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Introduction to Accounting 1 Notes Unit 1: Introduction to Accounting Structure 1.1 Introduction 1.2 Meaning and Objectives of Accounting 1.2.1 Objectives of Accounting 1.3 Accounting Principles 1.3.1 Accounting Concepts 1.3.2 Accounting Conventions 1.4 Book Keeping 1.4.1 Types of Bookkeeping Systems 1.5 Rules of Double Entry 1.6 Journal 1.6.1 Characteristics of Journal 1.6.2 Format of Journal 1.7 Ledger 1.7.1 Characteristics of Ledger 1.7.2 Rules of Posting 1.8 Subsidiary Books 1.8.1 Cash Book 1.8.2 Purchases Book 1.8.3 Purchase Return Book 1.8.4 Sales Book 1.8.5 Sale Return Book 1.8.6 Bills Receivable Book 1.8.7 Bills Payable Book 1.8.8 Journal Proper 1.9 Summary 1.10 Check Your Progress 1.11 Questions and Exercises 1.12 Key Terms 1.13 Further Readings

2 Financial Accounting Notes Objectives After studying this unit, you should be able to: ? Discuss the meaning and objectives of accounting ? Explain the accounting principles ? Discuss the systems of bookkeeping ? Describe the rules of double entry ? Prepare journal and ledger ? Understand different subsidiary books ? Solve problems on three column cash book 1.1 Introduction Accounting is the language of the business which is used to communicate financial transactions and their results. It is a comprehensive system to collect, analyzes, and communicates financial information. Financial transactions of a business are recorded according to certain accounting principles and standards and as prescribed by an accountant depending upon the size, nature, volume, and other constraints of a particular organization. In this unit, we shall be discussing about the meaning and objectives of accounting, the accounting principles, systems of Book keeping and the rules of double entry. You will be able to prepare journal and ledger and understand different subsidiary books. At last we shall be discussing the problems on cash book. 1.2 Meaning and Objectives of Accounting The American Institute of Certified Public Accountant has defined Financial Accounting as: "the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which in part at least of a financial character and interpreting the results thereof." 1.2.1 Objectives of Accounting The main objectives of Accounting are as follows: ? To keep systematic records: The primary objective of accounting is to collect financial data and record it systematically to develop correct and useful results of financial statements. ? To ascertain profitability: Accounting helps in evaluating the profits and losses incurred during a specific accounting period of the business. ? To ascertain the financial position of the business: A balance sheet or a statement of affairs indicates the financial position of a company as on a particular date. A properly drawn balance sheet gives the indication of the class and value of assets, the nature and value of liability, and also the capital position of the firm and with that the soundness of any business entity can be easily ascertained. ? To assist in decision-making: One of the main objectives of accounting is to take right decisions at right time and accounting gives the accurate figures which helps in taking decisions for the future. ? To fulfill compliance of Law: Business entities such as companies, trusts, and societies are being run and governed according to different legislative acts. Similarly, different taxation laws are also applicable to every business house. Everyone has to keep and maintain different types of accounts and records as prescribed by corresponding laws of the land. Introduction to Accounting 3 Notes 1.3 Accounting Principles American Institute of Certified Public Accountants (AICPA) states the following meaning of Accounting Principle: It is desirable that the accountant conceives of his work as a complex problem to be solved and of his statements as creative works of art, and that he reserves to himself the freedom to do his work with the canons of art constantly in mind and as his skill, knowledge and experience best enable him. Every art must work according to a body of applicable rules, but also must reserve the right to depart from the rules, whenever it can thereby achieve a better result. The principles of accounting are divided into two categories i.e.: Accounting concepts and accounting conventions which are discussed below: 1.3.1 Accounting Concepts The most important concepts of accounting are as follows: ? Business Entity Concept: According to this concept, the law has given separate entity to the business. The business and the owner of the business are two different entities. For example, Mr. X starts a new business in the name and style of M/s Fresh Trading Company and introduced a capital of Rs 2,00,000 in cash. It means the cash balance of M/s Fresh Trading Company will increase by a sum of Rs 2,00,000/-. At the same time, the liability of M/s Fresh Trading Company in the form of capital will also increase and the firm is liable to pay Rs 2,00,000 to Mr. X. ? Money Measurement Concept: According to this concept only those transactions are recorded which can be measured in terms of money. Non monetary transactions are not entered in the books of accounts. For example a firm purchases 100 pieces of shirts then it will not be recorded in the books unless the monetary value of these shirts is known. If it is like this that firm purchases 100 pieces of shirts for Rs.5000 then it will be recorded in the books of accounts. ? Going Concern Concept: Accounting is based on the assumption that a business unit is a going concern and financial transactions of a business are recorded keeping this point of view in mind. Otherwise, the banker will not provide loans, the supplier will not supply goods or services, the employees will not work properly, and the method of recording the transaction will change altogether. The concept of going concern does not work in the following cases: ? If a unit is declared sick (unused or unusable unit). ? When a company is going to liquidate and a liquidator is appointed for the same. ? When a business unit is passing through severe financial crisis and going to wind up. ? Cost Concept: According to this concept the assets are recorded in the books of accounting on the basis of cost not on the net realizable value or market value of the assets. It is based on the assumption that a business unit is a going concern. The cost concept stops any kind of manipulation by taking into account the net realizable value or the market value whereas this concept ignores the effect of inflation in the market, which can sometimes be very steep. ? Dual Aspect Concept: According to this concept there must be a double entry to complete any financial transaction. Every debit should have an equivalent credit. Therefore, every financial transaction has its dual aspect. For example, if a firm buys some stock of Rs. 5,000 from Mr. G, then it will have two effects: ? The value of stock will increase by Rs. 5,000 and ? It will increase the liability in the form of creditors. ? Accounting Period Concept: The life of a business unit is indefinite as per the going concern concept. But to determine the profit or loss of a firm, and to ascertain

4 Financial Accounting Notes its financial position, profit & loss accounts and balance sheets are prepared at regular intervals of time, usually at the end of each year. This one-year cycle is known as the accounting period. The purpose of having an accounting period is to take corrective measures keeping in view the past performances, to nullify the effect of seasonal changes, to pay taxes, etc. Thus, accounting period helps in ascertaining the correct position of the firm at regular intervals of time, i.e., at the end of each accounting period. ? Matching Concept: According to this principle, revenue of the period should be matched with the costs (expenses) of that period for determining the profits made by the business during a period. Thus, profit is ascertained by reducing expenses from the revenue. If income is more than expenses, then it is profit; and if expenses are more than income, then it is loss. In other words, expenses incurred in an accounting year should be matched with the revenues generated in that year. ? Accrual Concept: According to this concept, the revenue is recognised on its realisation and not on its actual receipt. Accrual is concerned with expected future cash receipts and payments; it is the accounting process of recognising assets, liabilities, and gains or losses for amounts expected to be received or paid in future. Similarly, the costs are recognised when they are incurred and not when payment is made. Under cash accounting system, the revenues and costs are recognised only when they are actually received or paid but under accrual concept it is necessary to make certain adjustments regarding revenues and costs in the preparation of income statements. ? Objective Evidence Concept: According to the Objective Evidence concept, every financial entry should be supported by some objective evidence. Purchase should be supported by purchase bills, sale with sale bills, cash payment of expenditure with cash memos, and payment to creditors with cash receipts and bank statements. Similarly, stock should be checked by physical verification and the value of it should be verified with purchase bills. In the absence of these, the accounting result will not be trustworthy, chances of manipulation in accounting records will be high, and no one will be able to rely on the financial statements. 1.3.2 Accounting Conventions Conventions refer to the general agreement on the usage and practices in social or economic life. These refer to customs or traditions which are used since long by the professionals. Following are the generally accepted accounting conventions: ? Convention of Consistency: A firm should be consistent and follow the same accounting rules and principles for similar transactions in order to compare the results of different years. Reliability of financial statements may be lost, if frequent changes are observed in accounting treatment. For example, if a firm chooses cost or market price whichever is lower method for stock valuation and written down value method for depreciation to fixed assets, it should be followed consistently and continuously. ? Consistency also states that if a change becomes necessary, the change and its effects on profit or loss and on the financial position of the company should be clearly mentioned. ? Convention of Disclosure: According to this convention a firm should disclose all the information that is significance to the users of the financial statements, such as investors, owner, and creditors. The Companies Act, 1956, also prescribed a format and made provisions in which financial statements must be prepared. The purpose of these provisions is to disclose all essential information so that the view of financial statements should be true and fair. ? Convention of Materiality: As per this convention, only the material or important facts about the commercial activities are to be recorded through the financial statements. In other words, those items or facts which are not important for business are not accounted and can be ignored. Materiality means ‘relative importance’, i.e., whether a matter should be disclosed or not in the financial

Introduction to Accounting 5 Notes statements depends on its materiality. 'American Accounting Association defines the term materiality' as "An item should be regarded as material if there is reason to believe that knowledge of it would influence the decision of informed investor." ? Convention of Conservatism or Prudence: According to this convention a firm should "Anticipate no profit, and provide for all possible losses". It is a policy of playing safe. A firm should anticipate all the future losses and made a provision to deal with these losses. For future events, profits are not anticipated, but provisions for losses are provided as a policy of conservatism. 1.4 Book Keeping Bookkeeping is the process of recording financial transactions and keeping financial records. It is mainly associated with the recording of financial data which are measurable in terms of money. It helps in keeping a complete record of business transactions in a systematic manner by which the financial position of business enterprise for a certain period may be ascertained. 1.4.1 Types of Bookkeeping Systems There are two types of bookkeeping systems used in recording business transactions: single-entry bookkeeping system and double-entry bookkeeping system. Single-Entry Bookkeeping System Single-entry Bookkeeping System is commonly used for small businesses with very little or minimal transactions. It is very simple, practical and informal method of recording. Usually, it maintains a record of cash disbursement, cash receipts, sales and purchases. Rest of the accounting records such as inventory, equipment, capital, etc., are recorded in the form of memorandum or notes. In single-entry bookkeeping system, a transaction only affects one account. However, single-entry bookkeeping system is likely to show error and incompleteness because it lacks a detailed recording system compared to double-entry bookkeeping system. Double-Entry Bookkeeping System Double-Entry Bookkeeping System is the standard method of record keeping which is used by most businesses, bookkeepers and accountants. The procedure of double-entry bookkeeping system is more detailed and complex than single-entry bookkeeping system. It introduces the concept of debit and credit, which means that for every transaction there is something received (debit) and given up (credit) and recorded transaction affects two or more accounts. The benefit of double-entry bookkeeping system is that it has a process to ensure accurate and complete recording of business transactions. It is a reliable source of financial information and gives a fair valuation of the condition or performance of a business. 1.5 Rules of Double Entry The following rules of debit and credit are called the golden rules of accounts: 1. For Personal Accounts: ? Debit the receiver ? Credit the giver 2. For Real Accounts: ? Debit what comes in ? Credit what goes out
6 Financial Accounting Notes 3. For Nominal Accounts: ?

100%	MATCHING BLOCK 1/50	W
Debit all expenses and losses ? Credit all incomes and gains 1.6		

100%	MATCHING BLOCK 2/50	W
Debit all expenses and losses ? Credit all incomes and gains 1.6		

Journal Journal is the book of original entry in which financial transactions are recorded date- wise and serial-wise. It is a book for recording daily business transactions. The process of recording transactions in a journal is called journalising. The form or manner in which transactions are recorded in the journal is called 'journal entry'. Journal is also called a book of original entry because various ledger accounts are recorded and/or posted from this book. In other words, transactions are recorded first in the journal before being recorded anywhere else. 1.6.1 Characteristics of Journal Following are the characteristics of journal: 1. Journal is a book of original entry. 2. Keeps a chronological record of the transactions, i.e., according to occurrence of the transactions. 3. Helps in the preparation of the ledger, which is the principal book of accounts. 4. Gives a complete picture of each transaction thus helps in maintaining the identity of the transaction. 5. Tells the true nature of each and every transaction with the help of narration. 6. Also known as a daybook. 1.6.2 Format of Journal The format of journal is as follows: Journal Date Particulars Ledger folio Amount (Dr) Amount (Cr) 1. Date of Transaction: Date is written with every entry on which the transaction has occurred. 2. Particulars: Debit and credit side of every transaction is written in particulars. Firstly, the account is written which is to be debited and the word 'Dr' is written at the end of column, the account to be credited is written below the debit entry and the word 'To' is written as few space. Narration of transaction is written in column of particulars after writing of debit and credit of accounts. 3. Ledger Folio or L.F.: This column contains the page number of the ledger where the account has been opened. 4. Debit Amount: The amount of debit is written against the debited account. 5. Credit Amount: The amount of credit is written against the credited account. Compound Journal Entry When there are two or more transactions of similar nature occurring on the same day and either Dr or Cr account in common, such transactions can be recorded in the form of one journal entry instead of making a separate entry for each transaction. Such entry

Introduction to Accounting 7 Notes is known as 'Compound Journal Entry'. For example, on 31 March, ` 2,500 is paid for salaries and ` 1000 is paid for rent, the following entry will be: Particulars ` ` Salaries A/c Dr 2,500 Rent A/c Dr 1,000 To Cash A/c (For expenses paid) 3,500 Compound entries may be recorded by any of the three ways: (i) One particular account may be debited while several other accounts may be credited (ii) Several accounts may be debited while one particular account may be credited (iii) Several accounts may be debited and several other accounts may be credited, e.g. opening entry Opening Entry The previous year's balance of assets and liabilities will have to be brought forward to the current year's new books of accounts. This is done by passing a journal entry, which is known as 'opening entry'. This entry is made on the basis of accounting equation, i.e., by debiting all assets and crediting liabilities and capital account. If the amount of capital is not given in the question, the balancing figure will depict capital, i.e., Assets – Liabilities. Illustration 1: From the following particulars of Mrs. Ranjana, pass opening entry as on January 1, 2013: Cash ` 6,000; Bank Loan ` 15,000; Capital ` 75,000; Building ` 50,000; Debtors `12,000; Furniture Rs. 18,000; Creditors Rs.9,000; Stock Rs.13,000. Solution: Journal Date Particular L.F. Amount (Dr) ` Amount (Cr) `
Building A/c Dr Debtors A/c Dr Furniture A/c Dr Stock

61%	MATCHING BLOCK 3/50	W

A/c Dr Cash A/c Dr To Creditors A/c To Bank Loan A/c To Capital A/c (Being

assets and liabilities
brought in new accounting year) 50,000 12,000 18,000 13,000 6,000 9,000 15,000 75,000 Illustration 2: Enter the following transactions in the journal of Mr. Manoj. Assets: Cash in hand ` 10,000; Cash at bank ` 1,200; Stock ` 15,000; Debtors ` 12,000 (Rohit ` 4,600; Raman ` 5,800; Akbar ` 1,600)
8 Financial Accounting Notes Liabilities: Creditors ` 3,500 (Ram ` 2,000; Rahim ` 1,500); Bank Loan ` 7,000. The following transactions took place during the month of June 2014: June 2 Goods sold to Rohit ` 2,000. June 3 Purchased goods from Shah for ` 8,000, at a discount of 15% and cash discount of 2.5%, paid 50% amount immediately. June 4 Received a cheque from Rohit for ` 6,500 (discount allowed ` 100); cheque deposited into bank. June 7 Received a cheque from Raman for ` 5,600 in full settlement of his account. This cheque was immediately deposited into the bank. June 12 Cheque of Raman dishonoured. June 16 Deposited into bank ` 2,200 for cash sales. June 19 Paid life insurance premium of ` 3,500 and insurance premium of office building of ` 1,500 by cheque. June 21 Akbar became insolvent and 60 paise in a rupee could be recovered from his estate. June 24 Purchased goods from Vikas for ` 1,400 and paid by cheque. June 27 Sold half of the above goods at a profit of 25% on cost to Ankit. June 28 Paid interest on loan of ` 500. June 30 Income tax paid by cheque of ` 1,200. Solution: Journal of Mr. Manoj S. No. Particulars L.F.Amount (Dr) ` Amount (Cr) ` 2014 June 1 Cash
A/c Dr Cash at bank A/c Dr Stock A/c Dr Rohit Dr Raman Dr Akbar Dr To Ram To Rahim To Bank Loan A/c To Capital A/c (Balancing figure) (Being assets and liabilities
brought forward) 10,000 1,200 15,000 4,600 5,800 1,600 2,000 1,500 7,000 27,700 June 2 Rohit Dr To Sales A/c (Being goods sold to Rohit) 2,000 2,000 June Purchases A/c Dr 6,800
Introduction to Accounting 9 Notes 3 To Cash A/c To Discount A/c To Shah (Being goods purchased and discount received) 3,315 85 3,400 June 4 Bank A/c Dr Discount A/c Dr To Rohit (Being cheque received and discount allowed) 6,500 100 6,600 June 7 Bank A/c Dr Discount A/c Dr To Raman (Being cheque received and discount allowed) 5,600 200 5,800 June 12 Raman
Dr To Bank A/c To Discount A/c (Being Raman's cheque dishonoured) 5,800 5,600 200 June 16 Bank

35%	MATCHING BLOCK 6/50	W

A/c Dr To Sales A/c (Being cash received from sales, deposited into bank) 2,200 2,200 June 19 Drawings A/c Dr Insurance Premium A/c Dr To Bank A/c (Being

payment of life insurance and insurance premium by cheque) 3,500 1,500 5,000 June 21 Cash A/c Dr Bad debts A/c Dr To Akbar (Being cash received and bad debts written off) 960 640 1,600 June 24 Purchases
A/c Dr To Bank A/c (Being goods purchased by cheque) 1,400 1,400 June 27 Ankit Dr To Sales A/c 875 875
10 Financial Accounting Notes (Being goods sold on credit, i.e. 700 + 25% on 700) June 28 Interest on Loan A/c Dr To Cash A/c (Being interest paid) 500 500 June 30 Drawings A/c Dr To Bank A/c (Being

income tax paid by cheque) 1,200 1,200 1.7 Ledger According to L.C. Cropper, The book in which a trader's transactions are recorded in a classified, permanent record is called the ledger. Format of Ledger: It is like a register. Its every page is divided into two parts. The left part is called debit part, and the right part is called credit part. Every part has four columns. The format is as follows: Format of Ledger Dr Cr Date Particulars J.F. Amount (`) Date Particulars J.F. Amount (`) Details of the above columns are as follows: ? Date: Date on the transaction took place is written in this column. ? Particulars: The name of the other account, which is affected by the transaction, is written in this column. In debit 'To' and in credit 'By' words are used. ? Journal Folio No.: In this column, that number of journal is written from where the transaction is posted. ? Amount: The amount related to transaction is written. 1.7.1 Characteristics of Ledger Following are the characteristics of ledger: 1. Principal book of accounts. 2. Prepared with the help of data provided by the journal. 3. The balances of all nominal accounts are transferred to the trading/profit & loss account at the end of the period. 4. The balances of real and personal accounts are shown in the balance sheet. 5. Trial balance is prepared with the help of the closing balances of all accounts maintained in it. 6. Depicts the present position of the accounts.

Introduction to Accounting 11 Notes 1.7.2 Rules of Posting Posting means recording the transaction in ledger from journal or other subsidiary books. The following rules should be observed while posting entries in the ledger. 1. The name of account should be written on the top of the account like wages account, furniture account, etc. 2. Write the date in the account on the proper side. Date should be noted from journal or subsidiary book. 3. All transactions related to one account should be written at one page. 4. As 'Dr' is written on the top corner of debit side and 'Cr' is written on the top corner of the credit side, so all the debit entries are written with 'To' and all the credit entries are written with 'By'. 5. The amount written in the debit side of one account should be same as written in the credit side of other account. 6. Folio column is meant for writing the page number of journal or subsidiary book, from where posting is being done. So, it should be filled by the page number of source book. Illustration 3: Suraj commenced his business on 1 January, 2013 for ` 8,00,000. Then, its journal entry will be as follows: Journal Date Particulars L.F. Amount Dr (`) Amount Cr (`) 2013 Jan 1 Cash A/c Dr To Capital A/c (Being business started with cash) 8,00,000 8,00,000 The above entry from journal to ledger will be posted as follows: Cash A/c Dr Cr Date Particulars J.F. Amount (`) Date Particulars J.F. Amount (`) 2013 Jan 1 To Capital A/c 8,00,000 Capital A/c Dr Cr Date Particulars J.F. Amount (`) Date Particulars J.F. Amount (`) 2013 Jan 1 By Cash A/c 8,00,000

12 Financial Accounting Notes Posting of Compound Journal Entries Sometimes two or more than two accounts are involved in a transaction, which are recorded as a single entry and are known as compound journal entry. For posting of this entry many accounts will be opened as shown in the entry. Illustration 4: On 12 June, 2015, ` 10,500 was paid to Mohit and discount of ` 500 was received. Journal Date Particulars L.F. Amount Dr (`) Amount Cr (`) 2015 June 12 Mohit Dr To Cash A/c To Discount A/c (Being cash paid to
Mohit, discount received) 11,000 10,500 500 The posting of above entry will be: Mohit A/c Dr Cr Date Particulars J.F. Amount (`) Date Particulars J.F. Amount (`) 2015 June 11 June 12 To Cash A/c To Discount A/c 10,500 500 Cash A/c Dr Cr Date Particulars J.F. Amount (`) Date Particulars J.F. Amount (`) 2015 June 12 By Mohit 10,500 Discount A/c Dr Cr Date Particulars J.F. Amount (`) Date Particulars J.F. Amount (`) 2015 June 12 By Mohit 500

Introduction to Accounting 13 Notes It is clear from the above example that for posting of compound journal entry, the same amount will be recorded in the concerned account as shown in the journal against that account. Such as Cash A/c ` 10,500, Discount A/c ` 500 and Mohit A/c ` 11,000 have been recorded because the same amount has been shown against the accounts in journal. Posting of Opening Entry In the beginning of every accounting period, a journal entry is passed to record the opening balances of all the accounts, which is called opening entry. In this entry, all assets are debited and all the liabilities are credited. The word 'To Balance b/d' is written in debit in the ledger for the accounts, which have debit balances and the word 'By Balance b/d' is written in credit in the ledger for the accounts, which have credit balances. This has been explained by the following examples: Illustration 5: Mr. Amit has the following balances as on 1 April, 2015; cash in hand ` 12,000, cash at bank ` 10,000; due from Karim ` 7,000; furniture ` 8,000; loan from Kamal ` 11,000; due to Amrit ` 8,500; due to Arvind ` 6,500. You are required to pass the opening entry and post it into ledger. Solution: Journal Date Particulars L.F. Amount Dr (`) Amount Cr (`) 2015 April 1 Cash
A/c Dr Bank A/c Dr Karim Dr Furniture A/c Dr To Kamal's loan A/c To Amrit To Arvind To Capital A/c (Being the opening entry for balances brought forward from the last year) 12,000 10,000 7,000 8,000 11,000 8,500 6,500 11,000 Ledger Cash Account Dr Cr. Date Particulars J.F. Amount (`) Date Particulars J.F. Amount (`) 2015 April 1 To Balance b/d 12,000

14 Financial Accounting Notes Bank Account Dr Cr. Date Particulars J.F. Amount (`) Date Particulars J.F. Amount (`) 2015 April 1 To Balance b/d 10,000 Karim ` 2015 April 1 To Balance b/d 7,000 Furniture Account ` 2015 April 1 To Balance b/d 8,000 Kamal's Loan Account ` 2015 April 1 By Balance b/d 11,000 Amrit ` 2015 April 1 By Balance b/d 8,500

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Introduction to Accounting 15 Notes Arvind ` 2015 April 1 By Balance b/d 6,500 Capital Account ` 2015 April 1 By Balance b/d 11,000 Illustration 6: The following balance appeared in the books of Ramesh on 1 January, 2012: Assets: Cash ` 40,000; Stock ` 25,000; Debtors ` 40,000, Machinery ` 50,000. Liabilities: Creditor: Vijay ` 30,000. The following transactions took place in January 2012: Jan 3: Sold goods for cash ` 6,000 and on credit of ` 3,000 to Ajay. Jan 5: Ajay returned goods for ` 1,500. Jan 9: Purchased goods from Vijay of the list price ` 10,000 valued at ` 9,000. Jan 13: Purchased goods of list price of ` 15,000 from Rajan less 10% trade discount and 5% cash discount and paid 40% price immediately. Jan 19: Paid to Vijay ` 38,600 in full settlement of his account. Jan 23: Paid ` 700 for the life insurance premium of the proprietor. Jan 30: Received for commission ` 2,500 Pass journal entries in journal and post them into the ledger. Solution: Journal of Ramesh Date Particulars L.F.Amount Dr (`) Amount Cr (`) 2012 Jan 1 Cash
A/c Dr Stock A/c Dr Debtors A/c Dr Machinery A/c Dr To Vijay To Capital A/c (Being opening balances of assets and liabilities recorded) 40,000 25,000 40,000 50,000 30,000 125.000
16 Financial Accounting Notes Jan 3 Cash A/c Dr Ajay Dr To Sales A/c (Being goods sold) 6,000 3,000 9,000 Jan 5 Sales Returns A/c Dr To Ajay (Being goods purchased) 1,500 1,500 Jan 9 Purchases A/c Dr To Vijay (Being goods purchased) 9,000 9,000 Jan 13 Purchases A/c Dr To Cash A/c To Discount A/c
To Rajan (Being goods purchased and discount received) 13,500 5,130 270 8,100 Jan 19 Vijay
Dr To Cash
A/c To Discount A/c (Being goods purchased and discount received) 39,000 38,600 400 Jan 23 Drawings
A/
c Dr To Cash A/c (
Being life insurance premium paid) 700 700 Jan 30 Cash A/c Dr To Commission A/c (Being
commission received) 2,500 2,500
Introduction to Accounting 17 Notes Ledger Cash A/c Dr Cr Date Particulars J.F. Amount (`) Date Particulars J.F. Amount (`) 2012 Jan 1 Jan 3 Jan 30 To Balance b/d To Sales A/c To Commission A/c 40,000 6,000 2,500 2012 Jan 13 Jan 19 Jan 23 Jan 31 By Purchases A/c By Vijay By Drawings
A/c By Balance c/d 5,130 38,600 700 4,070 48,500 48,500 Feb 1 To Balance b/d 4,070 Stock A/c Dr Cr 2012 Jan 1 To Balance b/d 25,000 2012 Jan 31 By Balance c/d 25,000 25,000 25,000 Feb 1 To Balance b/d 25,000 Debtors A/c Dr Cr 2012 Jan 1 To Balance b/d 40,000 2012 Jan 31 By Balance c/d 40,000 40,000 40,000 Feb 1 To Balance b/d 40,000
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Financial Accounting Notes Machinery A/c Dr Cr 2012
Jan 1 To Balance b/d 50,000 2012 Jan 31 By Balance c/d 50,000 50,000 50,000 Feb 1 To Balance b/d 50,000
Vijay Dr Cr 2012 Jan 19 Jan 19 To Cash
A/c To Discount A/c 38,600 400 2012 Jan 1 Jan 9 By Balance b/d By Purchases A/c 30,000 9,000 39,000 39,000 Capital A/c Dr Cr 2012 Jan 31 To Balance c/d 1,25,000 2012 Jan 1 By Balance b/d 1,25,000 1,25,000 1,25,000 Feb 1 By Balance b/d 1,25,000 Ajay Dr Cr 2012 Jan 3
To Sales A/c 3,000 2012 Jan 5 Jan 31 By Sales Return A/c By Balance c/d 1,500 1,500 3,000 3,000 Feb 1 To Balance b/d 1,500
Sales A/c Dr Cr 2012 Jan 31 To Balance c/d 9,000 2012 Jan 3 Jan 3 By Cash A/c By Ajay 6,000 3,000
Introduction to Accounting 19 Notes 9,000 9,000 Feb 1 By Balance b/d 9,000 Sales Returns A/c Dr Cr 2012 Jan 5 To Ajay 1,500 2012 Jan 31 By Balance c/d 1,500 1,500 1,500 Feb 1 Balance b/d 1,500 Purchases A/c Dr Cr 2012 Jan 9 Jan 13 Jan 13 Jan 13 To Vijay To Cash A/c To Discount A/c To Ranjan 9,000 5,130 270 8,100 2012 Jan 31 Balance c/d 22,500 22,500 22,500 Feb 1 To Balance b/d 22,500 1.8 Subsidiary Books Under the double entry system, all the business transactions are recorded first in the book of original record, i.e. journal; and then posted into ledger, which is the principle book. When daily transactions are in large number then the process of recording the transactions is very time consuming which results in an increase of overhead costs. So, it is economical as well as easier to keep records for a particular class or group of transactions within a separate book which are known as subsidiary books. These can be sub-divided as cash book, purchases journal, purchases return journal, sales journal, sales return journal, bills receivable journal, bills payable and journal proper. 1.8.1 Cash Book All the transactions related to cash are recorded in the cash book. For example expenses paid in cash, revenue collected in cash, payments made to creditors, payments received from debtors, cash deposited in bank, withdrawn of cash for office use, etc. There are three types of cash book i.e. Simple cash book, double column cash book and triple column cash book. Single Column Cash Book Cash book is just like a ledger account. There is no need to open a separate cash account in the ledger. The balance of cash book is directly posted to the trial balance. Since cash account is a real account therefore all the received cash is posted in the debit side and all payments and expenses are posted in the credit side of the cash book. The format of the simple column cash book is as follows:

20 Financial Accounting Notes Format: Receipts Payments Date Particulars Vouch er No. L.F . Amount (`) Date Particular s Vouche r No. L.F . Amount (`) Double Column Cash Book In the double cash book an additional Discount column on each side of the cash book is added. The debit side column of discount represents the discount to debtors of the company and the credit side of discount column means the discount received from our suppliers or creditors while making payments. The total of discount column of debit side of cash book is posted in the ledger account of 'Discount Allowed to Customers' account as 'To Total as per Cash Book'. Similarly, credit column of cash book is posted in ledger account of 'Discount Received' as 'By total of cash book'. Double Column Cash Book Dr Date Particulars L.F. Discount ` Amount ` Date Particulars L.F. Discount ` Amount ` Triple Column Cash Book In the triple column cash book one more column of Bank is added in both sides of the cash book to post all banking transactions. All banking transactions are routed through this cash book and there is no need to open a separate bank account in ledger. Triple Column Cash Book Date Particulars L.F. Dis. ` Cash Bank ` Date Particulars L.F. Dis. ` Cash Bank ` Illustration 7: Enter the following transactions in triple-column cash book of Mr. Ajay. 2015 ` June 1 Started business with cash 15,000 June 2 Deposited into bank 6,000 June 3 Purchased machinery for cash 3,000 June 7 Cash purchases, issued cheque 2,800 June 10 Cheque received from Mr. Bansal on account 2,450 June 15 Cash sales, received cheque 1,750 June 19 Paid salaries 600 June 22 Office expenses paid by cheque 250 June 23 Paid cash for advertisement 60 June 26 Received cheque from Rahim and endorsed the same to Vikas 700

Introduction to Accounting 21 Notes June 28 Paid advance income tax by cheque 450 June 30 Paid rent 200 Solution: Cash Book (Triple Column) of Mr. Ajay Dr Cr Date Particular s L.F. Dis . ` Cash ` Bank ` Date Particular s L.F. Dis . ` Cash ` Bank ` 201 5 Jun e 1 2 10 15 26 To Capital

A/c To Cash A/c To Mr. Bansal To Sales To Rahim C 15,00 0 700 6,000 2,450 1,750 201 5 Jun e 2 3 7 19 22 23 26 28 30 30 By Bank

40%	MATCHING BLOCK 13/50	W

A/c By Mach. A/c By Purchase s A/c By Salaries A/c By Off. Exp A/c By Advert. A/c By Vikas By Drawings A/c By Rent A/c By Balance c/d

C 6,000 3,000 600 60 700 200 5,140 2,800 250 450 6,700 Nil 15,70 0 10,20 0 Nil 15,70 0 10,20 0 July 1 To Balance b/d 5,140 6,700

Note: 1. Cheque received from Rahim has been entered in the cash column because the same was endorsed to Vikas in transaction dated June 26. 2. Payment of advance income tax has been treated as drawings because income tax on sole proprietor is treated as his personal expenditure. Illustration 8: Enter the following transactions in a cash book with discount, cash and bank columns:

22 Financial Accounting Notes 2015 Feb 1 Sushil started business with ` 60,000 in cash. Feb 2 He receives a cheque of ` 2,000 from Sai & Co. on account. Feb 5 He pays ` 42,000 into bank current account. Feb 7 Sushil pays into banks Sai & Co's cheque for ` 2,000. Feb 11 He pays Luxman & Co by cheque ` 850 and received discount ` 50. Feb 13 He receives cheque of ` 1,125 from Karan and allows him discount ` 25. Feb 18 He pays by cheque for cash purchase ` 700. Feb 20 He draws a cheque for office use ` 1,000. Feb 25 He gives cheque to Rohan for purchase of office equipment for ` 2,000. Feb 28 He pays salaries in cash ` 600. Solution: Cash Book (Triple Column) of Sushil Dr Cr Date Particular s L. F. Dis. Cash ` Bank ` Date Particular s L.F . Dis. Cash ` Bank ` 2015 Feb 1 " 2 " 5 " 7 "13 " 20 To Capital

A/c To Sai & Co

30%	MATCHING BLOCK 4/50	W

To Cash A/c To Cash A/c To Karan To Bank A/c C C C C 2 225 60,00 0 2,000 1,000 42,00 0 2,000 1,125 201 5 Feb 5 " 7 " 11 " 18 " 20 " 25 " 28 " 28 By Bank A/c By Bank A/c By Luxman & Co By Purchases A/c By Cash A/c By Furniture A/c By Salaries A/c By Balance c/d

C C 5 50 42,00 0 2,000 600 18,40 0 850 700 1,000 2,000 40,57 5 2 5 63,00 0 45,12 5 5 0 63,00 0 45,12 5 Marc h 1 To Balance b/d 18,40 0 40,57 5 Petty Cash Book In an organization there may be many minor transactions for which payments have to be done. Therefore, a cashier is appointed and he keeps the cash and makes regular payments out of it. To make it simple and secure, mostly a constant balance is kept with the cashier.

