finally settled and received after the end of the relevant accounting period..

Q-8: How will you deal with the following?

S-89 received Rs.10,00,000 as Govt. grants during the period ended 2017-18. There were certain conditions which should be fulfilled by the Entity. Unfortunately Entity did not satisfy the conditions for which the whole amount, during the period 2019-20, was refundable although Rs.8,00,000 appeared in the books as deferred credit.

Response:

Thus, in the present case, refundable Govt. Grant amounting to Rs.10,00,000 should first be adjusted against un-amortised deferred charges of Rs.8,00,000. The rest of Rs.2,00,000 should be charged to the statements of profit and loss as an extraordinary item.

Q-9: How will you deal with the following?

During the year 2019-20, F-555 Ltd received Government grant for Rs.5,00,000 as promoter's contributions. 10% of the said grant became refundable as the prescribed conditions were not fulfilled by the Entity.

Response:

Where the government grants are of the nature of promoters' contribution, i.e., they are given with reference to the total investment in an undertaking or by way of contribution towards its total capital outlay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can be neither distributed as dividend nor considered as deferred income.

Thus, in the present case, as the entire amount of Rs.5,00,000 had already been credited to Capital Reserve and 10% of grant (Rs.5,00,000 x 10%) Rs.50,000 has become refundable for which Capital Reserve Account should be debited and Bank account should be credited.

Q-10: H - 999 Ltd. bought a plant for Rs. 8,00,000 during the period 2020-21. It received a Govt. grant amounting to Rs. 3,00,000. The useful life of the plant was 5 years, having no residual value. H-999 Ltd. had to refund the grant due to non-fulfillment of certain terms and conditions during the period 2024 - 25.

How will you treat the same?

Response:

As per AS 12, the amount refundable in respect of a Govt. grant related to a specific fixed asset is recorded by increasing the book value of the assets or by reducing the Capital Reserve or the deferred income balance by the amount refundable.

In the first alternative, where the book value of the assets is increased, depreciation on the revised book value is to be provided prospectively over the residual useful life of the asset.

Second alternative is to reduce the capital reserve or deferred income balance, as appropriate, by amount refundable.

Thus, in this case:

First Alternative

2021-22: Cost of Plant (Rs.8,00,000 – Rs.3,00,000)	=	5,00,000
Depreciation for 3 years @ Rs.1,00,000 x3	=	3,00,000
(Dep. = Rs.5,00,000/5 years)	=	2,00,000
Add: Refund of Grant	=	3,00,000
Revised Book Value	=	5,00,000

Annual Depreciation will be = Revised Book Value/Rest of life = Rs.5,00,000/2 years = Rs.2,50,000

So, from 2024-25, annual depreciation will be Rs.2,50,000.

Second Alternative

The refundable amount may be debited to Capital Reserve. Or, If the grant was treated as a deferred income, the same should be eliminated.

Q-11 G-676 limited purchased fixed assets for Rs. 50,00,000. Government grant received towards it is 20%. Residual value is Rs. 8,00,000 and useful life is 8 years. Assumed depreciation is on the basis of SLM. Assets are shown in the balance sheet net of grant. After one year, grant becomes refundable to the extent of Rs. 7,00,000 due to non-compliance of certain conditions.

Pass journal entries for 2nd year in the books of the company

Fixed Asset A/c Dr. To Bank A/c (Govt. Grant refunded)	7,00,000
Depreciation A/c Dr. To Fixed Asset A/c (dep. Provided on Revised book value)	5,00,000

Profit and Loss A/c Dr. To Depreciation A/c (dep. Charged to P&L)	5,00,000

Q-12: Ram Limited purchased machinery for Rs. 80 lakhs (useful life 4 years and residual value 8 lakhs). Government grant received is 32 lakhs. Show the journal entry to be passed at the time of refund of grant and the value of fixed assets in the third year and the amount of depreciation for remaining two years, if—

- Grant is credited to fixed asset account
- If grant is credited to deferred grant a/c

Response:

