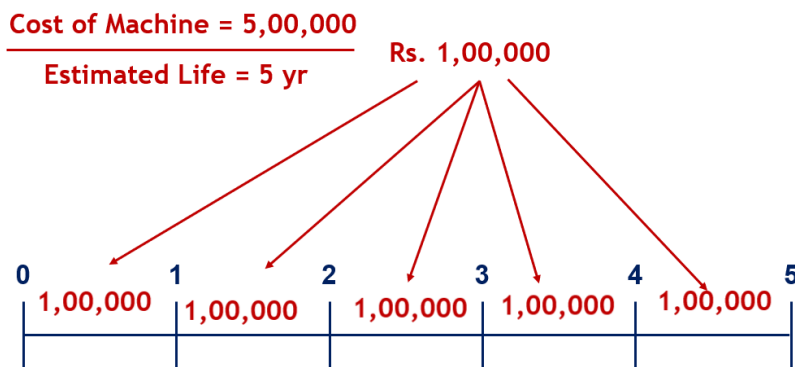


# Depreciation Accounting



### Meaning of Depreciation

The amount or value of fixed assets ( Let Cost of Asset = 5,00,000) allocated as an expense in each of the accounting period ( Let Estimated Life = 5 yr) in which the asset is utilized to respective accounting period is called depreciation.



For Doubt Helpline No. 8975003156

Reason of Depreciation

Objectives of Depreciation

Factors to be consider for Assessment (Calculation) of Depreciation

Navneet Agrawal

### Reason of depreciation

**Wear and tear** Due to its use in business

**Effluxion of time** Even when it is not being used

**Obsolescence** Due to technological or other changes

**Decrease in market value**

**Depletion** Mainly in case of mines and other natural reserves

### *Objectives of Depreciation*

Presentation of Correct Financial Position

Calculation of Correct Profits

Funds for Replacement of assets

Ascertainment of correct cost of production

### Factors to be consider for Assessment (Calculation) of Depreciation

Historical cost

Expected useful life

Estimated residual value










**In the books of M/s Vishal  
Machinery Account (for            )**

Date	Particular	₹	Date	Particular	₹

### Machine Hour Rate Method

**Q No. 3:** A plant was purchased for ₹ 30,00,000 having an estimated total working of 24,000 hours. The scrap value is expected to be ₹ 2,00,000 and anticipated pattern of distribution of effective hours is as follows:

Year	Machine Hours
1 - 3	3,000 hours per year
4 - 6	2,600 hours per year
7 - 10	1,800 hours per year

**Required:** Determine Annual Depreciation under Machine Hour Rate Method.

**Answer**

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### Calculation of Annual Depreciation

Year	Working	Depreciation (₹)

### Production Unit Method

**Q No. 4:** A machine is purchased for ₹ 2,00,000. Its estimated useful life is 10 years with a residual value of ₹ 20,000. The machine is expected to produce 1,50,000 units during its life time. Expected distribution pattern of production is as follows:

Year	Production
1-3	20,000 units per year
4-7	15,000 units per year
8-10	10,000 units per year

**Required:** Determine the value of depreciation for each year using production units method.

**Answer**

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### Calculation of Annual Depreciation

Year	Working	Depreciation (₹)

### Depletion Method

**Q No. 5:** M/s Surya took lease of a quarry on 1-1-2013 for ₹ 1,00,00,000. As per technical estimate the total quantity of mineral deposit is 2,00,000 tonnes. Depreciation was charged on the basis of depletion method. Extraction pattern is given in the following table:

Year	Quantity of Mineral extracted
2013	2,000 tonnes
2014	10,000 tonnes
2015	15,000 tonnes

**Required:** Show the Quarry Lease Account for each year from 2013 to 2015.





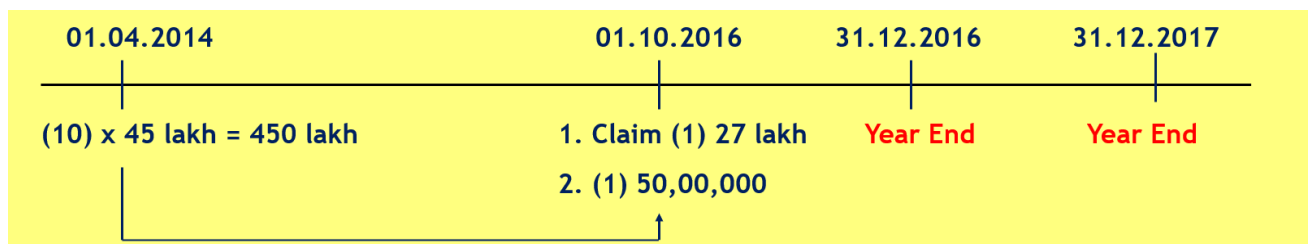
**2. Depreciation for the year ended 31.12.1991**

**3. Profit or loss on sale of machinery**

**4. Depreciation for the year ended 31.12.1992**

**Q No. 7:** The LG Transport company purchased 10 trucks at ₹ 45,00,000 each on 1st April 2014. On October 1st, 2016, one of the trucks is involved in an accident and is completely destroyed and ₹ 27,00,000 is received from the insurance in full settlement. On the same date another truck is purchased by the company for the sum of ₹ 50,00,000. The company write off 20% on the original cost per annum. The company observe the calendar year as its financial year.

Give the motor truck account for two year ending 31 Dec, 2017.



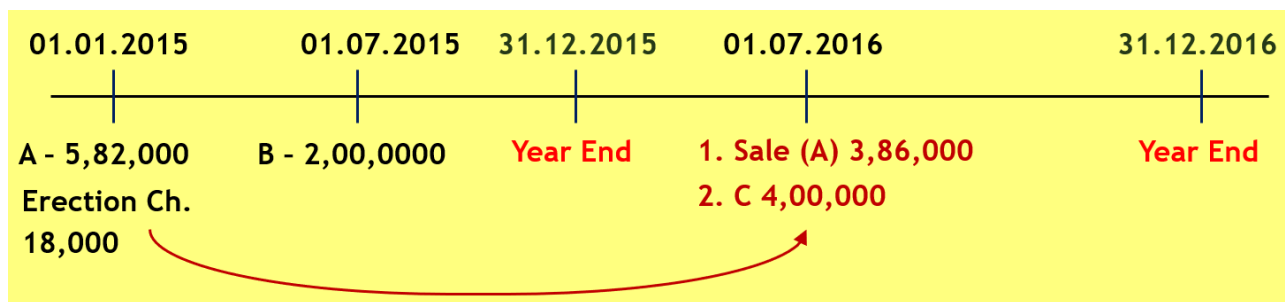


**3. Depreciation for the year ended 31.12.2016**

**4. Depreciation for the year ended 31.12.2017**

**Q No. 8:** AB & Co. purchased on 1st January, 2015 certain machinery for ₹ 5,82,000 and spent ₹ 18,000 on its erection. On July 1, 2015 another machinery for ₹ 2,00,000 was acquired. On 1st July, 2016 the machinery purchased on 1st January, 2015 having become obsolete was auctioned for ₹ 3,86,000 and on the same date fresh machinery was purchased at a cost of ₹ 4,00,000. Depreciation was provided for annually on 31st December at the rate of 10 per cent p.a. on written down value.

**Required:** Prepare machinery account.



In the books of LG Transport  
Machinery A/c (10%, WDV)

Date	Particular	₹	Date	Particular	₹

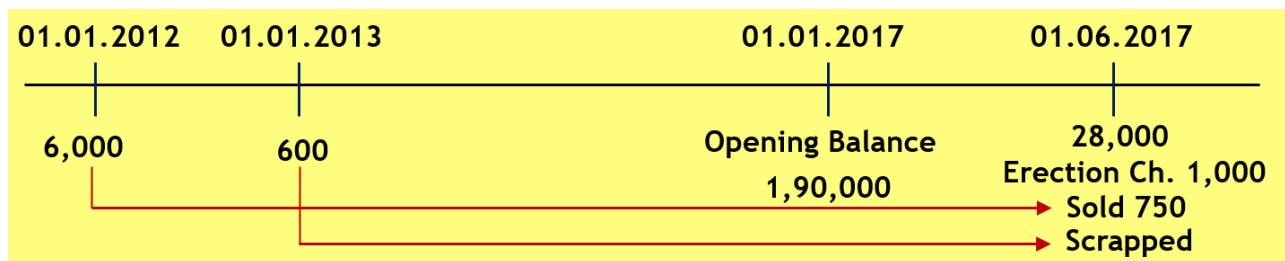


**2. Profit or loss on Machine Sold**

**3. Depreciation for the year ended 31.12.2016**

**Q No. 9:** The Machinery Account of Rohit showed a balance of ₹ 1,90,000 on 1<sup>st</sup> January 2017. Its accounts were made up on 31st December each year and depreciation is written off at 10% p. a. under the Diminishing balance Method.

On 1st June, 2017, new machinery was acquired at a cost of ₹ 28,000 and installation charges incurred in erecting the machine works out to ₹ 1,000 on the same date. On 1st June 2017 a machine which had cost ₹ 6,000 on 1st January, 2012 was sold for ₹ 750 and another machine which had cost ₹ 600 on 1st January 2013, was scrapped on the same date and it realized nothing. Write up plant and Machinery Account. For the year 2017, allowing the same rate of depreciation as in the past calculating depreciation to the nearest multiple of a rupee.



**Q No. 10:** On 1.1.2019 machinery was purchased for ₹ 80,000. On 01.07.2020 additions were made to the amount of ₹ 40,000. On 31.3.2021, machinery purchased on 1.7.2020, costing ₹ 12,000 was sold for ₹ 11,000 and on 30.06.2021 machinery purchased on 01.01.2022 costing ₹ 32,000 was sold

for ₹ 26,700. On 1.10.2021, additions were made to the amount of ₹ 20,000. Depreciation was provided at 10% p.a. on the Diminishing Balance Method.

Show the Machinery Accounts for three years from 2019-2021. (year ended 31st December)

### Provision for Depreciation Account

**Q No. 11:** Mr. Singh acquired a machine on 1st Jan, 2019 at a cost of ₹ 50,000 and spent ₹ 10,000 on its installation having scrap value of ₹ 5,000 at the end of its useful life of 4 years. Books are closed on 31st December every year. Prepare machinery account and provision for depreciation account for 2019, 2020 and 2021. Mr. Singh follows straight line method for charging depreciation in his books.

**Q No. 12:** S & Co. purchased a machine for ₹ 1,00,000 on 1.1.2019. Another machine costing ₹ 1,50,000 was purchased on 1.7.2020. On 31.12.2021, the machine purchased on 1.1.2019 was sold for ₹ 50,000. The company provides depreciation at 15% on Straight Line Method. The company closes its accounts on 31st December every year.

Prepare -

- (i) Machinery A/c,
- (ii) Machinery Disposal A/c and
- (iii) Provision for Depreciation A/c.

**Q No. 13:** On April 1, 2015, a firm purchased a machinery for ₹ 2,00,000. On 1st October in the same accounting year, additional machinery costing ₹ 1,00,000 was purchased. On 1st October, 2016, the machinery purchased on 1st April, 2015, having become obsolete, was sold off for ₹ 90,000. On October 1, 2017, new machinery was purchased for ₹ 2,50,000 while the machinery purchased on 1st October, 2015 was sold for ₹ 85,000 on the same day. The firm provides depreciation on its machinery @ 10% per annum on original cost on 31st March every year. Show Machinery Account, Provision for Depreciation Account and Depreciation Account for the period of three accounting years ending March 31, 2018.

**Answer:** Balance of Machinery Account as on 31.03.2018 = 2,50,000;

Balance of Provision for Depreciation Account as on 31.03.2016 - 25,000; 31.03.2017 - 15,000; 31.03.2018 - 12,500;

### Change in Method of Depreciation

**Q No. 14:** Ram Ltd. which depreciates its machinery at 10% p.a. on Diminishing Balance Method, had on 1st January, 2022 ₹ 9,72,000 on the debit side of Machinery Account.

During the year 2013 machinery purchased on 1st January, 2020 for ₹ 80,000 was sold for ₹ 45,000

on 1st July, 2022 and a new machinery at a cost of ₹ 1,50,000 was purchased and installed on the same date, installation charges being ₹ 8,000.

The company wanted to change the method of depreciation from Diminishing Balance Method to Straight Line Method with effect from 1st January, 2019. Difference of depreciation up to 31st December, 2022 to be adjusted. The rate of depreciation remains the same as before. Prepare the Machinery Account.

### Practice Questions

#### PQ No. 1:

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

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

#### Solution:

M. No.	Cost of Machine (₹)	Expenses incurred at the time of purchase to be capitalized (₹)	Total Cost of Asset = (b+c) (₹)	Estimated Residual Value (₹)	Expected Useful Life in years	Depreciation = (d-e)/f (₹)	Rate of Depreciation under SLM = (g/d)×100
a	b	c	d	e	f	g	h
1	90,000	10,000	1,00,000	20,000	8	10,000	10%
2	24,000	7,000	31,000	3,100	6	4,650	15%
3	1,05,000	20,000	1,25,000	12,500	5	22,500	18%
4	2,50,000	30,000	2,80,000	56,000	10	22,400	8%

**PQ No. 2:** A machine is purchased for ₹ 7,00,000. Expenses incurred on its cartage and installation ₹ 3,00,000. Calculate the amount of depreciation @ 20% p.a. according to Straight Line Method for the first year ending on 31st March, 2022 if this machine is purchased on:

- (a) 1st April, 2021
- (b) 1st July, 2021

(c) 1st October, 2021

(d) 1st January, 2022

**Solution:**

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

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

The machine was purchased on	Amount of Depreciation
1st April, 2021	₹ 2,00,000
1st July, 2021	₹ 1,50,000
1st October, 2021	₹ 1,00,000
1st January, 2022	₹ 50,000

**PQ No. 3:** On 1.1.2019 a machine was purchased for ₹ 1,00,000 and ₹ 50,000 was paid for installation. Assuming that the rate of depreciation was 10% on Reducing Balance Method, calculate amount of depreciation upto 31.12.2021.