Introduction to Accounting 23 Notes A cashier pays Rs 5,000 to Mr. Ajay, who will pay day-to-day organization expenses out of it. Suppose Mr. Ajay spends Rs 4,200 out of it in a day, the main cashier pays Rs 4,200, so his balance of petty cash book will be again Rs 5,000. It is very useful system of accounting, as it saves the time of the main cashier and provides better control. Petty cash book is in a columnar form. A separate column for each head of expenditure and for the total small cash payments is provided. The specimen of petty cash book is given as under: Petty Cash Book Dr Cr Cash Recd. Date Particulars V. No. Total Stationery & Printing Postage & Telegram Cartage Sundry Exp. Conveyance Advantages of Petty Cash Book The main advantages are as follows: 1. Simple like a simple cash book. 2. Saves time of petty cashier. 3. Less chances of fraud as the petty cashier is supposed to make the small payments against the vouchers. 4. Errors can also be easily detected when the book of petty expenses/statement is submitted along with the vouchers by the petty cashier. 1.8.2 Purchases Book Purchases book or purchases day book is a book of original entry maintained to record credit purchases. Cash purchases will not be entered in purchases day book. At the end of each month, the purchases book is totalled. The total shows the total amount of goods purchased on credit. Purchases book is written up daily from the invoices received. The specimen of the purchases day book is given as under: Specimen of Purchases Day Book Date Particulars Invoice No. L.F. Details (`) Amount (`) The details of all the columns are as under: ? Date: It is the date of purchase. ? Particulars: All the details of suppliers, goods, rate, quantity, charges, etc. are considered. ? Invoice Number: The invoice numbers given by the sellers are to be recorded for future reference. A statement, in case of credit sale, is sent by the seller to the customers stating all the details of the goods is known as invoice. ? Ledger Folio: The ledger folio number is to be recorded where the transaction is recorded within the ledger. ? Details: The amount added and deducted are to be shown clearly. ? Amount: The net amount payable by the buyer is recorded in this column.

24 Financial Accounting Notes 1.8.3 Purchase Return Book Sometimes goods are to be retuned back to the supplier, for various reasons. The most common reason being defective goods or poor quality goods. In this case, a debit note is issued. Purchase Return Book Date Particulars Debit Note No. L.F. Detail Amount ` Total Amount ` Debit Note A 'Debit Note' is a document sent to the person to whom goods are returned or from whom an allowance is claimed. This document informs the supplier of the goods that his account has been debited to the extent of the value of goods returned or allowance claimed. The specimen of debit note is given below: Specimen of Debit Note SHARMA BOOK DEPOT Debit Note S. No....... Mai Hiran Gate Jalandhar Dated 10.1.2010 To M/S Chopra & Sons Rohini New Delhi Goods Returned Rs. 10 copies of 'Commerce' 1500 15 copies of 'Commercial Law' 3000 4500 Goods returned as per For Sharma Book R/R No.....; .... Dated..........Purchased Partner Against Invoice No. 1.8.4 Sales Book Credit sales are recorded in this book. Cash sales are recorded in cash book. This book is also called Sales Journal, Sales Register and Sales Day Book. For each sale, the selling firm will send a document to the buyer giving details of the goods sold and the price of the goods. This document is known as an invoice and it is known as a sales invoice to the seller. The invoice is prepared in duplicate/triplicate, the original copy is sent to the customers and the other copies are retained by the firm for future references and recordings. The specimen of the sales book is given below:

Introduction to Accounting 25 Notes Sales Book Date Particulars Outward Invoice No. L.F.Details Amount 1.8.5 Sale Return Book Sometimes the customers returns the goods if they don't meet the quality standards promised. In such cases, a credit note is issued to the customer. The format of sales returns book is as follows: Sales Return Book Date Particulars Credit Note No. L.F. Detail ` Amount ` Credit Note When goods are received back from a customer, the credit note is prepared. A credit note is a document or statement which is sent by the seller to the purchaser for the goods returned by the latter to the former. It is called a credit note because the party's account is credited with the amount written in this note for the goods returned by the party. Credit note gives the information about the description and details of goods returned, name and place of the customer returning goods as well as the net value of goods so returned. The specimen of a credit note is given below: Chopra & Sons Rohini New Delhi S. No...... Dated 13.1.2010 To Sharma Book Depot Mai Hiran Gate Jalandhar Goods Returned Rs. 10 copies of 'Commerce' 1,500 15 copies of 'Commercial Law' 3,000 Total 4,500 E&OE For Sharma Book .... Partner 1.8.6 Bills Receivable Book Bills are issued by creditors to debtors. The debtors accept them and thereafter return them to the creditors. Bills accepted by debtors are called as 'Bills Receivables' in the books of creditors, and 'Bills Payable' in the books of debtors. The bills receivable book is ruled according to the requirements of a particular account. This book keeps records about the bills receivable received with a certain period and gives the information about the name of the acceptor, date of bill, received from, term, date of maturity amount and remarks, if any.

26 Financial Accounting Notes Format of Bills Receivable Book Bills Receivable Book Date From whom received Term Due date L.F. Amount 1.8.7 Bills Payable Book Bills payable book is used to record bills accepted by the firm. When a bill drawn by the creditor is accepted, particulars of the same are recorded in this book. It is maintained like a bills receivable book. It is meant to record all the details, related to the bills accepted by a person or a party, which are retained for use in the future, in case of need. Bills payable book is made for giving the acceptance to creditors that we will pay the amount of bill at the time of its maturity. In the ledger, the account of each person whose bill has been accepted is debited with the amount of the bill. The monthly total of the bills accepted is credited to the bills payable account ledger. Thus, personal accounts of creditors will be debited with the amount of bills payable by writing “To Bills Payable Account”. Format of Bills Payable Book Bills Payable Book Date To whom given Term Due date L.F. Amount 1.8.8 Journal Proper All transactions which are not recorded in any of the subsidiary books will be recorded in the book whose name is journal proper. It is also known as ‘General Journal’. The following transactions are the main examples of the entries recorded in the journal proper: 1. Opening Entries 2. Closing Entries 3. Transfer Entries 4. Rectification Entries 5. Entries related to Dishonour of Bills 6. Adjustment Entries 7. Credit Purchases or Sale of Fixed Assets 8. Entry of Depreciation 9. Interest on Capital Entries of which there is no Special Journal When a trader cannot record the entries in the above mentioned sub-journals, the same are entered in the journal proper. The common transactions, which cannot be recorded in any of the books of original entry, are: ? Distribution of goods as free sample ? Distribution of goods as charity
Introduction to Accounting 27 Notes ? Goods destroyed by fire ? Goods stolen away by employees ? Exchange of one asset for another asset, etc. 1.9 Summary Accounting is the language of the business which is used to communicate financial transactions and their results. It is a comprehensive system to collect, analyzes, and communicates financial information. Financial transactions of a business are recorded according to certain accounting principles and standards and as prescribed by an accountant depending upon the size, nature, volume, and other constraints of a particular organization. American Institute of Certified Public Accountants (AICPA) states the following meaning of Accounting Principle: It is desirable that the accountant conceives of his work as a complex problem to be solved and of his statements as creative works of art, and that he reserves to himself the freedom to do his work with the canons of art constantly in mind and as his skill, knowledge and experience best enable him. Conventions refer to the general agreement on the usage and practices in social or economic life. These refer to customs or traditions which are used since long by the professionals. Bookkeeping is the process of recording financial transactions and keeping financial records. It is mainly associated with the recording of financial data which are measurable in terms of money. Journal is the book of original entry in which financial transactions are recorded date-wise and serial-wise. It is a book for recording daily business transactions. The process of recording transactions in a journal is called journalising. The form or manner in which transactions are recorded in the journal is called ‘journal entry’. The book in which a trader’s transactions are recorded in a classified, permanent record is called the ledger. When daily transactions are in large number then the process of recording the transactions is very time consuming which results in an increase of overhead costs. So, it is economical as well as easier to keep records for a particular class or group of transactions within a separate book which are known as subsidiary books. In an organization there may be many minor transactions for which payments have to be done. Therefore, a cashier is appointed and he keeps the cash and makes regular payments out of it. To make it simple and secure, mostly a constant balance is kept with the cashier. The bills receivable book is ruled according to the requirements of a particular account. This book keeps records about the bills receivable received with a certain period and gives the information about the name of the acceptor, date of bill, received from, term, date of maturity amount and remarks, if any. 1.10 Check Your Progress Multiple Choice Questions 1. Which of the following principle states that all expenses incurred while earning revenues should be identified with the revenues when they are earned, and reported for the same time period is the: (a) Cost principle (b) Revenue principle (c) Expense principle (d) Matching principle 2. Which of the following is the book of original entry? (a) Subsidiary Books (b) Journal (c) Ledger (d) Journal Proper

28 Financial Accounting Notes 3. According to the going concern concept: (a) The entity will be profitable in the coming year (b) The entity will not be involved in a merger within a year (c) The entity will continue to operate in the foreseeable future (d) Top management of the entity will not change in the coming year. 4. The principle of consistency states that: (a) The accounting methods used by an entity never change. (b) The same accounting methods are used by all firms in an industry. (c) The effect of any change in an accounting method will be disclosed in the financial statements or notes thereto. (d) There are no alternative methods of accounting for the same transaction. 5. Which of the following is true about purchases book? (a) Purchases made but not paid for at time of purchase (b) Purchases of assets to be used within the firm (c) Purchases made for immediate cash settlement (d) Returns of goods purchased on credit 6. The purpose of returns inwards book is to show: (a) Goods purchased on credit that are returned to the original supplier (b) Stock returned by customers (c) Goods purchased on credit (d) Fixed assets purchased that are unsuitable for business use 7. Cash book is used to record. (a) All Cash receipts only (b) All Cash payments only (c) All Cash & credits sales (d) All receipts & payments of Cash 8. The source document for making entries in the sales returns book is: (a) Credit note (b) Purchase invoice (c) Debit note (d) Cheque counterfoil 9 Purpose of Sales Book is- (a) To record all sales made by the firm (b) To record payment due to creditors (c) To record all credit sales made by the firm (d) To record credit sales of goods made by the firm 10. A Ledger Account is prepared from:- (a) Events (b) Transactions (c) Journal (d) Invoices Introduction to Accounting 29 Notes 1.11 Questions and Exercises 1. What do you understand by bookkeeping? What are the different systems of bookkeeping? 2. Define accounting. What are the objectives of accounting? 3. What do you understand by journal? Discuss the characteristics of journal. 4. Explain the meaning of ledger. Give a specimen of the ledger. 5. What do you understand by subsidiary books? Explain the purchases book and purchases return book. 6. Discuss the concept of petty cash book along with the advantages of maintaining petty cash book. 7. Explain bills receivables and bills payable book. Also give the specimen of both. 8. Pass the necessary journal entries in the book of Mr. Kapil: 2011 June 1 Business started with ` 1,00,000 and cash deposited in bank ` 60,000 June 2 Machinery purchased from Karan for cash of ` 20,000 June 3 Furniture purchased from Mr. A on credit of ` 10,000 June 6 Goods sold to Rohit at ` 9,000 June 9 Goods returned by Rohit of ` 2,500 June 13 Sold goods for cash of ` 15,000 June 14 Bought goods for cash of ` 12,000 June 16 Cash received from Rohit of ` 4,000 June 20 Cash paid to Karim of ` 7,000. June 24 Cash withdrawn from bank of ` 18,000 June 27 Paid for advertisement at ` 4,200 June 28 Paid rent of ` 1,200 June 30 Office stationery purchased for ` 2,000 June 30 Cash withdrawn from bank for his personal use ` 3,000 9. Give journal entries of the following transactions and post them into ledger: 2013 ` Sept 1 Amitabh started business with cash 15,000 Sept 2 Paid into bank 8,000 Sept 4 Purchased furniture for office use 1,300 Sept 7 Purchased goods for cash 600 Sept 11 Withdrew from bank for office use 1,000 Sept 13 Goods sold to Varun 700 Sept 16 Purchased goods from Tarun 410 Sept 20 Paid trade expenses 100 Sept 22 Received cash from Varun 680 Allowed him discount 20

30 Financial Accounting Notes Sept 24 Paid rent 200 Sept 28 Paid Tarun in full settlement 400 Sept 29 Interest on capital 100 Sept 30 Paid wages 150 10. Prepare a triple column cash book from the following transactions: 2015 ` March 1 Opening Balance: Cash in hand 52 Cash at bank 9,850 March 2 Paid Cash into bank 5,200 March 4 Cash sales 6,000 March 5 Purchased stationery for cash 150 March 7 Paid Sonu by cheque 480 Discount received 20 March 11 Withdrew cash for personal use 500 March 14 Bought goods for ` 1,400 and payment made by cheque March 16 Received from Chawla & Co. for ` 1,860 in full settlement of account for ` 1,990. March 19 Paid wages in cash 750 March 24 Paid salaries by cheque 1,500 March 28 Paid into bank: Cash 100, Cheque 360 March 30 Withdrew from bank in cash for office 250 March 30 Sold goods for cash 900 March 31 Paid Rent by cheque 150 1.12 Key Terms ? Financial Accounting : The art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which in part at least of a financial character and interpreting the results thereof. ? Business Entity Concept: According to this concept, the law has given separate entity to the business. The business and the owner of the business are two different entities. ? Cost Concept: According to this concept the assets are recorded in the books of accounting on the basis of cost not on the net realizable value or market value of the assets. ? Convention of Conservatism: According to this convention a firm should “Anticipate no profit, and provide for all possible losses”. It is a policy of playing safe. ? Debit Note: A ‘Debit Note’ is a document sent to the person to whom goods are returned or from whom an allowance is claimed.

Introduction to Accounting 31 Notes ? Journal Proper: All transactions which are not recorded in any of the subsidiary books will be recorded in the book whose name is journal proper. It is also known as ‘General Journal’. Check Your Progress: Answers 1. (d) Matching principle 2. (b) Journal 3. (c) The entity will continue to operate in the foreseeable future 4. (c) The effect of any change in an accounting method will be disclosed in the financial statements or notes thereto. 5. (a) Purchases made but not paid for at time of purchase 6. (b) Stock that customers have returned 7. (d) All receipts & payments of Cash 8. (a) Credit note 9. (d) To record credit sales of goods made by the firm 10. (c) Journal 1.13 Further Readings ? Maheshwari S.N.,

Studies in Advanced Accounting, Sultan Chand and Sons, New Delhi. ? Gupta Shashi K., Aggarwal Nisha and Gupta Neeti, Financial Accounting, Kalyani Publishers, Ludhiana. ? Tulsian P.C., Financial Accounting, Pearson Education, New Delhi. ? W. Albrecht, Stice Earl, Stice James, Financial Accounting, Cengage Learning.

32 Financial Accounting Notes Unit 2: Bills of Exchange Structure 2.1 Introduction 2.2 Meaning and Characteristics of Bills of Exchange 2.2.1 Characteristics of Bills of Exchange 2.3 Parties to Bills of Exchange 2.4 Discounting and Endorsement of Bill 2.4.1 Endorsement of Bill 2.4.2 Accounting Treatment 2.5 Dishonour of a Bill 2.6 Noting Charges 2.7 Protesting the Bill 2.8 Renewal of the Bill 2.9 Summary 2.10 Check Your Progress 2.11 Questions and Exercises 2.12 Key Terms 2.13 Further Readings Objectives After studying this unit, you should be able to: ? Discuss the meaning and characteristics of bills of exchange ? Explain the parties to bills of exchange ? Discuss noting, protest, endorsement, renewal and dishonor of bills ? Solve problems on trade bills 2.1 Introduction Goods can be sold or bought for cash or on credit. Payment is received immediately if in case goods are sold or bought for cash whereas payment is deferred to a future dates if goods are sold/bought on credit. In such a situation, normally the firm relies on the party to make payment on the due date but to avoid any possibility of delay or default, the buyer assures the seller that the payment shall be made according to the agreed conditions through a instrument which is called the bills of exchange. In this unit, we shall be discussing about the meaning, characteristics of bills of exchange and parties to bills of exchange. We shall also discuss the noting, protest, endorsement, renewal and dishonor of bills. 2.2 Meaning and Characteristics of Bills of Exchange According to the Negotiable Instruments Act 1881, a 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, or to the order of a certain person or to the bearer of the instrument.

Bills of Exchange 33 Notes A bill of exchange is generally drawn by the creditor upon his debtor. It has to be accepted by the drawee (debtor) or someone on his behalf. It is just a draft till its acceptance is made. For example, Ajay sold goods to Ram on credit for Rs. 1,000 for three months. To ensure payment on due date Ajay draws a bill of exchange upon Ram for Rs. 1,000 payable after three months. Before it is accepted by Ram it will be called a draft. It will become a bill of exchange only when Ram writes the word “accepted” on it and sign the instrument to communicate his acceptance. 2.2.1 Characteristics of Bills of Exchange The following features of a bill of exchange emerge out of this definition. ? A bill of exchange must be in writing. ? It is an order to make payment. ? The order to make payment is unconditional. ? It must be signed by the drawer of the bill of exchange. ? The payment to be made must be certain. ? The date on which payment is made must also be certain. ? The bill of exchange must be payable to a certain person. ? The amount mentioned in the bill of exchange is payable either on demand or on the expiry of a fixed period of time. ? It must be stamped as per the requirement of law. 2.3 Parties to Bills of Exchange There are three parties to a bill of exchange: 1. Drawer is the maker of the bill of exchange. A seller/creditor who is entitled to receive money from the debtor can draw a bill of exchange upon the buyer/debtor. The drawer after writing the bill of exchange has to sign it as maker of the bill of exchange. 2. Drawee is the person upon whom the bill of exchange is drawn. Drawee is the purchaser or debtor of the goods upon whom the bill of exchange is drawn. 3. Payee is the person who receives the payment from the drawee. The drawer of the bill himself will be the payee if he keeps the bill with him till the date of its payment. The payee may change in the following situations: (i) When the bill is discounted by the drawer from his bank- payee is the bank. (ii) When the bill is endorsed by the drawer to his creditors : payee is the endorsee. Normally, the drawer and the payee is the same person. Similarly, the drawee and the acceptor is normally the person. For example, Manoj sold goods worth Rs.10,000 to Jayram and drew a bill of exchange upon him for the same amount payable after three months. Here, Manoj is the drawer of the bill and Jayram is the drawee. If the bill is retained by Manoj till due date and the amount of Rs. 10,000 is received by him on the due date then Manoj will be the payee. If Manoj gives away this bill to her creditor Ruchi, then Ruchi will be the payee. If Manoj gets this bill discounted from the bank then the bankers will become the payee. In the above mentioned bill of exchange, Manoj is the drawer and Jayram is the drawee. Since Jayram has accepted the bill, he is the acceptor. Suppose in place of Jayram the bill is accepted by Amar then Amar will become the acceptor.

34 Financial Accounting Notes Manoj New Delhi Rs.10,000 April 01, 2014 Three months after date pay to me or my order, the sum of Rupees Ten Thousand only, for value received. Stamp Accepted (signed) (Signed) Jayram Manoj 1.4.2014 196, Karol Bagh 73-B, Mahipalpur New Delhi New Delhi 110 037 To Jayram 73-B, Mahipalpur New Delhi 110 037 2.4 Discounting and Endorsement of Bill If the holder of the bill is in need of funds, he can line up with the bank for encashment of the bill before the due date. The bank shall make the payment of the bill after deducting some charges. This process of encashing the bill with the bank is called discounting the bill. The bank in return gets the amount from the drawee on the due date. Illustration 1: Rajesh sold goods to Shivam for Rs. 30,000 at credit on 1st April, 2011. Rajesh discounted the bill with his bank on 4th May 2011 @ 9% per annum find out : (i) The amount of discounting charges. (ii) The amount that Rajesh will receive from his bank at the time of discounting the bill. Solution: (i) Discounting Charges= Amount of Bill Discounting *Rate ÷100×Unexpired Period = 9 2 3000× × =Rs.450 100 12 (ii) Rajesh will receive from his bank Rs. 29,500 (i.e., Rs. 30,000 - 450) at the time of discounting the bill. 2.4.1 Endorsement of Bill The holder of the bill may transfer the bill to other person in discharge of his debt. The process of transferring the bill is known as endorsement of the bill. The person who transfers the bill is known as 'Endorser' and the person to whom the bill is transferred called 'Endorsee'. The bill can be endorsed by the endoser by putting his/her signature at the back of the bill along with the name to whom it is being transferred. Thus, endorsement is executed by putting the signature at the back of the bill. 2.4.2 Accounting Treatment Accounting treatment in the books of Drawer A bill receivable can be treated in the following four ways by its receiver. 1. He can retain it till the date of maturity, and (a) get it collected on date of maturity directly, or

Bills of Exchange 35 Notes (b) get it collected through the banker. 2. He can get the bill discounted from the bank. 3. He can endorse the bill in favour of his Creditor. The accounting treatment in the books of receiver under all the four alternatives is given below under the assumption that the bill is duly honoured on maturity by the acceptor. (1) When the bill of exchange is retained by the receiver with him till date of its maturity: On receiving the bill

Bills Receivable A/c Dr. To Debtors A/c On maturity of the bill Cash/Bank A/c Dr. To Bills Receivable A/c

However, when the bill of exchange is retained by the receiver with him and sent to bank for collection a few days before maturity, the following two entries are recorded: On sending the bill for collection Bills Sent for Collection A/c Dr. To Bills Receivable A/c On receiving the advice from the bank that the bill has been collected Bank A/c Dr. To Bills Sent for Collection A/c (2) When the receiver gets the bill discounted from the bank: On receiving the bill

Bills Receivable A/c Dr. To Debtors A/c On discounting the bill Bank A/c Dr. Discount A/c Dr. To Bills Receivable A/c

On Maturity No entry is recorded because the bill becomes the property of the bank, therefore, the bank collects the amount of the bill from the acceptor and no journal entry is recorded in the books of the drawer. (3) When the bill is endorsed by the receiver in favour of his creditor: On receiving the bill Bills Receivable A/c Dr. To Debtor's A/c

36 Financial Accounting Notes On endorsing the bill Creditor's A/c Dr. To Bills Receivable A/c On Maturity No entry is recorded because the bill has been transferred in favour of the creditor, therefore the creditor becomes its owner and will receive the payment on maturity. Hence, no entry is recorded

in the books of drawer or endorser. Accounting Treatment in the books of Acceptor The following journal entries are recorded in the books of the

acceptor under all the four alternatives. It makes no difference whether the bill is retained discounted, endorsed or pledged. On accepting the bill Creditor's

A/c Dr. To Bills Payable A/c On Maturity of the bill Bills Payable A/c Dr. To Bank A/c

Illustration 2: Amarjeet sold goods for Rs.20,000 to Mr. Singh on credit on Jan 01, 2015. Amarjeet drew a bill of exchange upon Mr. Singh for the same amount for three months. Mr. Singh accepted the bill and returned it to Amarjeet. Mr. Singh met his acceptance on maturity. Record the necessary journal entries under the following circumstances: (i) Amarjeet retained the bill till the date of its maturity and collected directly (ii) Amarjeet discounted the bill @ 12% p.a. from his bank (iii) Amarjeet endorsed the bill to his creditor Ankita (iv) Amarjeet retained the bill and on March, 31 2015. Amarjeet sent the bill for collection to its bank. On April 05, 2015 bank advice was received. Solution Books of Amarjeet Journal (i) When the bill was retained till its maturity. Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Jan 01 Mr. Singh's A/c Dr. 20,000 To Sales A/c 20,000 (Sold goods to Mr. Singh's on credit) Jan 01

Bills Receivable A/c Dr. 20,000 To Mr. Singh's A/c 20,000 (Received Mr. Singh's acceptance payable

Bills of Exchange 37 Notes after three months) Apr.05 Bank A/c Dr. 20,000 To Bills Receivable A/c 20,000 (

Mr. Singh met his acceptance on maturity) (ii) When the bill was discounted from the book. Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Jan 01 Mr. Singh's A/c Dr. 20,000 To Sales A/c 20,000 (Sold goods to Mr. Singh's) Jan 01

Bills Receivable A/c Dr. 20,000 To Mr. Singh's A/c 20,000 (Received Mr. Singh's acceptance three months) Jan 01 Bank A/c Dr. 19,400 Discount A/c Dr. 600 To Bills Receivable A/c 20,000 (

Mr. Singh's acceptance discounted with the bank) (iii) When Amarjeet endorsed the bill in favour of his creditor Ankita. Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Jan. 01 Mr. Singh's A/c Dr. 20,000 To Sales A/c 20,000 (Sold goods to Mr. Singh's on credit) Jan. 01 Bills Receivable A/c Dr. 20,000 To Mr. Singh's A/c 20,000 (Received Mr. Singh's acceptance for three months) Jan. 01 Ankit's A/c Dr. 20,000 To Bills Receivable A/c 20,000 (Mr. Singh acceptance endorsed in favour of Ankita) (iv) When the bill was sent for collection by Amarjeet to the bank.

38 Financial Accounting Notes Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Jan. 01 Mr. Singh's A/c Dr. 20,000 To Sales A/c 20,000 (Sold goods to Mr. Singh's on credit) Jan. 01 Bills Receivable A/c Dr. 20,000 To Mr. Singh's A/c 20,000 (Received Mr. Singh's acceptance payable after three months) Mar. 31 Bills Sent for Collection A/c Dr. 20,000 To Bills Receivable A/c 20,000 (Bills sent for collection) Apr. 05 Bank A/c Dr. 20,000 To Bills sent for collection A/c 20,000 (Bills sent for collection collected by the bank) The following journal entries will be made in the books of Mr. Singh under all the four circumstances: In the books of Mr. Singh Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Jan. 01 Purchases A/c Dr. 20,000 To Amarjeet's A/c 20,000 (Purchases goods from Amarjeet on credit) Jan. 01 Amarjeet's A/c Dr. 20,000 To Bill's Payable A/c 20,000 (Accepted bill drawn by Amarjeet payable after three months) Apr. 04 Bills payable A/c Dr. 20,000 To Bank A/c 20,000 (Met acceptance maturity) 2.5 Dishonour of a Bill A bill is said to have been dishonoured when the drawee fails to make the payment on the date of maturity. In this situation, liability of the acceptor is restored. Therefore, the

Bills of Exchange 39 Notes entries made on the receipt of the bill should be reversed. For example, Anuj received bill of exchange duly accepted by Manuj, which was dishonoured. The entries of dishonour will be as follows in the books of Anuj (receiver): When the bill was kept by Anju with her till maturity Manuj's A/c Dr. To Bill Receivables A/c When the bill had been endorsed by Anuj in favour of Sandhya Manuj's A/c Dr. To Sandhaya's A/c When the bill was discounted by Anuj with his bank Manuj's A/c Dr. To Bank A/c When the bill was sent for collection by Anuj Manuj's A/c Dr. To Bill Sent for Collection A/c Illustration 3: On Jan 01, 2015 Shikha sold goods to Vinay for Rs. 10,000 and drew upon him a bill of exchange for 2 months. Vinay accepted the bill and returned it to Shikha. On the date of maturity the bill was dishonoured by Vinay. Record the necessary entries in all the cases listed below in the books of Shikha and Vinay: (i) When the bill kept by Shikha till its maturity; (ii) When the bill is discounted by Shikha for Rs. 200; (iii) When the bill is endorsed to Lalit by Shikha. Solution (i) When the bill was kept by Shikha till its maturity. Books of Shikha Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Jan.01 Vinay'

s A/c Dr. 10,000 To Sales A/c 10,000 (Sold goods to Vinay) Jan. 01 Bills Receivable A/c Dr. 10,000 To Vinay's A/c 10,000 (Received Vinay's acceptance) Mar. 04 Vinay's A/c Dr. 10,000 To Bills Receivable A/c 10,000 (

Vinay dishonoured his acceptance)

40 Financial Accounting Notes (ii) When the bill was discounted by Shikha Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Jan.01 Vinay's

A/c Dr. 10,000 To Sales A/c 10,000 (Sold goods to Vinay) Jan. 01

Bills Receivable A/c Dr. 10,000 To Vinay's A/c 10,000 (Received Vinay's acceptance) Jan. 01 Bank A/c Dr. 9,800 Discount A/c Dr. 200 To Bills Receivable A/c 10,000 (

Vinay's Bill dishonoured his acceptance) Mar.04 Vinay's A/c Dr. 10,000 To Bank A/c 10,000 (

Discounted bill dishonoured by Vinay) (iii) When the bill was endorsed by Shikha to Lal Chand Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Jan.01 Vinay'

s A/c Dr. 10,000 To Sales A/c 10,000 (Sold goods to Vinay) Jan. 01 Bills Receivable A/c Dr. 10,000 To Vinay's A/c 10,000 (Received Vinay's acceptance) Jan. 01 Lalit A/c Dr. 10,000 To Bills Receivable A/c 10,000 (

Vinay's acceptance endorsed in favour of Lalit) Mar.04 Vinay's A/c Dr. 10,000 To Lalit A/c 10,000 (Endorsed bill dishonoured by Vinay)

Bills of Exchange 41 Notes Whereas, in the book of Vinay, the following entries will be recorded Books of Vinay Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Jan.01 Purchases

A/c Dr. 10,000 To Shikha's A/c 10,000 (Purchased good from Shikha) Jan. 01 Shikha's A/c Dr. 10,000 To Bills Payable A/c 10,000 (Accepted Shikha's draft) Mar. 04 Bills Payable A/c Dr. 10,000 To Shikha's A/c 10,000 (

Acceptance in favour of Shikha dishonoured) 2.6 Noting Charges A bill of exchange should be duly presented for payment on the date of its maturity. The drawee is released of his liability if the bill is not duly presented. Proper presentation of the bill means that it should be presented on the date of maturity to the acceptor during business working hours. To establish beyond doubt that the bill was dishonoured, despite its due presentation, it may preferably to be got noted by Notary Public. Noting authenticates the fact of dishonour. For providing this service, a fees is charged by the Notary Public which is called Noting Charges. Ultimately all noting charges are borne by the drawee of the bill. The following facts are generally noted by the Notary: ? Date, fact and reasons of dishonour; ? If the bill is not expressly dishonoured, the reasons why he treats it as dishonoured and; ? The amount of noting charges. 2.7 Protesting the Bill Protesting a bill of exchange is a public act, which is drafted by a notary according to art. 85 of the bill of exchange Law. Reasons for protesting a bill of exchange may include non-receipt of the bill of exchange, or refusal to pay it. The protest contains: ? a surname of a person who protests, and of a person against whom the protest shall be affected. ? a statement that the person against whom the protest is to be made did not obey the notice levelled to this person, and a statement given by this person, or a statement that this person was not present at home, or that the premises of this person's enterprise or place of residence could not be found; ? designation of place and date when the notice was made, or was attempted to be made without results; ? designation of how many and what sort of bills of exchange were presented;