		Rs. in lakhs
If grant is credited to Fixed Asset	Fixed Asset a/c Dr.	32
	To, Bank a/c	32
If grant is credited to deferred grant a/c	Deferred Grant a/c Dr.	16,00,000 unamortised amount
	P/L A/c Dr.	16,00,000 amount credited to P/L now reverted
	To Bank a/c	32,00,000 Refund amount
Total Grant Money	32,00,000	
Useful life is 4 Years ...therefore amount of grant which must have been credited to P/L during two completed years must be	16,00,000	
Un-amortised amount in Deferred Grant a/c i.e. remaining amount	16,00,000	

Q-13: Z Ltd. purchased a fixed asset for Rs. 50 lakhs, which has the estimated useful life of 5 years with the salvage value of Rs. 5,00,000. On purchase of the assets government granted it a grant for Rs. 10 lakhs. Pass the necessary journal entries in the books of the company for first two years if the grant amount is deducted from the value of fixed asset.

Response:

Journal in the books of Z Ltd.

Year	Particulars		Rs. (Dr.)	Rs. (Cr.)
1st	Fixed Assets Account	Dr.		50,00,000
	To Bank Account		50,00,000	
	(Being Fixed Assets purchased)			
	Bank Account	Dr.		10,00,000
	To Fixed Assets Account		10,00,000	
	(Being grant received from the government)			
	Depreciation Account	Dr.		7,00,000
	To Fixed Assets Account		7,00,000	
	(Being Depreciation charged on SLM)			
	Profit & Loss Account	Dr.		7,00,000
	To Depreciation Account		7,00,000	
	(Being Depreciation transferred to P/L Account)			
2nd	Depreciation Account	Dr.		7,00,000
	To Fixed Assets Account		7,00,000	
	(Being Depreciation charged on SLM)			

	Profit & Loss Account	Dr.		7,00,000
	To Depreciation Account		7,00,000	
	(Being Depreciation transferred to P/L Account)			