**Solution:**

Year	Opening Book Value (₹)	Rate	Depreciation (₹)	Closing Book Value (₹)
2011	1,50,000	10%	15,000	1,35,000
2012	1,35,000	10%	13,500	1,21,500
2013	1,21,500	10%	12,150	1,09,350

**Note:** Cost of the machine (i.e. Opening Book Value for the year 2019)

= Cost of Purchase + Cost of Installation

= ₹ 1,00,000 + ₹ 50,000 = ₹ 1,50,000

**PQ No. 4:** On 1st April, 2019, Som Ltd. purchased a machine for ₹66,000 and spent ₹5,000 on shipping and forwarding charges, ₹7,000 as import duty, ₹1,000 for carriage and installation, ₹500 as brokerage and ₹500 for an iron pad. It was estimated that the machine will have a scrap value of ₹ 5,000 at the end of its useful life which is 15 years. On 1st January, 2020 repairs and renewals of ₹ 3,000 were carried out. On 1st October, 2021 this machine was sold for ₹ 50,000. Prepare Machinery Account for the 3 years.

**Solution:**

In the books of Som Ltd.

Dr.		Machinery Account		Cr.	
Date	Particulars	(₹)	Date	Particulars	(₹)
01.04.19	To, Bank A/c	66,000	31.03.20	By, Depreciation A/c	5,000
	To, Bank A/c	14,000		By, Balance c/d	75,000
		<b>80,000</b>			<b>80,000</b>

01.04.20	To, Balance b/d	75,000	31.03.21	By, Depreciation A/c	5,000
				By, Balance c/d	70,000
		<b>75,000</b>			<b>75,000</b>
01.04.21	To, Balance b/d	70,000	01.10.21	By, Depreciation A/c	2,500
				By, Bank A/c (sale)	50,000
				By, Profit & Loss A/c (Loss)	17,500
		<b>70,000</b>			<b>70,000</b>

**Hint:** The amount spent on repairs and renewals on 1st January, 2020 is of revenue nature and hence, does not form part of the cost of asset.

**PQ No. 5:** M/s. Hot and Cold commenced business on 01.07.2017. When they purchased a new machinery at a cost of ₹ 8,00,000. On 01.01.2019 they purchased another machinery for ₹ 6,00,000 and again on 01.10.2021 machinery costing ₹ 15,00,000 was purchased. They adopted a method of charging depreciation @ 20% p.a. on diminishing balance basis.

On 01.07.2021, they changed the method of providing depreciation and adopted the method of writing off the Machinery Account at 15% p.a. under straight line method with retrospective effect from 01.07.2017, the adjustment being made in the accounts for the year ended 30.06.2020.

The depreciation has been charged on time basis. You are required to calculate the difference in depreciation

to be adjusted in the Machinery on 01.07.2021, and show the Machinery Account for the year ended 30.06.2022.

**Solution:**

**In the books of M/s Hot and Cold**

Dr.			Machinery Account			Cr.		
Date	Particulars	(₹)	Date	Particulars	(₹)			
01.07.21	To, Balance b/d	6,73,280	30.06.22	By Depreciation A/c	3,78,750			
	To, Profit and Loss A/c	21,720		By Balance c/d	18,16,250			
	(Depreciation Overcharged)							
01.10.21	To, Bank A/c (Purchase)	15,00,000						
		<b>21,95,000</b>			<b>21,95,000</b>			

**Working Notes:**

1. **Statement of Depreciation:**

Date	Particulars	Machine - I (₹)	Machine - II (₹)	Total Depreciation (₹)
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01.07.2017	Book Value	8,00,000		
30.06.2018	Depreciation @ 20%	1,60,000		1,60,000
01.07.2018	W.D.V.	6,40,000		
01.01.2019	Bank (Purchase)		6,00,000	
30.06.2019	Depreciation @ 20%	1,28,000	60,000	1,88,000
01.07.2019	W.D.V.	5,12,000	5,40,000	
30.06.2020	Depreciation @ 20%	1,02,400	1,08,000	2,10,400
01.07.2020	W.D.V.	4,09,600	4,32,000	
30.06.2021	Depreciation @ 20%	81,920	86,400	1,68,320
01.07.2021	W.D.V.	3,27,680	3,45,600	
		<b>6,73,280</b>		<b>7,26,720</b>

### 1. Depreciation Overcharged:

Now depreciation under Straight Line Method

On ₹ 8,00,000 @ 15% = ₹ 1,20,000 × 4 years (from 01.07.2017 to 30.06.2021)	₹ 4,80,000
On ₹ 6,00,000 @ 15% = ₹ 90,000 × 2.5 years (from 01.01.2019 to 30.06.2021)	₹ 2,25,000
	₹ 7,05,000

Depreciation overcharged = Reducing Balance Basis - Straight Line Basis

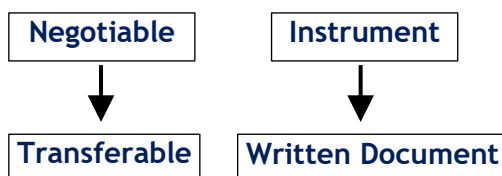
= ₹ (7,26,720 - 7,05,000) = ₹ 21,720

### 2. Depreciation for the year:

On ₹ 14,00,000 @ 15% for the year	₹ 2,10,000
On ₹ 15,00,000 @ 15% for the 9 months	₹ 1,68,750
	₹ 3,78,750

## Accounting for Bills of Exchange

# 10



### Negotiable Instruments

According to section 13(1) of **The Negotiable Instruments Act, 1881**, “A negotiable instrument means a promissory note or bill of exchange or cheque, payable either to order or to the bearer”.

### Bills of Exchange

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

### Essential Elements of a Bills of Exchange

1. It **must be in writing** and may be in any language and in any form
2. It must be drawn on a **particular date**
3. There are three parties to a Bill of Exchange - **Drawer / Maker, Drawee and Payee**
4. It must be **signed by the Drawer / Maker**
5. It must contain an **unconditional and imperative order to pay**
6. The order to pay must be **directed to a certain person**
7. The order must be to pay a **certain sum of money only**
8. It must be accompanied with **proper stamp** as per the requirement of the law

### Parties to a Bills of Exchange

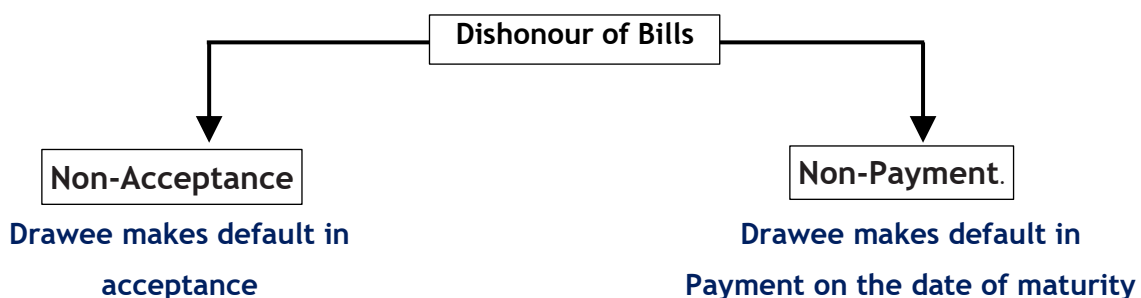
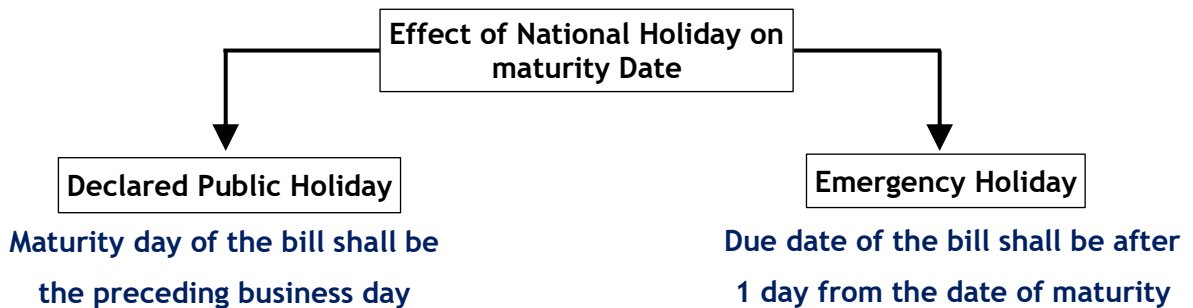
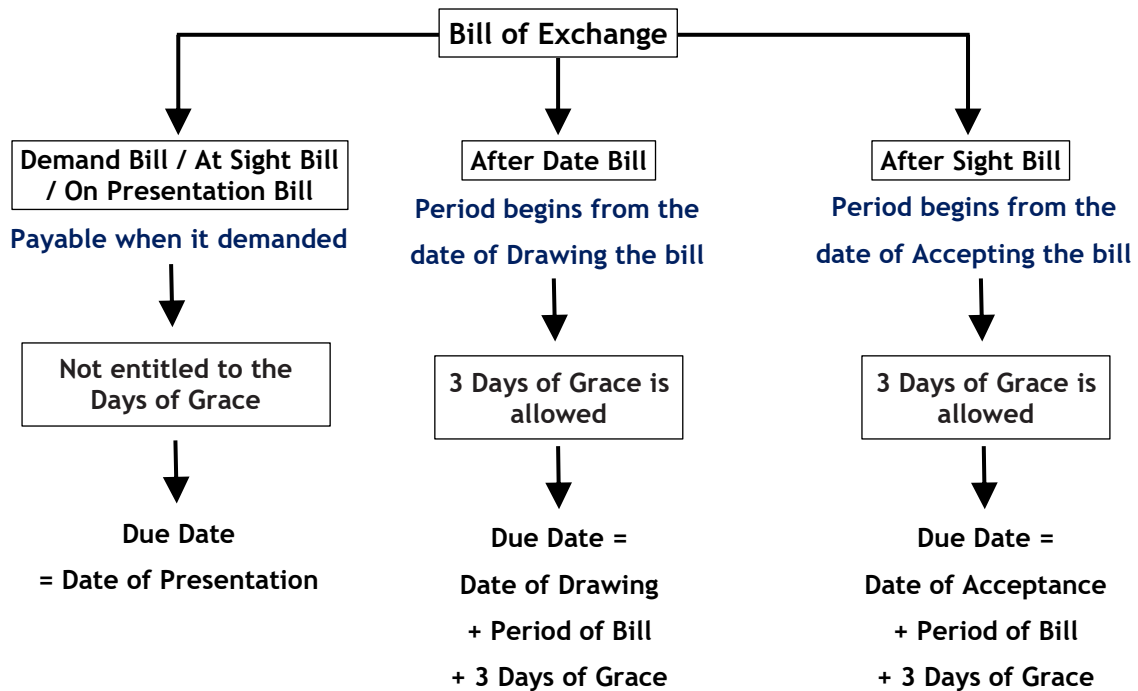
**Drawer:** Drawer is the party that issues a Bill of Exchange - Creditor, Lender or Seller. He is the maker of the bill and his signature is necessary.

**Drawee:** Drawee is the party to which the order to pay is sent - Debtor or Purchaser. The

drawee becomes the acceptor of the bill when he/she/it has written the acceptance on the bill of exchange.

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

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



**Noting of a Bill:** The recording of the fact of dishonour of bill by a Notary Public is referred to as Noting of a Bill. For this purpose, a fee, called the Noting Fee or Noting Charge, is required to be paid. It is an expense for the holder of the bill and is recovered from the party is responsible for the such dishonour.

### Renewal of Bills

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

### Retirement of a Bill

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

### Accommodation Bills

**Meaning:** Accommodation Bills refer to those bills which are drawn, accepted or endorsed without any consideration.

**Purpose:** Accommodation Bills are drawn and accepted to meet the financial needs of the drawer /drawee /both temporarily.

### Important Point w.r.t accommodation bills

- On discounting of Accommodation Bills, proceeds may be shared by drawer and drawee in an agreed ratio.

- Each party bears the Discounts Charges of Accommodation Bills in the proportion in which it shares the proceeds of the bills unless otherwise agreed.
- On dishonour of Accommodation Bills, drawer cannot file suit against the drawee because drawee is not liable to drawer.

### Accounting entries passed in case of accommodation bills

The accounting entries in case of Accommodation Bills are made in the usual manner as in case of trade bills.

### Distinction between trade bills and accommodation bills

Basis of Distinction	Trade Bills	Accommodation Bills
<b>1. Purpose</b>	These bills are drawn to settle a business transaction.	These bills are drawn to meet the financial needs of the drawer/ drawee/both temporarily.
<b>2. Consideration</b>	These bills are accepted for a consideration.	These bills are accepted without any consideration.
<b>3. Role</b>	These bills act as an evidence of indebtedness.	These bills act as a source of finance.
<b>4. Sharing of Proceeds of the Bill</b>	On discounting of such bills, proceeds remain with the holder.	On discounting of such bills, proceeds may be shared by drawer and drawee in an agree ratio.
<b>5. Recovery in case of dishonour</b>	On dishonour of such bills, drawer can file a suit against the drawee, because drawee is liable to drawer.	On dishonour of such bill, drawer cannot file suit against the drawee because drawee is not liable to drawer.

**Practical Questions****Q No. 1:** Calculate due dates of following bills

Bill No.	Date of Drawing	Date of Acceptance	Period	Nature of bill
1.	13-03-2023	14-03-2023	3 months	After date
2.	12-03-2023	15-03-2023	2 months	After sight
3.	15-04-2023	17-04-2023	30 days	After sight
4.	18-04-2023	20-04-2023	60days	After date

**Solution:**


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**Q No. 2:** Amrit sell goods worth Rs. 1,500 to Anand on 01.01.2023. On the same date Anand accepts a bill for two months drawn on him by Amrit for the amount. Give journal entire in the books of Amrit and Anand in the following cases.

- a. The bill is retained till maturity.
- b. The bill is endorsed in favour of Sudesh.
- c. The bill is immediately discounted with bank @ 16% per annum.
- d. X retained the bill and on March 31, 2021 X sent the bill for collection to its bank. On April 05, 2021 bank advice was received.