42 Financial Accounting Notes ? signature of the body drafting a protest, official stamp and protest number. A protest is drafted on the back side of a bill of exchange, or on a separate sheet attached to the bill of exchange. If there are no statements on the back side, writing of a protest shall begin from the edge, otherwise it shall start right after the last statement. If a protest is to be written in full, or partially on the separate additional sheet, the sheet shall be attached to the bill of exchange in such a way that there is no place left on the opposite side of the bill of exchange; the attachment of the bill of exchange to the additional sheet shall be stamped over with an official stamp, or written over the content of the protest act. 2.8 Renewal of the Bill Sometimes, the acceptor of the bill predicts that it may be difficult to meet the obligation of the bill on maturity and approaches and request the drawer for the extension of time for payment. If the drawer accepts this then the old bill is cancelled and the fresh bill with fresh terms of payment is drawn and duly accepted and delivered. This is called renewal of the bill. Noting of the bill is not required because the cancellation of bill is mutually agreed upon. The drawee may have to pay interest to the drawer for the extended period of credit. The interest is paid in cash or may be included in the amount of the new bill. Sometimes, a part of the amount due may be paid and the new bill may be drawn only for the balance. For example, a bill of Rs. 10,000 is cancelled on a cash payment of Rs. 3,000 and acceptance of a new bill for the balance of Rs. 7,000 plus interest as agreed between the parties. The journal entries in the books of the drawer and the drawee will be the same as that of dishonour of bill. As for the interest is valued, if it is not paid in cash, the drawer debits the drawee's account and credits the interest account, and the drawee debits the interest and credits the drawer's account in his books. The journal entries recorded in case of renewal for the cancellation of the old bill, for interest and for the acceptance of the new bill in the books of the drawer and drawee are given below: Transaction Books of Drawer Books of Drawee Cancellation of old bill Drawee'
s

35%	MATCHING BLOCK 5/50	W

A/c Dr. To Bills Receivable A/c Bills Payable A/c Dr. To Drawer's A/c Interest Drawee's A/c Dr. To Interest A/c

Interest A/c Dr. To Drawer's A/c New bill Bill Receivable A/c Dr. To Drawee's A/c Drawer's A/c Dr. To Bills Payable A/c
For
example on February 01, 2015 Ramesh sold goods to Mahesh for Rs.18,000; Rs. 3,000 were paid by Mahesh immediately and for the balance he accepted three months bill drawn upon him by Ramesh. On the date of maturity of the bill Mahesh requested Ramesh to cancel the old bill and a new bill upon him for a period of 2 months. He further agreed to pay interest in cash to Ramesh @ 12% p.a. Ramesh agreed to Mahesh's request and cancelled the old bill and drew a new bill. The new bill was met on maturity by Mahesh. In this case, the following entries will be recorded in the books of Ramesh and Mahesh.
Bills of Exchange 43 Notes Books of Ramesh Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Feb. 01 Mahesh'
s A/c Dr. 18,000 To Sales A/c 18,000 (Sold goods to Mahesh) Feb. 01 Cash A/c Dr. 3,000 Bills Receivable A/c Dr. 15,000 To Mahesh's A/c 18,000 (
Received Rs. 3,000 in cash from Ramesh and an acceptance for the balance) May 01 Mahesh's Account Dr. 15,300 To Bills Receivable A/c 15,000 To Interest A/c 300 (Cancelled old bill on renewal Rs. 300 as interest) May 04 Bill's Receivable A/c Dr. 15,000 Cash A/c Dr. 300 To Mahesh's A/c 15,300 (Received new acceptance from Mahesh) Jul. 07 Bank A/c Dr. 15,000 To Bills Receivable A/c 15,000 (

Mahesh met his new acceptance) Book of Mahesh Journal Date Particulars L.F. Debit Credit Amount Amount ` ` 2015 Feb. 01 Purchases
A/c Dr. 18,000 To Ramesh A/c 18,000 (Purchased goods from Ramesh) Feb.01 Ramesh's
A/c Dr. 18,000 To Cash's A/c 3,000 Bills Payable A/c 15,000 (Received cash
from Ramesh and his acceptance)
44 Financial Accounting Notes May 04 Bill Payable A/c Dr. 15,000 Interest A/c Dr. 300 To Ramesh A/c 15,300 (Old bill cancelled on renewal, Rs. 300 charged as interest) May 04 Ramesh's A/c Dr. 15,300 To Bills Payable A/c 15,000 To Cash A/c 300 (Accepted new bill and paid cash for interest) Jul. 07 Bill Payable A/c Dr. 15,000 To Bank A/c 15,000 (Met acceptance of the new bill on maturity) 2.9 Summary Goods can be sold or bought for cash or on credit. Payment is received immediately if in case goods are sold or bought for cash whereas payment is deferred to a future dates if goods are sold/bought on credit. In such a situation, normally the firm relies on the party to make payment on the due date but to avoid any possibility of delay or default, the buyer assures the seller that the payment shall be made according to the agreed conditions through an instrument which is called the bills of exchange. According to the Negotiable Instruments Act 1881, a 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, or to the order of a certain person or to the bearer of the instrument. If the holder of the bill is in need of funds, he can line up with the bank for encashment of the bill before the due date. The bank shall make the payment of the bill after deducting some charges. This process of encashing the bill with the bank is called discounting the bill. The holder of the bill may transfer the bill to other person in discharge of his debt. The process of transferring the bill is known as endorsement of the bill. A bill is said to have been dishonoured when the drawee fails to make the payment on the date of maturity. In this situation, liability of the acceptor is restored. Protesting a bill of exchange is a public act, which is drafted by a notary according to art. 85 of the bill of exchange Law. Sometimes, the acceptor of the bill foresees that it may be difficult to meet the obligation of the bill on maturity and may, therefore, approach the drawer with the request for extension of time for payment. If it is so, the old bill is cancelled and the fresh bill with new terms of payment is drawn and duly accepted and delivered. This is called renewal of the bill. 2.10 Check Your Progress Multiple Choice Questions 1. X draws a bill on Y for Rs. 3,000. X endorsed this bill to Z. Y will pay the bill amount to : (a) X (b) Z (c)To himself (d) None of these 2. Fees paid in cash to Notary Public are charged by: (a) Drawer Bills of Exchange 45 Notes (b) Drawee (c) Holder of the bill (d) None of these 3. When the bill is to be produced to Notary Public: (a) At the time of drawing the bill (b) At the time of acceptance of the bill (c) At the time of dishonour of the bill (d) None of these 4. Under which circumstance drawer and payee will be the same person: (a) When drawer discounted the bill with banker (b) When drawer endorse the bill to the third party (c) When drawer held the bill till maturity (d) None of these 5. The holder of the bill may transfer the bill to other person in discharge of his debt which is known as ....of the bill. (a) Endorsement (b) Dishonour (c) Renewal (d) Discounting 6. The process of encashing the bill with the bank is called ....the bill. (a) Endorsing (b) Renewing (c) Noting (d) Discounting 7. Which of the following is the person upon whom the bill of exchange is drawn? (a) Drawer (b) Drawee (c) Payee (d) Payer 8. Which of the following is not the party to bills of exchange? (a) Drawer (b) Drawee (c) Payee (d) Payer 9. All of the following are the characteristics of Bills of Exchange Except: (a) It is in written (b) It is signed by the drawer (c) It is signed by the drawee (d) Date should be mentioned 10. A bill is said to have been ....when the drawee fails to make the payment on the date of maturity. (a) Dishonoured (b) Discounted (c) Renewal

46 Financial Accounting Notes (d) Protesting 2.11 Questions and Exercises 4. Explain the meaning and characteristics of Bills of Exchange. 5. Discuss the parties to Bills of Exchange. 6. Generally the drawer of the bill himself will be the payee if he keeps the bill with him till the date of its payment. Discuss the situation when the payee may change. 7. Discuss the concept of bill discounting along with the example. 8. Define the term bill endorsement. Who are endorser and endorsee? 9. Explain renewal of bill. In which situation the bill is renewed by the drawer? 10. What do you understand by bill dishonour? Explain. 11. Write short notes on noting charges and protesting the bill. 12. Rajesh draws a bill in favour of Amar for Rs. 10,000 on Jan 1, 2015 for three months. Amar keeps the bill of exchange with him till date of its maturity. Pass the necessary journal entries. 13. Amit sold goods for Rs.20,000 to Sumit on credit on Jan 01, 2015. Amit drew a bill of exchange upon Sumit for the same amount for three months. Sumit accepted the bill and returned it to Amit. Sumit met his acceptance on maturity. Record the necessary journal entries when Amit retained the bill and on March, 31 2015 Amit sent the bill for collection to its bank. On April 05, 2015 bank advice was received. 2.12 Key Terms ? Bill of Exchange: According to the Negotiable Instruments Act 1881, a 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, or to the order of a certain person or to the bearer of the instrument. ? Drawer: Drawer is the maker of the bill of exchange. ? Drawee: Drawee is the person upon whom the bill of exchange is drawn. ? Payee: Payee is the person who receives the payment from the drawee. ? Endorsement: The process of transferring the bill is known as endorsement of the bill. ? Bill Dishonour: A bill is said to have been dishonoured when the drawee fails to make the payment on the date of maturity. ? Noting Charges: A fees charged by the Notary Public for authenticating the fact of dishonor is called Noting Charges. ? Protest: A protest is drafted on the back side of a bill of exchange, or on a separate sheet attached to the bill of exchange. ? Renewal of Bill: When the acceptor of the bill approaches the drawer with the request for extension of time for payment and the old bill is cancelled and the fresh bill with new terms of payment is drawn and duly accepted and delivered. This is called renewal of the bill. Check Your Progress: Answers 1. (b) Z 2. (b) Drawee 3. (c) At the time of dishonour of the bill 4. (c) When drawer held the bill till maturity 5. (a) Endorsement 6. (d) Discounting

Bills of Exchange 47 Notes 7. (b) Drawee 8. (d) Payer 9. (c) It is signed by the drawee 10. (a) Dishonoured 2.13 Further Readings ? Maheshwari S.N.,

Studies in Advanced Accounting, Sultan Chand and Sons, New Delhi. ? Gupta Shashi K., Aggarwal Nisha and Gupta Neeti, Financial Accounting,

Kalyani Publishers, Ludhiana. ? Tulsian P.C., Financial Accounting, Pearson Education, New Delhi. ? W. Albrecht, Stice Earl, Stice James, Financial Accounting, Cengage Learning.

48 Financial Accounting Notes Unit 3: Final Accounts Structure 3.1 Introduction 3.2 Meaning of Final Accounts 3.2.1 Need for Preparing Final Accounts 3.3 Trial Balance 3.3.1 Format of Trial Balance 3.3.2 Objectives of Preparing Trial Balance 3.3.3 Methods of Preparing Trial Balance 3.4 Trading Account 3.5 Profit and Loss Account 3.6 Balance Sheet 3.7 Summary 3.8 Check Your Progress 3.9 Questions and Exercises 3.10 Key Terms 3.11 Further Readings Objectives After studying this unit, you should be able to: ? Discuss the meaning and need for preparing final accounts ? Prepare Trial balance ? Prepare Trading a/c , Profit and loss a/c and Balance sheet 3.1 Introduction Every business entrepreneur is interested to know the ultimate results of his business enterprise, i.e., whether he/she has earned profits or suffered losses in the accounting period. In order to achieve these objectives of accountancy, final accounts are prepared after trial balance. Trial balance indicates that all the transactions have been duly entered, posted and balanced. The final accounts are prepared to ascertain the profit or loss and the financial position of the business. In this unit, we shall be discussing about the meaning and need for preparing final accounts and the preparation of trail balance, trading account, profit and loss account and balance sheet. 3.2 Meaning of Final Accounts Final accounts are those accounts and statements, which are prepared to represent the financial position

of the business at the end of the financial year to cater to the needs of the users of the

accounting information. It refers to trading account, profit and loss account and balance sheet. These are called final accounts because they are the last accounts which are prepared at the end of the year.

Final Accounts 49 Notes Financial statements mean the two statements these are (a) Income statement or Trading and Profit and Loss Account which are prepared to ascertain the profit earned and loss suffered during a specified period; (b) Position Statement or Balance Sheet which is prepared to know the financial position on a particular date. According to American Institute of Certified Public Accountants, "Financial Statements are prepared for the purpose of presenting a periodical review or report on the progress by the management and deal with the (i) status of the investment in the business; and (ii) results achieved during the period under review." 3.2.1 Need for Preparing Final Accounts The main objectives of preparing financial statements are to: ? Provide a true and fair view of all the affairs of business ? Show the net financial results of the business ? Give adequate, timely and accurate information for decision making ? Provide information that assist in estimating the earning potentials of a business 3.3 Trial Balance The fundamental principle of double entry system of accounting is that for every debit, there must be a corresponding credit. Hence, in the preparation of journals as well as ledgers, both aspects of a transaction are taken into account. For this verification, a statement is prepared which is called trial balance. If the totals of the debit and credit amount columns of the trial balance are equal, it is presumed that the postings to the ledger in terms of debit and credit amounts are accurate. In other words, trial balance is a statement in which debit and credit balances of all the accounts of ledger including cash and bank balances are shown to test the arithmetical accuracy of the books of accounts. If the trial balance does not agree, it shows that there are some errors which must be detected and rectified if the correct final accounts are to be prepared. According to J R Batliboi- Trial balance is a statement prepared with the debit and credit balances of ledger accounts to verify the arithmetical accuracy of the books. According to Spicer and Pegler- A trial balance is a statement, a list of all the balance standing on the ledger account and cash book of a concern at any given time. 3.3.1 Format of Trial Balance The format of trial balance is as follows: Name of the Firm… Trial Balance as on… S. No. Name of Ledger Accounts L.F. Dr Balances (Rs.) Cr Balances (Rs.) (1) (2) (3) (4) (5) 3.3.2 Objectives of Preparing Trial Balance The objectives of preparing trial balance are as follows: 1. It provides a basis on which Trading Account, Profit and Loss Account and Balance Sheet are prepared. In fact, it forms a connecting link between the ledger accounts and final accounts.
50 Financial Accounting Notes 2. It checks or ascertains the arithmetical accuracy of ledger accounts. If the total of the debit balances agrees with the total of credit balances, it is a proof that the ledger accounts have been correctly written up else there are some errors which need to be identified and rectified before the final accounts are prepared. 3. The balances of all the accounts of ledger can be easily and conveniently known by the trial balances, which supply useful information to the management. 4. It serves as a summary of what is contained in the ledger. 3.3.3 Methods of Preparing Trial Balance There are three methods of preparation of the trial balance: 1. Total Method: In this method, the debit and credit total of each account of ledger are recorded in trial balance. This method is simple but it has some limitations. The totaling of large amount is difficult and more time consuming. Moreover balancing is also a prerequisite for preparation of final accounts. 2. Balance Method: In this method, only the balances of the accounts of ledger accounts are recorded. This method is the most common and considered as the best method of preparation of trial balance. Firstly, small amounts are totaled in lieu of large amounts, which are very easy; and secondly, balancing of accounts helps in preparation of final accounts. The balance method is also known as net trial balance. One important point is that if an account shows no balance, it is ignored. 3. Compound Method: It is a combination of the above two methods, i.e., under this method both debit and credit totals of each account are shown under respective total columns. Similarly, debit and credit balances are shown under respective balance columns. There will be different totals according to different methods but the total of debit and credit of each method will be equal. The following points should be kept in mind while preparing trial balance: 1. All assets balances are shown in the debit side of trial balance, viz. cash, bills receivable, debtors, furniture, goodwill, prepaid expenses, etc. 2. All liabilities balances are shown in the credit side of trial balance, viz. creditors, bills payable, bank overdraft, outstanding expenses, etc. 3. Drawings account shows debit balance while capital account shows credit balance. 4. All expenses and losses show debit balance while all incomes and gains show credit balance. 5. All provisions or reserves have a credit balance. 6. Purchases account shows debit balance while purchase return account shows credit balance. 7. Sales account shows credit balance while sales returns account shows debit balance. 8. Sundry Debtors Account: All the personal accounts showing debit balances are put together and are collectively shown under debit balances in the trial balance as 'Sundry Debtors'. 9. Sundry Creditors Account: Similarly, all the personal accounts showing credit balances are put together and collectively shown under credit balances in the trial balance as 'Sundry Creditors'. 10. Closing Stock: Generally, closing stock does not appear in the trial balance because it is not an account extracted from ledger. Only if the entry for closing stock

Final Accounts 51 Notes is passed before the preparation of trial balance, it can be shown inside the trial balance. Illustration 1: The accountant of a firm wrongly prepared the following trial balance. You are required to draw up correctly. S. No. Name of Ledger Accounts L.F. Balance Dr (`) Balance Cr (`) 1. 2. 3. 4. 5. 6. 7. 8. 9. 10. 11. 12. 13. 14. 15. 16. 17. 18. 19. 20. 21. 22. Capital Opening Stock Fixed Assets Purchases Sales Discount Allowed Commission Received Returns Outwards Returns Inwards Bills Receivable Cash Interest Paid Loan Taken Bills Payable Bad Debts Wages & Salary Carriage Inwards Carriage Outwards Debtors Creditors Stock at the End Suspense Account 25,000 25,500 300 610 1,500 16,000 360 26,000 13,000 1,800 2,500 1,550 1,600 18,500 25,000 29,780 70,000 34,000 28,000 2,500 29,500 25,000 Total 1,89,000 1,89,000

52 Financial Accounting Notes Solution: Trial Balance as on .... S. No. Name of Ledger Account L.F. Balance Dr (`) Balance Cr (`) 1. 2. 3. 4. 5. 6. 7. 8. 9. 10. 11. 12. 13. 14. 15. 16. 17. 18. 19. 20. Capital Opening Stock Fixed Assets Purchases Sales Discount Allowed Commission Received Returns Outwards Returns Inward Bills Receivable Cash Interest Paid Loan Taken Bills Payable Bad Debts Wages & Salary Carriage Inwards Carriage Outwards Debtors Creditors 25,000 34,000 28,000 300 2,500 29,500 16,000 360 1,800 2,500 1,550 1,600 18,500 70,000 25,500 610 1,500 26,000 13,000 25,000 Total 1,61,610 1,61,610 3.4 Trading Account Trading account is the first part of the financial statements and is prepared to know the gross profit or gross loss of business. In the trading account, the cost of goods sold is shown on the left-hand side and the sales on the right-hand side. If the sales are more than the cost of goods sold, the difference is called gross profit, and, in the reverse case, there will be a gross loss. Debit Side Items ? The value of opening stocks of goods (i.e., the stock of goods with which the business was started) ? Net purchase made during the year (i.e., purchases less returns) ? Direct expenses, if any Credit Side Items ? Total sales made during the period less the value of returns, i.e., net sales ? The value of closing stock of goods

Final Accounts 53 Notes The difference between the two sides of the trading account represents either gross profit or gross loss. The balance of trading account which represents either gross profit or gross loss is transferred to profit and loss account. The format of trading account (T or Account Form) is given below: Trading Account for the year ending ....20........ Dr. Cr Date Particulars L.F. Amount ` Date Particulars L.F. Amount ` To Opening Stock To Purchases Less: Purchase Return To Wages To Carriage Inwards To Cartage To Dock To Manufacturing Expenses To Power To Freight To Consumable Stores To Octroi To Packing Expenses To Royalty on Production To Gross Profit Transferred to Profit and Loss Account - - - - - - - - - - - - - By Sales Less: Sales Return By Closing Stock By Gross Loss Transferred to Profit and Loss Account - - - - - Illustration 2: On the basis of the following balances, prepare the trading account for the year ending on 31 December, 2015:

54 Financial Accounting Notes ` ` Opening Stock 15,000 Sales 40,000 Purchases 20,000 Sales Return 1,800 Carriage 12,000 Purchases Return 1,200 Power 800 Wages 2,200 Freight 2,500 The value of closing stock at the end of year is ` 26,000 Solution: Trading account for the year ending on 31 December, 2015: Dr Cr Date Particulars Amount ` Date Particulars Amount ` To Opening Stock To Purchases 20,000 Less: Purchase Return 1,200 To Wages To Carriage To Power To Freight To Gross Profit c/d 15,000 18,800 2,200 1,200 800 2,500 23,700 By Sales 40,000 Less: Sales Return 1,800 By Closing Stock 38,200 26,000 64,200 64,200 3.5 Profit and Loss Account Profit and loss account is the second part of the income statement, which is prepared to ascertain the net profit of the business. Every businessman has to spend expenses other than on manufacture or purchase of goods, which are called indirect expenses and are recorded on the debit side of the profit and loss account. There are other incomes except sales, so gross profit or loss is adjusted keeping in view these indirect expenses and other incomes to find out the net profit or net loss.

The format of the profit and loss account is given below:

84%	MATCHING BLOCK 16/50	W
Profit and Loss Account for the year ended............. Particulars Amount (`) Particulars Amount (`) To		

Gross Loss b/d To Office and Management Expenses: Office Salaries By Gross Profit b/d By Commission Received By Discount Received By Income from Investment

Final Accounts 55 Notes Rent, Rates and Taxes Printing and Stationery Heating and Lighting Telephone Charges Audit Fees Postage & Telegraphs Legal Charges General Charges To Selling & Distribution Charges: Advertisement Selling Commission Bad Debts Travelling Expenses Godown Rent Brokerage Packing Charges Carriage Outwards Upkeep of Motor Lorries To Depreciation & Maintenance: Depreciation on Furniture, Machinery, Building Repairs to Machinery, Building, Furniture To Financial Expenses: Interest on Capital Interest on Loan Bank Charges Discount Allowed Discount on Bills Discounted To Losses and Miscellaneous: Loss by Fire Loss on Sale of Fixed Assets Charity, Donations By Interest Received By Interest on Debentures By Dividend Received By Apprenticeship Premium By Rent from Tenants By Reserve for Discount on Creditors By Miscellaneous Receipts By Net Loss transferred to Capital A/c

56 Financial Accounting Notes To Net Profit Transferred to Capital A/c Indirect expenses can be divided into two categories, i.e., (i) operating expenses, and (ii) non-operating expenses. Operating expenses are those expenses, which are incurred to run the business efficiently such as administration, selling and distribution expenses. Non-operating expenses are those expenses, which are not required to be incurred for efficient operation of the business but are shown on the debit side of the profit and loss account. These are loss on sale of fixed assets, writing off tangible assets and intangible assets, etc. Illustration 3: From the following balances extracted at the close of the year ended 31 March, 2013, prepare profit and loss account of Mr. Anuj: Particulars Rs. Particulars Rs. Discount (Dr) 650 Apprentice Premium (Cr) 1,200 Gross Profit 98,000 Carriage Outward 1,800 Printing &Stationery 350 Salaries 5,200 Income Tax Paid 2,150 Rates & Taxes 300 Rent 3,800 Fire Insurance Premium 750 Bad Debts 1,700 Travelling Expenses 150 Rent received 1,200 Solution: Profit & Loss Account of Mr. Anuj for the Year Ended 31 March, 2013 Particulars ` Particulars ` To Carriage Outward 1,800 By Gross Profit b/d 98,000 To Salaries 5,200 By Apprentice Premium 1,200 To Rent 3,800 By Rent Received 1,200 To Rates & Taxes 300 To Fire Insurance Premium 750 To Printing & Stationery 350 To Discount 650 To Travelling Expenses 150 To Net Profit c/d 87,400 1,00,400 100,400 Note: Income tax paid being personal expense of the proprietor has not been debited to profit and loss account. This is to be taken as drawings and deducted from capital account.

Final Accounts 57 Notes 3.6 Balance Sheet The balance sheet presents a company's financial position at the end of a specified date. It is not an account but only a statement that represents the closing assets and liabilities of the business on a certain date. In fact, it is a summary of whole of the accounting record. The balance sheet or position statement is based on fundamental accounting equation, i.e., Assets = Liabilities + Capital. The left-hand side of the balance sheet shows liabilities and right-hand side shows assets. If assets are more than liabilities, the business is said to be solvent; and if liabilities are more than assets, the business is said to be insolvent. There are generally three major categories of account classification on a balance sheet: 1. Assets: Assets are economic resources owned by business. Two major asset classes are tangible assets and intangible assets. 2. Liabilities: This includes all debts and obligations owed by the business to outside creditors, vendors or banks. 3. Equity: Stockholders', partners' or owners' equity is made up of the owner/investor investment in the business as well as any retained earnings that are reinvested in the business. A specimen of a balance sheet is given below. Balance Sheet as on--------- Liabilities Amount ` Assets Amount ` Sundry Liabilities Capital ---------- ---------- Sundry Assets ---------- ---------- ---------- Advantages of Balance Sheet 4. Helps in knowing the amount of capital employed in business. 5. Helps in ascertaining the financial position at the end of the accounting period. 6. Solvency of the business can be judged from the total amount of assets available for the payment of liabilities. 7. Helps in comparison of assets and liabilities of business on two dates for ascertaining their progress. 8. Helps in calculating various ratios which help in better management of the business. Limitations of Balance Sheet 9. It ignores non-monetary terms such as honesty, skill, loyalty of workers, etc. 10. It is prepared on a historical cost basis and changes in prices are not taken into account. 11. Intangible assets such as goodwill are shown as imaginary figures having no relationship with the market value. Illustration 4: From the following particulars, prepare a balance sheet as on 31 December, 2012.

58 Financial Accounting Notes Dr Cr Particulars ` ` Drawings Capital Debtors and Creditors Cash at Bank Cash in Hand Plant Furniture Net Profit General Reserve Bills Receivable 5,000 - 6,200 8,200 1,400 10,600 21,000 15,800 - 60,000 4,500 2,200 1,500 68,200 68,200 Solution: Balance Sheet as on 31 December, 2012 Liabilities Amount (`) Assets Amount (`) Sundry Creditors General Reserve Capital 60,000 Add Profits 2,200 Less Drawings (5,000) 4,500 1,500 57,200 Cash in Hand Cash in Bank Debtors Bills Receivable Furniture Plant 1,400 1,400 6,200 15,800 21,000 10,600 63200 63,200 Illustration 5: From the following balances extracted from the books of M/s Jain Bros., prepare a trading and profit and loss account and balance sheet for the year ended 31 December, 2014. Particulars ` Particulars ` Stock on 1 st January 11,500 Returns Outwards 500 Bills Receivables 4,500 Trade Expenses 200 Purchases 39,000 Office Fixtures 1,000 Wages 2,800 Cash in Hand 600 Insurance 700 Cash at Bank 4,750 Sundry Debtors 30,000 Rent and Taxes 1,100 Carriage Inwards 600 Carriage Outwards 1,250 Commission (Dr) 850 Sales 60,000 Interest on Capital 750 Bills Payable 3,000 Stationery 650 Creditors 19,650 Returns Inwards 800 Capital 17,900 The stock on 31 December, 2014 was valued at ` 25,000.

Final Accounts 59 Notes Solution: M/s Jain Bros.

28%	MATCHING BLOCK 7/50	W

Trading and Profit and Loss Account for the Year ended 31 st December, 2014 To Opening stock 11,500 By Sales 60,000 To Purchases 39,000 Less: Returns i/w 800 Less: Returns o/w 500 59,200 38,500 By Closing stock 25,000 To Carriage Inwards 600 To Wages 2,800 To Gross Profit c/d 30,800 84,200 84,200 To Stationery 650 By Gross profit b/d 30,800 To

Rent and Rates 1,100 To Carriage Outwards 1,250 To Insurance 700 To Trade Expenses 200 To Commission 850 To Interest on Capital 750 To Net Profit Transferred to Capital a/c 25,300 30,800 30,800 M/s Jain Bros. Balance Sheet as on 31 December, 2014 Liabilities ` Assets ` Creditors 19,650 Cash in Hand 600 Bills Payable 3,000 Cash at Bank 4,750 Capital 17,900 Sundry Debtors 30,000 Add: Net Profit 25,300 Bill Receivable 4,500 43,200 Stock 25,000 Office Equipment 1,000 65,850 65,850 3.7 Summary Every business entrepreneur is interested to know the ultimate results of his business enterprise, i.e., whether he/she has earned profits or suffered losses in the accounting
60 Financial Accounting Notes period. In order to achieve these objectives of accountancy, final accounts are prepared after trial balance. Final accounts are those accounts and statements, which are prepared to represent the financial position
of the business at the end of the financial year to cater to the needs of the users of the
accounting information. The fundamental principle of double entry system of accounting is that for every debit, there must be a corresponding credit. Hence, in the preparation of journals as well as ledgers, both aspects of a transaction are taken into account. For this verification, a statement is prepared which is called trial balance. There are three methods of preparation of the trial balance i.e. Total method, balance method and compound method. All assets balances are shown in the debit side of trial balance, viz. cash, bills receivable, debtors, furniture, goodwill, prepaid expenses, etc whereas All liabilities balances are shown in the credit side of trial balance, viz. creditors, bills payable, bank overdraft, outstanding expenses, etc. 3.8 Check Your Progress Multiple Choice Questions 1. Which of the following shows summary of a company's financial position at a specific date? (a) Profit & Loss Account (b) Cash Flow Statement (c) Balance Sheet (d) Income & Expenditure Account 2. The unfavorable balance of Profit and Loss account should be: (a) Added in liabilities (b) Subtracted from current assets (c) Subtracted from capital (d) Subtracted from liabilities 3. Trial balance is prepared to check accuracy of (a) Ledger accounts balances (b) Balance sheet balances (c) Income statement balances (d) Cash flow statement balances 4. Which of the following is the common base for preparing a trial balance (a) Ledger accounts (b) General Journal (c) Specialized journals (d) Balance sheet 5. Which of the following is true about a trial balance? (a) Lists down the balances of accounts (b) Lists down the balances of a balance sheet (c) Kind of financial statement (d) Not a part of accounting cycle 6. Net profit is computed in which of the following? (a) Balance sheet (b) Income statement (c) Cash flow statement
Final Accounts 61 Notes (d) Statement of changes in equity 7. The primary purpose of the balance sheet is to (a) report the financial position of the reporting entity at a particular point in time (b) measure the net income of a business up to a particular point in time (c) determine cash flow for the period (d) report the difference between cash inflows and cash outflows for the period 8. Which of the following is the limitation of balance sheet? (a) Does not calculates the amount of capital employed (b) Ignores non-monetary terms (c) Does not compares assets and liabilities on two dates (d) Does not calculates ratios 9. The balance sheet or position statement is based on fundamental accounting equation: (a) Assets = Liabilities - Capital (b) Assets = Liabilities / Capital (c) Assets = Liabilities * Capital (d) Assets = Liabilities + Capital 10. Which of the following is not an example of operating expenses? (a) Administrative expenses (b) Selling expenses (c) Writing off intangible assets (d) Distribution expenses 3.9 Questions and Exercises 1. Explain the meaning of final accounts. 2. Define financial statements as per American Institute of Certified Public Accountants. 3. What are the objectives of preparing final accounts? 4. Explain the advantages of preparing balance sheet. 5. Discuss the different methods of preparing trial balance? 6. What do you understand by trial balance? 7. Prepare profit and loss account of Mrs. Kavita from the following balances extracted at the end of the year ended 31 March, 2014,: Particulars ` Particulars ` Discount (Dr) 150 Apprentice Premium (Cr) 2,000 Gross Profit 15,000 Carriage Outward 800 Printing &Stationery 50 Salaries 5,000 Income Tax Paid 250 Rates & Taxes 3,000 Rent 4,000 Fire Insurance Premium 1,250 Bad Debts 700 Travelling Expenses 1,050 Rent received 2,000
62 Financial Accounting Notes 8. Prepare the trading account for the year ending on 31 December, 2015 on the basis of the following balances: ` ` Opening Stock 5,000 Sales 4,000 Purchases 2,000 Sales Return 800 Carriage 2,000 Purchases Return 200 Power 500 Wages 2,000 Freight 200 The value of closing stock at the end of year is ` 2,600 9. Prepare a balance sheet of Mr. Tarun as on 31 December, 2012. Dr Cr Particulars ` ` Drawings Capital Debtors and Creditors Cash at Bank Cash in Hand Plant Furniture Net Profit General Reserve Bills Receivable 5,000 - 6,200 8,200 1,400 10,600 21,000 15,800 - 60,000 4,500 2,200 1,500 68,200 68,200 10. From the following information of Jain Ltd. on 31st March, 2013 you are required to prepare the Trading, Profit and Loss A/c and a Balance Sheet: ` ` Opening Stock 5,000 Capital 89,500 Bills Receivable 22,500 Commission (Cr.) 2,000 Purchases 1,95,000 Return Outward 2,500 Wages 14,000 Trade Expenses 1,000 Insurance 5,500 Office Fixtures 5,000 Sundry Debtors 1,50,000 Cash in Hand 2,500 Carriage Inward 4,000 Cash at Bank 23,750 Commission (Dr.) 4,000 Rent & Rates 5,500 Interest on Capital 3,500 Carriage Outward 7,250 Stationery 2,250 Sales 2,50,000 Return Inward 6,500 Bills Payable 15,000 Creditors 98,250 Closing Stock 12,500
Final Accounts 63 Notes 3.10 Key Terms ? Final Accounts: Final accounts are those accounts and statements, which are prepared to represent the financial position
of the business at the end of the financial year to cater to the needs of the users of the

accounting information. ? Trial Balance: trial balance is a statement in which debit and credit balances of all the accounts of ledger including cash and bank balances are shown to test the arithmetical accuracy of the books of accounts. ? Trading Account: Trading account is the first part of the financial statements and is prepared to know the gross profit or gross loss of business. ? Profit and Loss Account: Profit and loss account is the second part of the income statement, which is prepared to ascertain the net profit of the business. ? Balance Sheet: The balance sheet presents a company's financial position at the end of a specified date Check Your Progress: Answers 1. (c) Balance Sheet 2. (c) Subtracted from capital 3. (a) Ledger accounts balances 4. (a) Ledger accounts 5. (a) Lists down the balances of accounts 6. (b Income statement 7. (a) report the financial position of the reporting entity at a particular point in time 8. (b) Ignores non-monetary terms 9. (d) Assets = Liabilities + Capital 10. (c) Writing off intangible assets 3.11 Further Readings ? Maheshwari S.N.,

Studies in Advanced Accounting, Sultan Chand and Sons, New Delhi. ? Gupta Shashi K., Aggarwal Nisha and Gupta Neeti, Financial Accounting,

Kalyani Publishers, Ludhiana. ? Tulsian P.C., Financial Accounting, Pearson Education, New Delhi. ? W. Albrecht, Stice Earl, Stice James, Financial Accounting, Cengage Learning.