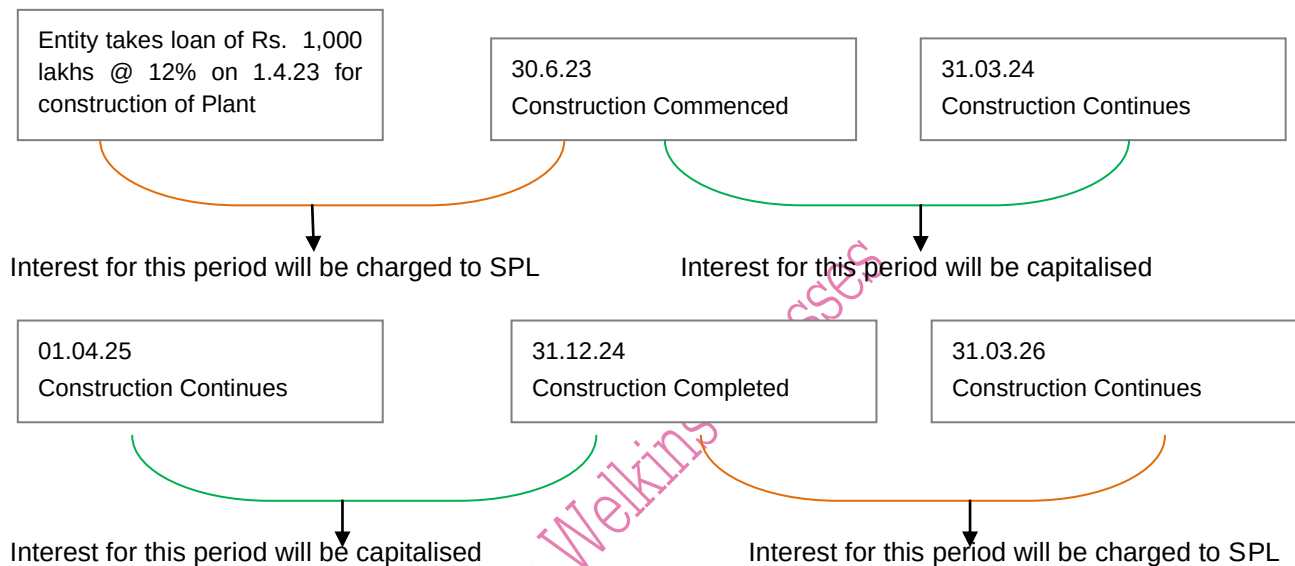
Sanjay Welkins' Classes

AS 16

Borrowing Costs

1. Core principle

Standard discusses about the accounting treatment of Borrowing costs (BC) i.e. whether BC should be Capitalised or should be charged to Statement of Profit and loss (SPL).



Interest will be capitalised till Asset remains in construction stage that is Qualifying stage. Capitalisation shall continue till asset is completed.

1. Objective

The objective of the standard is to prescribe the accounting treatment of borrowing costs. i.e. whether BC should be Capitalised or should be charged to Statement of Profit and loss (SPL).

2. Nature & Scope

This Notified accounting standard is mandatorily applicable to all enterprises. It is specifically stated that this accounting standard is only related to External Borrowings and does not deal with the cost of raising Equity or Convertible Preference Shares. Effective date: This standard came into effect from Financial Year starting on or after 1st April 2000

3. Borrowing Cost

As per ICAI "Borrowing Costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds"

The following points should be taken into consideration for borrowing costs:

a. Interest on short term loans or long-term debts should be included as part of borrowing cost.

Ex: Interest paid to financial institutions for loan taken to acquire the asset.

b. If an enterprise has incurred any discounts or premiums related to the borrowing cost, then it will also be amortised.

Ex: Amount paid to the financial institutions as loan processing cost

c. If an enterprise has incurred any finance/ancillary cost in connection with the borrowings, then it will also be amortised.

Ex: Amount to the professionals for preparation of project reports, etc.

d. If an enterprise has acquired any asset under finance lease or any other similar arrangement, then those finance cost will also be amortised.

Ex: Leasing cost paid to the lessor every year.

e. If an enterprise has taken any borrowing in foreign currency, then the exchange rate fluctuation will also be amortised to the extent they are regarded as an adjustment of interest costs.

Ex: An enterprise has taken a loan from foreign financial institutions when the rate of US \$ was 84, while at the end of the financial year the rate of US \$ was 85. The rate difference of US \$ 1 will be treated as Borrowing Cost.

4. Qualifying Assets

Qualifying Assets are those assets which take substantial time to be ready for the intent of sale or use. Substantial period primarily depends on the facts and circumstances of the case. Generally, a period of 12 months is considered as a substantial period unless a shorter or longer period can be justified based on facts and circumstances of the case.

Borrowing costs are capitalized in the books of accounts with the qualifying assets when it is certain that it will have future economic benefits. Any other borrowing costs must be treated as an expense in the period in which they are incurred.

5. Capitalization of Borrowing Cost

The following conditions should be satisfied for capitalization of borrowing costs:

a. Those borrowings costs which are directly attributable to the acquisition, construction or production of qualifying asset, are eligible for capitalization.

Directly attributable costs are those costs which would have been avoided if the expenditure on the qualifying assets has not been made.

b. Qualifying assets will give future benefit to the enterprises and the cost can be measured reliably

6. Commencement of Capitalization

The Commencement of Capitalization of borrowing cost should commence when all the conditions below are fulfilled:

- a. Expenditure for the acquisition, construction or production of a qualifying asset is being incurred. Here expenditure includes those expenditure in the nature of cash or transfer of any asset or the assumption of interest bearing liabilities
- b. Borrowing Costs are being incurred.
- c. Activities that are necessary to prepare the asset for its intended use or sale are in progress. The activities here need not be the physical activities, but the technical and administrative work related to the assets is also taken into consideration

7. Suspension of Capitalization

Capitalization of Borrowing cost are commenced when the above mentioned 3 points are satisfied. However, if there is a temporary delay in which the active necessary developments are interrupted then there will be a suspension of capitalization.