Assume that the bill is met on maturity.

**Solution:****Journal Entries**

Date	Particular	L.F.	Dr.	Cr.



















**PQ No. 2:** X sold goods for ₹ 20,000 to Y on credit on January 01, 2022. X drew a bill of exchange upon Y for the same amount for three months. Y accepted the bill and returned it to X. Y met his acceptance on maturity. Record the necessary journal entries under the following circumstances:

- (i) X retained the bill till the date of its maturity and collected directly
- (ii) X discounted the bill @ 12% p.a. from his bank
- (iii) X endorsed the bill to his creditor Z
- (iv) X retained the bill and on March 31, 2021 X sent the bill for collection to its bank. On April 05, 2021 bank advice was received.

**Solution:**

**In the Books of X Journal**

(i) When the bill is retained till its maturity

Date	Particulars	LF	Dr. (₹)	Cr. (₹)
2021				
January 1	Y's A/c Dr. To, Sales A/c (Being goods sold to Y's on credit)		20,000	20,000
January 1	Bills Receivable A/c Dr. To, Y's A/c (Being received Y's acceptance payable after three months)		20,000	20,000
April 5	Bank A/c Dr. To, Bills Receivable A/c (Being Y met his acceptance on maturity)		20,000	20,000

(i) When the bill was discounted from the book

Date	Particulars	Dr. (₹)	Cr. (₹)
2022			
January 1	Y's A/c Dr. To, Sales A/c (Sold goods to Y's)	20,000	20,000

January 1	Bills Receivable A/c Dr. To, Y's A/c (Received Y's acceptance three months)	20,000	20,000
January 1	Bank A/c Dr. Discount A/c (₹ 20,000 x 12% x 3) Dr. □ 12 □ □ To, Bills Receivable A/c (Y's acceptance discounted with the bank)	19,400 600	20,000

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

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2022				
January 1	Y's A/c Dr. To, Sales A/c (Sold goods to Y's on credit)		20,000	20,000
January 1	Bills Receivable A/c Dr. To, Y's A/c (Received Y's acceptance for three months)		20,000	20,000
January 1	Z's A/c Dr. To, Bills Receivable A/c (Y acceptance endorsed in favour of Z)		20,000	20,000

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

Date	Particulars	Dr. (₹)	Cr. (₹)
2022			
Jan. 01	Y's A/c Dr. To, Sales A/c (Sold goods to Y's on credit)	20,000	20,000
Jan. 01	Bills Receivable A/c Dr. To, Y's A/c (Received Y's acceptance payable after three months)	20,000	20,000
Mar. 31	Bills Sent for Collection A/c Dr. To, Bills Receivable A/c	20,000	20,000

	(Bills sent for collection)			
Apr. 05	Bank A/c To, Bills sent for collection A/c (Bills sent for collection collected by the bank)	Dr.	20,000	20,000

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

#### In the Books of Y Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
<b>2022</b>				
Jan. 01	Purchases A/c To, X's A/c (Purchases goods from X on credit)	Dr.	20,000	20,000
Jan. 01	X's A/c To, Bill's Payable A/c (Accepted bill drawn by X payable after three months)	Dr.	20,000	20,000
Apr. 04	Bills payable A/c To, Bank A/c (Met acceptance maturity)	Dr.	20,000	20,000

**PQ No. 3:** Mr Devish draws two bills of exchange on 1st Jan. for ₹ 6,000 and ₹ 10,000. The bills of exchange for ₹ 6,000 is for two months while the bill of exchange for ₹ 10,000 is for three months. These bills are accepted by Tina. On 4th March Tina requests Mr Devish to renew the first bill with interest at 18% p.a. for a period of two months. Mr Devish agrees to this proposal. On 20th March, Tina retires the acceptance for ₹ 10,000, the interest rebate i.e., discount being ₹ 100. Before the due date of the renewed bill, Tina becomes insolvent and only 50 paise in a rupee could be recovered from the estate. You are to required to give the journal entries in the books of Mr Devish.

#### Solution

#### Journal of Mr. Devish

Date	Particulars	L.F.	₹	₹
------	-------------	------	---	---

Jan.	Bills Receivable No. 1 A/c	Dr.		6,000	
	Bills Receivable No. 2 A/c	Dr.		10,000	
1	To Tina				16,000
	(Beings bills due on 4th March and 4th April respectively accepted by Mr Tina)				
Mar.	Tina	Dr.		6,000	
4	To Bills Receivable No. 1 A/c				6,000
	(Being cancellation of B/R No. 1 upon renewal)				
Mar.	Tina	Dr.		180	
4	To Interest A/c				180
	(Being the interest due on ₹ 6,000 @ 18% p.a. for 2 months on renewal of bill)				
Mar.	Bills Receivable No. 3 A/c	Dr.		6,180	
4	To Tina				6,180
	(Being B/R No. 3 due on 7th May, accepted by Mr Tina in lieu of bill already cancelled)				
Mar.	Cash A/c	Dr.		9,900	
	Rebate A/c	Dr.		100	
20	To Bills Receivable No. 2 A/c				10,000
	(Being the amount received on retirement of B/R No. 2 before due date)				
May	Tina	Dr.		6,180	
7	To Bills Receivable No. 3 A/c				6,180
	(Being the entry for dishonour of B/R No. 3 on maturity)				
	Cash A/c	Dr.		3,090	
	Bad Debts A/c	Dr.		3,090	
	To Tina				6,180

(Being a dividend of 50 paise in a rupee received from official assignee of Mr. Tina and the irrecovered balance written off as bad debts)			
--	--	--	--

**PQ No. 4:** A sold goods to B for ₹ 10,000 on 1 Jan. and drew upon him a three months bill for the amount. B accepted the bill and returned it to A. One month before the due date, B returned the bill under a rebate of 18% p.a. Pass the necessary journal entries in the books of A and B.

### Solution

#### A's Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	B To Sales A/c (Being the goods sold to B on credit)	Dr.	10,000	10,000
Jan. 1	Bills Receivable A/c To, B (Being the acceptance of the bill received from B)	Dr.	10,000	10,000
Mar. 1	Cash A/c Rebate on Bills A/c To Bills Receivable A/c (Being the bill collected after allowing rebate @ 18% p.a.)	Dr. Dr.	9,850 150	10,000

#### B's Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Purchases A/c To A (Being the goods purchased on credit)	Dr.	10,000	10,000
Jan. 1	A To Bills Payable A/c (Being the acceptance of bill given to A)	Dr.	10,000	10,000
Mar.	Bills Payable A/c	Dr.	10,000	

1	To Cash A/c			9,850
	To Rebate on Bills A/c			150
	(Being the bill discharged under a rebate @18% p.a.)			

**PQ No. 5:** On 1<sup>st</sup> Jan PREM, for the temporary and mutual accommodation of himself and DIPANSHU, draws upon the latter a bill of exchange at 3 months for ₹ 2,000. On 4th Jan. PREM discounts the bill @ 6% p.a and hands half the proceeds to DIPANSHU. At maturity PREM remits the amount due to DIPANSHU who meets the bill. Pass Journal entries in the books of both the parties.

**SOLUTION:**

#### Prem's Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
Jan. 1	Bills Receivable A/c To, DIPANSHU (Being the acceptance of the bill received from DIPANSHU)	Dr.	2,000	2,000
Jan. 4	Bank A/c Discount A/c To Bills Receivable A/c (Being the bill discounted with Bank @ 6% p.a.)	Dr. Dr.	1,970 30	2,000
Jan. 4	DIPANSHU To Cash A/c To Discount A/c (Being half the proceeds remitted to DIPANSHU was also debited with half the discount.)	Dr.	1,000	985 15
April 4	DIPANSHU To Cash A/c (Being remaining half amount of the bill now remitted to DIPANSHU to enable him to meet it.)	Dr.	1,000	1,000

#### Dipanshu's Journal

Date	Particulars	L.F.	Dr. ( ₹ )	Cr. ( ₹ )
Jan. 1	PREM To Bills Payable A/c (Being the acceptance given in favour of PREM)	Dr.	2,000	2,000
Jan. 4	Cash A/c Discount A/c To, PREM (Being half the proceeds received from PREM who is also credited with half the discount)	Dr. Dr.	985 15	1,000
April 4	Cash A/c To, PREM (Being the amount retained by PREM now received from him)	Dr.	1,000	1,000
April 4	Bills Payable A/c To Cash A/c (Being the bill discharged)	Dr.	2,000	2,000

# Consignment Account

# 11

## Difference between Consignment and Regular Sales

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

### Commission

It is the consideration for which the Consignee acts as an agent of the Consignor.

**Ordinary Commission:** This Commission is due to the consignee from the consignor because of rendering of the regular activities of the consignment business. It is calculated on the gross sales made by consignee in the consignment business.

**Del-credere Commission:** This is a commission that is payable for taking the risk associated with credit sale of the goods, namely risk of bad debts and collection responsibility. It is generally calculated on the 'gross sales' made by the consignee, unless otherwise agreed upon.

**Over-riding Commission:** This is an extra commission which is paid over and above the ordinary commission. It is also referred to as Special Commission. This commission is paid when the consignee manages to sell the goods above a pre-determined selling price, or exceeds the sales target.

### Loss of goods sent on consignment

**Normal Loss:** The loss of goods which occurs due to the **inherent nature** of the goods involved is referred to as Normal Loss. It is by nature **unavoidable loss** and forms part of the cost of goods sold.

**Example:** Evaporation of materials, spillage of liquid materials etc.

**Abnormal Loss:** Abnormal Loss of goods refers to those losses which are **avoidable in nature**. Such loss is not considered to be a part of the cost of goods sold.

**Example:** Goods pilfered, goods stolen, goods lost by fire and other natural calamities etc.

## *Practical Questions*

### Q No. 1: (Abnormal Loss in Transit)

S Ltd. of Surat consigned 5,000 liters of edible oil costing ₹ 32 each to M Ltd. of Mumbai on 1.2.2022. S Ltd. paid ₹ 5,000 as freight and insurance charges. During transit 200 liters were destroyed for which the insurance company agreed to pay ₹ 5,000 in full settlement.

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

On 30.6.2022, M Ltd. reported that 4,000 liters were sold at ₹ 1,65,000 and 100 liters were lost due to evaporation. A customer who bought oil for ₹ 1,500 could pay only 40% of his amount. M Ltd. paid its balance due by a cheque.

Show the Consignment Account in the books of S Ltd.

**Q No. 2:** On Jan. 1, 2022 goods costing ₹ 1,32,000 were consigned by Shri G of Chennai to his agent Shri H in Amritsar at a pro-forma invoice price of 20% above cost. Shri G paid freight and other forwarding charges amounting to ₹ 4,000. The consignee was allowed ₹ 2,000 p.a. towards establishment costs, 5% commission on gross sales. Shri H paid ₹ 1,000 as godown rent and insurance for three months ended Mar. 31, 2022.

Three-fourths of the goods were sold at 33 $\frac{1}{3}$ % profit on cost, half of which were credit sales. Balance stock was valued at pro-forma invoice price. Consignee reported that a customer who purchased goods worth ₹ 10,000 was untraceable and his balance was considered to be unrealisable. All other the debtors cleared their dues. Shri H cleared his

dues by sending a bank draft on Mar. 31, 2022.

Prepare necessary accounts in the books of Consignor, for 3 months ending on Mar. 31, 2022.

**Q No. 3:** Kunal of Kolkata consigned goods costing ₹ 45,000 to Qureshi of Meerut. The invoice price was made so as to show a profit of 331/3% on cost. Kunal paid ₹ 300 as carriage and ₹ 1,200 as freight & insurance, Goods costing ₹ 5,000 were destroyed while in-transit and the insurance company admitted the full claim. In Meerut, Qureshi paid ₹ 40 as carriage and ₹ 600 as godown rent. 2/3 rd of the goods received by Qureshi were sold by him. Qureshi sent a cheque to P for the sale proceeds after deducting the expenses incurred by him and the commission due to him: ordinary @ 5% and del credere @ 2-1/2%.

Show the Consignment to Meerut A/c and Q's A/c in Kunal's Ledger.

**Q No. 4:** Veemal of Delhi sends a consignment of wall clocks to Anand of Kolkata and charges proforma invoice price so as to show a profit of 25% on cost. The agent received commission @ 5% on all sales plus 3% del credere commission on credit sales made by him.

Stock of goods with the agent at the beginning of the year: 40 clocks at proforma invoice price ₹ 25,000. During the year ended 31st December 2011, Veemal had the following transactions with Anand:

Proforma invoice price of 200 Clocks consigned to Anand: ₹ 1,25,000

Railway charges and insurance on the consignment paid by Veemal: ₹ 3,500

Advance received from Anand: ₹ 37,500

Sales made by Anand;

80 clocks for cash: ₹ 53,750

100 clocks on credit: ₹ 70,000

Selling expenses made by agent: ₹ 6,250 and discount allowed by him ₹ 2,500.

30 clocks were damaged by the railway for which Anand recovered ₹ 6,750. The damaged clocks were sold on cash by Anand at ₹ 5,750.

Out of the clock sold on credit, ₹ 5,000 was irrecoverable and considered bad by the agent.

The agent remitted the balance due by him by a bank draft. Show necessary Ledger Accounts in the books of Veemal.

**Q No. 5:** The Account Sales received from an agent disclosed that the total sales effected by him during 2021-22 amounted to ₹ 4,50,000. This included ₹ 3,12,500 for sales made at invoice price which is cost plus 25% and the balance at 10% above the invoice price. He incurred expenses to the tune of ₹ 5,000 out of which a sum of ₹ 1,800 is recurring in nature. Forwarding expenses of the Consignor totalled ₹ 2,400. The Agent had remitted the balance

due from him through Bank Draft after deducting the expenses. 5% commission on gross sales, bad debts ₹ 850 and a Bills payable accepted by him for ₹ 10,000.

The value of unsold stock at original cost lying with the Agent as on 31st March, 2022 amounted to ₹ 50,000. You are required to prepare the Consignment Account and the Consignee's Account in the Books of the Consignor.