64 Financial Accounting Notes Unit 4: Depreciation Structure 4.1 Introduction 4.2 Meaning and Definition of Depreciation 4.2.1 Definitions of Depreciation 4.3 Causes of Depreciation 4.4 Depreciation V/s Fluctuations 4.5 Methods of Depreciation 4.5.1 Fixed Installment Method or Straight Line Method or Original Cost Method 4.5.2 Diminishing Balance or Written Down Value Method 4.5.3 Depreciation Fund Method or Sinking Fund Method 4.6 Summary 4.7 Check Your Progress 4.8 Questions and Exercises 4.9 Key Terms 4.10 Further Readings Objectives After studying this unit, you should be able to: ? Discuss the meaning and the causes of depreciation ? Understand the difference between depreciation and fluctuations ? Explain different methods of depreciation ? Solve problems on depreciation 4.1 Introduction The term 'depreciation' means decrease in the value of assets due to their continuous use and obsolescence. Decrease in the value of fixed assets is called depreciation. In terms of accounting, it is used to denote decrease in the book value of a fixed asset. In this unit we shall be discussing about the meaning and causes of depreciation, difference between depreciation and fluctuation. We shall also discuss the different methods of depreciation and solve problems on depreciation. 4.2 Meaning and Definition of Depreciation In general words, depreciation is the reduction in the value of an asset due to usage, passage of time, wear and tear, technological out dating or obsolescence, depletion, inadequacy, decay or other such factors. The monetary value of an asset decreases over time due to use, wear and tear or obsolescence. This decrease is measured as depreciation.

Depreciation 65 Notes 4.2.1 Definitions of Depreciation According to BG Wickery Depreciation may be defined as the permanent decrease in the value of an asset through wear and tear in use or the passage of time. According to J R Battiboi Depreciation represents loss or diminution in the value of an asset consequent upon wear and tear, obsolescence effluxion of time or fall in the market value. Following are the features of depreciation: 1. It is related to tangible fixed assets. 2. It is the decrease in the book value of fixed assets. 3. It is charged on a continuous basis. 4. Reduction in the value of an asset is due to the use of the asset in business operations, effluxion of time, etc. 5. It is a charge against profit for a particular accounting period. 4.3 Causes of Depreciation The main causes of depreciation are as follows: 1. Physical Wear and Tear: When an asset is constantly used for production, the value of such assets may decline due to its continuous use or physical wear and tear. 2. Lapse of Time: The value of assets decreases gradually with the lapse of time, whether the asset is used in business or not. 3. Obsolescence: It means the process of becoming obsolete or out of date. Appearance of new and improved machines results in discarding of old means. The main reasons to discard the value of an asset are new inventions, change in fashion and taste, market conditions, etc. 4. Depletion: Some assets are of wasting nature. Assets like oil wells, mineral mines, etc., get exhausted or depleted through working. If there is continuous extraction of oil or minerals, a stage comes when the mine or well gets completely exhausted. 5. Accidents: The value of an asset also decreases due to accident, e.g., fire, flood, etc. 6. Fall in the Market Price: Sometimes, fluctuations in the market price also decrease the value of an asset and if this fall is permanent then it is assumed as depreciation. 4.4 Depreciation V/s Fluctuations Depreciation of asset and fluctuation in its market value are not the same. For example, a businessman purchases a machine which is not intended for resale and the estimated life of which is 10 years. If for certain reasons the market value of the machine decreases by say 10%, the businessman should not consider this decrease at all. Because it is not going to decrease the productive capacity or the utility of the machine and he will not have to suffer any loss, unless he sells the machine. But he cannot ignore the depreciation. Thus, the points of difference between depreciation and fluctuation are stated as follows:

66 Financial Accounting Notes Depreciation Fluctuation ? Depreciation is a permanent fall in the value of an asset. ? Depreciation is continuing and gradual in nature. ? Depreciation is a fall in value. ? Depreciation is concerned with book value. ? Depreciation refers to a fixed asset. ? Fluctuation is a temporary variation in the price of an asset. ? Fluctuation is neither continuing nor gradual and in most cases it happens all of a sudden. ? Fluctuation may represent either a fall or a rise in value. ? Fluctuation is concerned with market value. ? Fluctuation refers to a floating or current asset. 4.5 Methods of Depreciation There are various methods of providing depreciation on assets but the use of a method depends on certain factors such as nature of business, type of asset and policy of the management. The methods of depreciation are as follows: 4.5.1 Fixed Installment Method or Straight Line Method or Original Cost Method Under this method, depreciation is charged evenly every year during the effective life of an asset. The amount of depreciation is fixed for each year and the value of the fixed asset gets reduced until it reaches its scrap value. Thus, the amount of depreciation is calculated as: Depreciation = Original Cost of the Assets – Scrap Value Estimated Life of the Asset or D = C – S N where, D = Amount of yearly depreciation C = Cost of the asset S = Scrap Value N = Estimated Life of the Asset. For example, if a machine was purchased for ` 50,000, and the scrap value is estimated at ` 5,000 at the end of its life of 5 years, then the depreciation would be: Depreciation = 50,000 – 5,000 5 Years = 9000 each year The amount of depreciation charged during the period of an asset's life is constant. The depreciation to be charged every year can also be expressed as a percentage of cost. Merits of the Straight Line Method The merits of straight line method are as follows: 1. This method is very simple and easy to understand. Once the amount is calculated, the same is written off as depreciation every year.

Depreciation 67 Notes 2. It is suitable for assets on lease, patents, copyrights, etc. 3. It is suitable for those assets whose effective lives can easily be estimated. 4. It helps in calculating the closing values of the fixed assets easily. Demerits of the Straight Line Method The demerits of straight line method are given below: 1. It is not suitable for all types of fixed assets. 2. The amount of depreciation remains constant every year, the expenses incurred on account of repairs increase gradually as the asset grows older. 3. This method ignores the working capacity of an asset. 4. This method does not take into account interest on investment in the asset. 5. No provision is made for purchasing of asset in case of obsolescence. 6. It ignores the cost of capital. Illustration 1: On 1 Jan, 2012, Ramesh purchased a plant for ` 12,000. The expected life of a plant is 10 years and the net residual value would be ` 2,000. Prepare plant account for three years on fixed installment method. Also show the depreciation account. Solution: Amount of Depreciation = 12,000 – 2,000 10 = Rs. 1,000 Plant Account Dr Cr Date Particulars Amount (`) Date Particulars Amount (`) 2012 2012 Jan 1 To Bank A/c 12,000 Dec 31 By Depreciation A/c 1,000

Dec 31 By Balanced c/d 11,000 12,000 12,000 2013 2013 Jan 1 To Balance b/d 11,000 Dec 31 By Depreciation A/c 1,000 Dec 31 By Balance c/d 10,000 11,000 11,000 2014 2014 Jan 1 To Balance b/d 10,000 Dec 31 By Depreciation A/c 1,000 Dec 31 By Balance c/d 9,000 10,000 10,000

68 Financial Accounting Notes Depreciation

29% **MATCHING BLOCK 8/50** W

Account Dr Cr Date Particulars Amount (`) Date Particulars Amount (`) 2012 2012 Dec 31 To Plant A/c 1,000 Dec., 31 By Profit & Loss A/c 1,000 2013 2013 Dec 31 To Plant A/c 1,000 Dec 31 By Profit & Loss A/c 1,000 2014 2014 Dec 31 To Plant A/c 1,000 Dec 31 By Profit & Loss A/c 1,000

Illustration 2: Zoo Ltd. purchased Machinery I on 1 January, 2010 for Rs 20,000. Machinery II was purchased on 1 July, 2010 for Rs 16,000. Machinery III was purchased on 1 January, 2012 for Rs 12,000 and Machinery IV was purchased on 1 July, 2012 for Rs 10,000. You are required to write up Machinery Account for the years from 2010 to 2012. Depreciation is written off at the rate of 20% p.a. on the Straight Line Method. Machinery Account Dr Cr Date Particulars Amount (Rs) Date Particulars Amount (

Rs) 2010 2010 Jan 1 To Bank A/c 20,000 Dec 31 By Depreciation A/c (4,000 + 1,600) 5,600 July 1 To Bank A/c 16,000 Dec 31 By Balance c/d 30,400 36,000 36,000 2011 2011 Jan 1 To Balance b/d 30,400 Dec 31 By Depreciation A/c (20% on 36,000) 7,200 Dec 31 By Balance c/d 23,200 30,400 30,400 2012 2012 Jan 1 To Balance b/d 23,200 Dec 31 Jan 1 To Bank A/c 12,000 Dec 31 By

Depreciation A/c (20% on ` 36,000; 20% on ` 12,000; 20% on 10,000 for 6 months) 10,600 July 1 To Bank A/c 10,000 By Balance c/d 34,600 45,200 45,200 4.5.2 Diminishing Balance or Written Down Value Method This method is also known as reducing balance method. Under this method, depreciation is charged on the book value of an asset every year, and therefore, depreciation goes on decreasing every year.

Depreciation 69 Notes The charges in the initial years are higher than those in the later years. This method is suitable in case of those assets whose repair charges increase as they become old, for example, machinery, furniture and fixtures, i.e. on those assets, which have a longer life and are difficult to estimate. The formula for determining the rate of depreciation in diminishing balance method is as follows: Rate of Depreciation = S 1– n C Where S = Scrap value C = Cost n = No. of years Merits of the Diminishing Balance Method Merits of diminishing balance method are mentioned below: 1. This method is simple to understand and its application is very easy. 2. It maintains uniformity regarding the total cost (Repairs and Maintenance Cost + Depreciation) incurred for maintaining an asset. It means that the total cost charged to the profit and loss account for maintaining an asset each year is more or less equal or reasonable. 3. It is recognized by Income Tax Authorities for charging depreciation. 4. This method is suitable for those assets which have long life. 5. As the asset becomes older, repairs cost increases, which are compensated by charging less depreciation during the said periods. Demerits of the Diminishing Balance Method Demerits diminishing balance method are as follows: 1. It does not take into account the interest on capital invested in the asset. 2. The value of asset under this method is never reduced to zero. 3. For assets having very short lives, the amount of depreciation charged in the early years is very high 4. Calculation of rate of depreciation under this method is not very simple. 5. It does not provide for the replacement of the asset on the expiry of its useful life. Illustration 3: Angad purchased a machine on January 1, 2009 at cost of Rs 80,000 and spent ` 5,000 on its installation. The firm writes off depreciation @ 10% p.a. by written down value method. The scrap value of the machine at the end of its economic life of 5 years is expected to be ` 50,191.6. Show the machine account for 5 years in the books of Angad. The books are closed on 31 st December every year. Solution:
70 Financial Accounting Notes Machine Account Dr Cr Date Particulars Amount (Rs) Date Particulars Amount (
Rs.) 2009 2009 Jan 1 To Cash A/c 80,000 Dec 31 By Depreciation A/c (10% on 85,000) 8,500 Jan 1 To Cash A/c 5,000 Dec 31 By Balance c/d 76,500 85,000 85,000 2010 2010 Jan 1

43%	MATCHING BLOCK 9/50	W

To Balance c/d 76,500 Dec 31 By Depreciation A/c 7,650 Dec 31 By Balance c/d 68,850 76,500 76,500 2011 2011 Jan 1 To Balance b/d 68,850 Dec 31 By Depreciation A/c 6,885

Dec 31 By Balance c/d 61,965 68,850 68,850 2012 2012 Jan 1 To Balance b/d 61,965 Dec 31 By Depreciation A/c 6,196.5 Dec 31 By Balance c/d 55,768.5 61,965 61,965.0 2013 2013 Jan 1 To Balance b/d 55,768.5 Dec 31 By Depreciation A/c 5,576.9 Dec 31 By
Balance c/d 50,191.6 55,768.5 55,768.5 4.5.3 Depreciation Fund Method or Sinking Fund Method Under this method, the amount of depreciation is invested to each year along with the interest in certain securities. At the end of the effective life of the asset, the securities are sold away and the amount so realised is used for the purchase of a new asset. A fixed amount is debited every year to depreciation account or profit or loss account and is credited to depreciation fund account, instead of asset account. The amount credited in the depreciation fund account is invested in readily saleable securities. The interest on such investment is also invested in similar securities. This process of investing goes on till the time of replacement of asset. At the time of replacement, all investments are sold out and cash received, thereafter new asset is purchased. The amount invested depends on the rate of interest, which is calculated from Sinking Fund Tables. The accounting entries for the first year are as follows: (i) For providing annual depreciation Depreciation
A/c Dr To Depreciation Fund A/c (ii) For investing the amount of depreciation Depreciation Fund Investment A/c Dr To Bank A/c (
iii) For transferring to Profit & Loss Account Profit & Loss A/c Dr
Depreciation 71 Notes To Depreciation A/c Depreciation Fund Account appears on the liabilities side and Depreciation Fund Investment Account appears on the asset side of the Balance Sheet. Subsequent Years (i) For interest received on investment out of depreciation fund:
Bank A/c Dr To Depreciation Fund A/c (ii) For annual investment of depreciation: Depreciation A/c Dr To Depreciation Fund A/c (
iii) For amount of interest earned and depreciation invested in securities Depreciation Fund
Investment
A/
c Dr To Bank A/c (iv) For transferring depreciation to Profit & Loss A/c Profit & Loss A/c Dr To Depreciation A/c
Last Year (i) For interest received on investment:
Bank A/c Dr To Depreciation Fund A/c (ii) For annual investment of depreciation: Depreciation A/c Dr To Depreciation Fund A/c (iii) For transferring depreciation to Profit & Loss A/c Profit & Loss A/c Dr To Depreciation A/c (iv) For sale of investment: Bank A/c Dr To Depreciation Fund Investment A/c (v) For Profit on sale of securities: Depreciation Fund Investment A/c Dr To Depreciation Fund A/c

Note: Reverse Entry will be passed in case of loss. (vi) For writing off the old Asset: Depreciation Fund A/c Dr To Asset A/c (vii) For transferring the Balance of Depreciation Fund Account (if credit balance)
72 Financial Accounting Notes Depreciation Fund A/c Dr To Profit & Loss A/c Note: Reverse Entry will be passed if there is Debit Balance. (viii) For purchase of the New Asset: New Asset A/c Dr To Bank A/c Illustration 4: Gujral & Sons purchased 4 years lease on 1 January, 2010 for ` 12,00,000. It was decided to provide for the renewal of the lease at the end of the 4 years by setting up a depreciation fund. It is expected that the investment will fetch @ 12% p.a. Sinking fund table shows that Rs 0.2092344 invested each year will produce ` 1 at the end of 4 years @ 12% p.a. On 31 December, 2013 investments were sold for ` 8,32,000. On 1 January, 2014 the same lease was renewed for a further period of 4 years by making a payment of ` 13,50,000. Prepare mercenary ledger accounts in the books of Gujral & Sons. Solution: Annual Depreciation = `12,00,000 × 0.2092344 = ` 2,51,081.28 Lease

Account Dr Cr Date Particulars Amount (`) Date Particulars Amount (`) 2010 2010 Jan 1 To Bank A/c 12,00,000 Dec 31 By Balance c/d 12,00,000 12,00,000 12,00,000 2011 2011 Jan 1 To Balance b/d 12,00,000 Dec 31 By Balance c/d 12,00,000 12,00,000 12,00,000 2012 2012 Jan 1 To Balance b/d 12,00,000 Dec 31 By Balance c/d 12,00,000 12,00,000 12,00,000 2013 2013 Jan 1 To Balance b/d 12,00,000 Dec 31 By Depreciation Fund A/c 12,00,000 12,00,000 12,00,000 Depreciation Fund Account Dr Cr Date Particulars Amount (RS.) Date Particulars

Amount (`) 2010 2010 Dec 31
To Balance c/d 2,51,081.28 Dec 31 By Depreciation A/c 2,51,081.28 2,51,081.28 2,51,081.28
Depreciation 73 Notes 2011 2011 Dec 31 To Balance c/d 5,32,292.31 Jan 1 By Balance b/d 2,51,081.28 Dec 31 By Bank
A/c (12% on 2,51,081.28) 30,129.75 Dec 31 By Depreciation A/c 2,51,081.28 5,32,292.31 5,32,292.31 2012 2012 Dec 31 To Balance c/d 8,47,248.67 Jan 1 By Balance b/d 5,32,292.31 Dec 31 By Bank A/c (12% on 5,32,292.31) 63,875.00 Dec 31 By Depreciation A/c 2,51,081.28 8,47,248.67 8,47,248.67 2013 2013 Dec 31 To Depreciation Fund Investment A/c 15,248.67 Jan 1 By Balance b/d 8,47,248.67 Dec 31 To Lease A/c 12,00,000.00 Dec 31 By Bank A/c (12% on 8,47,248.67) 1,01,669.84 Dec 31 By Depreciation A/c 2,51,081.28 12,15,248.67 12,15,248.67 Depreciation Account Dr Cr Date Particulars Amount (`) Date Particulars Amount (`) 2010 2010 Dec 31 To Depreciation Fund A/c 2,51,081.28 Dec 31 By Profit & Loss

A/c 2,51,081.28 2,51,081.28 2,51,081.28 2011 2011 Dec 31 To Depreciation Fund A/c 2,51,081.28 Dec 31 By Profit & Loss A/c 2,51,081.28 2,51,081.28 2,51,081.28 2012 2012 Dec 31 To Depreciation Fund A/c 2,51,081.28 Dec 31 By Profit & Loss A/c 2,51,081.28 2,51,081.28 2,51,081.28 2013 2013 Dec 31 To Depreciation Fund A/c 2,51,081.28 Dec 31 By Profit & Loss A/c 2,51,081.28 2,51,081.28 2,51,081.28 74

Financial Accounting Notes Depreciation Fund Investment Account Dr Cr Date Particulars Amount (`) Date Particulars Amount (`) 2010 2010 Dec 31
To Bank A/c 2,51,081.28 Dec 31
By Balance c/d 2,51,081.28 2,51,081.28 2,51,081.28 2011 2011 Jan 1 To Balance b/d 2,51,081.28 Dec 31 By Balance c/d 5,32,292.31 Dec 31 To Bank A/c 2,81,211.03 [2,51,081.28 + 30,129.75] 5,32,292.31 5,32,292.31 2012 2012 Jan 1 To Balance b/d 5,32,292.31 Dec 31 By Balance c/d 8,47,248.67 Dec 31 To Bank A/c 3,14,956.36 [2,51,081.28 + 63,875.75] 8,47,248.67 8,47,248.67 2013 2013 Jan 1 To Balance b/d 8,47,248.67 Dec 31 By Bank A/c 8,32,000.00
Dec 31 By Depreciation Fund A/c 15,248.67 (
Balancing figure) 8,47,248.67 8,47,248.67 New Lease
A/c Dr Cr Date Particulars Amount (`) Date Particulars Amount (`) 2014 Jan 1 To Bank A/c 13,50,00.00 4.6
Summary In general words, depreciation is the reduction in the value of an asset due to usage, passage of time, wear and tear, technological out dating or obsolescence, depletion, inadequacy, decay or other such factors. Depreciation is a permanent fall in the value of an asset. Fluctuation is a temporary variation in the price of an asset. Under Fixed Installment method, depreciation is charged evenly every year during the effective life of an asset. The amount of depreciation is fixed for each year and the value of the fixed asset gets reduced until it reaches its scrap value. Diminishing Balance or Written Down Value Method is also known as reducing balance method. Under this method, depreciation is charged on the book value of an asset every year, and therefore, depreciation goes on decreasing every year. Under Depreciation Fund Method or

Depreciation 75 Notes Sinking Fund Method the amount of depreciation is invested to each year along with the interest in certain securities. At the end of the effective life of the asset, the securities are sold away and the amount so realised is used for the purchase of a new asset. 4.7 Check Your Progress Multiple Choice Questions 1. What is depreciation? (a) Cost of a fixed asset (b) Cost of a fixed asset's repair (c) The residual value of a fixed asset (d) Portion of a fixed asset's cost consumed during the current accounting period 2. Under which depreciation method the amount of depreciation expenses remains same throughout the useful life of a fixed asset (a) Straight line method (b) Reducing balance method (c) Number of units produced method (d) Machine hour method 3. A company purchased a vehicle for Rs.6000. It will be used for 5 years and its residual value is expected to be Rs. 1000. What is the annual amount of deprecation using straight line method of depreciation? (a) Rs. 1000 (b) Rs.2000 (c) Rs. 3000 (d) Rs. 3300 4. A fixed asset was bought for Rs.5000. Its accumulated depreciation is Rs.3000 and rate of depreciation is 20%. Calculate its depreciation expenses for the current accounting period using reducing balance method? (a) Rs. 600 (b) Rs. 2000 (c) Rs. 300 (d) Rs. 400 5. Under which method of depreciation the amount of depreciation expenses changes throughout the life of a fixed asset (a) Reducing balance method (b) Unit of activity method (c) Straight line method (d) None of these 6. Which of the following term is generally used for the depreciation of natural resources? (a) Amortization (b) Depletion (c) Appreciation (d) Disposal value 7. Under which of the following method of depreciation a fund is created? (a) Straight line

76 Financial Accounting Notes (b) Diminishing (c) Depreciation Fund (d) None of the above 8. How fluctuations are different from depreciation of assets? (a) Depreciation is a permanent fall in the value of an asset while fluctuation is a temporary variation in the price of an asset. (b) Depreciation is a fall in value while fluctuation is a rise in value. (c) Depreciation is concerned with market value while fluctuation is concerned with book value. (d) Depreciation refers to a floating or current asset while fluctuation refers to a fixed asset 9. Which of the following is not the feature of straight line method of depreciation? (a) Simple (b) Easy to understand (c) Recognized by Income Tax Authorities (d) Suitable for assets on lease 10. Which of the following method is recognized by Income Tax Authorities for charging depreciation? (a) Straight line (b) Written down value (c) Depreciation fund (d) All of the above 4.8 Questions and Exercises 1. What is depreciation? Explain the features of depreciation. 2. What are the causes of depreciation? Write a brief note on the fixed installment method of depreciation. 3. Explain diminishing balance method of depreciation with a suitable example. 4. How does written down method differ from fixed installment method? 5. Explain the concept of depreciation fund method. 6. Discuss how straight line method is different from written down value method of depreciation. 7. Differentiate between depreciation and fluctuations. 8. On 1 Jan, 2014, an asset was purchased for Rs 4,00,000. Its estimated life is 5 years after which its scrap value will be Rs. 25,000. Prepare asset account for the first three years after providing depreciation on every 31 December by straight line method. 9. Vimal & Sons purchased a second hand machine for Rs. 25,000 on 1 Jan 2008. On 1 June, 2009, additions were made to the amount of Rs. 5,000. On 1 March, 2010, additions were made to the amount of RS. 3,200. On 30 June, 2011, machinery of which the original value on 1 January, 2008 was Rs. 4,000 was sold for Rs. 3,000. Depreciation is charged at 10% on the original cost. Show the Machinery A/c for the four years from 2008 to 2011. 10. On 1 April 2006, A Ltd. purchased a machinery for Rs. 2,00,000 and incurred Rs. 20,000 towards installation charges. It is estimated that the machinery will have a scrap value of Rs. 20,000 at the end useful life which is four years. Prepare Machinery A/c for the first four years ending 31st March every year. The company charges written down value method of depreciation.

Depreciation 77 Notes 4.9 Key Terms ? Depreciation: The term 'depreciation' means decrease in the value of assets due to their continuous use and obsolescence. ? Fluctuations: It means fall in the market value of assets. ? Straight Line Method: Under this method, the amount of depreciation is fixed for each year and the value of the fixed asset gets reduced until it reaches its scrap value. ? Written Down Method: Under this method, depreciation is charged on the book value of an asset every year, and therefore, depreciation goes on decreasing every year. ? Depreciation Fund Method: Under this method the amount of depreciation is invested to each year along with the interest in certain securities. At the end of the effective life of the asset, the securities are sold away and the amount so realised is used for the purchase of a new asset. Check Your Progress: Answers 1. (d) Portion of a fixed asset's cost consumed during the current accounting period 2. (a) Straight line method 3. (a) Rs. 1000 4. (d) Rs. 400 5. (a) Reducing balance method 6. (b) Depletion 7. (c) Depreciation Fund 8. (a) Depreciation is a permanent fall in the value of an asset while fluctuation is a temporary variation in the price of an asset. 9. (c) Recognized by Income Tax Authorities 10. (b) Written down value 4.10 Further Readings ? Maheshwari S.N.,

Studies in Advanced Accounting, Sultan Chand and Sons, New Delhi. ? Gupta Shashi K., Aggarwal Nisha and Gupta Neeti, Financial Accounting,

Kalyani Publishers, Ludhiana. ? Tulsian P.C., Financial Accounting, Pearson Education, New Delhi. ? W. Albrecht, Stice Earl, Stice James, Financial Accounting, Cengage Learning.

78 Financial Accounting Notes Unit 5: Consignment Structure 5.1 Introduction 5.2 Meaning of Consignment 5.3 Difference between Consignment and Sales 5.4 Proforma Invoice 5.5 Account Sale 5.6

Accounting Treatment of Consignment Transactions 5.6.1 Books of the Consignor 5.6.2 Books of the Consignee 5.7 Accounting for Loss of Goods 5.8 Invoicing Goods higher than

the Cost 5.9 Summary 5.10 Check Your Progress 5.11 Questions and Exercises 5.12 Key Terms 5.13 Further Readings Objectives After studying this unit, you should be able to: ? Discuss the meaning of consignment ? Understand the difference between consignment and
sales ? Solve problems on consignment ? Discuss Normal loss and abnormal loss in consignment 5.1 Introduction In the business world
it is very common that manufacturers or wholesale dealers appoint their agents at different places to increase their sales
because it is very expensive for the manufactures to sell the goods directly either in home market or in foreign market. Therefore agents are appointed
and sales are made through them. In this unit, we shall be discussing about the meaning of consignment, difference between consignment and sales, proforma invoice and account sale. We shall also solve the problems on consignment and discuss normal and abnormal loss in consignment. 5.2 Meaning of Consignment Manufacturers or wholesalers nowadays sell their goods both within and outside the country through agents.
The one who forwards the goods is known as consignor, the one to whom the goods are sent is known as consignee, goods so sent are called 'Goods sent on Consignment'
and the process of sending goods is known as
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consignment. Consignment is a way of facilitating sale but actually it is different from sales. If goods are not sold then
a consignment is returnable but in case of sale, the goods are not returnable except for some special reasons like below standard goods are supplied. When goods are sold to a person the property in them passes to that person, but when goods are consigned to a person the legal ownership of the goods remains with the consignor. Hence when goods are sold the relationship between two parties is that of a creditor and debtor but when the goods are consigned relationship between the consignors and consignee is that of 'principal' and 'an agent'. 5.3 Difference between Consignment and Sales Basis Consignment Sale Ownership Ownership remains with the consignor Ownership is passed to
the buyer Relation Consignee is the agent of the consignor Buyer is debtor of seller until the account is settled. Risk and damage Consignee holds the goods at the risk of the consignor therefore any successive damage to the goods is the loss of the consignor Any successive damage to the goods is the loss of the buyer Return of goods Goods may be returned if not sold Goods are not returnable except for special reasons like defective goods etc. Expenses after delivery Consignor borne the expenses after delivery Buyer borne the expenses after delivery Forwarding Letter Proforma Invoice Invoice 5.4 Proforma Invoice When goods are sent by consignor to consignee it is supplemented by a document called pro-forma invoice. It is a forwarding letter which gives a description about the name of the item; quantity, weight or measurement of items, price, and transportation charges etc.
The goods sent on consignment cannot be treated as sales therefore the consignor does not prepare
the proper invoice. The consignor makes a proforma invoice and sends it to consignee to give him the information about the despatched goods. This forwarding letter is substitute of invoice but it is drawn up in the form of an invoice and therefore termed as pro-forma invoice.
80 Financial Accounting Notes Figure 5.1: Specimen of Proforma Invoice 5.5 Account Sale Account sale is a statement which is regularly prepared and sends by the consignee to the consigner. This statement gives a description about the no. of items received, sales, expenses incurred, commission charges, amount sent and the remaining balance payable by the consignee to the consignor. Through this statement consignor is kept aware of the business transactions. It is a periodic statement which is made for a certain time and has a starting and an ending date.
On receipt of Account Sales the consignor shall make entries in his books of account and complete the Consignment account and the Consignee's account.
A specimen of Account sale is shown as follows: Account Sales as received from M/s Sam Traders of Mumbai For the sales made on consignment for the period from ____ to _____ Particulars Amount (in Rs) Amount (in Rs) Amount (in Rs) Gross Sale Proceeds: Cash Sales 1. xx
Consignment 81 Notes 2. xx xxxx Credit Sales 1. xx 2. xx xxxx Total Sale Proceeds xxxx Other Receipts 1. xx 2. xx xxxx Total Receipts xxxx Less: Amounts to be deducted Advances Sent 1. xx 2. xx xxxx Expenses paid to be reimbursed 1. xx 2. xx xxxx Commissions receivable 1. xx 2. xx xxxx Total Deductions xxxx Gross Amount Due xxxx Less: Bad Debts (Consignor's responsibility) xxxx Net Amount Due xxxx Less: Amounts still to be collected (Balance due from Consignment Debtors) xxxx Cash Due xxxx Less: Amounts sent (along with a/c sales) xxxx Net Cash Due xxxx 5.6 Accounting Treatment of Consignment Transactions The accounting treatment in the books of consignor and consignee are discussed as follows: 5.6.1
Books of the Consignor The consignor opens three accounts in his ledger. (1) Consignment Account: It is prepared to ascertain profit or loss on each consignment e.g. Consignment to Bombay
Account.