However, capitalization of borrowing costs is not normally suspended during a period when substantial, technical and administrative work is being carried out that is, activities that are not necessary to prepare the assets.

The capitalization of borrowing costs is also not suspended when there is a temporary delay that is a necessary part of the process of getting the assets ready for its intended use or sale. For example, capitalization continues during the extended period needed for inventories to mature or the extended period during which high water levels delay.

8. Cessation of Capitalization

Capitalization of borrowing cost ceases when all the activities necessary to prepare the qualifying assets are complete. If an asset has been completed in parts and a completed part is capable of being used while the construction for the other part continues then the capitalization for that completed part will cease. Example: A business park consists of several buildings and each building can be treated as an individual part.

9. Types of Borrowings

The two types of borrowings which are detailed below in the table are: a. Specific borrowings b. General borrowings Amount of borrowing cost to be capitalized is:

Type of Borrowing	Amount to be Capitalized
Specific Borrowing	The amount to be capitalized is: Actual Borrowing Cost incurred during the period Minus Any income on temporary investment of borrowed funds(Ex: The excess money invested in Fixed Deposit will have interest gain)
General	The amount to be capitalized involves few steps:

Borrowing	a. Calculate Capitalization Rate. It will be weighted average of borrowing cost. b. Cost to be Capitalized = Capitalization rate x Amount spent on qualifying asset out of general borrowing Note: Amount of borrowing cost capitalized during a period should not exceed the amount of borrowing cost incurred during the period.

10. Disclosures

The Financial Statements should disclose the following:

- a. The accounting policy adopted for borrowing costs
- b. The amount of borrowing costs capitalized during the year

11. AS 16 Vs Ind AS 23

AS 16	IND AS 23
AS 16 explains the meaning of “substantial period of time”.	This explanation is not included in IND AS 23.
Disclosure of Capitalisation rate is not required as per AS 16	IND AS 23 requires the disclosure of capitalisation rate, used to determine the amount of borrowing costs eligible for capitalisation.
Does not provide for such exemption.	Does not apply to borrowing costs directly attributable to qualifying asset measured at fair value. (e.g.: biological assets)
Does not provides any exemption and is applicable to all borrowing costs that require substantial period of time to bring them in saleable condition.	IND AS 23 is not applicable to borrowing costs attributable to inventories, that are produced or manufactured, in large quantities and on repetitive basis.

Illustrative Case Studies

Q- 1: On 25.4.2020 WLC Ltd. obtained a loan from the Bank for Rs. 70 lakhs to be utilized as under:

	Rs. in lakhs
Construction of a shed	28
Purchase of machinery	21
Working capital	14
Advance for purchase of truck	7

In March 31, 2021 construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ending 31.3.2011 was Rs. 12 lacs. Show the treatment of interest under AS-16

Particulars	Nature	Interest to be capitalised (in lacs)	Interest to be charged to P/L Account (in lacs)

Construction of factory shed	Qualifying Asset	$12 \text{ lacs} \times 28 / 70 = 4.80$	-
Plant and Machinery	Not a Qualifying Asset		$12 \times 21 / 70 = 2.40$
Advance for trucks	Not Qualifying asset		$12 \times 7 / 70 = 1.20$
Working capital	Not a qualifying asset		$12 \times 14 / 70 = 2.40$

Q-2: Briefly indicate the items which are included in the expressions 'Borrowing Costs' as per AS-16

Response:

Borrowing costs may include: (a) interest and commitment charges on bank borrowings and other short-term and long-term borrowings; (b) amortisation of discounts or premiums relating to borrowings; (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings; (d) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and (e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Q-3: Enumerate two points which the financial statements should disclose in respect of 'Borrowing Costs' as per AS- 16.

Response:

The financial statements should disclose:

- (a) the accounting policy adopted for borrowing costs; and
- (b) the amount of borrowing costs capitalised during the period

Q-4: An industry borrowed Rs. 40,00,000 for purchase of machinery on 1.6.2024. Interest on loan is 9% per annum. The machinery was put to use from 1.1.2025. Pass entries for the year ended 31.3.2025 to record the borrowing cost of loan as per AS-16.