**Q No. 6:** Mr. P consigned goods to Mr. D, his agent at Dhanbad, at cost price of ₹ 40,000. Mr. P's accountant at the end of the year drew up the agent account as below:

**Mr. D Account**

Particulars	(₹)	Particulars	(₹)
To, Goods	40,000	By, Cash	25,000
To, Cash-Freight	3,000	By, Balance	19,300
To, P/L A/c	1,300		
	44,300		44,300

Mr. D sold part of the goods for ₹ 45,000, which exceeded by ₹ 9,000 their invoice value. He collected ₹ 38,000 after allowing discount of ₹ 2,000 to customers. Bad Debts came to ₹ 1,000 and his expenses to ₹ 800 (including ₹ 200 for loading and cartage). Mr. D was entitled to a 5% commission on cash collected.

From the above information draw up Consignment A/c, Consignment Debtors A/c and Mr. D A/c in the books of Mr. P.

**Q No. 7:** The account sales received from an agent disclosed that the sales made at 10% above the price was 44% of the sales made at invoice price which is cost plus 25%. All the sales are made on credit basis. He incurred expenses to the tune of ₹ 5,000, out of which a sum of ₹ 1,800 is recurring in nature. Forwarding expenses of the consignor ₹ 2,400. The agent had remitted the balance due from him through bank draft of ₹ 4,11,650 after deducting the expenses, 5% commission on gross sales, bad debts ₹ 850 and a bill payable accepted by him for ₹ 10,000. The value of unsold stock at original cost lying with the agent amounted to ₹ 50,000. You are required prepare Consignment Account and the Agents' Account in the books of the consignor.

**Practice Questions [PQ]**

**PQ No. 1:** RG Cellular of Kolkata consigned 100 mobile handsets to Techno Traders of Durgapur. The cost of each handset was ₹ 25,000. The consignor paid insurance ₹ 15,000, freight ₹ 8,000. An account sale was received from Pluto, showing gross sale proceeds of 80 units at ₹ 30,000 each.

The expenses paid and deducted by him were: Carriage ₹ 2,000; Establishment expenses ₹ 10,300; Insurance ₹ 24,000; Commission ₹ 85,000. The handsets lying unsold with Pluto were valued at ₹ 5,05,000.

Pass the journal entries in the books of Techno Traders given that maintains Consignment Inward A/c.

**Solution:**

**Books of Techno Traders**

**Journal**

Date	Particulars	L.f.	Dr. (₹)	Cr. (₹)
	Consignment Inward A/c [100 × ₹ 25,000] Dr. To, RG Cellular A/c (Being goods received from Jupiter)		25,00,000	25,00,000
	Consignment Inward A/c Dr. To, Bank A/c (₹ 2,000 + ₹ 10,300 + ₹ 24,000) (Being expenses paid for consignment)		36,300	36,300
	Bank A/c Dr. To, Consignment Inward A/c (80 × ₹ 30,000) (Being goods received on consignment sold)		24,00,000	24,00,000
	Consignment Inward A/c Dr. To, Commission A/c (Being commission due from Jupiter)		85,000	85,000
	RG Cellular A/c Dr. To, Consignment Inward A/c (Being stock lying unsold)		5,05,000	5,05,000
	Consignment Inward A/c Dr. To, RG Cellular A/c (Being balance of Consignment Inward A/c transferred to Jupiter account)		2,83,700	2,83,700
	RG Cellular A/c Dr. To, Bank A/c		22,78,700	22,78,700

	(Being payment made for balance due to consignor)
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**PQ No. 2:** Agarwal of Agra sent on consignment goods valued ₹ 1,00,000 to Biyani of Bhagalpur on March 1, 2021. He incurred an expenditure of ₹ 12,000 on Freight and Insurance. Biyani was entitled to a commission of 5% on gross sales plus a del-credere commission of 3%. Biyani took delivery of the consignment by incurring expenses of ₹ 3,000 for goods consigned.

On Dec. 31, 2021, Biyani informed on phone that he had sold all the goods for ₹ 1,50,000 by incurring selling expenses of ₹ 2,000. He further informed that only ₹ 1,48,000 had been realised and rest was considered irrecoverable, and would be sending the cheque in a day or so for the amount due along with the accounts sale. The consignor closes his books on Dec. 31 each year.

On Jan. 5, 2022; Agarwal received the cheque for the amount due from Biyani and incurred bank charges of ₹ 260 for collecting the cheque. The amount was credited by the bank on Jan. 9, 2022.

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

**Solution:**

#### Books of Agarwal

##### Consignment to Bhagalpur Account

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

[Profit on consignment transferred]			
		1,50,000	1,50,000

## Biyani Account

Date	Particulars	(₹)	Date	Particulars	(₹)
31.12 .21	To Consignment to Bhagalpur A/c [Sales]	1,50,000	31.12 .21	By Consignment to Bhagalpur A/c [Expenses paid by consignee]	5,000
			31.12 .21	By Consignment to Bhagalpur A/c [Commission due]	12,000
			31.12 .21	By Balance c/d [Balance due: B/Fig.]	1,33,000
		1,50,000			1,50,000
1.1 .22	To Balance b/d	1,33,000	5.1 .22	By Cheque for Collection A/c [Final remittance]	1,33,000
		1,33,000			1,33,000

**PQ No. 3:** B consigned 100 calculators to A. Cost of each calculator was ₹ 190. B incurred expenses of ₹ 500 on despatch of such goods. A informed B that he had sold 68 calculators @ ₹ 280 each and 11 calculators @ ₹ 270 each and had spent ₹ 1,520 on behalf of the consignor. One damaged calculator was sold for ₹ 50 according to the instructions of consignor. A was entitled to a commission of 6% on gross sales and it includes del-credere commission. A could recover only ₹ 250 from a customer to whom one calculator had been sold on credit basis for ₹ 280. All other sales were made on cash basis.

Show the ledger accounts in the books of both the parties. Calculations may be made to the nearest rupee and assume that the expenses of consignee are recurring in nature.

**Solution:**

## Books of B

## Consignment Account

Particulars	(₹)	Particulars	(₹)
To, Goods sent on Consignment A/c	19,000	By, A A/c [Sale]	
[100 × ₹ 190]		[68 × ₹ 280]	19,040
To, Bank A/c [Expenses incurred]	500	[11 × ₹ 270]	2,970
To, A A/c [Expenses paid by consignee]	1,520	By, Goods Damaged A/c [WN: 1]	195
To, A A/c	1,321	By, Consignment Stock A/c	3,900

[Commission due: ₹ 22,010 × 6%]		[WN: 1]		
To, P/L A/c [Profit on consignment transferred]	3,764			
	26,105			26,105

**Goods Damaged Account**

Particulars	(₹)	Particulars	(₹)
To, Consignment A/c	195	By, A A/c [Sale of damaged calculator]	50
To, A A/c [Commission on sale of damaged goods: ₹ 50 × 6%]	3	By, P/L A/c [Net loss transferred - B/Fig.]	148
	198		198

N.B. As the commission is allowed on gross sales, consignee is also entitled to get commission on sale of damaged goods also.

**A Account**

Particulars	(₹)	Particulars	(₹)
To, Consignment A/c [Sale]	22,010	By, Consignment A/c [Expenses incurred]	1,520
To, Goods Damaged A/c	50	By, Consignment A/c [Commission due]	1,321
		By, Goods Damaged A/c [Commission on sale of damaged goods]	3
		By, Balance c/f	19,216
	22,060		22,060

**Goods Sent on Consignment Account**

Particulars	(₹)	Particulars	(₹)
To, Purchases/ Trading A/c [Transfer]	19,000	By, Consignment A/c	19,000

**Books of A****B Account**

Particulars	(₹)	Particulars	(₹)
To, Bank A/c [Expenses paid]	1,520	By, Bank A/c [Cash Sales: (₹ 22,010 - ₹ 280)]	21,730
To, Commission A/c [Commission earned]	1,324	By, Consignment Debtors A/c [Credit Sales]	280
To, Balance c/f [Balance due: B/Fig.]	19,216	By, Bank A/c [Sale of damaged calculator]	50
	22,060		22,060

**Consignment Debtors Account**

Particulars	(₹)	Particulars	(₹)
-------------	-----	-------------	-----

To, B A/c [Credit sales]	280	By, Bank A/c [Collection]	250
		By, Commission A/c [Bad debts written-off]	30
	280		280

**Commission Account**

Particulars	(₹)	Particulars	(₹)
To, Consignment Debtors A/c [₹ 280 - ₹ 250]	30	By, B A/c	1,324
To, P/L A/c [B/Fig.]	1,294		
	1,324		1,324

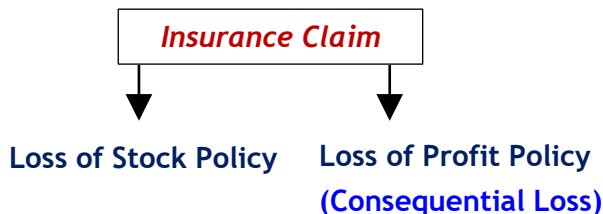
**Workings Note:**

**1. Value of goods damaged & unsold stock**

	Units	(₹)
Cost of goods sent	100	19,000
Add: Consignor's expenses	--	500
	100	19,500
Less: Goods damaged [ ₹ 19,500 × 1/100]	1	195
	99	19,305
Unsold stock = [100 - (68 + 11) - 1] = 20 units; Value of 20 units		₹ (19,305/99) × 20 = ₹ 3,900

# Insurance Claim 15

**Objective:** Calculation of Claim Amount



**1. Loss of Stock Policy** Monetary Value of Stock Lost Due to Fire

**Steps to Calculate the AMOUNT of Claim**

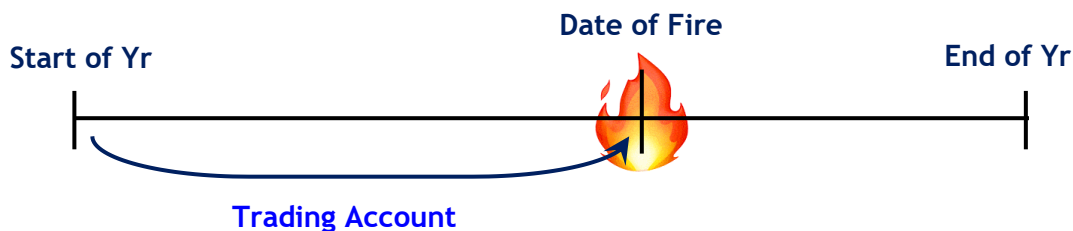
**Step 1:** Calculate Value of Stock IN GODOWN on the date of fire

**Step 2:** Calculate Amount of Actual Loss

**Step 3:** Check APPLICABILITY of Average Clause

**Step 1:** Calculate Value of Stock IN GODOWN on the date of fire

Prepare Trading Account from Start of Financial Year to Date of Fire



### Memorandum Trading Account

for the period from (Start of the year) to (date of fire)

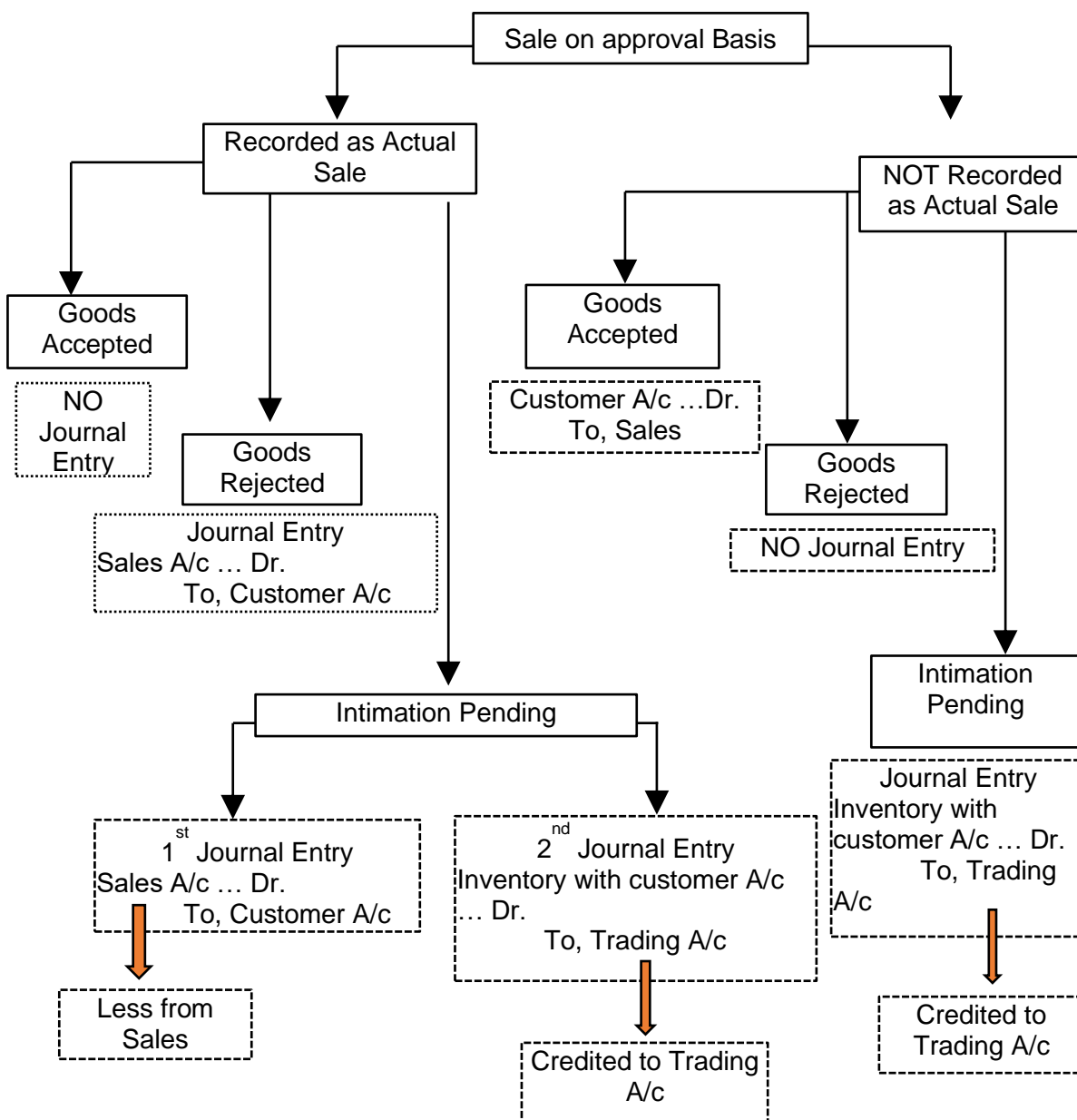
Particular	Rs.	Particular	Rs.
To, Opening Stock		By, Sales	
To, Purchase		Less: Return	
Less: Return		Less: Sale on Approval Basis	
Add/Less: Rectification of Error		By, Inventory with customer	
To, Wages		By, free Sample	
To, Other Direct Expenses		By, goods Sent on Consignment	