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Consignee's Account: It is prepared to show the balance due to or from consignee at a particular date. (3) Goods sent on Consignment Account: It is prepared to show the amount of goods sent to the consignee. The balance is credited to Purchase or Trading Account. Journal Entries 1 (a) When the goods are sent on consignment at cost or at invoice price: Consignment A/c Dr. To Goods sent on consignment A/c (Being goods sent on Consignment at cost) (b) If goods are sent at invoice price then one more entry is needed for making the adjustments. The amount of this entry is the difference between the invoice price and the cost price. The entry will be: Goods sent on consignment A/c Dr. To Consignment A/c 2. When expenses are incurred by the Consignor: Consignment A/c Dr. To Bank A/c (Being expenses incurred) 3. When the Account Sales is received from the Consignee: (i) Consignee A/c Dr. To Consignment A/c (Being the total sales by consignee) (ii) Consignment A/c Dr. To Consignee A/c (Being the expenses incurred by consignee and with his Commission) 4. When the consignee remits the cash or bills: Bank A/c/ Cash A/c/Bills receivable A/c Dr. To Consignee A/c (Being Cash/B/R received) 5. When bills is discounted with Bank: Cash A/c/ Bank A/c Dr. Discount A/c To Bills receivable A/c (Being B/R discounted with the Bank) 6. For Stock remaining unsold: Consignment stock A/c Dr. To Consignment A/c (Being the value of stock plus proportionate expenses)
Consignment 83 Notes 7. For Abnormal Loss of stock: General Profit & Loss Account A/c Dr. (with unrecoverable loss) Insurance company A/c (with total recoverable loss) Dr. To Consignment A/c (with total loss) (For the abnormal loss of stock, amount recoverable and amount not recoverable) 8. For Profit or loss on Consignment: (i) If there is profit on Consignment Consignment A/c Dr. To general Profit and Loss A/c (Being the Profit on consignment transferred to Profit and Loss A/c) (ii) If there is loss on Consignment General Profit and loss Account Dr. To Consignment A/c (Being the loss on Consignment transferred to Profit & Loss Account) 9. For settlement of account with consignee: Bank/Bills recoverable Dr. To Consignee A/c (Being amount sent for final settlement) The Goods sent on Consignment Account' which shows credit balance will now be transferred to the Trading Account. Then the entry is : Goods sent on consignment Account Dr. To Trading A/c (Being the goods sent on consignment account transferred to trading account).
Illustration 1: Vinay
Ltd. sent 100 pieces of suiting to Lalit House of Delhi on consignment basis. The consignees are entitled to receive 5 per cent commission plus expenses. The cost of Vinay Ltd. is Rs. 200 per suiting. Lalit House pays following expenses: Railway Freight Rs. 500 Godown Rent & Insurance Rs. 1,000 Vinay Ltd. draw on the consignees a bill for Rs. 10,000 which is duly accepted. Subsequently it is discounted for Rs. 9,500. The consignees informed the consignor of the sale of the entire consignment for Rs. 28,500. Show journal entries and ledger accounts in the book of the consignor.
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Financial Accounting Notes Solution Journal entries in the Book of Vinay
Ltd. (Consignor) Date Particulars Dr. Cr. Consignment A/c Dr. 20,000 To goods sent on consignment A/c 20,000 (100 pieces of suiting consigned to Lalit House at cost Rs. 200 per suiting) Bill receivable A/c Dr. 10,000 To Lalit House 10,000 (Being of the bills of exchange received from consignee) Cash Account Dr. 9,500 Discount Account Dr. 500 To bill receivable A/c 10,000 (Being bill discounted with the bank) Lalit House Dr. 28,500 To Consignment A/c 28,500 (Being gross proceeds of the goods sold) Consignment A/c Dr. 1,500 To Lalit House 1,500 (Being the expenses incurred by Lalit House) Consignment A/c Dr. 1,425 To Lalit House 1,425 (Being Commission @ 5% on sales) Consignment A/c Dr. 5,575 To Profit & Loss A/c 5,575 (Being profit on consignment transferred) Goods sent on Consignment A/c Dr. 30,000 To Trading A/c 30,000 (Being goods sent on consignment A/c transferred to trading A/c)
Consignment 85 Notes Consignment A/c Dr. Particulars Amount Rs. Particulars Cr. Amount ` To Goods sent on consignment a/c To Lalit House To Lalit House- Commission To Profit and Loss A/c- profit on consignment 20,000 1,500 1,425 5,575 By Lalit House (Sales) 28,500 28,500 28,500 Lalit House Dr. Particulars Amount Rs. Particulars Cr. Amount ` To Consignment a/c 28,500 By Bills Receivable By consignment A/c (exp.) By consignment A/c (Commission) By Balance c/d 10,000 1,500 1,425 15,575 28,500 28,500 Goods Sent on Consignment Account Dr. Particulars Amount Rs. Particulars Cr. Amount ` To Trading A/c (Transferred) 20,000 By consignment A/c 20,000 28,500 28,500 5.6.2 Books of the Consignee The consignee
opens two accounts i.e. consignor personal account and commission account. The consignee
also does the postings to the other accounts such as Consignment Debtor's Account, Consignment Expenses Account and Bills Payable Account etc.
Consignee need not pass any entry in his books on the receipt of goods by him or for expenses incurred by the consignor. He should open the Consignor's Account in his books and route all the transactions through it in the following manner: 1. When cash is remitted or bill is accepted Consignor A/c Dr. To Cash A/c/Bills payable A/c (Being cash remitted or bills accepted).

86 Financial Accounting Notes 2. When expenses are incurred Consignor A/c Dr. To Cash A/c (Being expenses incurred on consignment) 3. When sale is made on Consignment (i) For cash sales Cash a/c Dr. To Consignor's A/c (ii) For credit sales Debtor's A/c Dr. To Consignor A/c (Being goods sold on credit) 4. On remitting balance to consignor after commission Consignor's A/c Dr. To Cash A/c/Bank A/c To Commission A/c (Being cash remitted after commission) Note: (A) For unsold stock lying with consignee, no entry is to be passed in his book of account. (B) Consignee does not pass any entry for profit or loss in his books.

Illustration 2: To continue with the illustration 1, pass the journal entries in the books of consignee and prepare ledger accounts. Solution

Journal Entries Date Particulars L.F. Dr. Cr. Vinay Ltd. Dr. 10,000 To Bills payable A/c 10,000 (Being bill accepted) Vinay Ltd. Dr. 1,500 To Cash A/c 1,500 (Being expenses (incurred) Cash A/c Dr. 28,500 To Vinay Ltd. 28,500 (Being Sales proceeds received on consignment) Vinay Ltd. Dr. 1,425 To Commission A/c 1,425 (Being 5% commission on total sales) Consignment 87 Notes B/P A/c Dr. 10,000 To Cash A/c 10,000 (Being bill met on maturity) Vinay Ltd (Consignor) Dr. Particulars Amount Rs. Particulars Cr. Amount ` By Bills payable A/c By Cash A/c (exp.) By Commission A/c By Balance c/d 10,000 1,500 1,425 15,575

To Cash (Sale Proceeds) 28,500 28,500 28,500 5.7

Accounting for Loss of Goods Goods sent on consignment may be lost or damaged in transit. The loss of goods may be either (i) normal or (ii) abnormal. Treatment

of loss

in the books of accounts will depend upon the nature of loss. Normal Loss Normal loss of goods is

the loss which

is natural, unavoidable and is due to inherent characteristic of the goods

which are

despatched like evaporation, sublimation etc. The amount of stock to be carried down is the proportion of the total cost that the number of units on hand bears to be the total number units as diminished by loss. Deficiency of Stock When there is deficiency of stock at the time of assessment of stock and the consignee is under a liability to account for the missing stock, the entry will be: Consignee Dr. To Consignment a/c (Being the deficiency of stock charged to the consignee). If, on the other hand, he is not liable, the stock of the consignment will be shown at the gross figure and the consignment account will be debited with the loss in stock. Abnormal Loss These are the losses which are accidental and not natural like theft. Abnormal loss may occur in the godown of the consignee or in transit. When the abnormal loss

occurs in the godown of the consignee it will not affect the value of closing stock because the expenses incurred after they reach the godown of the consignee are not to be taken into account for

the

purpose. The treatment in accounts will depend upon whether the unforeseen loss has been insured against or not. In case of insurance the consignment account will be credited but the insurance companies or underwriter's account will be debited with the amount of loss which shall be calculated like valuation of stock on consignment i.e. including proportionate non-recurring expenses of both the consignor and the consignee. If the goods are not insured, instead of Insurance Company's or Underwriter's Accounts being debited, Profit and Loss Account will be debited and consignment account will be credited. In this way the final net profit on consignment is not adversely affected.

88 Financial Accounting Notes Illustration 3: Fox of Hyderabad sent on 15th January, 2015, a consignment of 500 toys bicycles costing Rs. 100 each. Expenses of Rs. 700 met by the consignor. Yak of Goa spent Rs. 1,500 for clearance and the selling expenses were Rs. 10 per bicycle. Yak sold, on 4th April 2015, 300 pieces @ Rs. 160 per piece and again on 20th June 2015, 150 pieces @ Rs. 172. Yak was entitled to a commission of Rs. 25 per piece sold plus one fourth of the amount by which the gross proceeds less total commission thereon exceeded a sum calculated at the rate of Rs. 125 per piece sold. Yak sent the amount due to Fox on 30th June 2015. You are required to show the Consignment Account and Yak's Account in the books of Fox. Solution Consignment Account

Date 2015 Dr. Particulars Amount ` Date 2015 Particulars Cr. Amount ` Jan 15 Jan 15 Jan 15 April 4 June 20 June 30 June 30

To Goods sent on consignment a/c 500@ Rs.100 To Bank account- Exp. To Yak- Clearing Exp. To Yak-Selling Exp. To Yak- selling Exp To Commission A/c To Profit and Loss A/c- profit on consignment 50,000 700 1,500 3,000 1,500 12,510 9,810

April 4 June 20 June 30 By Yak- sale of 300 pieces @ Rs. 160 By Yak- sale of 150 pieces @ Rs. 172 By consignment stock A/c 48,000 25,800 5,220 79,020 79,020 Yak Account Date 2015 Dr. Particulars Amount ` Date 2015 Particulars Cr. Amount ` April 4 June 20 To Consignment a/c To Consignment a/c 48,000 25,800 Jan 15 April 4 June 20

By consignment A/c (clearing exp.) By consignment A/c (selling exp.) By consignment A/c (selling exp.) 1,500 3,000 1,500

Consignment 89 Notes June 30 June 30 By consignment A/c (Commission) By Bank A/c 12,510 55,290 73,800 73,800 Working Note (1) Valuation of Closing stock 50 pieces @ Rs. 100 each= Rs. 5,000 Plus: Proportionate Expenses Expenses incurred by Fox on 500 pieces = Rs. 700 Clearing expenses incurred by Yak = Rs. 1500 Total Expenses Rs. 2,200 Therefore, expenses on 50 pieces 2200x50/500 = Rs. 220 Rs. 5,220 (2) Calculation of Commission Let Total Commission of Yak be a a = No. of pieces sold x Rs. 25 + ¼ [Gross sale proceeds - (Rs. 125x No. of pieces sold] - (a) a = 450 x Rs. 25 + ¼ [R. 73,800 - (Rs. 125 x 450] -a) a = Rs. 45,000 + Rs. 17,500 -a 5a = Rs. 62, 550 Therefore: a = 62,550/5 = Rs. 12,510 5.8 Invoicing Goods higher than

the Cost Sometimes the consignor send the goods at selling price or it can be said that the goods are sent on consignment above cost i.e. at selling or near selling price. It does not affect the profits of the consignor but

the purpose is to hide the real profit on the consignment from the competitive eye of the consignee. A few adjusting entries in respect of goods sent on consignment and stock are to be made at the end of the financial year. The entries are as follows: To bring down the invoice of the goods sent on consignment to cost, debit goods sent on consignment account and credit consignment account with the difference in the invoice and the cost price. (i) Goods sent on consignment A/c Dr. To consignment A/c (Being the excess of Invoice price written back) To adjust the value of the stock lying unsold with the consignee, debit the consignment account and credit 'Stock Reserve Account' with the difference in prices. (ii) Consignment A/c Dr. To Consignment Stock Reserve A/c

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Financial Accounting Notes (

Being the excess of invoice price or value over cost Price of unsold stock adjusted). The balance of the goods sent on consignment account will be transferred to the Trading Account. The stock on consignment and Stock Reserve Account will be closed and the balance will be shown in Balance sheet. Next year the stock on consignment account will be transferred to the debit of the 'Consignment Account' and Stock Reserve Account will be transferred to the Consignment Account. Illustration 4: Bahadur. Ltd. of Delhi consigned 1,000 cases of milk powder to Surat of Bombay. The goods were charged at proforma invoice value of Rs 10,000 including a profit of 25% on invoice price. The consignors paid Rs. 600 for freight and insurance. Consignee paid import duty Rs. 1,000, Dock Dues Rs. 200 and sent to the Consignors a bank draft of Rs. 4,000 as advance. They sold 80 cases for Rs. 10,500 and sent for the balance due to the consignors after deducting commission of 5% on gross sale proceeds. Show ledger accounts in the books of the consignor. Solution: Consignment Account Dr. Particulars Amount ` Particulars Cr. Amount ` To Goods sent on consignment a/c 25% above cost To Bank account- Exp. To Surat of Bombay- Exp. To consignment stock reserve A/c (25% of stock Rs. 200) To Profit and Loss A/c- profit on consignment 10,000 600 1,200 500 2,535 By Surat of Bombay (Consignee) By Goods sent on consignment By Consignment stock A/c 10,500 2,500 2,360 15,360 15,360 Surat of Bombay (Consignee) Dr. Particulars Amount ` Particulars Cr. Amount ` To Consignment a/c 10,500 By Bank A/c By

Consignment A/c-Exp By Consignment A/c- Commission By Bank A/c 4,000 1,200 525 4,775 10,500 10,500 Goods Sent on Consignment Account Dr. Particulars Amount ` Particulars Cr. Amount ` To Consignment A/c To Trading A/c 2,500 7,500 By consignment A/c 10,000 10,000 10,000

Consignment 91 Notes Consignment Stock Account Dr. Particulars Amount ` Particulars Cr. Amount ` To Consignment A/c 2,360 By Balance c/d 2,360 2,360 2,360 Consignment Stock Reserve Account Dr. Particulars Amount ` Particulars Cr. Amount ` To Balance c/d 500 By consignment A/c 500 500 500 Working Notes 1. Valuation of Stock 20 cases of Milk Rs. 100 = Rs. 2,000 Proportionate Expenses = Consignor expenses + Consignee Expenses = Rs. 600 (freight and insurance + Rs. 1000 (Import duty) + Rs. 200 (Dock Dues) = Rs. 1800 Expenses on unsold Stock= 1800 x 20/100 = 360 Total value = Rs. 2000 + 360 = Rs. 2360 2. Adjustment Entries - Excess of invoice price over cost price in case of goods sent on consignment = 10,000 x 25/100 = Rs. 2500. 5.9 Summary

Manufacturers or wholesalers nowadays sell their goods both within and outside the country through agents.

The one who forwards the goods is known as consignor, the one to whom the goods are sent is known as consignee, goods so sent are called 'Goods sent on Consignment'

and the process of sending goods is known as

consignment. Consignment is a way of facilitating sale but actually it is different from sales. If goods are not sold then

a consignment is returnable but in case of sale, the goods are not returnable except for some special reasons like below standard goods are supplied. When goods are sold to a person the property in them passes to that person, but when goods are consigned to a person the legal ownership of the goods remains with the consignor. Hence when goods are sold the relationship between two parties is that of a creditor and debtor but when the goods are consigned relationship between the consignors and consignee is that of 'principal' and 'an agent'.

The consignor opens three accounts in his ledger i.e. Consignment Account which

is prepared to ascertain profit or loss on each consignment e.g. Consignment to Bombay

Account, consignee’s account which is prepared to show the balance due to or from consignee at a particular date and goods sent on Consignment Account which is prepared to show the amount of goods sent to the consignee. The balance is credited to Purchase or Trading Account.

The consignee opens two accounts i.e. consignor personal account and commission account. Sometimes the consignor send the goods at selling price or it can be said that the goods are sent on consignment above cost i.e. at selling or near selling price. It does not affect the profits of the consignor but

the purpose is to hide the real profit on the consignment from the competitive eye of the consignee.

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Financial Accounting Notes 5.10 Check Your Progress Multiple Choice Questions 1. Consignment means. (a) Goods forwarded from one place to another (b) Goods forwarded by a person to another (c) Goods sent by its owner to his agent (d) Goods sent by its owner to his agent for the purpose by sale 2. Goods sent on consignment should be debited by consignor to: (a) Consignment A/c (b) Goods sent on consignment A/c (c) Consignees A/c (d) Consignors A/c 3. Who is a consignor? (a) Principal (b) Agent (c) Debtor (d) None of them 4. Which of the following best describes consignee? (a) Principal (b) Agent (c) Buyer (d) Seller 5. Who among the following submits the Account sales? (a) Consignor (b) Consignee (c) Principal to his agent (d) Debtor to creditor 6. Normal losses are due to: (a) Avoidable factor (b) Contingent (c) Unavoidable (d) None 7. Consignee debits the expenses incurred by him on consignment in his books on: (a) Consignment

A/c (b) Cash A/c (c) Consignor’s A/c (d) Expense A/c 8. In the books of

consignor in which of the following account the abnormal loss should be credited to: (a) Profit & loss A/c (b) Consignment A/c (c) Trading A/c (d) Consignees A/c

Consignment 93 Notes 9. The expenses incurred by consignor should be debited to in which of the following accounts in his own books of accounts? (a) Consignees A/c (b) Consignment A/c (c) Expenses A/c (d) Consignor’s A/c 10. The expenses incurred by consignee should be debited to in which of the following accounts in the consignor books of accounts? (a) Consignee A/c (b) Consignment A/c (c) Expenses A/c (d) Consignor’s A/c 5.11 Questions and Exercises 1. Explain the meaning of consignment. 2. Define the term consignor and the consignee. 3. Discuss how consignment is different from sales? 4. Explain the normal loss and abnormal loss. 5. Discuss the accounts opened by the consignor in his books for treating consignment transactions. 6. What is proforma invoice? How it is different from actual invoice? 7. What do you understand by account sale? 8. Why goods are sent at invoice price to consignee? Explain the adjustments necessary if the goods are sent at invoice price. 9. On 1st July, 2014 LCD House of Madras consigned 200 LCD’s

to Big Bros. of the Punjab. The cost of each LCD was Rs. 400. LCD House paid Rs. 5,000 for freight and insurance. On 7 July, 2014 Big Bros. accepted a 3 months bill drawn upon them by LCD House for Rs. 50,000, Big Bros. paid Rs. 2,200 as rent and Rs. 1,300 for advertisement and upto 31st December, 2014 (on which date LCD House close their books) they sold 180 LCDs at Rs. 500 each. Big Bros. were entitled to a commission of 5% on sales. Give Journal entries and prepare necessary accounts to record the above transactions in the books of the parties. 10. Aruna sends goods on consignment to Seema. The terms are that Seema will receive 10% commission on the price (which is cost plus 25%) and 20% of any price realised above the invoice price. Seema will meet her expenses herself, goods to be sent freight paid. Aruna sent goods whose cost was Rs. 16,000 and spent Rs. 1,500 on freight, forwarding, etc. Seema accepted a bill for Rs. 16,000 immediately on receiving the consignment. Her expenses were Rs. 200 as rent and Rs. 100 as insurance. Seema sold ¾ of the goods for Rs. 19,500. Part of the sales were on credit and one customer failed to pay Rs. 400. Give Consignment Account and Seema's Account in the books of Aruna and Aruna's Account in the books of

Seema. 5.12 Key Terms ?

Consignment: Consignment is a way of facilitating sale but actually it is different from sales. ?

Proforma Invoice: When goods are sent by consignor to consignee it is supplemented by a document called pro-forma invoice. It is a forwarding letter

94 Financial Accounting Notes which gives a description about the name of the item; quantity, weight or measurement of items, price, and transportation charges etc. ? Account Sale: Account sale is a statement which is regularly prepared and sends by the consignee to the consigner. This statement gives a description about the no. of items received, sales, expenses incurred, commission charges, amount sent and the remaining balance payable by the consignee to the consignor. ? Normal loss : Normal loss of goods is the loss which

is natural, unavoidable and is due to inherent characteristic of the goods

which are despatched like evaporation, sublimation etc ?

Abnormal loss: These are the losses which are accidental and not natural like theft. Abnormal loss may occur in the godown of the consignee or in transit.

Check Your Progress: Answers 1. (d) Goods sent by its owner to his agent for the purpose by sale 2. (a) Consignment A/c 3. (a) Principal 4. (b) Agent 5. (b) Consignee 6. (c) Unavoidable 7. (c) Consignor’s A/c 8. (b) Consignment A/c 9. (a) Consignees A/c 10. (b) Consignment A/c 5.13 Further Readings ? Maheshwari S.N.,

Studies in Advanced Accounting, Sultan Chand and Sons, New Delhi. ? Gupta Shashi K., Aggarwal Nisha and Gupta Neeti, Financial Accounting,
Kalyani Publishers, Ludhiana. ? Tulsian P.C., Financial Accounting, Pearson Education, New Delhi. ? W. Albrecht, Stice Earl, Stice James, Financial Accounting, Cengage Learning.
Joint Venture 95 Notes Unit 6:
Joint Venture Structure 6.1 Introduction 6.2 Concept of Joint Venture 6.2.1 Meaning of Joint Venture 6.2.2 Features of Joint Venture 6.2.3 Difference between Consignment and Joint Venture 6.3 Methods of Recording Joint Venture Transactions 6.3.1
Each co-venturer records the transactions 6.3.2 Memorandum Joint Venture Account Method 6.3.3 Separate Books 6.4 Summary 6.5 Check Your Progress 6.6 Questions and Exercises 6.7 Key Terms 6.8 Further
Readings Objectives After studying this unit, you should be able to: ? Define a joint venture and explain its feature ? Understand the difference between joint venture and consignment. ? Learn to prepare the account for joint venture transactions under different methods. 6.1 Introduction
In the modern world a business may require large amount of funds, technical knowhow but there are certain complexities such as lack of
huge funds requirements, lack of technical expertise which make it difficult to undertake a business assignment individually therefore two or more persons join hand together for finance, for technical know-how, for sharing risk etc. When two or more persons join together to carry out a specific business and share the profits on predetermined basis, it is known as a Joint Venture.
In this unit, we shall be discussing about the meaning and essential features of joint ventures, understand the difference between joint venture and consignment. We shall also be discussing the preparation of accounts for joint venture transactions under different methods. 6.2 Concept of Joint Venture Under this section you will learn the meaning and features of joint venture and the difference between joint venture and consignment.
96 Financial Accounting Notes 6.2.1
Meaning of Joint Venture A joint venture is usually a temporary partnership without the use of a firm name, limited to carrying out a particular business plan in which the persons concerned agree to contribute capital and to share profits or losses. The parties in a joint venture are known as co-ventures and their liability is limited to the adventure concerned for which they agree to contribute capital and share profits or losses. A joint venture may consist of a joint consignment of goods, speculation in shares, underwriting of shares or debentures, construction of a building, or any similar form of enterprise. 6.2.2 Features of Joint Venture Following are the main features of a joint venture: ? Two or more persons are needed. ? It is an agreement to execute a particular venture or a project. ? The joint venture may not have a specific name. ? It is of temporary nature. The agreement may come to an end as soon as the venture is completed. ? The co-ventures share profit and loss in an agreed ratio. The profits and losses are to be shared equally if not agreed otherwise. ? The co-ventures are free to continue with their own business unless agreed otherwise during the life of joint venture. 6.2.3 Difference between Consignment and Joint Venture Consignment and
joint venture are in the nature of an agreement between different parties but there are many points of differences between the two. Some of these are given below: Joint Venture Consignment Number of co-ventures is usually two but it can also be more than two. Normally two persons are involved, the consignor and the consignee. The relationship between co- venturers is that of partnership. Co- venturers are the owners. The relationship between the consignor and the consignee is that of principal and agent. The relationship comes to an end as soon as the venture is completed. The arrangement may continue for a long time. All the co-venturers contribute funds to a common pool. The funds are provided by the consignor. It may be for sale of goods or for carrying on any other activity like construction of building, investment in shares etc.
It is generally connected with sale of movable goods. The profit is shared by all the co- venturers. The profit belongs to the consignor only. The consignee is entitled only to his commission. There is joint ownership The consignor owns the goods. 6.3
Methods of Recording Joint Venture Transactions Joint venture accounts can be kept under any of the following three methods:
Joint Venture 97 Notes 1.

Each co-venture records the transaction in his own books and opens "Joint Venture Account" and accounts of his fellow partners. 2. One common Joint Venture Account on memorandum basis is prepared to find the profit or loss made on trading. Under this system each one of the partners opens only one account which is of the nature of personal account. The account is called. "Joint venture with ....a/c." 3. Venturers agree to keep a separate set of books and a person is made in charge of recording of all transactions. Generally this method is not adopted. 6.3.1 Each co-venturer records the transactions Under this system the "Joint Venture Account" is opened and debited with the value of goods bought and expenses incurred. Cash account or the party which has supplied the goods or incurred the expenses will be credited. When the sales proceeds are received, the party receiving it, will debit cash (for Debtors) account and credit the Joint Venture Account. The other parties will debit the recipient party and credit the Joint Venture Account. Sometimes, a bill of exchange is drawn by one of the parties and is discounted. In such a case the discount on the bill should be charged to Joint Venture Account. Joint Venture Account will now show the profit or loss on trading. Under this system, each (Joint venturer) partner will open two
accounts i.
e. (i) Joint Venture Account (ii) The account of other parties. Journal Entries: The following journal entries will be passed 1) For Investment in Joint Venture Joint Venture A/c Dr. To Cash/Good A/c (Being the amount of goods supplied or cash put in for Joint Venture) 2) As goods are supplied by the Co-venturer or cash is invested in Joint Venture by him Cash A/c (For cash sent) Dr. Joint Venture A/c Dr. To Co-venturer A/c (for goods sent) (Being goods supplied or cash invested by the other partner) 3) For recording sale of joint venture goods Cash A/c Dr. To Joint Venture A/c (Being Sale of goods made) 4) On sale of joint venture goods by the other party Co-Venturer A/c Dr. To Joint Venture A/c (Being Joint Venture goods sold by the other partner) 5) a) For receipt of Bill of Exchange from the other partner Bills receivable A/c Dr. To Co-Venturer A/c
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Financial Accounting Notes (
Being bill receivable received) b) For discounting the bill of exchange Bank A/c Dr. Joint Venture A/c Dr. To Bills Receivable A/c (Being bill discounted and discounting charges debited to Joint Venture A/c). 6) Entries in the books of other partner Acceptor's books regarding acceptance of bills of exchange Co-venturer A/c Dr. To Bills Payable A/c (Being acceptance given) 7) On discounting the bills of exchange by other party i.e. drawer Joint venture A/c Dr. To Co-Venturer A/c 8) On commission charged under Joint Venture Joint Venture A/c Dr. To commission A/c 9) On Commission charged by other partner Joint Venture A/c Dr. To Co-Venturer A/c (Being Commission on sale effected by other partners) 10) When some products are left unsold and transferred to his own stock. Purchase A/c Dr. To Joint Venture A/c (Being the unsold goods taken) 11) If the other partner has taken the unsold goods, the entry will be:- The Co-venturer A/c Dr. To Joint Venture A/c (Being the unsold goods taken by the other partner) 12) Now Joint Venture Account will be closed. If it shows profit then the profit will be divided in the agreed ratio. The entry will be Joint Venture A/c To P & L A/c (own share) To Co-venturers A/c (their share) (Being the profit on Joint Venture shared by the parties) Joint Venture 99 Notes Format of Two accounts to be maintained Joint Venture Account Dr. Particulars Amount ` Particulars Cr. Amount ` To Cash A/c (purchased) To Cash A/c (Expenses) To Purchase A/c (Material supplied) To Outstanding Expenses A/c To Profit transferred to: Profit & Loss A/c Co-venturers A/c By Cash A/c By Co-venturer A/c (Goods taken over) Co-venturer's Personal Account Particulars ` Particulars ` To Joint Venture A/c (Good taken over) To Cash a/c By Bills Receivables By Joint Venture A/c Illustration 1 X and Y entered into Joint Venture to sell a consignment of timber sharing profits and losses equally. X provides timber from stock at mutually agreed value of Rs. 50000. He pays expenses amounting to Rs. 2500. Y incurs further expenses on cartage, storage and collie age of Rs. 6500 and receives cash for sales Rs. 30,000. He also takes over goods to the value of Rs. 10000 for his own use. At the close, X takes over the balance stock in hand which is valued at Rs. 11000. Pass Journal Entries to record the above transactions and open the necessary ledger accounts in the books of X and Y. Journal Entries in the Books of X Particulars L.F. Dr. ` Cr. ` Joint Venture A/c Dr. 52,500 To Purchase A/c 50,000 To Bank A/c 2,500 (Being timber provided and expenses incurred) Joint Venture A/c Dr. 6,500 To Y 6,500 (Being expenses incurred by Y) Y Dr. 30,000 To Joint Venture a/c 30,000
100 Financial Accounting Notes (Being the sale proceeds by Y) Y Dr. 10,000 To Joint Venture A/c 10,000 (Y takes over the goods for his use) Purchase A/c Dr. 11,000 To Joint Venture A/c 11,000 (Being unsold goods taken) Y Dr. 4,000 Profit and Loss A/c Dr. 4,000 To Joint Venture A/c 8,000 (Being the loss on Joint Venture shared equally) Bank A/c Dr. 37,500 To Y 37,500 (Being draft received from Y) Ledger Account Joint Venture A/c Particulars ` Particulars ` To Purchase 50,000 By Y (sale proceeds) 30,000 To Bank (expenses) 2,500 By Y (goods for his use) 10,000 By Purchases (goods) 11,000 To Y (expenses) 6,500 By Y (loss) 4,000 By Profit and Loss A/c (Ratio being 1:1) 4,000 59,000 59,000 Y's Account Particulars ` Particulars ` To Joint Venture (Sale) 30,000 By Joint Venture (Expenses) 6,500 To Joint Venture (goods) 10,000 By Bank (Final Settlement) 37,500 To Joint Venture (goods) 4,000 44,000 44,000

Joint Venture 101 Notes Journal Entries in the Books of Y Particulars L.F. Dr. Cr. ` ` Joint Venture A/c Dr. 52,500 To X 52,500 (Being the goods supplied and expenses incurred) Joint Venture A/c Dr. 6,500 To Bank 6,500 (Being the expenses paid) Bank Dr. 30,000 To Joint Venture A/c 30,000 (Being the receipt of sale proceeds) Drawing A/c Dr. 10,000 To Joint Venture A/c 10,000 (Being the goods withdrawn for own use) X Dr. 11,000 To Joint Venture A/c 11,000 (Being the taking over the balance stock in hand by X) X Dr. 4,000 Profit and Loss A/c Dr. 4,000 To Joint Venture A/c 8,000 (For sharing of loss in equal ratio) X Dr. 37,500 To Bank 37,500 (Being the draft remitted X) Ledger Account Joint Venture A/c Particulars ` Particulars ` To X (goods supplied) 50,000 By Bank (by sales) 30,000 To X (expenses) 2,500 By Drawing of goods 10,000 To Bank (expenses) 6,500 By Balance (stock taken by X) 11,000 By X 4,000 By Profit and Loss A/c (
Ratio being 1:1) 4,000 59,000 59,000
102 Financial Accounting Notes X's Account Particulars `
Particulars ` To Joint Venture A/c 11,000 By Joint Venture (Goods & Expenses) 52,500 To Joint Venture (Loss) 4,000 By Bank (Final Settlement) 37,500 44,000 44,000 6.3.2 Memorandum
Joint
Venture Account Method Under the Memorandum Joint Venture Account Method each co-venturer will record only those transactions relating to the joint venture which are directly concerned with him and not those of others. a) Under this method each co-venturer opens a Joint Venture Account including the name of the other co-venturer. The heading of the account is 'Joint Venture with (name of
co-venturer)
Account'. The Joint Venturer with (name of co-venturer) Account is a personal account and it does not show any profit or loss. The following entries will be made in this account: i) Joint Venture with..........................Account Dr. To cash/Bank/Creditors Account (Being payments by cheque or cash or liabilities incurred on Joint Venture) ii) Cash/Debtors Accounts Dr. To Joint Venture............Account (Being sale Cash/Credit made on account of Joint Venture) b) A separate 'Joint Venture Memorandum Account' is prepared to ascertain profit or loss in Joint Venture. It is just like profit and loss account, all the expenses and losses are debited to it and all incomes and gains are credited to it. All the items of personal accounts will also appear on the same side of 'Joint Venture Memorandum Account'. The balance of Joint Venture Memorandum Account shows profits or loss on joint venture and each party makes an entry for his share of profits or losses. The journal entry is as under: Joint Venture with.................Account Dr. To Profit and Loss Account (Being profit earned on Joint Ventures) Or Profit and Loss Account Dr. To Joint Venture with................Account (Being loss effected on Joint Venture) Illustration 2 A and B entered into a Joint venture involving the buying and selling of old railway material with an agreement to share profit or loss equally. (The amount is in Rs. Hundreds). The cost of the material purchased was Rs. 30,000 which was paid by A, who drew bill of Rs. 20,000 on B at three months' period.
Joint Venture 103 Notes
The bill was discounted by A at cost of Rs. 160. The transactions relating to the ventures were: 1) A paid Rs. 200 for carriage, Rs. 600 for commission on sales and Rs. 100 for travelling expenses (ii) B paid Rs. 80 for travelling expenses and Rs. 120 for sundry expenses (iii) Sales made by A amounted to Rs. 21,400 less allowance for faulty goods Rs. 400 and (iv) Sales made by B were Rs. 15,000. The remaining goods were retained by A and B for their private use and these were charged to them as Rs. 1600 and Rs. 2400 respectively. A was credited with sum of Rs. 300 to cover the cost for warehousing and insurance. The expenses in connection with the discounting to the bill were to be treated as a charge against the venture. Prepare the ledger accounts in the books of both the parties and also the memorandum joint venture account. Solution Dr. Memorandum Joint Venture A/c Cr. (` In 000) Particulars ` Particulars ` To Materials 30,000 By Sales (21000+15000) 36000 To discount on Bill 160 By stock taken by A 1600 B 2400 4000 To carriage 200 To commission 600 To Travelling (100+8) 108 To Sundry expenses 120 To Warehousing expenses 300 To Profit A : 4220 B : 4220 8440 40,000 40,000 In the Books of A Joint Venture with B A/c (` in 000) Dr. Cr. Particulars ` Particulars ` To Bank (material) 30,000 By Bank (sales) 21,000 To discount on bill 160 By Stock taken 1,600 To Bank By Balance c/d 12,980 Carriage 200 Commission 600 Travelling exp. 100 Warehousing 300 1,200 By Profit & Loss A/c 4,220 35,580 35,580 To Balance b/d 12,980
104
Financial Accounting Notes
In the Books of B Joint Venture with A A/c Dr. Cr (` in '000) Particulars ` Particulars ` To Bank Travelling Exp. 80 Sundry Exp. 120 200 By Bank (Sales) 15,000 To Profit & Loss A/c 4,220
By Stock taken 2,400 To Balance c/d 12,980 17,400 17400 By Balance b/d 12980 6.3.3