Response:

Total interest on loan $40,00,000 \times 9\% \times 10 / 12 = 3,00,000$

Out of which interest related to period before 1.1.2025 shall be capitalised that is $3,00,000 \times 7 / 10 = 2,10,000$ and the balance that is Rs. 90,000 shall be treated as revenue expenditure

Entries

1.6.10 Machinery a/c	2,10,000
To loan a/c	
31.3.11 Interest on loan a/c	90,000
To loan /bank	
31.3.11 Profit and loss a/c	90,000
To interest on loan a/c	

Q-5

Welkins Formations began construction of a new plant on 1.4.2010 and obtained a special loan of Rs. 4,00,000 to finance the construction of the plant . The rate of interest on loan was 10%.

The expenditure that was made on the project of plant was as follows:

1.4.2010	5,00,000
1.8.2010	12,00,000
1.1.2011	2,00,000

The company's other outstanding non-specific loan was Rs. 23,00,000 at an interest rate of 12%.

The construction of plant was completed on 31.3.2011.

You are required to:

Amount of interest to be capitalised

Pass entries

Response:

1. Average accumulated expenses

1.4.2010	5,00,000x 12/2	5 ,00,000
1.8.2010	12,00,000 x 8/12	8,0,0,000
1.1.2011	2,00,000 x 3/12	50,000
	Total	13,50,000

2. Calculation of average rate of interest:

$23,00,000 \times 12\% = 2,76,000$

$276,000 / 23,00,000 \times 100 = 12\%$

3. Amount of interest to be capitalised

on Special Borrowings: $4,00,000 \times 10\% = 40,000$

On general borrowings:

$13,50,000 - 4,00,000 = 9,50,000 \times 12\% = 1,14,000$

4. Total expenses to be capitalized for borrowings:

Cost of plant $5,00,000 + 12,00,000 + 2,00,000 = 19,00,000$

Amount of interest to be capitalized = 1,54,000

5. Entries

Plant a/c 20,54,000

To bank 20,54,000

Q-6: X limited began a construction of a new building on 1.4.2011. it obtained Rs. 1 lakh special loan to finance the construction of the buildings on 1.4.2011 at an interest rate of 10%. The company's other outstanding two non-specific loans were:

Loans	rate of interest

Rs. 5,00,000	11%

Rs. 9,00,000	13%

The expenditure that was made on the buildings project were as follows:

1.4.2011	2,00,000
1.7.2011	2,50,000
1.10.2011	4,50,000
1.3.2011	1,20,000

Building was completed by 31.3.2012. Calculate the amount of interest to be capitalized and pass entries

Response:

First step.

Calculation of average accumulated expenses

2,00,000 x 12/12	2,00,000
2,50,000 x 9/12	1,87,500
4,50,000 x 6/12	2,25,000
1,20,000 x 1/12	10,000
Total	6,22,500

Second step:

Total Expenditure incurred: 6,22,500



Financing: out of Specific borrowings 1,00,000; out of General Borrowings 5,22,500

3rd Step:

Calculation of weighted average rate of interest:

Non- Specific Loan	Interest %	interest	Weighted Average Rate of Interest: $1,72,000 / 14,00,000 = 0.12285$ That is 12.285 %
5,00,000	11	55,000	
9,00,000	13	1,17,000	

14,00,000		1,72,000	

4th Step:

Interest to be capitalised

Specific borrowings Rs. 1,00,000 x 10% = 10,000

General borrowings Rs. 5,22,000 x 12.285%* = 64,189

5th Step:

Amount to be capitalised for buildings

Cost of building Rs. 2,00,000+2,50,000+450,000+1,20,000 = 10,20,000

Add amount of interest to be capitalised =74,189

=10,94,189

Entry:

Building a/c	Dr.	10,94,189
To bank		10,94,189

Sanjay Welkins' Classes

AS 22

Accounting for Taxes on Income

1. Preface

Accounting Standard 22 has been prescribed by ICAI to be applied in accounting for taxes on income. This AS is applied to match the differences between accounting income and taxable income.