To, Gross Profit		By, Stock on Date of Fire	
(Given / Calculate)		(Balancing Figure)	
(Sales x G.P. Ratio)			
Total		Total	

**Note 1:** Inventory will be always valued at cost for CLAIM purpose.

**Note 2:** If Gross Profit Ratio is not given in the question, Prepare Trading Account of Previous year and Calculate G.P. and G.P. Ratio.

$$\text{G.P. (Adjusted)} = \boxed{\text{G.P. of Previous year}} (\pm) \boxed{\text{Upward/ Downward Trend}}$$



**STEP 2: Calculate Amount of Actual Loss**

Particular	Rs.
Value of Stock on the Date of Fire (Step 1)	xx
Less: Salvage Goods	(xx)
Add: Fire Fighting Expenses (if any)	Xx
Actual Loss	xx

**Step 3: Check APPLICABILITY of Average Clause**

Average Clause is applicable if Policy is UNDER-INSURED

Policy Amount < Stock on Date of Fire

$$\text{Claim} = \text{Loss of Stock (Step 2)} \times \frac{\text{Policy Amount}}{\text{Stock on Date of Fire}}$$

**Loss of Profit Policy (Consequential Loss Policy)**



**Steps to Calculate the AMOUNT of Claim**

**Step 1: Calculate G.P. Ratio**

$$\text{G.P. Ratio} = \frac{\text{Net profit of Previous Year} + \text{*Insured Standing Charges}}{\text{Net Sales of Previous Year}} \times 100$$

G.P. (Adjusted) = G.P. (±) Upward/ Downward Trend

**\*Insured Standing Charges** = Fixed Expenses Covered by Insurance Policy

**\*Uninsured Standing Charges** = Fixed Expenses NOT Covered by Insurance Policy

**Step 2: Calculation of Short Sale (Reduction in Turnover)**

Particular	₹
Standard T/o (Turnover of Previous Year Corresponding Period)	XX
<b>Add/ less:</b> Upward Trend / Downward Trend (Given / Not Given)	XX
Adjusted Standard Turnover	XX
<b>Less:</b> Actual Turnover of Disruption Period (If Given in question)	(XX)
<b>Short Sale or Reduction on Turnover</b>	XX

**Step 3: Calculation of Loss of Profit**

$$\text{Loss of Profit} = \text{Short Sale (Step 2)} \times \text{G.P. Ratio (Step 1)}$$

**Step 4: Calculate G.P. on Annual Adjusted T/o of Previous 12 months from the Date of Fire**

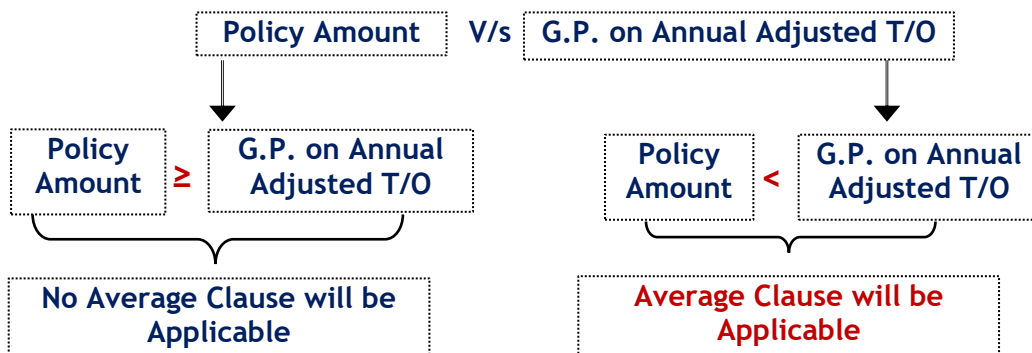
Particular	₹
Annual T/O of Previous 12 months from the date of Fire	XX
Add/ Less: Upward trend / downward trend	XX
Annual Adjusted T/O	XX
X G.P. Ratio (Step 1)	x %
G.P. on Annual Adjusted T/O	XX

**Step 5: Calculate Additional Admissible Expense**

Least of the following will be admissible

- (a) Actual Additional Expenses XX
- (b) G.P. on Additional T/O Due to additional Expenses XX
- (c) 
$$\text{Additional Expenses} \times \frac{\text{G.P. on Annual Adjusted Turnover (Step 4)}}{\text{G.P. (As Above)} + \text{Uninsured Standing Charges (Given)}}$$
 XX

**Step 6: Check Applicability of Average Clause**



$$\text{Claim} = \text{Loss of Profit (Step 2)} \times \frac{\text{Policy Amount (Given)}}{\text{G.P. on Annual Adjusted T/O (Step 4)}}$$

**Practical Questions**

**Loss of Stock Policy**

**Q NO. 1:** On 20<sup>th</sup> October, 2020, the godown and business premises of Bhima Ltd. were affected by fire. From the salvaged accounting records, the following information is available.

Stock of goods @ 10% lower than cost as on 31 <sup>st</sup> March, 2020	2,16,000
Purchases less returns (01 April, 2020 to 20 October, 2020)	2, 80,000
Sales less returns (01 April, 2020 to 20 October, 2020)	6,20,000
Wages from 1 <sup>st</sup> April, 2020 to 20 <sup>st</sup> October, 2020	33,000

**Additional information:**

- (1) Sales up to 20<sup>th</sup> October, 2020 includes 80,000 for which goods had not been dispatched.
- (2) Purchases up to 20<sup>th</sup> October, 2020 did not include 40,000 for which purchase invoices had not been received from supplies though goods have been received in Godown.
- (3) Past records show the gross profit rate of 25%
- (4) The value of goods salvaged from fire 31,000
- (5) A plant was installed by the firm’s own worker. He was paid ₹ 500 which was included in wages.
- (6) Purchase includes the purchase of the plant for ₹ 5,000.
- (7) Bhima Ltd. has insured this stock for 1, 00,000
- (8) Commission on purchase to be paid @ 2%

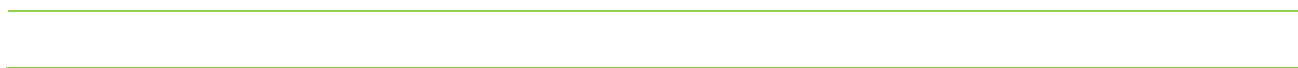
Compute the amount of claim to be lodged to the insurance company.

**Answer 2: Mr. Bhima Ltd.**



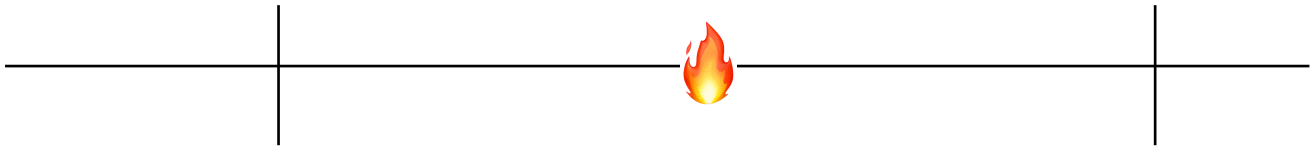
**Statement of Actual Loss of Stock**

Particular	(₹)





Answer 2: Suraj Brothers'



Statement of Actual Loss of Stock

Particular	(₹)

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WN 1:

Trading Account (For the period from .....to .....)

Particular	(₹)	Particular	(₹)

**Q NO. 3:** A fire occurred in the premises of Sri. G. Venkatesh on 1.4.2022 and a considerable part of the stock was destroyed. The stock salvaged was ₹ 28,000. Sri Venkatesh had taken a fire insurance policy for ₹ 17,10,000 to cover the loss of stock by fire.

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

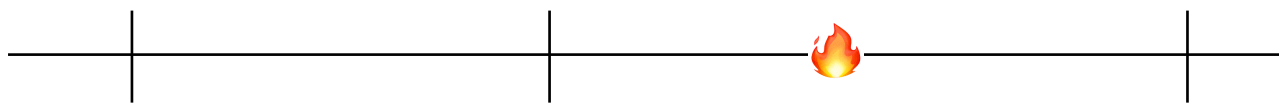
	(₹)
Purchases for the year 2021	9,38,000
Sales for the year 2021	11,60,000
Purchases from 1.1.22 to 1.4.22	1,82,000
Sales from 1.1.22 to 1.4.22	24,00,000
Stock on 1.1.21	1,44,000
Stock on 31.12.2021	2,42,000
Wages paid during 2021	1,00,000
Wages paid 1.1.22 to 1.4.22	1,80,000

Sri Venkatesh had in June 2021 consigned goods worth ₹ 50,000, which unfortunately were lost in an accident.

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

Stocks at the end of each year for and till the end of calendar year 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.

**Answer 3: G. Venkatesh**



**Statement of Actual Loss of Stock**

Particular	(₹)



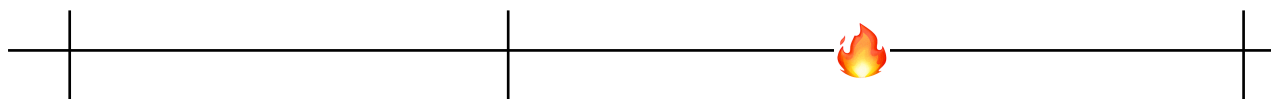
**Q NO. 4:** On 1<sup>st</sup> April, 2020 the stock of Shri Ramesh was destroyed by fire but sufficient records were saved from which following particulars were ascertained:

	(₹)
Stock at cost - 1 <sup>st</sup> January, 2019	73,500
Stock at cost - 31 <sup>st</sup> December 2019	79,600
Purchases - year ended 31 <sup>st</sup> December 2019	3,98,000
Sales - year ended 31 <sup>st</sup> December 2019	4,87,000
Purchases 1-1-2019 to 31-3-2020	1,62,000
Sales - 1-1-2020 to 31-3-2020	2,31,200

In valuing the stock for the Balance sheet at 31<sup>st</sup> December, 2019 ₹ 2,300 had been written off on certain stock which was a poor selling line having the cost ₹ 6,900. A portion of these goods were sold in March, 2020 at loss of ₹ 250 on original cost of ₹ 3450. The remainder of this stock was now estimated to be worth its original cost. Subject to the above exception, gross profit had remained at a uniform rate throughout the year.

The value of stock salvaged was ₹ 5,800. The policy was for ₹ 50,000 and was subject to the average clause. Work out the amount of the claim of loss by fire.

**Answer 4: Shri Ramesh**



**Statement of Actual Loss of Stock**

Particular	(₹)



**Q NO. 5:** A fire occurred in the premises of M/s Bad Luck Traders twice during the accounting year 2021-22 that is on 31st August 2021 and again on 30th November, 2021. From the following particulars, calculate the claim to be lodged in respect of the goods lost by fire on the aforementioned date:

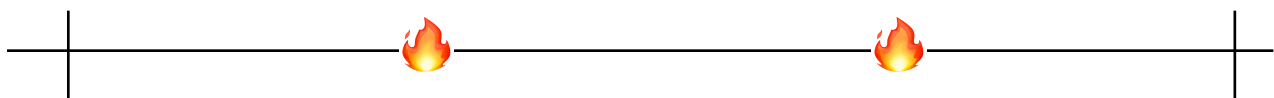
1. The stock as at 31st March, 2021 was valued at ₹ 59,000.
2. The purchases from 1st April, 2021 to 31st August, 2021 amounted to ₹ 3,45,000.
3. The purchases from 1st September, 2021 to 30th November, 2021 amounted to ₹ 1,90,000 of which goods costing ₹ 45,000 were received on 10th December, 2021.
4. Sales for the period from 1st April, 2021 to 31st August, 2021 amounted to ₹ 4,71,000.
5. The sales for the period from 1st September, 2021 to 30th November, 2021 amounted to ₹ 2,25,000. It includes sale of old furniture of ₹ 27,000.

The company earns a steady rate of Gross profit at 20% at the beginning of the year 2021.

However, the selling price was raised by 20% from the month of April.

The value of the goods salvaged was ₹ 30,000 and ₹ 2,000 on 31st August, 2021 and on 30th November, 2021 respectively.

The firm had taken out a fire insurance policy of ₹ 45,000 on 1st April, 2021. At the time of receiving the insurance claim on 31st August, 2021, no additional premium was paid for restoration of the insurance policy to its original amount. The policy was subject to average clause.



1. Statement of Actual Loss of Stock (On.....)

Particular	(₹)

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2. Statement of Actual Loss of Stock (On.....)

Particular	(₹)

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**Working Note:**

1. Calculation of Revised G.P. Ratio

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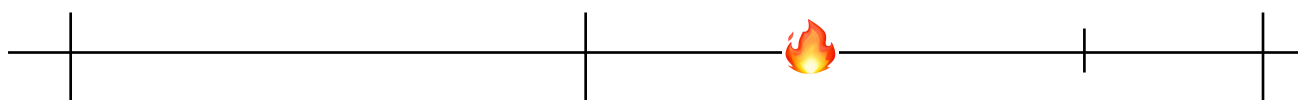
**Loss of Profit Policy**

**Q NO. 6:** A fire occurred on 1<sup>st</sup> February, 2020, in the premises of Pioneer Ltd. a retail store and business were partially disorganized upto 30<sup>th</sup> June, 2020. The company was insured under a loss of profits for ₹ 1,25,000 with a six months period indemnity. Form the following information; compute the amount of claim under the loss of profit policy.