Separate Books Recording of transactions is done not in books of parties but in a separate set of books. Co-venturer first contributes to a common bank account and then all payments are made through it. Accounts of parties are also opened. Profit or Loss on Joint Venture is transferred to the respective partner's accounts in due ratios. Finally, the books are closed with the close of the venture. Three main accounts opened under separate set of accounts are: 1. Joint Venture Account 2. Joint Bank Account, and 3. Personal Capital Accounts of Joint Venturers. The following entries will be passed under this system 1. When cash is invested by Joint Venturer Joint Bank A/c Dr. To Capital Accounts of Joint Venturers. (Being cash invested by Joint Venturers and deposited into the Bank) 2. When purchases are made for joint venture out of bank A/c Joint Venture A/c Dr. To Joint Bank A/c (Being Purchase made for Joint Venture) 3. When expenses are incurred for joint venture out of Bank A/c Joint Venture A/c Dr. To Joint Bank A/c (Being expenses incurred for Joint Venture Account)
Joint Venture 105 Notes 4. When sales are made Joint Bank A/c Dr. To Sales (Being sales made and receipts from sales deposited into Bank) 5. When some products are left unsold and are taken away by Joint Venturers Capital accounts of Joint Venturer A/c Dr. To Joint Venture A/c (Being unsold stock taken by Joint Venturers) 6 (a) For Profit on Joint Venture account Joint Venture A/c Dr. To capital accounts of Joint Venturers A/c (Being profit earned on Joint Venturers) 6 (b) The reverse entry will be passed in cases of losses on Joint Venture. Illustration 3 X and Y enter into joint venture to underwrite public issue of Reliance Ltd. They agree to guarantee the subscription at par on 1,00,000 shares of Rs. 10 each of Reliance Ltd. and sharing profits and losses in the ratio of 2:3. The terms with the company are 4.5 % commission payable in cash and 6,000 fully paid shares of the company. They agreed to pay expenses in connection with the issue of shares. The expenses incurred are advertisement Rs. 5,000; Printing and stationery Rs. 2,000 and postage Rs. 600. All expenses are paid by X. The public subscribed to 88,000 shares only. The remaining shares under the agreement were duly taken by X and Y who provided the necessary cash equally. The commission is received in cash and is shared by the co-venturers in the ratio of 4:5. The entire holding of the joint venture is then sold in the market through brokers as follows: 25% at a price of Rs. 9 per share, 50% at a price of Rs. 8.75 per share, 15% at a price of Rs. 8.50 per share and the remaining 10% is taken over by A and B equally at an agreed price of Rs. 8 per share. Prepare the Joint Venture Account, Joint Bank Account, Shares Account and the Accounts of X and Y showing the final statement. Solution Joint Venture Account Dr. Cr. Particulars ` Particulars ` To
Advertisement 5000 Printing 2000 Postage 600 7,600 By Joint
A/c (commission) 45,000 To Shares A/c (Loss on sale) 23,400 By Shares A/c (commission) 60,000 To profit transferred to X: 29,600 Y: 44,400 74,000 1,05,000 1,05,000
106 Financial Accounting Notes Joint Bank Account Dr. Cr. Particulars ` Particulars ` To X (Contribution) 60,000 By Shares A/c 1,20,000 To Y (Contribution) 60,000 BY X (Commission) 20,000 To Joint Venture (Commission) 45,000 By Y (Commission) 25,000 To Shares A/c (Sale for cash) 25% 40,500 50% 78,750 15% 22,950 1,42,200 By X (final settlement) By y (final settlement) 70,000 72,000 3,07,200 3,07,200 Share A/c
Particulars ` Particulars ` To Joint Bank A/c 1,20,000 By Joint Bank A/c (Sale of Shares) 40,500 To Joint Venture (commission) 60,000 By Joint Bank A/c (Sale of Shares) 78,750 By Joint Bank A/c (Sale of Shares) 22,950 By X (shares taken over) 7,200 By Y (shares taken over) 7,200 By Joint Venture A/c 23,400 1,80,000 1,80,000 X's Account

19% MATCHING BLOCK 12/50 W

Particulars ` Particulars ` To Joint Bank A/c (Commission) 20,000 By Joint Venture A/c (Expenses) 7,600 To Shares A/c 7,200 By Joint Bank A/c (Commission) 60,000 To Joint Bank A/c (Final Settlement) 70,000 By Joint Venture A/c (Profit) 29,600 97,200 97,200 Joint Venture 107 Notes Y's Account Particulars ` Particulars ` To Joint Bank A/c (Commission) 25,000 By Joint Bank A/c (

Commission) 60,000 To Shares A/c 7,200 By Joint Venture A/c (Profit) 44,400 To Joint Bank A/c (Final Settlement) 72,200 1,04,400 1,04,400 Working Notes 1. Distribution of commission received in cash 4.5 % of Rs. 10,00,000 = Rs. 45,000 Xs shares 4/9 x 45,000 = Rs. 20,000 Y's shares 5/9 x 45,000 = Rs. 25,000 2. Treatment of shares received Shares received by way of commission 6,000 Shares not subscribed by public 12,000 Total Number of shares received 18,000 a) Sold for cash 25% of 18,000 i.e. 4,500 shares sold @ Rs. 9 per share Rs.40,500 50% of 18,000 i.e. 9,000 shares sold @ Rs. 8.75 per share Rs. 78,750 15% of 18,000 i.e. 2,700 shares sold @ Rs. 8.50 per share Rs. 22,950. b) Dividend amongst X and Y 10 % of the remaining shares i.e. 1,800 shares are taken over equally by X and Y at an agreed price of Rs. 8 per share. X : 900 shares @ Rs. 8 per share = Rs. 7200 Y : 900 shares @ Rs. 8 per share = Rs. 7200 6.4 Summary
In the modern world a business may require large amount of funds, technical knowhow but there are certain complexities such as lack of

huge funds requirements, lack of technical expertise which make it difficult to undertake a business assignment individually therefore two or more persons join hand together for finance, for technical know-how, for sharing risk etc. When two or more persons join together to carry out a specific business and share the profits on predetermined basis, it is known as a Joint Venture.
The
parties in a joint venture are known as co-ventures and their liability is limited to the adventure concerned for which they agree to contribute capital and share profits or losses.
Joint
venture accounts can be kept under any of the three methods: each co- venture records the transaction in his own books and opens "Joint Venture Account" and accounts of his fellow partners, one common Joint Venture Account on memorandum basis is prepared to find the profit or loss made on trading. Under this system each one of the partners opens only one account which is of the nature of personal account. The account is called. "Joint venture with ....a/c." and
108 Financial Accounting Notes Venturers agree to keep a separate set of books and a person is made in charge of recording of all transactions. Generally this method is not adopted. 6.5
Check Your Progress Multiple Choice Questions 1. Joint venture account is in the nature of a (a) Real account (b) Personal account (c) Nominal account (d) Partnership account 2. A joint venture is a: (a) General partnership (b) Particular partnership (c) Vague partnership (d) Common partnership 3. A separate set of books of account is kept when the size of the venture is: (a) Large (b) Medium (c) Small (d) Very small 4. Profit or loss on a joint venture is shared by the co-venturers: (a) Equally (b) As per the capital contributed (c) As per the shared agreement (d) All of the above 5. Joint bank account is opened under which of the following method? (a) Each co-venturer records the transactions (b) Memorandum Joint Venture Account Method (c) Separate Books (d) Either 1 or 2 6. Under the separate books of accounts all payments are made through: (a)
Joint Venture Account (b) Joint Bank Account (c) Personal Capital Accounts of Joint Venturers. (
d) Capital Accounts of Joint Venturers 7. Which of the following is not the feature of Joint venture? (a)
Two or more persons are needed. (b) Agreement to execute a particular venture or a project. (c) The joint venture has a specific name. (d) Temporary nature. 8. The
relationship between co-venturers is that of: (a) Partnership (b) Principle agent
Joint Venture 109 Notes (c) Consigner consignee (d) None of the above 9. A separate ....
is prepared to ascertain profit or loss in Joint Venture. (
a) Joint Venture Memorandum Account (b) Joint Venture Account (c) Joint Bank Account (d) Joint Account of Venturers 10. Under the
separate set of books co-venturers first contribute to ....and then all payments are made through it. (
a) Joint Venture Memorandum Account (b) Joint Venture Account (c) Joint Bank Account (d) Joint Account of Venturers 6.6 Questions and Exercises 1. Explain the meaning of Joint Venture. 2. Discuss the need for joint venture in the modern times. 3. What are the main features of joint venture business? 4. Explain the difference between joint venture and consignment. 5. Discuss the memorandum method of keeping joint venture accounts. 6. Explain the different methods of recording joint venture transactions. 7. Which journal entries are passed if each co-venturer records the transactions? 8. If the conditions are not given then at what rate the profit and loss is shared among all the co-ventures'? 9. M
and N enter into joint venture to underwrite public issue of Wipro Ltd. They agree to guarantee the subscription at par on 1,00,000 shares of Rs. 10 each of Wipro Ltd. and sharing profits and losses in the ratio of 3:2. The terms with the company are 4.5 % commission payable in cash and 6,000 fully paid shares of the company. They agreed to pay expenses in connection with the issue of shares. The expenses incurred are advertisement Rs. 50,000; Printing and stationery Rs. 20,000 and postage Rs. 6000. All expenses are paid by M. The public subscribed to 88,000 shares only. The remaining shares under the agreement were duly taken by M and N who provided the necessary cash equally. The commission is received in cash and is shared by the co-venturers in the ratio of 3:2. The entire holding of the joint venture is then sold in the market through brokers as follows: 25% at a price of Rs. 9 per share, 50% at a price of Rs. 8.75 per share, 15% at a price of Rs. 8.50 per share and the remaining 10% is taken over by M and N equally at an agreed price of Rs. 8 per share. Prepare the Joint Venture Account, Joint Bank Account, Shares Account and the Accounts of X and Y showing the final statement. 10.
X

and Y entered into a Joint venture involving the buying and selling of building material with an agreement to share profit or loss equally. The cost of the material purchased was Rs. 30,000 which was paid by X, who drew bill of Rs. 20,000 on Y at three months' period. The bill was discounted by X at cost of Rs. 1600. The transactions relating to the ventures were: 1) X paid Rs. 2000 for carriage, Rs. 6000 for commission on sales and Rs. 1000 for travelling expenses (ii) Y paid Rs. 800 for travelling expenses and Rs. 1200 for sundry expenses (iii) Sales made by X amounted to Rs. 21,400 less allowance for faulty goods Rs. 400 and (iv) Sales made by Y were Rs. 15,000. The remaining goods were retained by X and Y for their private use and these were
110 Financial Accounting Notes charged to them as Rs. 1600 and Rs. 2400 respectively. X was credited with sum of Rs. 3000 to cover the cost for warehousing and insurance. The expenses in connection with the discounting to the bill were to be treated as a charge against the venture. Prepare the ledger accounts in the books of both the parties and also the memorandum joint venture account. 6.7 Key Terms ? Joint Venture: A
joint venture is usually a temporary partnership without the use of a firm name, limited to carrying out a particular business plan in which the persons concerned agree to contribute capital and to share profits or losses. ? Co-Venturers: The parties in a joint venture are known as co-
ventures. ? Bills of Exchange: A bill of exchange is a written order to a person requiring them to make a specified payment to the signatory or to a named payee at a particular date. ? Memorandum
Joint Venture Account: Under the Memorandum Joint Venture Account Method each co-venturer will record only those transactions relating to the joint venture which are directly concerned with him and not those of others.
Check Your Progress: Answers 1. (c) Nominal account 2. (b) Particular partnership 3. (a) Large 4. (c) As per the shared agreement 5. (c) Separate Books 6. (b) Joint Bank Account 7. (c) The joint venture has a specific name. 8. (a) Partnership 9. (a) Joint Venture Memorandum Account 10. (c) Joint Bank Account 6.8 Further Readings ? Warren Carl S., Reeve Jim, Duchac Jonathan, Financial Accounting, Cengage Learning, 2015. ? O'Bryan David W., Financial Accounting, IAP, 2010. ? W. Albrecht, Stice Earl, Stice James, Financial Accounting, Cengage Learning, 2010. ? V Rajasekaran, Financial Accounting, Pearson Education India, 2011.
Branch Accounting 111 Notes Unit 7: Branch Accounting Structure 7.1 Introduction 7.2 Objective of Branch Accounting 7.3
Types of Branches 7.3.1 Branch not keeping full system of Accounting 7.4
Dependent Branches 7.4.1 Features of Dependent Branches 7.5 Foreign Branches 7.6 Debtors System 7.6.1 When goods are sent to Branch at Cost Price 7.6.2 When goods are sent to branch at Invoice Price 7.7 Summary 7.8 Check Your Progress 7.9 Questions and Exercises 7.10 Key Terms 7.11 Further Readings Objectives After studying this unit, you should be able to: ? Discuss the objectives and types of branch accounting ? Understand the features of dependent branches ? Solve problems on debtors system at cost and invoice price 7.1 Introduction
As the business of a firm grows in size it open branches in order to sell its product over a large territories.
The
object of keeping the branch accounts are to evaluate the progress and performance of each branch and to know the profit and loss of each branch separately. The financial position of each branch on a particular date
can be ascertained and the cash and goods requirements of various branches can be ascertained. In this unit, we shall be discussing about the objectives and types of branch accounting, the features of dependent branches and we shall also be discussing the calculation of branch profit on debtor system. 7.2 Objective
of Branch Accounting The main objective of maintaining branch accounts depends on the nature of the business and specific need of a particular branch.
Following are the main objectives of keeping branch accounting for
all businesses: i) To know the profit or loss of each branch separately. ii) To ascertain the financial position of each branch on a particular date. iii) To know the cash and goods requirements of the various branches.
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iv) To evaluate the progress and performance of each branch. v) To calculate commission for payment to the managers, if based on profits of branch. vi) To know the profitability of each branch and type of business for expansion of the business. vii) To give concrete suggestions for the improvement in the working of the various branches. viii) To meet the requirements of specific enactments as all branches of a company must keep the accounts for audit purposes. 7.3 Types of Branches For the purposes of accounting, branches may be divided into three
categories such as: 1.
Branches which do not keep their accounting records, their accounting
are

wholly performed at the Head office. 2. Branches which keep their own accounting records independently; and 3. Foreign branches 7.3.1 Branch not keeping full system of Accounting The main features of these type of branches are as follows: (a) These branches sell only those goods which are supplied by the Head office. These branches are not allowed to make any purchases from the outside market. (b) Head office supplies goods to these branches either at the cost price or at the invoice price. (c) All expenses of a regular nature of the branch such as salary, rent, advertisement etc. are paid by the Head Office. (d) Some petty expenses e.g. cartage, entertainment etc. are paid by the branch manager out of the petty cash balance. Petty cash book may be maintained by the branch either on sample basis or on Imprest system. (e) Such branches are required to deposit the cash collected by them either by way of cash sales or cash collected from debtors into the bank account opened in the name of the Head office. (f) Sales are made by the branch normally on a cash basis but sometimes the branches are permitted to sell the goods on a credit basis also. (g) Such branches keep only some memorandum records e.g. stock registers. A copy of the stock register is forwarded to the Head Office every week or every month. This statement will show for each item, the opening stock, the stock received during the period, sales during the period, breakage losses etc. during the month and the closing stock. The sanction of the Head Office will be necessary in order to write off the breakage losses etc. The stock statement will serve the purpose of controlling the stock at the branch and of the purpose of guiding the Head Office as to which stocks should be replenished. This statement is normally required to be submitted by branch to Head office by a fixed day. Since these type of branches do not keep any account, accounts are maintained by the Head Office. The system of maintaining accounts by the Head office depends on the size of the branch, and the degree of control which the Head office wants to exercise. Keeping in view the above factors the Head office maintains the accounts of the branch in any one of the following ways: ? Debtors system: This system is generally adopted in the case of concerns which are fairly of a small size. Under this system for each branch a separate account is

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opened in the books of Head office in order to record all transactions relating to that branch. ? Final Account System: Under this system the office opens a Branch Trading and Profit and Loss Account and a branch account. Branch account opened under this system is quite different from the branch account opened under the debtors system. ? Stock and Debtors System: Under this system the head office opens for each branch a Branch Stock Account, Branch Debtors Account, Branch Expenses Account and Branch Adjustment Account in order to find out the profit or loss made by the branch. ? Wholesale branch: This method is adopted when the goods are supplied to the branch at the wholesale price i.e. at the price at which the goods are supplied to the wholesalers. 7.4

Dependent Branches Dependent branches are that section of an enterprise that is geographically separated from the rest of the business. The activities of branch are controlled by head office and usually it carries on the same functions as of the enterprise 7.4.1 Features of Dependent Branches (1) The branch does not maintain its own set of books. But the head office maintain record of all transactions in respect of branch (2) Goods are received from the head office. However, the outside purchases by branch are not allowed (3) Goods are often supplied by head office at cost price. But sometimes they are sent at invoice price or loaded price (4) All expenses of regular nature directly paid by head office through cheques (5) All petty expenses at branch are paid by the branch manager from the petty cash received in advance from the head office (6) Usually branch makes sales on cash basis. But in certain cases credit sales may be made with the authorization from the head office (7) Cash received on account of cash sales and from debtors is duly remitted to head office or deposited with a local bank in the account of head office 7.5

Foreign Branches When a branch is located in a foreign country it is called a foreign branch. Such branch will keep its books of accounts in foreign currency. The main problem which the head office is to face under this type of branch is to convert the branch trial balance from the foreign currency to the currency of that country where a head office is working in order to incorporate the branch trial balance in the books of head office. Otherwise for all purposes, this branch is treated as an independent branch. 7.6

Debtors System Under this system a separate account known as the Branch Account is opened for each branch for the purpose of calculating the profit. Branch account opened in the books of Head office is in the nature of a nominal account. The salient features of this type of accounting are as follows: 1. Stock in the beginning and at the end: Stock in the beginning of the period is shown in the debit side of the branch account while stock at the end of the period is shown on the credit side of the branch account. Stock is shown at the cost price. 2. Goods sent to the branch: Goods sent to the branch during the year is shown on the debit side of the branch account at the cost price. If the goods are returned by

114 Financial Accounting Notes branch to the Head office it is shown in the credit side of the Branch Account. Alternatively it can be shown by way of a deduction from the 'Goods sent to the Branch' on the debit side of Branch Account. 3. Branch expenses paid by the Head Office: Branch expenses paid by the Head office are shown in the debit side of branch account. 4. Branch expenses paid by branch office: Expenses paid by the branch do not appear anywhere because they reduce the balance of cash in hand. Reduced balance of cash appears on the credit side of Branch Account. 5. Treatment of branch expenses paid by office when petty cash system is maintained on the imprest system: If petty cash is maintained at the branch on the imprest system, then the petty expenses paid by the branch manager are reimbursed by the Head office. These expenses then take the form of expenses paid by the head office and are shown in the debit side of the branch account. The petty cash balance at the end of the period must be shown on the credit side of the branch account at the same figure at which it appeared at the commencement of the period. 6. Depreciation on the branch fixed assets: Depreciation on the branch fixed asset is not shown anywhere in the branch account. Branch Account is debited with the value of branch fixed asset at the commencement and is credited with the adjusted value of branch fixed asset at the end. 7. Bad debts, discount allowed, allowances etc.: Similarly bad debts, discount allowed to customers, allowances, returns from customers are not shown in the Branch Account because these accounts reduce the figure of debtors at the end. 8. Cash sales and credit sales: The figure of cash and credit sales are not shown in the Branch Account. These figures are replaced by remittances which
are
calculated by adding cash sales and cash received from customers. 9. Purchase of fixed asset: Where some fixed asset is purchased by the branch it increases the book value of the fixed asset on the one hand and reduces the remittances (if purchased on cash) or increases the liabilities (if purchased on credit. 10. Sale of fixed asset : On the sale of the fixed asset by the branch, the book value of the fixed asset is reduced on the one hand, and on the other hand it increases either the remittances (if the sale is for cash) or increases debtors at the end (if the sale is on credit). 7.6.1
When goods are sent to Branch at Cost Price
Journal Entries: The following journal entries are passed under the Debtor system: 1. When goods are sent to branch Branch Account Dr. To Goods sent to Branch Account 2. When goods are returned by branch Goods sent to Branch Account Dr. To Branch Account 3. When cheque is sent to the branch for expenses Branch Account Dr. To Bank Account 4. When cash/cheque is received from the branch for remittances Bank Account Dr. To Branch Account
Branch Accounting 115 Notes 5. For closing balances of assets at the branch Branch Assets Account Dr. To Branch Account The closing balances of assets will be shown in the balance sheet of the Head office. At the beginning of the next accounting period a reverse entry will be passed. Branch Account Dr. To Branch Assets Account 6. For closing balances of liabilities at the branch Branch Account Dr. To Branch Liabilities Account Dr. The closing balances of liabilities will be shown in the Balance Sheet of the Head office. At the beginning of the next accounting period a reverse entry will be passed. Branch Liabilities Account Dr. To Branch Account 7. For transferring profit or loss of the branch Branch Account (Profit) Dr. To General Profit and Loss Account In case of loss the above entry is reversed General Profit and Loss Account Dr. To Branch Account (Loss) 8. For goods sent to branch account Goods sent to Branch Account Dr. To Purchases Account (in trading concerns) To Trading Account (in manufacturing concerns) Branch Account in the books of Head office will appear as under : BRANCH ACCOUNT Dr. Particulars Amount ` Particulars Cr. Amount ` To Balance b/d (opening balances of assets) Cash in hand Stock in trade (at cost) Sundry debtors Furniture Prepaid Insurance To Goods sent to Branch A/c (at cost) To Bank account (Expenses paid by H.O.) To Balance c/d (closing balance of liabilities) To General Profit and Loss Account (
Profit)
By Balance b/d (opening balances of liabilities) By Bank Account Cash sales Received from debtors By Balance c/d (closing balances of assets) Cash in hand Stock in trade (at cost) Sundry debtors
Prepaid Insurance Furniture By
General Profit and Loss Account (Loss)
116 Financial Accounting Notes Illustration 1: ABC Co. of New Delhi opened a branch at Kanpur. The following is the list of transactions between the Head office and the branch for the year ending March 31, 2001 ` Stock at Branch on 1st April, 2000 1,500 Goods supplied to Branch during the year 24,000 Cash sent to Branch for – Salaries 1,200 – Rent 360 – Telephone expenses 100 – Petty Expenses 150 Remittances received from the branch during the year 27,500 Stock on 31st March,2006 1,250 Balance of Petty Cash 10 All the branch expenses are paid by Head office. Give journal entries and show the Branch Account in the Head office books. Solution Journal Particulars ` ` Branch Account Dr. 1,500 To Branch Stock Account 1,500 (Being the opening balance of branch stock transferred back) Branch Account Dr. 24,000 To Goods sent to Branch Account 24,000 (Being the goods sent to the branch during the year) Branch Account Dr. 1,810 To Cash Account 1,810 (Being the cash sent to branch to meet the following expenses Salaries 1,200 Rent 360 Telephone expenses 100 Petty expenses 150) Cash Account Dr. 27,500 To Branch Account 27,500 (Being the cash received from the branch) Branch Stock Account Dr. 1,250 Branch Petty Cash Account Dr. 10

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Branch Accounting 117 Notes To Branch Account 1,260 (Being the closing balances of stock and petty cash Branch Account Dr. 1,450 To General Profit and Loss Account 1,450 (Being the profit at the branch transferred) Branch Account Dr. Particulars Amount ` Particulars Cr. Amount ` To Branch stock account To Goods sent to Branch A/c (at cost) To Cash account -Salaries 1200 - Rent 360 - Telephone Exp. 100 -Petty Exp. 150 To General Profit and Loss
Account 1,500 24,000 1,810 1,450
By Bank Account -– Remittances from Branch By Branch stock account By Branch Petty Cash
Account 27,500 1,250 10 28,760 28,760 7.6.2
When goods are sent to branch at Invoice Price Goods are marked on invoice price in order to have effective control on stock and to keep secret from the branch manager the cost price of the goods and profit made, so that he may not start a competing business with the concern. Head Office will maintain branch account on the same lines but the entries relating to goods sent to branch, goods returned by the branch to head office, opening and closing stock at the branch will be at invoice price and in order to calculate the net profit of the branch, the following adjustment entries will have to be passed in the head office books at the end of the accounting period: 1. For adjustment of excess price of the Opening Stock at Branch: Stock Reserve Account Dr. To Branch Account 2. For adjustment of excess price of goods sent to branch less returns to head office: Goods Sent to Branch Account Dr. To Branch Account 3. For adjustments of excess price of the closing stock at the Branch: Branch Account Dr. To Stock Reserve Account Illustration 2: From the following details prepare Branch Account in the books of Head Office.
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Goods sent to Branch at cost 50,000 Goods returned by Branch at cost 3,000 Branch Credit Sales 51,000 Cash Sales at Branch 2,500 Cash remitted to H.O. by Branch 45,000 Expenses paid by H.O. 10,000 Discount allowed to customers by Branch 1,800 Closing stock with Branch at cost 17,000 Closing Debtors (Closing Balance) 7,700 Solution In the books of Head Office Dr. BRANCH ACCOUNT Cr.
Particulars Amount ` Particulars Amount ` To Branch stock at cost
To Branch Debtors To Goods sent to Branch A/c 50,000 Less: Goods returned to H.O.3,000 To Bank (Exp by H.O.) To General Profit & Loss A/c (Profit) - 1,000* 47,000 10,000 11,700
By Remittances from Branch: Cash Sales 2,500 Recd. From Debtors 42,500*
By Branch stock at cost By Branch Debtors 45,000 17,000 7,700 69,700 69,700 Branch Debtors Account Particulars Amount ` Particulars Amount ` To Balance c/d To Credit Sales 1,000 51,000 By cash By
Discount By Balance c/d 42,500 1,800 7,700 52,000 52,000 7.7 Summary As
the business of a firm grows in size it open branches in order to sell its product over a large territories.
The
object of keeping the branch accounts are to evaluate the progress and performance of each branch and to know the profit and loss of each branch separately.
The main objective of maintaining branch accounts depends on the nature of the business and specific need of a particular branch. For the purposes of
accounting, branches may be divided into three categories such as: (i) branches which
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do not keep their accounting records, their accounting is wholly performed at the head office, (ii) branches which keep their own accounting records independently; and (
iii) foreign branches.
Goods are marked on invoice price in order to have effective control on stock and to keep secret from the branch manager the cost price of the goods and profit made, so that he may not start a competing business with the concern.
7.8
Check Your Progress Multiple Choice Questions 1. Under Debtors System, the Debtors at close are shown: (a) On the credit side of the Head Office Account (b) On
the debit side of the Branch account (c) On the credit side of the Branch account
after adjusting for bad debts, discount allowed etc. (d) Are not shown in the Branch account 2. Under Debtors System, the Branch

95%	MATCHING BLOCK 17/50	W
Account is: (a) Real Account (b) Nominal Account (c) Personal Account (d)		

100%	MATCHING BLOCK 14/50	W
is: (a) Real Account (b) Nominal Account (c) Personal Account (d) None of the above 3.		

In branch accounting, if the head office maintains all the accounts then the accounts are used for three main purposes. Which one of the following would not apply? (a) To ascertain the profitability of each branch (b) To check for theft at the branch level (c) To record changes in assets, liabilities and capital (d) To measure the qualities of staff 4. The treatment of petty expenses made by the Debtors System is as follows: (a) It is not recorded in
the Branch account (b) It is shown on the debit side of the Branch account (
c) It is shown on the general Profit and Loss account of Head Office (d) Only the closing balance of Petty Cash (Opening balance plus amount reduced from Head Office less petty expenses) will appear in the credit side
of the Branch account 5. Which of the following system is generally adopted in case of concerns which are fairly of a small size? (
a) Debtor System (b) Final Account System (c) Wholesale Branch (d) Dependent Branch 6. Under which of the following system the office opens a Branch Trading and Profit and Loss Account and a branch account? (
a) Debtor System (b) Final Account System (c) Wholesale Branch (d) Dependent Branch
120 Financial Accounting Notes 7.
If petty cash is maintained at the branch on the imprest system, then the petty expenses paid by the branch manager are reimbursed by the Head office
under: (a) Wholesale system (b) Final Account (c) Stock and Debtor system (d) Debtor system 8. Which of the following is not the feature of dependent branches? (a) The branch maintain its own set of books (b) Goods are received from the head office (c) Goods are often supplied by head office at cost price (d) All expenses of regular nature directly paid by head office through cheques 9. Which of the following
method is adopted when the goods are supplied to the branch at the wholesale price? (
a) Debtor System (b) Final Account System (c) Wholesale Branch (d) Dependent Branch 10. ....branches are that section of an enterprise that is geographically separated from the rest of the business. (a) Dependent (b) Independent (c) Foreign (d) Debtor 7.9 Questions and Exercises 1. Explain the need for branch accounting. 2. Discuss the objectives of branch accounting. 3. What are the different types of branches for the purpose of accounting? Discuss. 4. Explain the features of dependent branches. 5. Discuss the features of foreign branches. What problems are associated with foreign branch accounting? 6. Explain the treatment of stock in hand at the beginning and at the end of the period under debtor system. 7. Discuss the different ways of keeping branch accounting. 8.
Explain the adjustments necessary if the goods are invoiced by a Head Office at cost plus profit price to its branch 9. Kamal
Co. of New Delhi opened a branch at Hyderabad. The following is the list of transactions between the Head office and the branch for the year ending March 31, 2012 ` Stock at Branch on 1st April, 2011 1,50,000 Goods supplied to Branch during the year 24,00,000 Cash sent to Branch for – Salaries 1,20,000 – Rent 36,000 – Telephone expenses 10,000
Branch Accounting 121 Notes –
Petty Expenses 15,000 Remittances received from the branch during the year 27,50,000 Stock on 31st March,2012 1,25,000 Balance of Petty Cash 5,000 All the branch expenses are paid by Head office. Give journal entries and show the Branch Account in the Head office books. 10.
Jain Bros. operate a retail branch at Delhi. All purchases are made by the head office at Madras; goods being charged out to the branch at cost price. All cash received by the branch is remitted to Madras. Branch petty expenses are paid out of an imprest which is reimbursed by the head office from time to time. From the following particulars relating to Delhi branch, you are required to prepare branch account (for calculating profit) in the books of head office. April 1:2006 Stock at cost 8,000 Petty
Cash 800 Plant 10,000 March 31,2007 Stock at cost 7,000 Goods sent to branch 5,000
Petty expenses paid by the branch out of imprest system 700 Cash sales during the year 70,000 Sale of the plant on July 1,2006 (Book value of the plant on the date of sale Rs.900) 800 Expenses paid by the head office 5,000 It is required to write off the plant at 20% p.a. 7.10
Key Terms ? Dependent branches: Dependent branches are that section of an enterprise that is geographically separated from the rest of the business. The activities of branch are controlled by head office and usually it carries on the same functions as of the enterprise. ?
Foreign Branches: When a branch is located in a foreign country it is called a foreign branch. Such branch will keep its books of accounts in foreign currency. ?
Debtors system: This system is generally adopted in the case of concerns which are fairly of a small size. ?