1. Accounting income is the net profit before tax for a period, as reported in the profit and loss statement.
2. Taxable income is the income on which income tax is payable, computed by applying provisions of the Income Tax Act, 1961 & Rules.

2. Types of differences and why they appear

The differences can be of two types:

2.1 Timing difference

Timing differences are those differences between accounting income and taxable income which can be reversed in one or more subsequent periods. For example, Depreciation allowed as per WDV method for computing taxable income and as per SLM method for computing accounting income.

2.2 Permanent difference

Permanent differences are those differences between accounting income and taxable income which cannot be reversed any subsequent period. For example, Donation paid in cash is disallowed in computing taxable income whereas it is allowed as expenditure while computing accounting income. There can be differences between accounting income and taxable income because of the following reasons :

1. Expenses debited in profit and loss statement, but disallowed as per Income Tax Act 1961, while computing taxable income
2. Provision for Bad/doubtful debts allowed while computing accounting income, but disallowed while computing taxable income
3. Charging depreciation using different rates as per Companies Act 2013 and Income Tax Act 1961
4. Any income recognized on an accrual basis in profit and loss statement but recognized on receipt basis in subsequent period for computing taxable income. In order to account for these kinds of differences, AS 22 needs to be applied.

3. When to apply AS 22 Accounting for Taxes on Income

AS 22 needs to be applied when there are differences between taxable income and accounting income.

If taxable income is greater than accounting income, then it will result in deferred tax asset.

And if accounting income is greater than taxable income, then it will result in deferred tax liability.

When the difference is resulting in deferred tax asset, then it should be recognized only when there is a reasonable certainty of its realization. The recognition of deferred tax asset should be to the extent of the reasonable certainty of the expected realization. The reasonable certainty can be determined by making the realistic estimates of future profits based on the examination of profits and loss statement of earlier periods.

Say, an entity has unabsorbed depreciation or carry forward of losses. In such a case, deferred tax asset should be recognized to the extent there is a virtual certainty supported by convincing evidence. Virtual

certainty is a matter of judgment of convincing evidence, which should be available in a concrete form at a particular date.

4. Measurement

- 1 Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.
- 2 Deferred tax assets and liabilities are usually measured using the tax rates and tax laws that have been enacted by the balance sheet date.
- 3 However, certain announcements of tax rates and tax laws by the government may have the substantive effect of actual enactment.
- 4 In these circumstances, deferred tax assets and liabilities are measured using such announced tax rate and tax laws.
5. Deferred tax assets and liabilities should not be discounted to their present value

5. Review of Deferred Tax Assets

- 1 The carrying amount of deferred tax assets should be reviewed at each balance sheet date.
- 2 An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available against which deferred tax asset can be realised.
- 3 Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be, that sufficient future taxable income will be available

6. Disclosure

Statement of Profit And Loss

- a. Under AS 22, there is no specific requirement to disclose current tax and deferred tax in the statement of profit and loss.
- b. However, considering the requirements under the Companies Act, 2013, the amount of income tax and other taxes on profits should be disclosed.
- c. AS 22 does not require any reconciliation between accounting profit and the tax expense.

Balance sheet

- a. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts.
- b. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period.
- c. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities.
- d. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

7. An enterprise should offset assets and liabilities representing current tax

if the enterprise:

- (a) Has a legally enforceable right to set off the recognised amounts and
- (b) Intends to settle the asset and the liability on a net basis.