	₹
Actual turnover form 1 <sup>st</sup> February to 30 <sup>th</sup> June 2020	80,000
Turnover from 1 <sup>st</sup> February to 30 <sup>th</sup> June, 2019	2,00,000
Turnover from 1 <sup>st</sup> February, 2019 to 31 <sup>st</sup> January, 2020	4,50,000
Net profit for last financial year	70,000
Insured standing charges for last financial year	56,000
Total standing charges for last financial year	64,000
Turnover for the last financial year	4,20,000

The company incurred additional expenses amounting to ₹ 6,700 which reduced the loss in turnover. There was also a saving during the indemnity period of ₹ 2,450 in the insured standing charges as a result of the fire.

There had been a considerable increase in trade since the date of the last annual accounts and it has been agreed that an adjustment of 15% be made in respect of the upward trend in turnover.



**Answer 6: Pioneer Ltd.**

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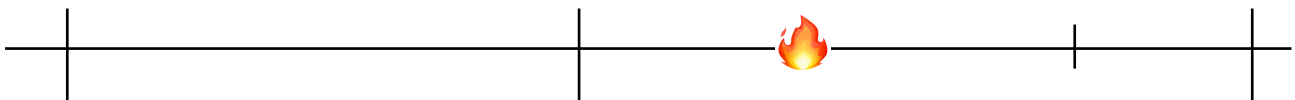


**Q NO. 7:** The premises of XY Limited were partially destroyed by fire on 1<sup>st</sup> March 2020 and as a result, the business was practically disorganized unto 31<sup>st</sup> August, 2020. The company is insured under a loss of profits policy for ₹ 1,65,000 having an indemnity period of 6 months.

Form the following information; prepare a claim under the policy:

(i) Actual turnover during the period of dislocation (01-03-2020 to 31-08-2020)	80,000
(ii) Turnover for the corresponding period (dislocation) In the 12 Months immediately before the fire (01-03-2019 to 31-08-2019)	2,40,000
(iii) Turnover for the 12 months immediately preceding the fire (01-03-2019 to 28-02-2020)	6,00,000
(iv) Net profit for the last financial year	90,000
(v) insured standing charges furs the last financial year	60,000
(vi) Uninsured standing charges	5,000
(vii) Turnover for the last financial year	5,00,000

Due to substantial increase in trade, before and up to 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 ₹ 9,300 immediately after the fire and but this expenditure, the Turing the period of dislocation would have been only ₹ 55,000. There was also a saving during the indemnity period of ₹ 2,700 in insured standing charges as a result of the fire.



**Answer 7: XY Ltd.**

1. Gross Profit Ratio =

2. Calculation of Short Sale

3. Loss of Profit =

4. G.P. on Annual adjusted turnover

5. Claim for additional Expenses

Statement of Claim

Particular	Rs.

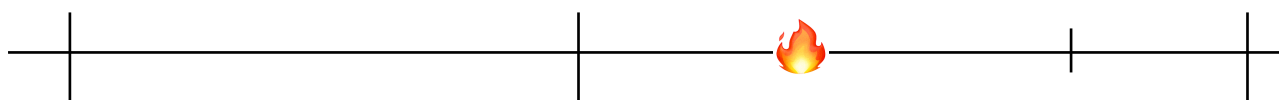
**Q NO. 8:** [Nov 2013; Old course; 16 marks] Monalisa & Co. runs plastic goods shop. Following details are available from quarterly sales tax return filed.

Sales	2009 ₹	2010 ₹	2011 ₹	2012 ₹
From 1 <sup>st</sup> January to 31 <sup>st</sup> March	1,80,000	1,70,000	2,05,950	1,62,000
From 1 <sup>st</sup> April to 30 <sup>th</sup> June	1,28,000	1,86,000	1,93,000	2,21,000
From 1 <sup>st</sup> July to 30 <sup>th</sup> September	1,53,000	2,10,000	2,31,000	1,75,000
From 1 <sup>st</sup> October to 31 <sup>st</sup> December	1,59,000	1,47,000	1,90,000	1,48,000
<b>Total</b>	<b>6,20,000</b>	<b>7,13,000</b>	<b>8,19,950</b>	<b>7,06,000</b>

Period	₹
Sales from 16-09-2011 to 30-09-2011	34,000
Sales from 16-09-2012 to 30-09-2012	Nil
Sales from 16-12-2011 to 31-12-2011	60,000
Sales from 16-12-2012 to 31-12-2012	20,000

A loss of profit policy was taken for ₹ 1,00,000. Fire occurred on 15<sup>th</sup> September, 2012. Indemnity period was for 3 months. Net Profit was ₹ 1,20,000 and standing charges (all insured) amounted to ₹ 43,990 for year ending 2011.

Determine the Insurance Claim.



**Answer 8: Monalisa & Co.**

1. Gross Profit Ratio =

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**Practice Questions [PQ]**

**PQ 1:** [May 2009; 2 marks] What is “average clause” under insurance claim?

**Answer:**

When a businessman wants to reduce the burden of Insurance Premium and wants to take an insurance policy which is less than the value of average stock, it is known as under insurance. For discouraging the under-insurance, fire insurance policies contain an average clause. In such a case, the net claim is calculated by using following formula.

$$\text{Amount of claim} = \frac{\text{Amount Policy}}{\text{Insurable Amount}} \times \text{Actual Loss}$$

**PQ 2:** [May 2009; 4 marks] What is Consequential loss policy and what items are generally covered by such policy

**Answer: Consequential Loss Policy:**

When a fire occurs, apart from the direct loss on accounts of stock or other assets destroyed, there is also a consequential loss because, for sometimes, the business is disorganised or has to be discontinued, and during that period, the standing expenses of the business-like rent, salaries etc.

**The consequential loss policy covered the following items:**

- (1) Loss of net profit
- (2) Standing charges
- (3) Any increased cost of working e.g., renting of temporary premises.

**PQ 3:** Stock as on the date of fire ₹ 58,050, Value of Salvaged Stock ₹ 5,800. Calculate the amount of claim

if the sum insured to cover the loss of Stock by fire is (a) ₹ 60,000 (b) ₹ 50,000.

**SOLUTION**

**Case (a)** Since sum insured (₹ 60,000) exceeds the sum insurable (₹ 58,050), average clause will not apply at all and hence the amount of claim will be restricted to the value of Stock lost by fire ₹ 52,250 (i.e. ₹ 58,050 - ₹ 5,800).

**Case (b)** Since sum insured (₹ 50,000) is less than the Sum insurable (₹ 58,050), average clause will apply as under:

$$\text{Claim} = \text{Loss suffered} \times \frac{\text{Sum Insured}}{\text{Actual Insurable Value}} = ₹ 52,250 \times \frac{₹ 50,000}{58,050} = ₹ 45,004$$

**PQ 4:** Calculate the amount of claim if sum insured is (a) ₹ 10,00,000 and (b) ₹ 7,50,000 from the following data:

Date of fire	1.3.2018
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Gross profit lost during Claim period	2,80,000
Turnover from 1.3.2017 to 28.2.2018	44,00,000
Agreed G.P. Ratio	20%
Net Claim for increased Cost of working	50,000

Special Circumstances Clause provides for the increase in turnover by 10%

### SOLUTION

#### (a) If the Sum Insured is ₹ 10,00,000

Sum Insurable = Adjusted Turnover during 12 months immediately preceding the date of fire x Agreed G.P. Ratio

$$= (\text{₹ } 44,00,000 + 10\% \text{ of ₹ } 44,00,000) \times 20\%$$

$$= \text{₹ } 48,40,000 \times 20\% = \text{₹ } 9,68,000$$

Since Sum Insured exceeds the Sum Insurable, Average Clause will not apply at all and hence the amount of claim will be calculated as under:

Total claim = Gross Profit on turn over lost during claim period + Net Claim for the increased cost of working

$$= \text{₹ } 2,80,000 + \text{₹ } 50,000 = \text{₹ } 3,30,000$$

#### (b) If the Sum Insured is ₹ 7,50,000

Since Sum Insured is less than the Sum Insurable, the average clause will apply as under:

$$\text{Claim amount} = 3,30,000 \times \frac{7,50,000}{9,68,000} = 2,55,681.81 \text{ or Approx. } 2,55,682$$

**PQ 5:** On 29<sup>th</sup> August, 2020, the godown of a M/s Daksha caught fire and a large part of the stock of goods was destroyed. However, goods costing ₹ 1,08,000 could be salvaged incurring firefighting expenses amounting to ₹ 4,700.

The trader provides you the following additional information:

	₹
Cost of stock on 01.04.2019	7,10,500
Cost of stock on 31.03.2020	7,90,100
Purchases during the year ended 31.03.2020	56,79,600
Purchases from 01.04.2020 to the date of fire	33,10,700
Cost of goods distributed as samples for advertising from 01.04.2020 to the date of fire	41,000
Cost of goods withdrawn by trader for personal use from 01.04.2020 to the date of fire	2,000
Sales for the year ended 31.03.2020	80,00,000
Sales from 01.04.2020 to the date of fire	45,36,000

The company also admitted firefighting expenses. The trader had taken the fire insurance policy for ₹ 9,00,000 with an average clause.

Calculate the amount of the claim that will be admitted by the insurance company.

**Answer:**

**Memorandum Trading Account for the period 1st April, 2012 to 29th August 2012**

Particulars	Rs.	Particulars	Rs.
To Opening Stock	7,90,100	By Sales	45,36,000
To Purchases 33,10,700		By Closing stock	8,82,600
Less: Advertisement (41,000)		(Bal. fig.)	
Drawing (2,000)	32,67,700		
To Gross Profit [30% of sales WN1]	13,60,800		
	54,18,600		54,18,600

**Statement of Insurance Claim**

Particulars	Rs.
Value of stock destroyed by fire	8,82,600
Less: Salvaged Stock	(1,08,000)
Add: Fire Fighting Expenses	4,700
Insurance Claim	7,79,300

**Note:** Because (policy amount is more than claim amount). Average clause will not apply. Hence, claim amount of only Rs. 7,79,300 will be admitted by the Insurance Company.

**Working Note:**

**Trading Account for the year ended 31<sup>st</sup> March, 2020**

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Opening Stock	7,10,500		By Sales	80,00,000
	To Purchases	56,79,600		By Closing stock	7,90,100
	To Gross Profit	24,00,000			
		87,90,100			87,90,100

Rate of Gross Profit in 2011-12 =  $24,00,000 / 80,00,000 \times 100 = 30\%$

**PQ NO. 6:** On 19<sup>th</sup> May, 2020, the premise of Shri Garib Das was destroyed by fire, but sufficient records were saved, wherefrom the following particulars were ascertained:

Stock at cost on 01.01.2019	36,750
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Stock at cost on 31.12.2019	39,800
Purchases less returns during 2019	1,99,000
Sales less returns during 2019	2,43,500
Purchases less returns during 01.01.2020 to 19.5.2020	81,000
Sales less returns during 01.01.2020 to 19.05.2020	1,15,600

In valuing the stock for the balance sheet as at 31<sup>st</sup> December, 2019, ₹ 1,150 had been written off on certain stock which was a poor selling line having the cost ₹ 3,450. A portion of these goods were sold in March, 2020 at a loss of ₹ 125 on original cost of ₹ 1,725. The remainder of this stock was now estimated to be worth the original cost. Subject to the above exception, Gross profit has remained at a uniform rate throughout. The stock salvaged was ₹ 2,900.

Show the amount of the claim of stock destroyed by fire. Memorandum Trading Account to be prepared for the period from 01.01.2020 to 19.05.2020 for normal and abnormal item.

**Answer 8: Garib Das**

#### Statement of claim

Particular		Rs.
Stock on Date of Fire		
Normal Goods	27,300	
Abnormal Goods	1,725	29,025
Less: Salvage Value		(2,900)
Loss of Stock or Claim		26,125

WN 1:

#### Trading Account

(For the year ended 31.12.2019)

Particular	Rs.	Particular		Rs.
To, Opening Stock	36,750	By Sales		2,43,500
To, Purchase	1,99,000	By, Closing Stock	39,800	
To G.P.	48,700	Add: Value W/off	1,150	40,950
	2,84,450			2,84,450

G.P. Ratio =  $(48,700 / 2,43,500) \times 100 = 20\%$

#### Memorandum Trading Account

(For the period ended on 19-05-2020)

Particular	Normal	Abnormal	Total	Particular	Normal	Abnormal	Total
To, Opening Stock	37,500	3,450	40,950	By Sales	1,14,000	1,600	1,15,600

To, Purchase	81,000	---	81,000	By, Closing Stock	27,300	1,725	
To G.P.	22,800	---	22,800	By Gross Loss		125	125
	1,41,300	3,450	1,15,725		1,41,300	3,450	1,15,725

**PQ 7:** Form the following details calculate consequential loss claim:

1. Date of fire: 1<sup>st</sup> September:
2. Indemnity period: 6 months:
3. Period of disruption: 1<sup>st</sup> September to 1<sup>st</sup> February
4. Sum insured: ₹ 1,08,900:
5. Sales were ₹ 6,00,000 for preceding financial year ended on 31<sup>st</sup> March:
6. Net profit for preceding financial year ₹ 36,000 plus insured standing charges ₹ 72,000
7. Rate of gross profit 18%
8. Uninsured standing charges ₹ 6,000
9. Turnover during the disruption period ₹ 67,500
10. Annual turnover for 12 months immediately preceding the date of fire ₹ 6,60,000
11. Standard turnover i.e. for corresponding months (1<sup>st</sup> September to 1<sup>st</sup> February) in the year preceding the date of fire ₹ 2,25,000
12. Increase in the cost of working capital ₹ 12,000 with a saving of insured standing charges ₹ 4,500 during the disruption period.
13. Reduced turnover avoided through increase in working capital ₹ 30,000
14. Special clause stipulated:  
 (a) Increase in rate of G.P. 2% (b) Increase in turnover (standard and annual) 10%.