Stock and Debtors System: Under this system the head office opens for each branch a Branch Stock Account, Branch Debtors Account, Branch Expenses Account and Branch Adjustment Account in order to find out the profit or loss made by the branch.
Check Your Progress: Answers 1. (c) On the credit side of the Branch account after adjusting for bad debts, discount allowed etc. 2. (b) Nominal Account 3. (d) To measure the qualities of staff 4. (d) Only the closing balance of Petty Cash (Opening balance plus amount reduced from Head Office less petty expenses) will appear in the credit side of the Branch account 5. (a) Debtor System
122 Financial Accounting Notes 6. (b) Final Account System 7. (d) Debtor system 8. (a) The branch maintains its own set of books 9. (c) Wholesale Branch 10. (a) Dependent 7.11 Further Readings ? Maheshwari S.N.,
Studies in Advanced Accounting, Sultan Chand and Sons, New Delhi. ? Gupta Shashi K., Aggarwal Nisha and Gupta Neeti, Financial Accounting,
Kalyani Publishers, Ludhiana. ? Tulsian P.C., Financial Accounting, Pearson Education, New Delhi. ? W. Albrecht, Stice Earl, Stice James, Financial Accounting, Cengage Learning.
Hire Purchase 123 Notes Unit 8: Hire Purchase Structure 8.1 Introduction 8.2 Meaning and Features of Hire Purchase 8.3 Difference between Sales and Hire purchase 8.4 Accounting Treatment in the Books of Hire Purchaser 8.4.1 Ascertainment of interest 8.4.2 Ascertainment of total cash price 8.4.3 Default and Repossession 8.4.4 Complete Repossession 8.4.5 Partial Repossession 8.5 Concept of Installment System 8.5.1 Features of Installment System 8.6 Difference between Hire Purchase system and Installment Purchase 8.7 Summary 8.8 Check Your Progress 8.9 Questions and Exercises 8.10 Key Terms 8.11 Further Readings Objectives After studying this unit, you should be able to: ? Discuss the meaning and features of hire purchase ? Understand the difference between sales and hire purchase ? Solve problems on hire purchase ? Discuss the concept of installment system ? Differentiate between hire purchase and installment purchase ? Solve problems on installment system 8.1 Introduction The demand for goods are increasing to make life better and the goods are consumed on a large scale but there is inadequate purchasing power transforming into effectual demand i.e. actual sale at set or agreed price. This has created the market for hire purchase. If the customer wants to purchase an asset but is not sure to make payment within a stipulated time he may opt for installment system provided the vendor agrees to it. This type of a business deal is known as hire purchase transactions. In this unit, we shall be discussing about the meaning and features of hire purchase, difference between sales and hire purchase, meaning of installment system and the difference between hire purchase and installment purchase. We shall also be solving problems related to hire purchase and installment system.
124 Financial Accounting Notes 8.2 Meaning and Features of Hire Purchase In hire purchase system the seller of goods delivers the goods to the buyer without transferring the ownership of goods. The payment for the goods will be made by the buyer in installments. If the buyer pays all the installments, the ownership of the goods will be transferred, on payment of the last installment. However, if the buyer does not pay for any installment, the goods will be repossessed by the seller and the money paid on earlier installments will be treated as hire charges for using the goods. So, under this system, the transaction may result in purchasing of goods by the buyer or in hiring the goods. Hence, the system is called Hire Purchase System. Following are the features of Hire Purchase system: ? It is a credit purchase ? The price under this is paid in installments ? The goods are delivered in the possession of the purchaser at the time of commencement of agreement ? Hire vendor remains the owner of the goods until the payment of last installment. ? Hire purchaser has the right to use goods as a bailer ? Hire purchaser has the right to terminate the agreement at any time ? Hire purchaser becomes the owner of the goods after the payment of all the installments as per the agreement. ? Hire vendor will take away the goods from the purchaser if there is any default in the payment of installment, without refunding him any amount. 8.3 Difference between Sales and Hire purchase Hire purchase system could ultimately result in sale of goods. The sale in normal sense and sale under hire purchase system are different in following terms Sale Hire Purchase ? A 'sale' is governed by the sale of Goods Act, 1930. ? In case of sale, the ownership of the goods is transferred to the buyer immediately. ? In case of sale, the buyer makes payment in lump sum. ? The buyer pays only for the price of goods. ? On non-payment of the consideration the seller cannot take back the goods, but can only take legal action on buyer. ? Once a sale has taken place, neither the seller, nor the buyer can terminate the contract (unless it is for genuine reason like damage of goods etc.) ? When the buyer becomes insolvent, the seller has to undertake the risk of loss. ? A sale is subject to levy of sales tax at the time of contract of sale. Hire purchase is governed by the Hire Purchase Act, 1972. In case of Hire purchase, the ownership of goods is transferred to buyer on payment of all installments. In case of hire purchase, the payment is made in installments. The hire purchaser pays for the price of goods and also some amount of interest. On non-payment of any installment, the seller can re-possess the goods. Either the buyer or the seller can terminate the contract at any point of time, until the payments of last installment. When the hire purchaser becomes insolvent, the seller can reposes the goods, and hence need not undertake the risk of loss. In this case, the sales tax will be liable at the time of ownership (i.e. on payment of last installment).

Hire Purchase 125 Notes 8.4 Accounting Treatment in the Books of Hire Purchaser There are three methods to maintain the accounts in the books of hire purchaser they are. ? Outright property method: under this method the asset is recorded at full cash price. ? Asset accrual method: under this method the asset is recorded at the cash price actually paid (asset accrued is recorded) ? Interest suspense method: under this method the total interest is first debited to interest suspense account at the beginning subsequently the interest due at the end of the period is credited to interest suspense account. ? Journal Entries in The Books of Hire – Purchaser Sl. No. Circumstances Outright property Asset accrual Interest suspense At the time of asset purchased. 01 When the asset is purchased Asset a/c Dr To hire vendor a/c No entry Asset
a/c Dr Interest suspense a/c Dr To vendor a/c 02 When the down payment is made Hire vendor
a/c Dr To bank a/c Asset a/c Dr To bank a/c Vendors a/c Dr To bank a/c
At the end of every year 03 When the installment interest becomes due Interest
a/c Dr To hire vendor

a/c Asset a/c Dr Interest a/c Dr To hire vendor a/c Interest a/c Dr To interest suspense a/c 04 When the installment is paid Hire vendor a/c Dr To bank a/c Hire vendor a/c Dr To bank a/c Vendors a/c Dr To bank a/c 05 When the depreciation is charged Depreciation a/c Dr To asset a/c Depreciation a/c Dr To asset a/c Depreciation a/c Dr To asset a/c 126

a/c Dr Interest a/c Dr To hire vendor a/c Interest a/c Dr To interest suspense a/c 04

Financial Accounting Notes 06 When the depreciation and interest is transferred to p/l a/c Profit / loss a/c Dr To interest a/c To depreciation a/c Profit / loss a/c Dr To interest a/c To depreciation a/c Profit / loss a/c Dr To interest a/c To depreciation a/c
Journal Entries in the Books of Hire – Vendor Sl. No. Circumstances Outright property Asset accrual Interest suspense At the time of asset purchased. 01 When the asset is sold Hire-purchaser
a/c Dr To sales a/c No entry Purchaser a/c Dr To sales a/c To interest suspense a/c 02 When the down payment is received Bank a/c Dr To hire-purchaser a/c Asset a/c Dr To bank a/c Bank a/c Dr To purchaser a/c
At the end of every year 03 When the installment interest becomes due Hire-purchaser

a/c Dr To Interest a/c Asset a/c Dr Interest a/c Dr To hire vendor a/c Interest suspense a/c Dr To Interest a/c 04 When the installment is received Bank a/c Dr To hire-purchaser a/c Hire vendor a/c Dr To bank a/c Bank a/c Dr To purchaser a/c 05 When the interest is transferred to p/l a/c Interest a/c Dr To Profit / loss a/c Profit / loss a/c Dr To interest a/c To depreciation a/c Interest a/c

Dr. To Profit / loss a/c 8.4.1
Ascertainment of interest 1. When rate of interest is given: – Cash price less down payment add interest less installment

Hire Purchase 127 Notes 2. When rate of interest is not given: – Ascertain total amount of interest (total amount- cash price) and then ascertain the interest installment with the help of ratio of amount due at the beginning of each year. Amount due at the beginning of 1st year = total amount- down payment Amount due at the beginning of 2nd year = first year due – 1st installment Amount due at the beginning of 3rd year = second year due – 2nd installment Illustration1: Cash Price of the Assets is Rs. 56,000, Hire Purchase price of the Assets is Rs. 60,000 payable in Rs. 15,000 Down and 3 Equal Installment of Rs. 15,000. Calculate the amount of interest of each installment. Solution: Calculation of Amount of Interest for each installment Installment Amount Due Ratio Amount of Interest I 45000 3 4000*3/6=2000 II 30000 2 4000*2/6=1333 III 15000 1 4000*1/6=667 8.4.2 Ascertainment of total cash price 1. Without the help of annuity table: – Total cash price = cash price installment + down payment Cash price installment is calculated by deducting the interest installment from the installment amount starting with last installment. The interest installment is calculated with the help of following formula: Interest= total amount due at the time of installment X (rate of interest /100+rate of interest) 2. With the help of annuity table: – Under this method the cash price is ascertained with the help of annuity value. Cash price installment = installment X annuity value Total cash price = cash price installment + down payment Illustration 2: Hire Purchase price of the Assets is Rs. 5000 payable as Rs. 800 down and 3 Equal Annual Installment of Rs. 1200, 2200 and Rs. 800 respectively, rate of interest is 10% pa. Solution: Calculation of Cash Price Interest paid= Rate of Interest Amt. Due+ Installment Amt.× 100+Rate of Interest 1. 10 800 73 110 ? ? CP=800-73=727 2. 2200+727= 10 2927 110 ? =266 CP=2200-266=1934

128 Financial Accounting Notes 3. 1200+1934+727= 10 3861 110 ? = 351 CP=1200-351=849 Total Cash Price=800+849+1934+727=Rs. 4310 Illustration 3: Autoworld sold a car sterio to Peter on 1 July 2012. The cash price was Rs. 25,000. Under the HP agreement, Peter was required to pay deposit of Rs.5,000 upon signing up the agreement. The balance together with the interest of 20% per annum need to be paid by 12 monthly installments beginning on 31 July. The cost of the car sterio was Rs.15,000. Solution: a) Calculate the HP profit on 31 Dec 2012 HP profit = HP sales – Cost of goods sold = 29,000 – 15,000 = Rs.14,000 b) Unrealized profit = Outstanding installment HP profit HP sales ? = 6 12 14000 29000 ? ? = Rs. 5,793 c) Realized profit = HP profit – Unrealized profit = Rs. 14,000 – Rs.5,793 = Rs.8,207 Debtor's Account Date Dr. Particulars Amount ` Date Particulars Cr. Amount ` 2012 1 July To HP Sales 29,000 2012 1 July 31 July 31 Aug 31 Sept 31 Oct 31 Nov 31 Dec 31 Dec By Bank Deposit By Bank-1st Installment By Bank-2 nd Installment By Bank 3 rd Installment By Bank 4 th Installment By Bank 5 th Installment By Bank 6 th Installment By Balance c/d 5,000 2,000 2,000 2,000 2,000 2,000 2,000 12,000 29,000 29,000 1 Jan 13 To Balance b/d 12,000

Hire Purchase 129 Notes Hire Purchase Sales A/c Date Dr. Particulars Amount ` Date Particulars Cr. Amount ` 2012 31 Dec To Trading A/c 29,000 2012 1 July By Debtor 29,000 29,000 29,000 Illustration 4: On 1st April,2010 Xtiz Company Ltd. purchased a machine from Yatin Machines Ltd. on hire-purchase basis, the cash price being Rs. 55,850 Rs. 15,000 was paid on the signing of the contract and the balance in three annual installments of Rs. 15,000 each on 31st March each year. Interest is charged at 5% per annum. Depreciation was written off at rate of 10% per annum on the diminishing balance system. Give journal entries in the books of Xtiz Company Ltd. whose accounting year ends on 31st March each year, under Asset Accrual Method. Solution: 1. Under Asset Accrual Method

Journal Entries in the Books of Xtiz Co. Ltd. Date Particulars LF Dr.(`) Cr.( `) 2010 April 1 Machinery A/c ....Dr. To Bank A/c (

Being down payment made at the time of delivery) 15,000 15,000 2011 March 31 Machinery A/c ....Dr. Interest A/c ....Dr. To Yatin Machine Ltd. (Being the first installment due). 12,957 2,043 15,000 " Yatin Machines Ltd ....Dr. To Bank (Being the amount paid in first installment) 15,000 15,000

130 Financial Accounting Notes " Depreciation

A/c ....Dr. To Machinery A/c (Being the depreciation charged) 5,585 5,585 " Profit & Loss A/c ....Dr. To Interest A/c To Depreciation A/c (Being the amount transferred) 7,628 2,043 5,585 2011 March 31 Machinery A/c ....Dr. Interest A/c ....Dr. To

Yatin Machine Ltd. (Being the second installment due). 13,605 1,395 15,000 " Yatin Machines Ltd. ......Dr. To Bank (Being the amount paid in second installment) 15,000 15,000 " Depreciation

A/c ....Dr. To Machinery A/c (Being the depreciation charged) 5,027 5,027 " Profit & Loss A/c ....Dr. To Interest A/c To Depreciation A/c (Being the amount transferred) 6,422 1,395 5,027

Hire Purchase 131 Notes 2012 March 31 Machinery A/c ....D r. Interest A/c ....Dr. To

Yatin Machine Ltd. (Being the third installment due). 14,288 712 15,000 " Yatin Machines Ltd. ....Dr. To Bank (Being the amount paid in third installment) 15,000 15,000 " Depreciation

A/c ....Dr. To Machinery A/c (Being the depreciation charged) 4,524 4,524 " Profit & Loss A/c ....Dr. To Interest A/c To Depreciation A/c (

Being the amount transferred) 5,236 712 4,524 8.4.3 Default and Repossession In the event of not paying an installment due, the hire vendor reserves the right to take back the goods from the purchaser. In such a case the vendor can also forfeit the amounts received from the purchaser hither to considering them only as hire. When the vendor sells different goods to the same party under hire purchase system, he may, at his option either repossess al the goods or a part thereof in case of default. Thus the repossession may be either complete or partial depending upon the circumstances of each case. 8.4.4 Complete Repossession Entries for interest and depreciation up to the date of default will be passed in the books of the buyer & vendor. As the payment of the particular installment is not made, it is not recorded. On repossession, the buyer will close the accounts of the vendor by transferring its balance to asset accounts by debiting the ventor's account & crediting the asset account. Any balance in the asset account will be either profit or loss on repossession which will be transferred to the Profit and Loss account.

132 Financial Accounting Notes The hire vendor will close account of the hire purchaser by transferring its balance to "Repossessed stock account" This account will further be debited with expenses incurred in repairing and credited with sales price. The balance will represent profit or loss on repossessed goods and will be transferred to Profit and Loss account. 8.4.5 Partial Repossession In the use also entries for interest and depreciation will be passed in the books of the hire purchaser and hire vendor for the period till the date of default in payment. Both the hire purchaser and hire seller will pass entries in their respective books for the agreed value of the assets which has been taken back by the vendor. Generally the vendor takes back the asset at a higher rate of depreciation. The hire purchaser will calculate the value of the asset left with him after partial repossession and carry down the amount to next period. The asset account balance will show profit or loss on default and will be transferred to profit and loss account in the books of the vendor. The repossessed assets account it debited with any amount spent for repairing it and credited with the sales price. The difference in this account is the profit or loss of the vendor in connection with repossession. 8.5 Concept of Installment System Installment payment system is also called as the deferred installment. It is a system where the buyer is given the ownership as well as the possession of the gods at the time of signing the contract. The buyer has the facility to pay the price in installments. Installment payment system is a system where there is an agreement to purchase and pay by installments the goods which become the property of the purchaser immediately when he receives the delivery of the same. 8.5.1 Features of Installment System Following are the features of installment system: ? There will be outright sale of goods ? The possession as well as the ownership is passed at the time of signing the contract ? Buyer can make the payment in installments ? The seller cannot repossess the goods and terminate the contract in case of any default in payment but can sue the buyer for the recovery of unpaid amount ? The buyer cannot exercise the option of returning goods and terminating the contract unless the contract becomes void under the act. 8.6 Difference between Hire Purchase system and Installment Purchase The following table shows how hire purchase system is different from installment purchase: Hire-Purchase System Installment Purchase It is a contract of hiring. It is a contract of sale. It is transferred by seller to buyer only after payment of all installments. It is transferred by seller to buyer, immediately on signing the contract.

Hire Purchase 133 Notes In this case, the buyer is like a bailee In this case, the buyer is not in the position of a bailee Such risk is on the seller. Such risk is on the buyer. On default of payment of any installment by the buyer, the seller can repossess the goods. On default and payment of any installment by the buyer, seller cannot repossess the goods, but can file a suit in the court of law against the buyer for the recovery of unpaid price. The buyer can exercise the option of return of goods. The buyer cannot exercise the option of return of goods. The buyer cannot dispose the goods, until the payment of last installment. If disposed, the third party buyer does not get a better title. The buyer has the right to dispose the goods, even if all installments are not yet paid. 8.7 Summary The demand for goods are increasing to make life better and the goods are consumed on a large scale but there is inadequate purchasing power transforming into effectual demand i.e. actual sale at set or agreed price. This has created the market for hire purchase. In hire-purchase system the seller of goods delivers the goods to the buyer without transfer the ownership of goods. The payment for the goods will be made by the buyer in installments. There are three methods to maintain the accounts in the books of hire purchaser they are: Outright property method: under this method the asset is recorded at full cash price. Asset accrual method: under this method the asset is recorded at the cash price actually paid (asset accrued is recorded) Interest suspense method: under this method the total interest is first debited to interest suspense account at the beginning subsequently the interest due at the end of the period is credited to interest suspense account. In the event of not paying an installment due, the hire vendor reserves the right to take back the goods from the purchaser. Entries for interest and depreciation up to the date of default will be passed in the books of the buyer & vendor. As the payment of the particular installment is not made, it is not recorded. On repossession, the buyer will close the accounts of the vendor by transferring its balance to asset accounts by debiting the ventor's account & crediting the asset account. Installment payment system is also called as the deferred installment. It is a system where the buyer is given the ownership as well as the possession of the gods at the time of signing the contract. The buyer has the facility to pay the price in installments. 8.8 Check Your Progress Multiple Choice Questions 1. Which of the following best describes the cash price? (a) Price paid by the buyer (b) Hire purchase price (c) The price of cash sales (d) The price of sales 2. Which of the following act governs Hire purchase?

134 Financial Accounting Notes (a) Hire Purchase Act, 1972 (b) Hire Purchase Act, 1968 (c) Hire Purchase Act, 1965 (d) Hire Purchase Act, 1945 3. Who among the following remains the vendor of the goods until the last installment? (a) Hire payee (b) Hire purchaser (c) Hire Vendee (d) Hire Vendor 4. Who among the following can terminate the contract at any point of time, until the payment of last installment? (a) Buyer (b) Seller (c) Either the buyer or seller (d) Neither the buyer nor seller 5. Under which of the following method the asset is recorded at the cash price actually paid? (a) Asset accrual method (b) Outright property method (c) Interest suspense method (d) All of the above 6. Who among the following reserves the right to take back the goods from the purchaser in case of not paying due installment? (a) Hire payee (b) Hire purchaser (c) Hire Vendee (d) Hire Vendor 7. Installment payment system is also known as: (a) Revenue Installment (b) Deferred Installment (c) Debtor Installment (d) Asset Installment 8. Which of the following is not the feature of installment system? (a) Outright sale of goods (b) Possession is passed at the time of signing the contract (c) Payments can be made in installment (d) None of the above 9. Who of the following cannot terminate the contract in case of any default in payment? (a) Seller (b) Buyer (c) Both 1 and 2 (d) None of the above 10. In Hire purchase, the ownership of goods transferred at the time?

Hire Purchase 135 Notes (a) Sales (b) Down Payment (c) Full cash payment (d) Full HP price paid 8.9 Questions and Exercises 1. Explain the meaning of hire purchase system. 2. What are the characteristics of hire purchase system? 3. What do you understand by installment system? Discuss its features. 4. Explain how sales are different from hire purchase system. 5. Differentiate between hire purchase system and installment system. 6. Madras Transport Ltd. purchased a fleet of 10 buses on 1st January 2008 for Rs.4,00,000, which have been depreciated at 20% per annum, on original cost. On 1st Jan. 2012 the company replaced these buses by 10 new vehicles at a price of Rs.50,000 each. An allowance of Rs.60,000 was made on account of the 10 old buses which were traded in under installment system. The terms of payment were that a deposit of Rs.2,50,000 should be made (less allowance for old buses) and further payments are made on 30th June 2012 and 31st. December 2012 of Rs.1,37,500 and Rs.1,31,250 respectively (both the installments include the balance of cash price equally). Pass necessary journal entries in the books of Madras Transport Ltd. 7. From the information given calculate cash price of an asset: 1st installment (Payable at the end of I quarter of the year) = Rs.7,200 2nd installment (Payable at end of II quarter of the year) = Rs.6,900 3rd installment (Payable at the end of III quarter of the year) =Rs.6,600 4th installment (Payable at the end of IV quarter of the year) = Rs.6,300 Rate of interest = 20% p.a. Rate of depreciation = 15% p.a. (St. line) Down payment Rs.6,0007. 8. On 1 st January, 2013 The Tirupati Industries bought a machine from the Gujrati Machine Co. on the Hire Purchase System. The Cash price of the machine was Rs.26,350 and the payment was to be made as below. Rs.10,000 on signing of the agreement and the balance in three yearly installments of Rs.6,000 each, 5% interest is charged by the vendors. Record the necessary Ledger Accounts in the books of the hire-buyer depreciating the machinery at 15% p.a. on the Diminishing Balance Method. 9. On July 1, 2012 Eastern Printers purchased a printing machine on a hire purchase basis, payments to be made Rs.10,000 on the said date and the balance in three half yearly installments of Rs.8,000 Rs.7,440 and Rs.6,300 commencing from December 2012. The vendor charged interest at 10% per annum calculated on half yearly. Eastern Printers close their books annually on December 31 and provide depreciation at 10% per annum on diminishing balance in each balance in each year. Determine the cash price of machine and show the necessary ledger accounts in the books of Eastern Printers. 10. Mr. Ramesh Kumar purchased a Motor Cycle on hire purchase system on 1-1- 2005. Total cash price of the Motor Cycle is Rs.31,960 payable Rs.7,960 down and three installment of Rs.8,000 each plus interest at 6% p.a. Depreciation @ 10%

136 Financial Accounting Notes p.a. is charged on diminishing balance method. Prepare Motor Cycle Account and Hire Vendor Account in the books of Mr. Ramesh Kumar. 8.10 Key Terms ? Hire Purchase System: Hire Purchase System refers to the system wherein, the seller of goods delivers the goods to the buyer without transferring the ownership of goods. ? Outright property method: Under this method the asset is recorded at full cash price. ? Interest suspense method: Under this method the total interest is first debited to interest suspense account at the beginning subsequently the interest due at the end of the period is credited to interest suspense account. ? Installment payment system: Installment payment system is also called as the deferred installment. It is a system where the buyer is given the ownership as well as the possession of the gods at the time of signing the contract. Check Your Progress: Answers 1. (c) The price of cash sales 2. (a) Hire Purchase Act, 1972 3. (d) Hire Vendor 4. (c) Either the buyer or seller 5. (a) Asset accrual method 6. (d) Hire Vendor 7. (b) Deferred Installment 8. (d) None of the above 9. (a) Seller 10. (d) Full HP price paid 8.11 Further Readings ? Maheshwari S.N., Studies in Advanced Accounting, Sultan Chand and Sons, New Delhi. ? Gupta Shashi K., Aggarwal Nisha and Gupta Neeti, Financial Accounting, Kalyani Publishers, Ludhiana. ? Tulsian P.C., Financial Accounting, Pearson Education, New Delhi. ? W. Albrecht, Stice Earl, Stice James, Financial Accounting, Cengage Learning.

Partnership Accounts 137 Notes Unit 9: Partnership Accounts Structure 9.1 Introduction 9.2 Definition and features of Partnership 9.2.1 Essential Features of a Partnership 9.3 Partnership Deed 9.4 Fixed Capital System V/s Fluctuating Capital System 9.5 Admission of a Partner 9.5.1

Determination of New Profit Sharing Ratio 9.5.2 Determination of the value of goodwill and its allocation among old partners 9.5.3 Revaluation of Assets and Liabilities 9.5.4

Adjustment for Undistributed Profits or Losses and Reserves 9.6 Retirement

of a Partner 9.7 Accounting Procedure at the Time of Retirement of a Partner 9.7.1 Treatment of Goodwill 9.7.2 Revaluation of Assets and Liabilities 9.7.3 Adjustment of Accumulated Reserves and Losses 9.7.4 Calculating the amount due to the retiring partner and its payment 9.8 Death of a Partner 9.8.1 Calculation of Deceased Partner's Share of Profit 9.8.2 Treatment of Life

Policies 9.9

Dissolution of partnership firm 9.10 Modes of Dissolution of Firm 9.11 Preparation of Accounts on Dissolution 9.12 Accounting treatment on Dissolution of a Partnership Firm 9.12.1

Insolvency of partners 9.13 Summary 9.14 Check Your Progress 9.15 Questions and Exercises 9.16 Key Terms 9.17 Further Readings

138 Financial Accounting Notes Objectives After studying this unit, you should be able to: ? Discuss the meaning and features of partnership ? Explain the concept of partnership dead ? Understand the difference between fixed capital system and fluctuating capital system ? Understand the accounting treatment on admission, retirement and death of a partner and solve their problems ? Discuss the treatment of goodwill, sacrificing ratio and gain ratio ? Prepare the accounts of dissolution of partnership firms 9.1 Introduction An individual may not be in a situation to cope with the demands of modern day business for the expansion and modernization of business. As a result two or more individuals decide to pool their resources to carry on a business. In this unit, we shall be discussing about the meaning and features of partnership and the concept of partnership deed. We shall also be discussing the difference between fixed and fluctuating capital system and the treatment of goodwill. At last we will discuss the problems on admission, retirement and death of a partner and the accounts of dissolution of partnership firms. 9.2 Definition and features of Partnership The Indian Partnership Act of 1932 contains the main provisions which are applicable to partnership firms working in India. According to this Act "Partnership is the relation between persons who have agreed to share the profit of the business carried on by all or any of them acting for all". Individually the persons who work in the firm are called partners and the name with which all partners work collectively is called the firm's name. For example, A, B and C working in a firm will be called partners and 'ABC & Co.', the name with which these partners work collectively will be called firm's name. 9.2.1 Essential Features of a Partnership The following are the essential features of a partnership firm: 1. Persons: In order to constitute a partnership firm, there must be at least two persons. The maximum number in partnership is 20 in case the firm is doing ordinary business and 10 in case the firm is engaged in banking business. This is as per Section 11 of the Companies Act, 1956. 2. Agreement: In order to have a partnership, it is necessary that there must be an agreement between partners. 3. Sharing of profits: It is one of the important terms to constitute a partnership firm. Generally sharing of profits (or losses) is one of the important elements to constitute a firm. 4. Business: It includes trade, profession, etc. The firm must be engaged in a lawful business. 5. Management: The management of the partnership firm will be done either by all the partners or any one of them on behalf of all other partners. There is mutual agency among the partners. Following are the characteristics of partnership: 1. It is a contract between two or more than two persons. Partnership Accounts 139 Notes 2.

A contract is necessary for division of profits/losses. 3. The business may be carried on by all or any of them acting for all. 9.3 Partnership Deed A document in which the terms and conditions of partnership are given is called Partnership Deed. In a partnership deed, the rights and duties of partners are given. If there is no partnership deed of a firm, all the provisions of Partnership Act, 1932 will be applicable with regard to duties, rights and liabilities of partners. A partnership deed should contain the following points: 1. Date of agreement. 2. Name and address of the partnership firm. 3. Name and address of the partners. 4. Nature and place of business. 5. Period of partnership, if any. 6. Capital of partners. 7. Profit sharing ratio. 8. Drawings of partners. 9. Interest on capital and on drawings. 10. Salary and commission of partners, if any. 11. Rights, duties and functions of partners. 12. Method of valuation of goodwill. 13. Accounting method at the time of retirement or death of a partner. 14. Arbitration clause to settle disputes among the partners. 15. Method of distribution of assets on the dissolution of the firm. 16. Accounting treatment or procedure at the time of dissolution. 17. Accounting procedures. 18. Any other provision. 9.4

Fixed Capital System V/s Fluctuating Capital System

Capital Accounts of partners may be fixed or fluctuating. If Capital Accounts are fixed, two accounts are prepared for each partner: (i) Partner's Capital Account and (ii) partner's Current Account. In case of fixed capital, partners' Capital Account

is

credited only with that amount of capital at which business is started. Later on, if additional capital is invested, the capital account is credited and it is debited with the amount withdrawn permanently. No other adjustment is made in this account. In partners' Current Accounts, all adjustments regarding interest on capital, salaries, share of profit and drawings are shown. The balance of this account always varies and that of Capital Account remains the same. In case of fluctuating capital, only one account is prepared, which is called Capital Account. In this account, all items relating to additional capital, interest, drawings, share of profit and salaries, etc. are shown. The balance of this type of Capital Account in the beginning and in the end will be different and, as such, it is called Fluctuating Capital Account. 9.5 Admission of a Partner Sometimes a running business may require new partner for the following reasons:

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Need of more capital for expansion of business. 2. Need of expertise in managerial or technical field for running the business. 3. For growth of the business by admitting a reputed person as partner. 4. To admit a new partner in place of an old retiring partner. When a new partner is admitted in business, he gets two types of rights: 1. Right to Share Future Profit-Loss of the Business: When a new partner is admitted in the business, he gets the right to receive profit in an agreed ratio. This share in profit is sacrificed by the old partners. To compensate the old partners for this sacrifice, the new partner pays a price in the form of goodwill adjustment. The method of valuation of goodwill is usually given in the partnership contract. When new partner comes into partnership, the profit sharing ratio of old partners is changed. 2. Right to Share in Assets of the firm: When a new partner is admitted in the firm, he also becomes the owner of firm's assets as per his share, for which he brings in the required capital. Hence, at the admission of a new partner, revaluation of assets and liabilities becomes necessary so that there should be no loss to the old partners or the new partner. At the time of admission of a new partner, the following are the main considerations which must be settled between the old and the new partners: (
a)
Determination of new profit sharing ratio. (b) Determination of the value of goodwill and its allocation among old partners. (
c)
Revaluation of assets and liabilities of the existing business. (d) Distribution of accumulated profits, reserves and losses. (
e)
Determination of the capital to be brought in by the new Partner. 9.5.1 Determination of New Profit Sharing Ratio When a new partner joins the firm, the share of old partners is reduced because they sacrifice some part of their share to the new partner. The determination of new profit-sharing ratio depends upon the agreement among the old and new partners. In
various circumstances, the calculation of new profit-sharing ratio is made as follows: If Share of New Partner is given When the share of new partner is given and in the absence of any direction, the old partners will continue to share the remaining share in their old profit sharing ratio after deducting the share of the new partner. Illustration 1: Y

37%	MATCHING BLOCK 21/50	W

and A are partners sharing profits and losses in the ratio of 3:2. They admit B as a partner for one fourth share in the future profits. Calculate the new profit- sharing ratio

100%	MATCHING BLOCK 20/50	W

are partners sharing profits and losses in the ratio of 3:2.

of partners. Solution: B's share is 1/4 Thus remaining share = 1 - ¼ = ¾ Hence Y's share = ¾ × 3/5 = 9/20 Now A'
s share = ¾ × 2/5 = 6/20 and B's share = ¼ or 5/20 = 9/20 : 6/20 : 5/20 Hence, the new profit sharing ratio will be = 9 : 6 : 5.
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When the New Partner Purchases His Share From Old Partners in a Certain Ratio In this case, the share of old partners will be calculated by deducting that portion which they have sacrificed in favour of a new partner. The remaining share will be treated as the share of old partners. Illustration 2: M

63%	MATCHING BLOCK 36/50	W

and N are partners in a firm sharing profits and losses in the ratio of 3: 2. A new partner

P is admitted. M surrenders 1/5 share of his profit in favour of P, and N surrenders 2/5 of his share in favour of P. Calculate the new profit sharing ratio of the partners. Solution: Sacrifice by M to P = 3/5 × 1/5 = 3/25 Sacrifice by N to P = 2/5 × 2/5 = 4/25 Share of P = 3/25 + 4/25 = 7/25 M's new share = 3/5 - 3/25 = (15-3)/25 = 12/25 N's new share = 2/5 - 4/25 = (10-4)/25 = 6/25 Share of M, N and P = 12/25 : 6/25 : 7/25 = 12 : 6 : 7 When Sacrificing Ratio is given In this case, the sacrifice made by old partners towards the new partner is given. Illustration 3: X and Y are partners sharing profit or loss in the ratio of 7:5. They admit that their manager Z into partnership gets one sixth share in the profits. He acquires his share as 1/24 from X and 1/8 from Y. Calculate the new profit sharing ratio. Solution (Old Ratio - Share given to new partner) X = 7/12 - 1/24 = (14-1)/24 = 13/24 Y = 5/12 - 1/8 = (10-3)/24 = 7/24 Z = 1/6 New ratio = 13/24 : 7/24 : 1/6 = 13 : 7 : 4 Sacrificing Ratio When Old and New Ratios are given In case, when old and new ratios of partners after admission of a partner are given, it is necessary to calculate the sacrificing ratio of the old partners by the formula: Sacrificing Ratio = Old Ratio - New Ratio Illustration 4:

71%	MATCHING BLOCK 22/50	W

A and B are partners sharing profits or losses in the ratio of 4:3. C is admitted and the new

ratios are
A-7, B-4
and C-3 (7:4:3:). Calculate the sacrificing ratio. Solution: Sacrificing Ratio = (Old Ratio - New Ratio)
A's sacrifice = 4/7-7/14 = (8-7)/14 = 1/14 B's sacrifice = 3/7 - 4/14 = (6-4)/14 = 2/14 Thus, sacrificing ratio is 1:2 for A and B. 9.5.2
Determination of the value of goodwill and its allocation among old partners
Goodwill is the value of the reputation of a firm. When a new partner is admitted in the partnership, he starts getting share in the profits of the firm immediately on his entrance.
142 Financial Accounting Notes He gets the benefit of the firm's reputation which has been developed by old partners through their hard work and efforts. Hence, the old partners want some compensation for their previous labour or efforts made by them to build the firm's reputation. The amount of compensation given by the new partner to old partners is called goodwill. It is an intangible asset which is not visible and touchable, but it is subject to fluctuations.
When a new partner gives money for goodwill, he hopes that he would receive some extra profit from this amount. If a new partner starts a new business, he will have to put in a lot of hard work and face difficulties to create and maintain customers. But when he becomes partner in an old established business, he does not face any such problem, and is therefore, willing to pay for the effort and money spent on establishing the business and providing credibility to the firm. Thus, we can say that goodwill is the value of the reputation of a firm which is concerned with the earning capacity of the business. Element of Goodwill Goodwill means the capacity of the business to earn more than normal profit. In other words, it is the value of reputation of the business. It attracts more customers. It is an intangible asset of the business. It takes time to develop goodwill which depends on many factors, mentioned as under: 1. Personal reputation of the owners and manager. 2. Specialty of goods or services provided. 3. Favorable location or site. 4. Patents, Copyrights or Trade Marks. 5. Advantage of an important license with the firm. 6. Advantage of selling a special type of product or raw material
It is important to note that goodwill exist only when the business is running in profit. In a business which is running at a loss, there will be no goodwill because the value of goodwill arises from the future possibility of the firm to earn profit. Need for valuation of goodwill of a firm 1. On Admission of a New Partner: When a new partner comes into the firm, he gets a share in the future profits. The share of the old partners is consequently reduced. So, the new partner has to pay for the goodwill besides his capital. The amount paid for goodwill is distributed among old partners in their sacrificing ratio. Valuation of goodwill depends on the agreement among old and new partners. 2. On Retirement or Death of a partner: As a new partner brings in the amount of goodwill, in the same way, at the time of retirement, a partner receives his share of goodwill of the firm. At the time of death, the deceased partner's share of goodwill is to be given to his legal representatives. For this, the need for valuation of goodwill arises. 3. On the Amalgamation of firms: When two or more than two firms are merged and a new firm is formed, it is called amalgamation. At the time of amalgamation, like other assets and liabilities, goodwill is also value and becomes the part of purchase consideration like other assets. 4. On Sale of firm's business to another firm or company, it is very important to value the firm's goodwill. 5. When profit sharing ratio of the partners is changed, there is a need to evaluate the goodwill so that the losing partners could be compensated. Methods of Evaluating Goodwill The following are the important methods of valuation of goodwill:
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A) Average Profits Method: Under this method, the average of the profits of last three or four years is calculated. The average profits are multiplied by number of years in which the anticipated profits will be available. If the goodwill is twice the average profits of last three years, it is to be valued at two years' purchase of the last three years average profit. Value of Goodwill = Average profit × Number of year's purchased. Formula = Total profits No. of years × No. of years purchased The following points need to be considered for valuation of average profit: 1. Abnormal Profit: If in any year, a firm earns abnormal profits, then it is to be deducted from the firm's profits because it is not or usual or recurring nature. For example, profit due to rise in prices at the time of war of after floods, etc. 2. Abnormal Loss: If in any year, a firm incurred any abnormal losses, them it is added back to the profits. These abnormal losses include loss of stock due to fire, theft or floods, etc. 3. Normal Expenses: If there are any normal expenses which are of recurring nature and are not deducted from the firm's profit, these should be deducted, such as insurance premium, etc. (B) Super Profit Method: In this method, super profit is calculated and it is multiplied with a specific number to find out the goodwill. Super profit is the profit above the normal profit being earned by other firms engaged in the same business.