An enterprise should offset deferred tax assets and deferred tax liabilities if:

- (a) The enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

- (b) The deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

AS 22 Versus IND AS 12

AS 22	Ind AS 12
AS 22 recognizes tax effect of differences between taxable income and accounting income.	IND AS 12 recognizes tax effect of differences between assets and/or liabilities and their tax base.
AS 22 is based on profit or loss statement approach.	IND AS 12 is based on balance sheet approach.
AS 22 is applied on account of timing differences and permanent differences.	IND AS 12 is applied due to taxable temporary differences and deductible temporary differences. Permanent differences are not dealt in by this standard.
DTA is recognized only when and to the extent there is a reasonable certainty of its realization	Deductible temporary differences are recognized to the extent of the probability of taxable profits in future periods.
AS 22 deals with the disclosure of DTA/DTL in the balance sheet.	IND AS 12 deals with the recognition of current or deferred tax as income or expense in profit and loss statement. It also deals with the disclosure of out of profit and loss transaction in the balance sheet as current or non-current assets/liability.
AS 22 does not cover the difference arising between taxable income and accounting income due to the revaluation of assets.	IND AS 12 deals with the difference between carrying the amount of revalued asset and its tax base.
AS 22 does not cover the difference arising due to goodwill arising a business combination.	As per IND AS 12, the difference between carrying the amount of goodwill and its tax base (which will be NIL) is the taxable temporary difference. It does not allow the recognition of such difference because goodwill is measured as a residual and its recognition would increase the carrying amount of goodwill.
When an entity has unabsorbed depreciation or carry forward of losses then in such a case deferred tax asset should be to the extent there is a virtual certainty supported by convincing evidence.	There is no concept of virtual certainty in IND AS 12. Deductible temporary differences are recognized to the extent of the probability of taxable profits in future periods.
AS 22 specifically provides guidance regarding recognition of deferred tax in the situations of Tax Holiday under Sections 80-IA, 80-IB, 10A and 10B of Income-tax Act.	IND AS 12 does not specifically deal with the situations of the tax holiday.
AS 22 provides guidance regarding recognition of DTA in case of loss under the head of 'capital gains'.	IND AS 12 does not specifically provide for the same.

Illustrative Studies

1. Rama Ltd. has provided the following information:

	Rs.
Depreciation as per accounting records	2,00,000

Depreciation as per income tax records	5,00,000
Unamortized preliminary expenses as per tax record	30,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset/ liability should be recognised as transition adjustment? Tax rate 50%.

Response

Table showing calculation of deferred tax asset / liability

Particulars	Amount	Timing differences	Deferred tax	Amount @ 50%
Excess depreciation as per tax records (Rs. 5,00,000 - Rs. 2,00,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortized preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability				1,35,000

2.

Ultra Ltd. has provided the following information.

Depreciation as per accounting records = Rs. 2,00,000

Depreciation as per tax records = Rs. 5,00,000

Unamortized preliminary expenses as per tax record = Rs. 30,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset/ liability should be recognised as transition adjustment when the tax rate is 50%?

Response

Calculation of difference between taxable income and accounting income

Particulars	Amount (Rs.)
Excess depreciation as per tax Rs. (5,00,000 - 2,00,000)	3,00,000
Less: Expenses provided in taxable income	(30,000)
Timing difference	2,70,000

Tax expense is more than the current tax due to timing difference.

Therefore deferred tax liability = 50% × 2,70,000 = Rs. 1,35,000

3.

From the following details of A Ltd. for the year ended 31-03-2025, calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the Profit and Loss Account for the year.

Particulars	Rs.
Accounting Profit	6,00,000
Book Profit as per MAT	3,50,000
Profit as per Income Tax Act	60,000
Tax rate	20%
MAT rate	7.50%

Response

Tax as per accounting profit	6,00,000x20%	= Rs. 1,20,000
Tax as per Income-tax Profit	60,000x20%	= Rs. 12,000
Tax as per MAT	3,50,000x7.50%	= Rs. 26,250

Tax expense = Current Tax +Deferred Tax

Rs. 1,20,000 = Rs. 12,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-2025

= Rs. 1,20,000 - Rs. 12,000 = Rs. 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-2025

Current Tax + Deferred Tax liability + Excess of MAT over current tax

= Rs. 12,000 + Rs. 1,08,000 + Rs. 14,250 (26,250 - 12,000)

= Rs. 1,34,250

Sanjay Welkins' Classes