**Answer: Computation of the amount of claim for consequential loss**

**1. Calculation of Short Sales**

Particulars	Rs.
Standard turnover for the period 1st September to 1st October (Preceding year)	2,25,000
Add: Increase of 10% due to upward trend	22,500
Adjusted turnover	2,47,500
Less: Actual turnover during disruption period i.e. 1 <sup>st</sup> September to 1 <sup>st</sup> October (following year)	67,500
Short Sale	1,80,000

2. Increased rate of G.P. = 18% + 2 = 20% on sales.
3. Loss of profit on short sales = 20% of Rs. 1,80,000 = Rs. 36,000.
4. Calculation of claim for increased cost of working capital

Increased cost of working will be lower of

	Rs.
(i) Actual expenses	12,000
(ii) Additional expenses x G.P. on annual adjusted Turnover/ (G.P. as Above + Uninsured standing charges)	
= $12,000 \times (7,26,000 \times 20\%) / (1,45,200 + 6,000)$	11,523
(iii) G.P. on additional sales = $30,000 \times 20\%$	6,000

Rs. 6,000 is lower of above three, so additional expenses would be Rs. 6,000.

Net claim for increased cost of working capital = Rs. 6,000 minus savings in insured standing charges.

= Rs. 6,000 - Rs. 4,500 = Rs. 1,500

### 5. Calculation of Adjusted Annual Sales

Particulars	Rs.
Sales for 12 months preceding the date of fire	6,60,000
Add: 10% of increase in trend Adjusted Annual Sales	66,000
	7,26,000

### 6. Insurable Amount i.e. gross profit on adjusted annual sales

	Rs.
Adjusted annual sales	7,26,000
Rate of Gross Profit	20%
Insurable amount (Rs. 7,26,000 x 20%)	1,45,200

### 7. Amount of Insurance Claim

= Total Loss (Loss of Profit + Claim for increased cost) x Policy Amount / G.P. on annual adjusted turnover

=  $(36,000 + 1,500) \times 1,08,900 / 1,45,200 = \text{Rs. } 28,125.$

**PQ 8: [May 2019; 10 Marks]** A fire occurred in the premises of M/s Bright on 25th May, 2017. As a result of fire, sales were adversely affected up to 30th September, 2017. The firm had taken Loss of profit policy (with an average clause) for ₹ 3,50,000 having indemnity period of 5 months. There is an upward trend of 10% in sales.

The firm incurred an additional expenditure of ₹ 30,000 to maintain the sales.

There was a saving of ₹ 5,000 in the insured standing charges.

Actual turnover from 25th May, 2017 to 30th September, 2017 ₹ 1,75,000

Turnover from 25th May, 2016 to 30th September, 2016 ₹ 6,00,000

Net profit for last financial year ₹ 2,00,000

Insured standing charges for the last financial year ₹ 1,75,000

Total standing charges for the last financial year ₹ 3,00,000

Turnover for the last financial year ₹ 15,00,000

Turnover for one year from 25th May, 2016 to 24th May, 2017 ₹ 14,00,000

You are required to calculate the loss of profit claim amount, assuming that entire sales during the interrupted period was due to additional expenses.

**Answer:**

### Computation of the amount of claim for the loss of profit

Calculation of loss of Profit	₹
Gross Profit on reduction in turnover @ 25% (WN 2) on ₹ 4,85,000 (WN1)	1,21,250
Add: Additional Expenses	22,647
	1,43,897
Less: Saving in Insured Standing Charges	(5,000)
Amount of claim before application of Average Clause	1,38,897

### Application of Average Clause:

Amount of Claim x Amount of Policy / G.P. on Annual Turnover

$1,38,897 \times (3,50,000/3,85,000) \times = ₹ 1,26,270$

Amount of claim under the policy = ₹ 1,26,270

### Working Notes:

#### 1. Reduction in turnover

	₹
Turnover from 25th May, 2016 to 30th September, 2016	6,00,000
Add: 10% expected increase	60,000
<b>Adjusted Turnover</b>	<b>6,60,000</b>
Less: Actual Turnover from 25th May, 2017 to 30th September, 2017	(1,75,000)
<b>Short Sales</b>	<b>4,85,000</b>

#### 2. Rate of Gross Profit for last Financial Year: ₹

Net Profit for last financial year	2,00,000	Rate of Gross Profit = $3,75,000 / 15,00,000 \times 100$ = 25%
Add: Insured Standing Charges	1,75,000	
Gross Profit	3,75,000	
Turnover for the last financial year	15,00,000	

#### 3. Additional Expenses

Lower of the following will be admissible	₹
1. Actual Expenses	30,000
2. Proportionate Additional Expense	22,647
= Addl. Exp. $\times \left[ \frac{G.P \text{ on Annual Adjusted turnover}}{G.P \text{ (as above) + Uninsured standing Charges}} \right]$	

$= 30,000 \times \left[ \frac{25\% \text{ of Rs. } 14,00,000 + 10\% \text{ of } 14,00,000}{3,85,000 + 1,25,000} \right]$	
3. Maximum saving of liability of the insurer (G.P. on sales generated by additional expenses) = Reduction in Turnover avoided through Increased Cost of Working x Agreed G. P. Ratio = ₹ 1,75,000 x 25%	43,750
Gross claim for Increased Cost of Working (being the least of the following three amounts)	22,647

**4. Annual Turnover (adjusted):**

Turnover from 25 May, 2016 to 24 May, 2017	14,00,000
Add: 10% expected increase	1,40,000
	15,40,000
Gross Profit on ₹ 15,40,000 @ 25%	3,85,000
Standing charges not Insured (3,00,000 - 1,75,000)	1,25,000
Gross profit + Uninsured standing charges	5,10,000

# Hire Purchase and Instalment Sale **16**



### Relationship between Hire Purchase Price, Cash Price and Interest

$$\text{Hire Purchase Price} = \text{Cash Price} + \text{Interest}$$

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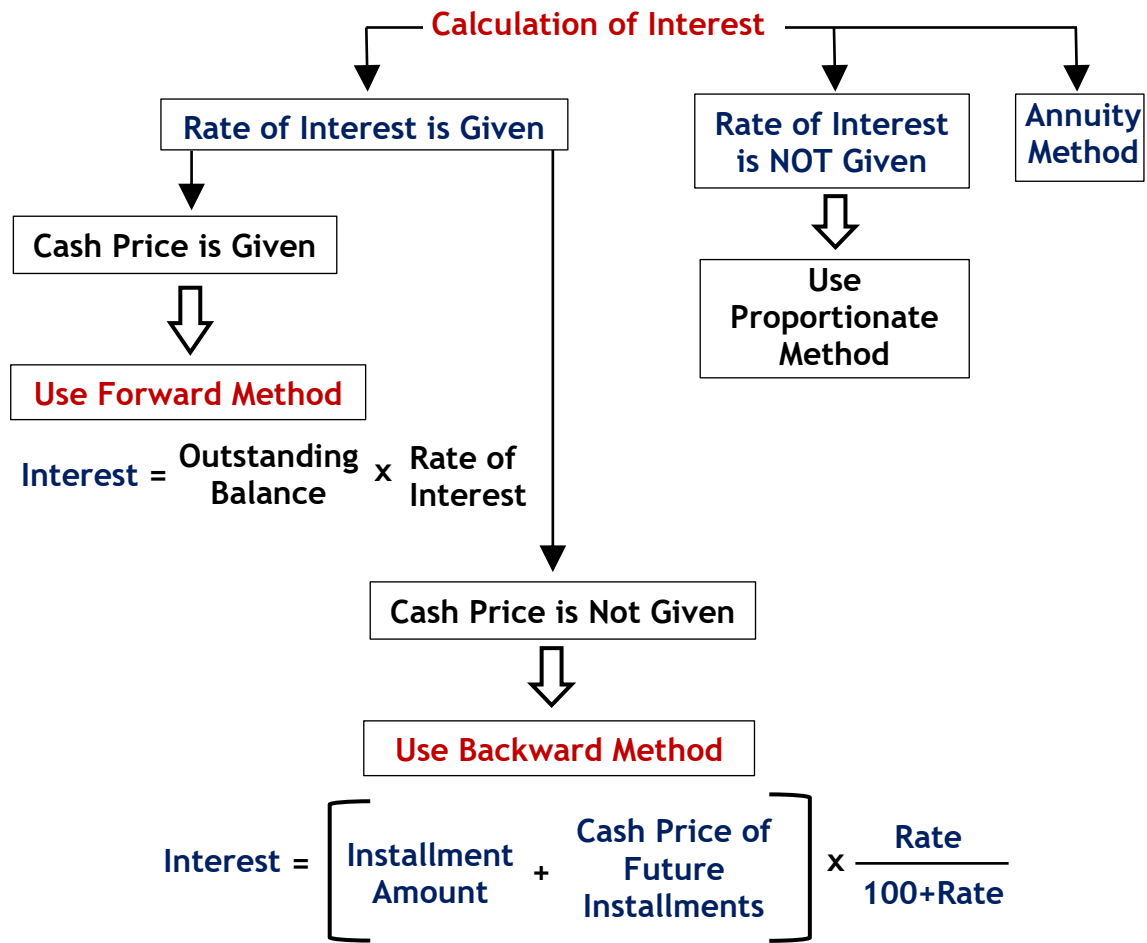
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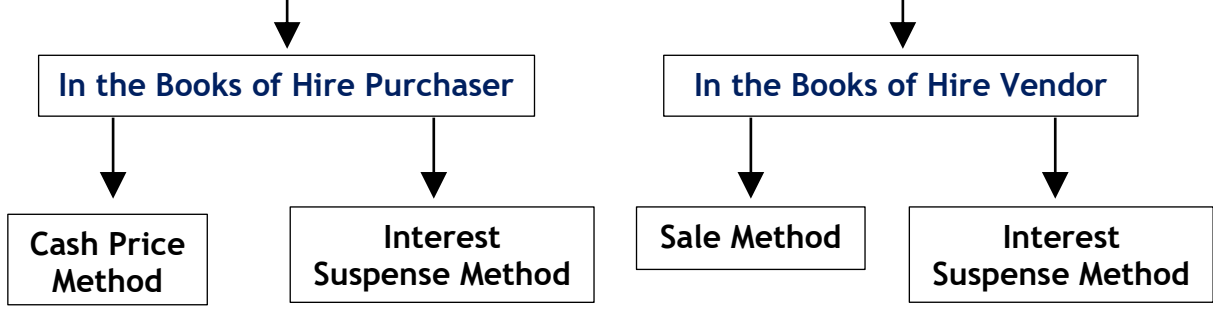
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**Method of Accounting for Hire Purchase Transactions**




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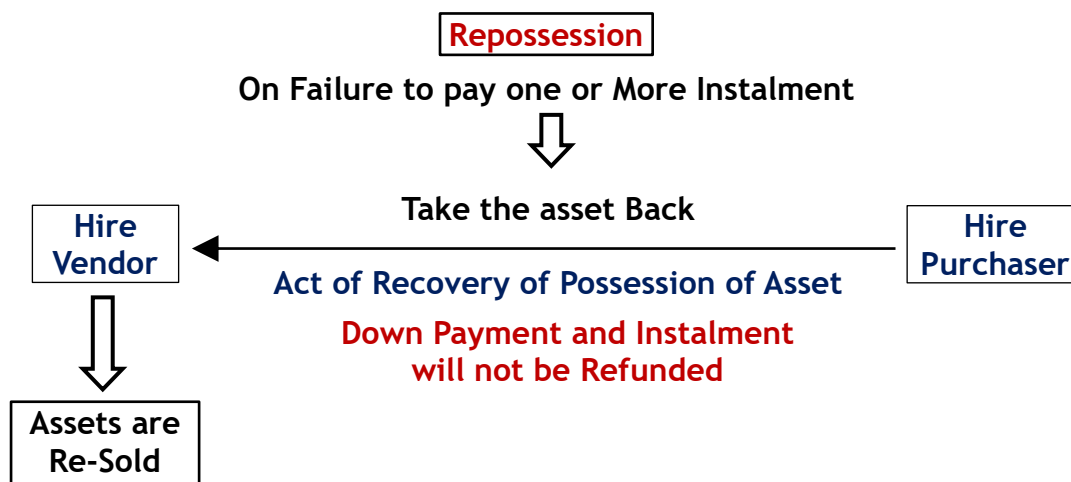


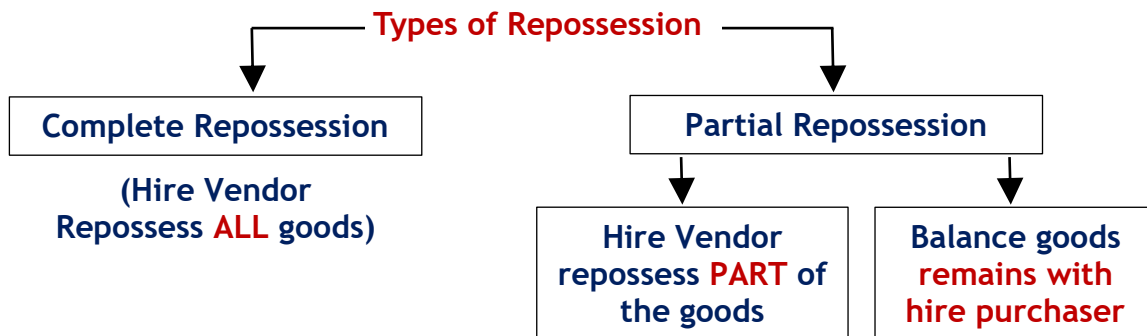
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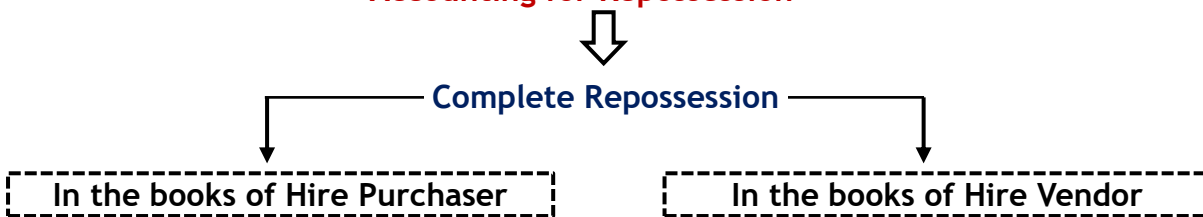
Journal Entries (Interest Suspense Method)

Transaction	Hire Purchaser	Hire Vendor	
	(Interest Sus. Method)	(Interest Sus. Method)	
(a) On Purchase / Sale of Asset on Hire Purchase	Asset A/c Dr.	Hire Purchaser A/c Dr.	} Only Once At the time of Signing of Contract
	Interest Sus A/c Dr.	To, Int Sus A/c	
	To, Hire Vendor A/c	To Sales A/c	
(b) On Making Down Payment	Hire Vendor A/c Dr.	Bank A/c Dr.	
	To, Bank A/c	To, Hire Purchaser A/c	
(c) On Charging Depreciation	Depreciation A/c Dr.	No Journal Entry	
	To, Asset A/c		
(d) To Record Interest Expense / Income	Interest on HP A/c Dr.	Int. Sus. A/c Dr.	
	To, Interest Sus A/c	To, Interest on HP	
(e) On Payment of Instalment	Hire Vendor A/c Dr.	Bank A/c Dr.	
	To, Bank A/c	To, Hire Purchase A/c	
(f) On Transfer of Income / Exp	P & L A/c Dr.	Interest on HP A/c Dr.	
	To, Depreciation A/c	To, P & L A/c	
	To, Interest on HP A/c		





**Accounting for Repossession**



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(To Close Hire Vendor's A/c and Asset A/c, Difference T/F to P& L)

**Note:**  
 In case of Partial Repossession assets are repossessed at **AGREED VALUE** (which is calculated on the basis of higher rate of depreciation)

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(To Close Hire Purchaser's A/c)

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(For additional exp. on reconditioning)

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(For sale of Repossessed goods)

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**Practice Question [PQ]**

**PQ 1:** Vikram Ltd. had purchased machinery on hire purchase system from Hind Machinery Ltd. The terms are that they would pay Rs. 20,000 down on 1.1.89 and 5 annual instalments of Rs. 11,000 each commencing from 1.1.90. They charged depreciation on machinery at the rate of 15% per annum under diminishing balance system.

Hind machinery Ltd. had charged interest at the rate of 15% per annum under diminishing balance system.

Show the Machinery Account and Hind Machinery Ltd. account to record the above transactions in the books of Dobson's Ltd till the instalments are paid off. Dobson's accounting year ended on 31<sup>st</sup> December in each year.

**Answer:**

**Calculation of Cash Price of machinery and interest included in each installment**

Inst. No.	Interest Calculation	Interest	Inst. (Rs.)	Cash Price Paid
(a)	(b)	(c)	(d)	(e) = (d) - (c)
V	$\frac{11,000 \times 15}{115}$	1,438	11,000	9,562
IV	$\frac{(11,000 + 9,562) \times 15}{115}$	2,682	11,000	8,318
III	$\frac{(11,000 + 8,318 + 9,562) \times 15}{115}$	3,767	11,000	7,233
II	$\frac{(11,000 + 7,233 + 8,318 + 9,562) \times 15}{115}$	4,710	11,000	6,290
I	$\frac{(11,000 + 6,290 + 7,233 + 8,318 + 9,562) \times 15}{115}$	5,531	11,000	5,469
<b>Add: down Payment</b>			20,000	20,000
<b>Total</b>		18,128	75,000	56,872

In the books of Vikram's Ltd

Machinery A/c

Date	Particular	Rs.	Date	Particular	Rs.
01.01.89	To, Hind Machinery Ltd. A/c	56,872	31.12.89	By, Depreciation A/c	8,531
			31.12.89	By, Balance c/d	48,341
		<b>56,872</b>			<b>56,872</b>
01.01.90	To, Balance b/d	48,341	31.12.90	By, Depreciation A/c	7,251
			31.12.90	By, Balance c/d	41,090

		<b>48,341</b>			<b>48,341</b>
01.01.91	To, Balance b/d	41,090	31.12.91	By, Depreciation A/c	6,164
			31.12.91	By, Balance c/d	34,926
		<b>41,090</b>			<b>41,090</b>
01.01.92	To, Balance b/d	34,926	31.12.92	By, Depreciation A/c	5,239
			31.12.92	By, Balance c/d	29,687
		<b>34,926</b>			<b>34,926</b>
01.01.93	To, Balance b/d	29,687	31.12.93	By, Depreciation A/c	4,453
			31.12.93	By, Balance c/d	25,234
		<b>29,687</b>			<b>29,687</b>

## Hind Machinery Ltd. A/c

Date	Particular	Rs.	Date	Particular	Rs.
01.01.89	To, Cash/ Bank A/c	20,000	01.01.89	By, Machinery A/c	56,872
31.12.89	To, Cash/ Bank A/c	11,000	31.12.89	By, Int. on H.P.	5,469
31.12.89	To, Balance c/d	31,341			
		<b>62,341</b>			<b>62,341</b>
31.12.90	To, Cash/ Bank A/c	11,000	01.01.90	By, Balance b/d	31,341
31.12.90	To, Balance c/d	25,051	31.12.90	By, Int. on H.P.	4,710
		<b>36,051</b>			<b>36,051</b>
31.12.91	To, Cash/ Bank A/c	11,000	01.01.90	By, Balance b/d	25,051
31.12.91	To, Balance c/d	17,818	31.12.90	By, Int. on H.P.	3,767
		<b>28,818</b>			<b>28,818</b>
31.12.92	To, Cash/ Bank A/c	11,000	01.01.90	By, Balance b/d	17,818
31.12.92	To, Balance c/d	9,500	31.12.90	By, Int. on H.P.	2,682
		<b>20,500</b>			<b>20,500</b>
31.12.93	To, Cash/ Bank A/c	10,938	01.01.90	By, Balance b/d	9,500
31.12.93	To, Balance c/d	Nil	31.12.90	By, Int. on H.P.	1,438
		<b>10,938</b>			<b>10,938</b>

**PQ 2:** Kamal Ltd. acquired a delivery van on hire purchase on 01.04.2011 from Ganesh Enterprises. The terms were as follows:

Particulars	Amount (₹)
Hire Purchase Price	180,000
Down Payment	30,000
1st instalment payable after 1 year	50,000

2nd instalment after 2 years	50,000
3rd instalment after 3 years	30,000
4th instalment after 4 years	20,000

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

**PQ 3:** Manmet Ltd. purchased 3 milk vans from Super Motors costing ₹ 75,000 each on hire purchase system. Payment was to be made: ₹ 45,000 down and the remainder in 3 equal instalments together with interest @ 9%. Manmet Ltd. writes off depreciation @ 20% on the diminishing balance.

It paid the instalment at the end of the 1st year but could not pay the next.

Super Motor agreed to leave one milk van with the purchaser, adjusting the value of the other two milk vans against the amount due. The milk vans were valued on the basis of 30% depreciation annually on written down value basis. Manmet Ltd. settled the seller's dues after three months.

You are required to give relevant accounts in the books of Manmet Ltd.

**Answer**

#### Scooters Account

Year		₹	Year		₹
1	To Super Motors A/c	2,25,000	1 end	By Depreciation A/c " By Balance c/d	45,000 1,80,000
		2,25,000			2,25,000
2	To Balance b/d	1,80,000	2 end	By Depreciation By Super Motors (Value of 2 scooters after depreciation for 2 year @ 30%) By P & L A/c (balancing figure) By Balance c/d (one scooter less dep. For 2 year) @ 20%	36,000 73,500 22,500 48,000
		1,80,000			1,80,000

#### Super Motors Account

Year		₹	Year		₹
1	To Bank A/c To Bank A/c To Balance c/d	45,000 76,200 1,20,000	1	By Scooters A/c By Interest @ 9% on ₹ 1,80,000	2,25,000 16,200
		2,41,200			2,41,200
2	To Scooters A/c	73,500	2	By Balance b/d	1,20,000

	To Bank A/c	57,300		By Interest A/c	10,800
		<b>1,30,800</b>			<b>1,30,800</b>

**PQ 4:** Z sold 3 Machinery for a total cash sale price of ₹ 6,00,000 on hire purchase basis to X on 01.01.2019. The terms of agreement provided for 30% as cash down and the balance of the cash price in three equal installments together with interest at 10% per annum compounded annually. The installments were payable as per the following schedule:

1st installment on 31.12.2020; 2nd installment on 31.12.2021 and 3rd installment on 31.12.2022. X paid the 1st installment on time but failed to pay thereafter. On his failure to pay the second installment, Z repossessed two machineries and valued them at 50% of the cash price. X charges 10% p.a. depreciation on straight line method.

Prepare necessary ledger accounts in the books of X for 2019-2021.

**Solution:**

**In the Books of X  
Machinery Account**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.19	To, Z's A/c	6,00,000	31.12.19	By, Depreciation A/c	60,000
				By, Balance c/d	5,40,000
		<b>6,00,000</b>			<b>6,00,000</b>
01.01.20	To, Bal. b/d	5,40,000	31.12.20	By, Depreciation A/c	60,000
				By, Bal. c/d	4,80,000
		<b>5,40,000</b>			<b>5,40,000</b>
01.01.21	To, Bal. b/d	4,80,000	31.12.21	By, Depreciation A/c	60,000
				By, Z's A/c	2,00,000
				By, P and L A/c	80,000
				(balancing figure)	
				By, Balance c/d	1,40,000
		<b>4,80,000</b>			<b>4,80,000</b>

**Z's Account**

Date	Particulars	(₹)	Date	Particulars	(₹)
01.01.19	To, Bank A/c	1,80,000	31.12.19	By, Machinery A/c	6,00,000
31.12.19	To, Balance c/d	4,62,000		By, Interest A/c	42,000
				[10% on (₹ 6,00,000 - ₹ 1,80,000)]	
		<b>6,42,000</b>			<b>6,42,000</b>
31.12.21	To, Bank A/c	2,28,200	01.01.20	By, Balance c/d	4,62,000

	1,40,000 + 42,000 + 46,200		31.12.20	By, Interest A/c	46,200
	To, Balance c/d	2,80,000		[10% x 4,62,000]	
		5,08,200			5,08,200
31.12.21	To, Machinery A/c	2,00,000	01.01.21	By, Balance b/d	2,80,000
	To, Balance c/d	1,08,000	31.12.21	By, Interest A/c	28,000
		3,08,000			3,08,000

**Working Notes:****1. Book value of machine left and repossessed**

Particulars	1 left	2 repossessed
A. Costs	2,00,000	4,00,000
B. Less: Depreciation for 3 years @10%	(60,000)	(1,20,000)
	1,40,000	2,80,000

**2. Agreed Value of 2 Machinery Repossessed = Cash Price - 50% of cash price**

$$= ₹ (4,00,000 - 2,00,000)$$

$$= ₹ 2,00,000$$

**3. Loss on Default = Agreed Value - Book Value**

$$= ₹ (2,00,000 - 2,80,000)$$

$$= ₹ 80,000$$

**PQ 5:** X purchased a truck for ₹ 2,80,000, payment to be made ₹ 91,000 down and 3 installments of ₹ 76,000 each at the end of each year. Rate of interest is charged at 10% p.a. Buyer depreciates assets at 15% p.a. on written down value method.

Because of financial difficulties, X, after having paid down payment and first installment to the end of 1st year could not pay second installment and seller took possession of the truck. Seller, after spending ₹ 9,200 on repairs of the asset sold for ₹ 150,000. Show the relevant accounts in the books of the purchaser & the vendor.

**Solution**

Particulars	Total Cash Price (₹)	Installment Paid (₹)	Interest Paid @ 10% (₹)	Cash Price Paid (Instal.-Int) (₹)
	280,000			
Down Payment	91,000	91,000	0	91,000
	189,000			
End of 1st year	57,100	76,000	18,900	57,100
	131,900			
End of 2nd Year	62,810	76,000	13,190	62,810
	69,090			
End of 3rd Year	69,090	76,000	6,910	69,090

Total	0	3,19,000	39,000	2,80,000
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**In the Books of X  
Truck Account**

Date	Particulars	(₹)	Date	Particulars	(₹)
1st	To, Vendor A/c	2,80,000		By, Depreciation A/c	42,000
Year				By, Bal c/d	2,38,000
		<b>2,80,000</b>			<b>2,80,000</b>
2nd	To, Bal b/d	2,38,000		By, Depreciation A/c	35,700
Year				By, Vendors A/c	1,45,090
				By, P/L A/c (Bal. figure)	57,210
		<b>2,38,000</b>			<b>2,38,000</b>

**Vendors Account**

Date	Particulars	(₹)	Date	Particulars	(₹)
1st	To, Bank (DP)	91,000		By, Truck A/c	2,80,000
Year	To, Bank (Installment)	76,000		By, Interest A/c	18,900
	To, Bal c/d	1,31,900			
		<b>2,98,900</b>			<b>2,98,900</b>
2nd	To, Asset A/c	1,45,090		By, Balance b/d	1,31,900
Year	(Default- Assets taken over)			" Interest A/c	13,190
		<b>1,45,090</b>			<b>1,45,090</b>

**In the Books of Vendor  
X Account**

Date	Particulars	(₹)	Date	Particulars	(₹)
1st	To, HP Sales A/c	2,80,000		By, Bank (Down) A/c	91,000
Year	To, Interest A/c	18,900		By, Bank (Installment) A/c	76,000
				By, Balance c/d	1,31,900
		<b>2,98,900</b>			<b>2,98,900</b>
2nd	To, Balance b/d	1,31,900		By, Goods Repossessed A/c	1,45,090
Year	To, Interest A/c	13,190			
		<b>1,45,090</b>			<b>1,45,090</b>

**Goods Repossessed Account**

Date	Particulars	(₹)	Date	Particulars	(₹)
	To, X A/c (Hire Purchaser)	1,45,090		By, Bank (Sales) A/c	1,50,000

	To, Bank (Repairing Charge) A/c	9,200		By, P/L A/c (Bal Figure)	4,290
		<b>1,54,290</b>			<b>1,54,290</b>