For example, if the investment in the business is of Rs. 5,00,000 and the rate of profit considered appropriate in similar business is 15%, the normal profit will be Rs. 75,000 (5,00,000 ×15/100). This normal profit is compared with the actual profit earned. If the actual profit is more than the normal profit, it will be called super profit. Suppose further that the actual profit is Rs. 1,00,000, then (1,00,000 - 75,000) Rs. 25,000 is super profit. Goodwill = Super profit × No. of years purchased. If the super profit will be available for three years, the value of goodwill will be : Rs. 25,000 × 3 = Rs. 75,000 Goodwill = Super profit × No. of years purchased Super Profit = Actual or Average Profit - Normal Profit Normal Profit = Capital Invested × Normal Rate of Return/100 (C) Capitalisation Method: Under this method, it is assumed that if capital invested by the firm earns a normal profit, there is no goodwill, but if firm earns more than normal profit, excess capital which might be invested to earn that excess profit is called goodwill. There are two ways of finding out goodwill under this method: 1. Capitalisation of Average Profit: Under this method goodwill is calculated as: Goodwill = Normal Capital Employed - Actual Capital Employed Normal Capital Employed = Profit or Average Profit Normal Rate of Return *100 Suppose the normal rate of profit is 10 per cent and the firm earns Rs. 10,000. If the actual capital employed is Rs. 80,000, then normal capital employed is calculated as under:

144 Financial Accounting Notes Normal Capital Employed = ? ? ? ? 10,000 Profit×100 10 Normal rate of return = Rs. 10,00,000 Goodwill = Normal Capital Employed - Actual Capital Employed = 1,00,000 - 80,000 = Rs. 20,000 Thus, the excess of normal capital employed over actual capital is the value of goodwill. 2. Capitalisation of Super Profit: Under this method, first the super profit is capitalized and on that basis the value of goodwill is determined. Here, super profit is := Actual Profit - Normal Profit After this goodwill is ascertained with the help of following formula : Goodwill = Super Profit × 100 Normal rate of return Treatment of Goodwill

in Account 1. When goodwill is paid by new partner to old partners outside the business: When the amount of goodwill is received by old partners privately or outside the business in case, no entry will be made in the books of firm. 2. When goodwill is brought by new partner and is withdrawn by old partners: In such a cash, the receipt of goodwill money is recorded in the books of firm and is transferred to Capital Accounts of old partners in their sacrificing ratio. The amount, thus, transferred is immediately withdrawn by old partners. The following entries are recorded in firm's books in the above case : i) When goodwill is brought in cash Cash Account Dr. To Goodwill Account (Being amount of goodwill brought in cash) ii) Transferring Goodwill old partners in their sacrificing ratio : Goodwill Account Dr. To Old Partners' Capital Account (Being amount of goodwill transferred to Capital Account) iii) On withdrawn of goodwill by old partners : Old Partners' Capital Account Dr. To Cash Account (Being goodwill withdrawn) 3.

Amount of Goodwill retained in the Business: In this method the amount of goodwill is retained in the business. For this, the following entries will be made: i) When amount of goodwill is brought in: Cash Account Dr. To Goodwill Account OR To New partner's Capital Account (Being amount of goodwill received)

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ii) Amount of goodwill transferred to old partners' Capital Accounts: New partner's Capital Account Dr. OR Goodwill Account Dr. To Old Partners' Capital Account (Being amount of goodwill transferred to old partners Accounts in sacrificing ratio) 4. Raising Goodwill Accounts: Sometimes, the amount of goodwill is not brought in cash by the new partner. Hence, goodwill account is raised with full value of firm's goodwill and capital account of old partners

is

credited in the old profit sharing ratio. a) When goodwill is raised: Goodwill Account Dr. To Old Partners' Capital Account (Being Goodwill Account raised in the books of the firm in old ratio) b) When goodwill is written off: All partners' (including new partner) Capital Accounts Dr. To Goodwill Account (Being Goodwill Account transferred to all partners' Capital Account in the new profit sharing ratio) When goodwill already appears in the books: If goodwill already appears in the books, it is transferred to old partner's Capital Accounts in their old ratio at the time of admission of a new partner. The only entry will be: Old Partners Capital Accounts Dr. To Goodwill Account (Being goodwill appeared in B/S is written-off in old ratio) After this, the entries for goodwill brought in by the new partner will be passed. When Goodwill is not brought in Cash and Goodwill Account is raised: When new partner does not bring goodwill in cash and goodwill already appears in the Balance Sheet, goodwill will be dealt with as under: Change in Profit Sharing Sometimes, partners change their profit-loss sharing ratio. In such a case to treat the amount of goodwill, the following entries will be made: 1. Raising Goodwill Account: First of all, goodwill is raised by debiting the Goodwill Account with full value and crediting all
partners'
capital accounts in their old ratio: Goodwill Account Dr. To All Partners' Capital Account (Being Goodwill Account raised in old ratio) 2. Writing off the Goodwill Accounts: After having raised the goodwill, Goodwill Account will be written off by debiting all partners' Capital Accounts in the new ratio. All Partners' Capital Accounts Dr. To Goodwill Account
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Financial Accounting Notes (
For Goodwill written off in the new ratio) 9.5.3 Revaluation of Assets and Liabilities Revaluation Account is prepared to revalue various assets and liabilities of the firm. When a new partner is admitted into a partnership concern, he acquires the ownership rights in the assets of the firm and is also responsible for the liabilities of the firm. It is, therefore, desirable that the
assets and liabilities as appearing in the Balance Sheet on the date of admission of the new partner should be properly valued.
For the adjustment of various assets and liabilities, a Profit and Loss Adjustment or Revaluation Account is prepared. On its debit side is shown decrease in assets, outstanding expenses and increases in liabilities, and on the credit side, increase in assets, prepaid expenses and decrease in liabilities are shown. The balance of this account is transferred to Capital Accounts of old partners in their old ratio. 9.5.4 Adjustment for Undistributed Profits or Losses and Reserves i) When a new partner is admitted in the firm, reserves, undistributed profits and credit or debit balance of Profit and Loss Account are transferred to old partners' Capital Accounts in their old ratio. For this purpose, the following journal entries are passed. Profit and Loss Account (if Profit) Dr. General Reserve Account Dr. To old partners' Capital Accounts (Being profits & reserve distributed in old partners in old ratio) ii) If the debit balance of Profit and Loss Account is shown in the Balance Sheet, then it will also be transferred to old partners' Capital Accounts in old ratio. Old Partners' Capital Accounts Dr. To Profit and Loss Account
Illustration 5: Tanya

72%	MATCHING BLOCK 23/50	W

and Sushil are partners in a firm sharing profit in the ratio 5 : 3. They admitted Gaurav as a new partner for 1/4th share in the profit.

Gaurav brings Rs. 30,000 for her share of goodwill and Rs.1,20,000 for capital. Make journal entries in the books of the firm after the admission of Gaurav. The new profit sharing ratio will be 2:1:1. Solution: Books of Tanya, Sushil and Gaurav Date Particulars LF Debit Credit Amount Amount (`) (`) Bank
A/c Dr. 1,50,000 To Goodwill A/c 30,000 To Gaurav's Capital A/c 1,20,000 (cash brought by Gaurav for his share of goodwill and

73%	MATCHING BLOCK 24/50	W

capital) Goodwill A/c Dr. 30,000 To Tanya's Capital A/c 15,000 To Sushil's Capital A/c 15,000

Partnership Accounts 147 Notes (Goodwill transferred to existing partners' capital account in their profit sharing ratio) Working Note: Calculation of sacrificing ratio [existing ratio – new ratio] Partners Existing ratio New ratio Sacrifice Sacrificing ratio Tanya 5/8 2/4 5/8 – 2/4 = 1/8 Tanya : Sushil Sushil 3/8 1/4 3/8 – 1/4 = 1/8 1 : 1 Illustration 6: Karuna and Taruna are partners
sharing profit and losses in the ratio of 2:1. Their Balance Sheet was as follows: Balance Sheet

of Karuna and Taruna as on December 31,2013 Liabilities Amount ` Assets Amount ` Creditors Bills payable Capitals: Karan 40,000 Tarun 30,000 10,000 7,000 70,000 87,000 Cash in hand Debtors Building Investment Machinery Stock 7,000 26,000 20,000 15,000 13,000 6,000 87,000 Nimarta is admitted as a partner and assets are revalued and liabilities reassessed as follows: (i) Create a Provision for doubtful debt on debtors at Rs.800. (ii) Building and investment are appreciated by 10%. (iii) Machinery is deprecated at 5% (iv) Creditors were overestimated by Rs.500. Make journal entries and Prepare revaluation account before the admission of Nimarta. Solution Journal Date Particulars LF Debit Credit Amount Amount (`) (`) Revaluation A/c Dr. 800 To Provision for Doubtful Debts 800 [Provision made for doubtful debts] Building A/c Dr. 2,000 Investment
A/c Dr. 1,500 To Revaluation A/c 3,500 [Increase in the value of Building & Investment] Revaluation A/c Dr. 650
148 Financial Accounting Notes To Machinery A/c 650 [
Decrease in the value of machinery] Creditor A/c Dr. 500 To Revaluation A/c 500 [Value of creditors reduced by Rs.500] Revaluation account Dr. Particulars Amount ` Particulars Cr. Amount ` Provision for Doubtful debts Machinery Profit transferred to Karuna's Capital 1,700 Taruna's Capital 850 800 650 2,550 Building Investment Creditors 2,000 1,500 500 4,000 4,000 Illustration 7: Asha and Pankhudi are partners sharing profit
in the ratio of 3 : 2, their Balance sheet on March 31, 2014 was as follows: Balance Sheet
of Asha and Pankhudi As on March 31, 2014 Liabilities Amount ` Assets Amount ` Creditors Bills payable Salaries Outstanding Profit and Loss Capitals: Asha 1,50,000 Pankhudi 1,30,000 38,000 40,000 5,000 40,000 70,000 2,80,000 Cash in hand Cash at Bank Debtors Stock Machinery Goodwill 15,000 62,000 58,000 85,000 1,45,000 38,000 4,03,000 4,03,000 They admitted Gurmeet into partnership on the following terms on March 31, 2014. (a) New profit sharing ratio is agreed as 3 : 2 : l. (b) He will bring in Rs.1,00,000 as his shared capital and Rs.30,000 as his share of goodwill. (c) Machinery is appreciated by 10% (d) Stock is valued at Rs. 87,000. (e) Creditors are unrecorded to the extent of Rs.6,000. (f) A provision for doubtful debts is to be created by 4% on debtors. Prepare Revaluation account, Capital Accounts, Bank account and Balance Sheet of the new firm after admission of Gurmeet.
Partnership Accounts 149 Notes Solution Revaluation account Dr. Particulars Amount ` Particulars Cr. Amount ` Provision for Doubtful debts Creditors 6,000 Profit transferred to Asha's Capital 4,908 Pankhudi's Capital 3,272 2,320 8,180 Machinery Stock 14,500 2,000 16,500 4,000 Capital account Particulars Asha Pankhudi Gurmeet Particulars Asha Pankhudi Gurmeet Goodwill A/c Balance
c/d 22,800 1,74,108 15,200 1,46,072 - 1,00,000 Balance B/d Profit & Loss A/c Revaluation A/c Bank A/c Goodwill A/c 1,50,000 24,000 4,908 - 18,000 1,30,000 16,000 3,272 - 12,000 - - - 1,00,000 - 1,96,908 1,61,272 1,00,000 1,96,908 1,61,272 1,00,000
Balance Sheet of Asha Pankhudi and Gurmeet As on March 31, 2014 Liabilities Amount ` Assets Amount ` Creditors Bills payable Salaries Outstanding Capitals: Asha 1,74,108 Pankhudi 1,46,072 Gurmeet 1,00,000 44,000 40,000 1,500 70,000 4,20,180 Cash in hand Cash at Bank Debtors 58,000 Less: Provision 2320 Stock Machinery 15,000 1,92,000 55,680 87,000 1,59,500 5,09,180 5,09,180
150 Financial Accounting Notes Bank account Dr. Particulars Amount ` Particulars Cr. Amount ` Balance b/d Gurmeet's Capital A/c Goodwill A/c 62,000 1,00,000 30,000 Balance c/d 1,92,000 1,92,000 1,92,000 Working Note: Sacrificing Ratio = Existing Ratio – New Ratio Partners Existing ratio New ratio sacrifice Sacrificing ratio Asha 3/5 3/6 Asha: Pankhudi Pankhudi 2/5 2/6 12 10 30 ? 3:2 9.6 Retirement of a Partner
When a partner retires he is entitled to his share in the following accounts: 1. The retiring partner is entitled to his share out of the past accumulated profits and reserves in his profit-sharing ratio. 2. He is also entitled to his share of profit upto the date of his retirement. Suppose the books of accounts of the firm are closed on 31st March every year and the partner is retiring on 30th June. He is entitled to his share of profit for this 3 months' period i.e., from 1st April to 30th June. 3. When a partner retires he is paid for his share of goodwill in the firm. 4. According to the terms of the Partnership Deed the value of all assets and liabilities are revalued on the retirement of a partner. For this purpose, a Revaluation Account is prepared. He is entitled to his share of profit (or loss) on the revaluation of assets and liabilities. In the absence of any agreement to the contrary, the profit sharing ratio between the remaining partners remains unchanged after his retirement. 9.7 Accounting Procedure at the Time of Retirement of a Partner The following problems arise when a partner retires from the firm and remaining partners continue with the business: 1. Treatment of goodwill 2. Revaluation of assets and liabilities 3. Adjustments of accumulated reserve and losses 4. Calculating the amount due to the retiring partner and its payment. 9.7.1 Treatment of Goodwill When a partner retires from the firm remaining partners are benefitted because future profit is shared only by them. For example, if A, B and C are partners and their profit sharing ratio is 2 : 2 : 1. If B retires from the firm, A and C will distribute the profits in 2:1 ratio or a new ratio. A and C will get share of B. Hence, A and C will compensate the retiring partner B in the gaining ratio. When a new partner is admitted in the firm, he pays the amount of

Partnership Accounts 151 Notes goodwill and if a partner retires from the firm, the remaining partners compensate the retiring partner by paying for the goodwill. Gaining ratio is the difference of new ratio and old ratio. If there is no other agreement, remaining partners will share the profits in the same ratio in which they shared earlier before the retirement of a partner.

For example, A B and C are sharing profits in the ratio 3:2:1. C retires from the firm. In this case, new ratio of A and B will be 3:2. Illustration 8 1. M, N and P were sharing profit and loss in the ratio of 2:3:1. Calculate the new ratio and the gaining ratio when (a) M retires, (b) N retires and (c) P retires. 2. X, Y and Z were partners sharing profit and loss in the ratio of 2:3:1. Z retires and X and Y decide to share future profit and loss in the ratio of 3:4. Calculate the gaining ratio. 3. A, B and C were partners sharing profit and loss in the ratio of 2:3:1. C retires and his share is taken by A and B in the ratio of 2:1. Find the new ratio. Solution i) (a) When M retires, the new ratio of N and P will be 3:1. This will also be their gaining ratio. (b) When N retires, the new ratio of M and P will be 2:1. This will also be their gaining ratio. (c) When P retires, the new ratio of M and N will be 2:3 This will also be their gaining ratio. ii) Gaining Ratio = New Ratio —Old Ratio Gain of X= 3/7 - 2/6 = 4/42 Gain of Y = 4/7 - 3/6 = 3/42 Thus, the gaining ratio of X and Y is 4/42 : 3/42 or 4:3 iii) Share got by A from C = 1/6 × 2/3 = 2/18 Share got by B from C = 1/6 × 1/3 = 1/18 New ratio of A = 2/6 + 2/18 = 8/18 New ratio of B = 3/6 + 1/18 = 10/18 Hence, new ratio of A and B = 8/18 : 10/18 or 8 : 10 or 4 : 5 Adjustment of Goodwill

Following are the methods of treating goodwill in books in case of retirement: 1. When Goodwill account is raised with full value: Under this method, Goodwill Account is debited with full value of Goodwill and the partners' Capital Accounts, including retiring partner's Capital Account are credited in the old ratio. Goodwill will be show in the Balance Sheet at full value. 2. When goodwill account is raised with full value and written off by remaining partners: Under this method, first of all Goodwill Account is debited with full value and all partners (including retiring partner) Capital Accounts are credited in the old ratio. Secondly, remaining partners' Capital Accounts are debited in new ratio and Goodwill Account is credited. Hence, the Goodwill Account is closed. It will be shown in Balance Sheet.

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Illustration 9 G, H

and I

88%	MATCHING BLOCK 25/50	W

are partners sharing profits and losses in the ratio of 4:3:2. H retires and

on retirement the goodwill of the firm is valued at Rs. 43,200, No goodwill appears in the books. G and I agree to share future profits in the ratio of 5:3. Find the gaining ratio and pass the journal entries for goodwill in each of above cases. Solution Old ratio between G, H and I = 4:3:2 New Ratio between G and I = 5:3 Gaining ratio = New ratio — old ratio G = 5/8 - 4/9 = (45 - 32)/72 = 13/72 I = 3/8 - 2/9 = (27 - 16)/72 = 11/72 Hence, G and I will compensate H in the ratio of 13 : 11 (a) When the full value of goodwill is raised in the books : ` ` Goodwill

100%	MATCHING BLOCK 26/50	W

A/c Dr. 43,200 To A's Capital A/c 19,200 To B's Capital A/c 14,400

83%	MATCHING BLOCK 27/50	W

To A's Capital A/c 19,200 To B's Capital A/c 14,400 To C's Capital A/c 9,600 (

Goodwill raised and credited to partners capital accounts in old ratio) Note :

Goodwill

will appear in the Balance Sheet as an asset until it is written off. (b) When the full value of goodwill is raised in the books and written off: ` ` Goodwill

100%	MATCHING BLOCK 28/50	W

A/c Dr. 43,200 To A's Capital A/c 19,200 To B's Capital A/c 14,400

83%	MATCHING BLOCK 29/50	W

To A's Capital A/c 19,200 To B's Capital A/c 14,400 To C's Capital A/c 9,600 (

Being the Goodwill credited to all partners in old ratio) A'

78%	MATCHING BLOCK 30/50	W

s Capital A/c Dr. 27,000 C's Capital A/c Dr. 16,200 To Goodwill A/

c 43,200 (Being the Goodwill written off in the new ratio)
Partnership Accounts 153 Notes (c) When the retiring partner's share of goodwill is raised and written off : ` ` Goodwill A/c Dr. 14,400 To B's Capital A/c 14,400 (Being B's share of Goodwill) A'

78%	MATCHING BLOCK 31/50	W

s Capital A/c Dr. 7,800 C's Capital A/c Dr. 6,600 To Goodwill A/

c 14,400 (Goodwill written off in the gaining ratio of 13:11) (d) When the goodwill is adjusted in Capital Account without opening a Goodwill Account: ` `

58%	MATCHING BLOCK 32/50	W

A's Capital A/c Dr. 7,800 C's Capital A/c Dr. 6,600 To B's Capital A/c 14,400 (

59%	MATCHING BLOCK 33/50	W

s Capital A/c Dr. 7,800 C's Capital A/c Dr. 6,600 To B's Capital A/c 14,400 (Being due to B adjusted between A and C

in their gaining ratio) Note : In all the above cases, B gets a credit for Rs.14,400 being his share of goodwill of the firm which comes from A and C in their gaining ratio of 13:11. When goodwill already exists in the books at the time of retirement, the need for its revaluation arises to find out increase or decrease in its value. If the value has increased, Goodwill Account will be debited and Capital Accounts of all partners will be credited in their old ratio with the amount of increase. On decrease in its value, a reverse entry will be made. 9.7.2 Revaluation of Assets and Liabilities Revaluation of assets and liabilities is also required at the time of retirement of a partner in the same way as it is done in case of admission of a partner. The profit or loss which results from revaluation will be transferred to all partners' Capital Accounts in their old profit sharing ratio. For this purpose, a "Revaluation Account" or "Profit and Loss Adjustment Account" is prepared. If the remaining partners wish to show assets and liabilities at their old values Memorandum Revaluation Account will be prepared. 9.7.3 Adjustment of Accumulated Reserves and Losses At the time of retirement, if general reserve, credit balance of Profit and Loss Account or other undistributed profits are given in the Balance Sheet, they are credited in the old partners' Capital Accounts in old profit sharing ratio. For this, the following journal entry is made: Reserve or Profit and Loss A/c Dr. To Partners' Capital A/c (Old ratio) If the partners want that only retiring partner's Capital Account be credited with his share in undistributed profits, then the following entry will be made. Reserves or Profit and Loss A/c Dr.
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To Retiring Partner's Capital A/c (With the share of retiring partner) Remaining undistributed profits will be shown in the Balance Sheet after retirement. If the remaining partners want that, without changing the amount of reserves or profit, share be given to retiring partner, the following entry will be made : Continuing Partner's Capital A/c Dr. (In their gaining ratio) To Retiring Partner's Capital A/c 9.7.4 Calculating the amount due to the retiring partner and its payment The retiring partner's Capital Account is credited with his share of capital, share of goodwill, share of profit on account of revaluation and undistributed profits and reserves of last years. This account will be debited with his drawings, share in revaluation loss and other losses. If payment is no made to the retiring partner, the amount due is transferred to his loan account. According to Section 37 of Partnership Act, the retiring partner can have either interest @ 6% per annum on this amount due or the profit earned by remaining partners with the help of this amount from the date of retirement. For this, the journal entry will be: Retiring Partner's Capital A/c Dr. To Retiring Partner's Loan A/c If remaining partners bring cash to pay off the retiring partner then, journal entry will be : Bank A/c Dr. To Continuing Partner's Capital A/c (For cash brought in by partners in the agreed ratio to pay off the retiring partner) Payment in Installments Capital Account of the retiring partner is settled as per agreement. It may be settled in two ways: 1. Payment in installments with interest 2. Payment in a fixed number of installments of equal amount (including interest). Amount of installment can be calculated with the help of Annuity Table. Note: In the absence of any information, balance of retiring partner's Capital Account will be transferred to his Loan Account. Illustration 10: A, B and C were carrying on business

100%	MATCHING BLOCK 34/50	W

in partnership sharing profits and losses in the ratio of 3: 2: 1, respectively.

On 31st December, 2012, the Balance Sheet of the firm stood as follows: Liabilities
Amount ` Assets Amount ` Creditors Capitals: A 15,000 B 10,000 C 10,000 13,590 35,000 Cash in hand Debtors Stock
Building 5,900 8,000 11,690 23,000 48,590 48,590
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B retires on the above mentioned date on the following terms: (i) Building
is appreciated by Rs. 7,000. (ii) Provision for bad debts is
made @ 5% on Debtors. (iii) Goodwill of the firm be valued at Rs. 9,000 and adjustment in respect be made without raising a Goodwill Account. (iv) Rs. 5,000 is paid to B immediately and the balance due to him be treated as loan carrying interest @ 6% per annum. Such loan is to be paid in three equal annual instalments together with interest. Pass the journal entries to record the above mentioned transactions and show the Balance Sheet of the firm as it would appear immediately after B's retirement. Prepare B's Loan Account till it is finally closed. Solution Journal Dr. Cr. Particulars ` ` Building A/c Dr. 7,000 To Revaluation A/c 7,000 (Being appreciation in the value of Building) Revaluation A/c Dr. 400 To Provision for Bad Debts 400 (Being provision for bad debts created on debtors) Revaluation

100%	MATCHING BLOCK 35/50	W

A/c Dr. 6,600 To A's Capital A/c 3,300 To B's Capital A/c 2,200

83%	MATCHING BLOCK 37/50	W

To A's Capital A/c 3,300 To B's Capital A/c 2,200 To C's Capital A/c 1,100 (

Being profit on revaluation credited to old partners)

58%	MATCHING BLOCK 38/50	W

A's Capital A/c Dr. 2,250 C's Capital A/c Dr. 750 To B's Capital A/c 3,000 (

77%	MATCHING BLOCK 39/50	W

s Capital A/c Dr. 2,250 C's Capital A/c Dr. 750 To B's Capital A/c 3,000 (Being B's share of goodwill adjusted in gaining ratio of 3:1 in A and C) B's Capital A/c Dr. 5,000 To Bank A/c 5,000 (Being the amount paid to B on retirement) B's Capital A/c Dr. 10,200 To B's Loan A/c 10,200 (Balance of amount due to B transferred to his loan account)

156 Financial Accounting Notes Balance Sheet As on 1st January, 2013 Liabilities Amount ` Assets Amount ` Creditors B's Loan A/c

Capitals: A 15,000 B 10,000 C 10,000 13,590 10,200 35,000 Cash in hand Debtors 8,000 Less: Provision 400 Stock Building 23,000 Add: Appreciation 7,000 900 7,600 11,690 30,000 50,190 50,190 B's Loan Account Dr. Particulars Amount ` Particulars Cr. Amount ` 2013

Dec 31 To Bank To Balance c/d 3,816 6,996 2013 Jan 1 By Balance b/d Dec 31 By Interest A/c 10,200 612 10,812 10,812 2014 Dec 31 To Bank To Balance c/d 3,816 3,600 2014 Jan 1 By Balance b/d Dec 31 By Interest A/c 6,996 420 7,416 7,416 2015 Dec 31 To Bank To Balance c/d 3,816 2015 Jan 1 By Balance b/d Dec 31 By Interest A/c 3,600 216 3,816 3,816 Working Notes (i) New Profit-Loss sharing Ratio: Old Profit-sharing Ratio of A, B and C = 3/6 : 2/6 : 1/6, After B's retirement the ratio between A & C will be = 3 : 1 or 3/4 : ¼ (ii) Gaining Ratio of A and C : Gain to A = 3/4 - 3/6 = (18-12)/24 = 6/24 Gain to C = 1/4 - 1/6 = (6-4)24 = 2/24 Hence the gaining ratio is 6/24 : 2/24 or 3 : 1 (iii) According to Annuity Table .37410981 should paid every your to repay rupee one with 6 per cent interest in 3 years. The annual instalment for payment of Rs. 10,200 comes to Rs. 10,200 × .37410981 = Rs. 3,816

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Death of a Partner The accounting treatment at the time of death of a partner is same as at the time of retirement. Main difference between the two is that of closing of the account of business. Deceased partner's capital account is credited with his opening capital, interest on capital upto his death, his share in undistributed profits, revaluation profits,

and

firm's profits from the date of the last balance sheet up to his death and with his share of goodwill. Drawings, interest on drawings and losses are debited in the deceased partner's Capital Account and the remaining amount is transferred to his legal representative's account. Legal representative can receive either interest at 6 per cent per annum, on the amount due from the date of death to the date of settlement or the profit earned with the help of that amount.

Following two points require special attention apart from

the points discussed in the retirement of a partner topic: 1. Calculation of deceased partner's share of profit. 2. Treatment of life policy or policies. 9.8.1 Calculation of Deceased Partner's Share of Profit The deceased partner's share of profit is to be determined either on the basis of time or turnover. (a) On the basis of time: In this case, it is assumed that the profit during the previous year has been earned uniformly in all months during the year, provided previous year is taken as the base for calculation of profit. Sometimes average

profit

of the past three or four years is taken as base rather than the previous year. Whatever base may be taken, it is to be multiplied by the period for which the deceased partner remained in the firm and also his profit sharing ratio at the time of his death. For example

64%	MATCHING BLOCK 40/50	W
A, B, and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1.		

B dies on 14th March, 2011. The average of the last three years is Rs. 30,000. B's share of profit on the basis of time is calculated as under: Average yearly profit = Rs. 30,000 Profit for 73 days i.e., Jan. 1 to March 14, 2011 = Rs. 30,000 × 73 365 = Rs. 6,000 B's share = 2/6 × 6,000 = Rs. 2,000 (b) On the basis of turnover: In this method, average past profit is divided into two portions i.e., before the death and after the death on the basis of ratio of turnover to the date of death to average turnover and then deceased partner's share is calculated and credited to his capital account. For example,

64%	MATCHING BLOCK 41/50	W
A, B and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1.		

B dies on 14th March, 2010. Turnover from 1st January, to 14th March, 2010 is Rs. 42,000. Average turnover of the last three years is Rs. 60,000 and profit is Rs. 30,000. B's share of profit on this basis will be calculated as under: Average turnover = Rs. 60,000 Sales to the date of death = Rs. 42,000. Profit to the date of death = Rs. 42,000 × 1/2 = Rs. 21,000 B's share of profit = 1 21,000 7,000 3 ? ?

158 Financial Accounting Notes 9.8.2 Treatment of Life Policies To make an arrangement for the payment of amount belonging to deceased partner to his legal representative, the firm can get insured the life of all the partners jointly or individually. Premiums on life policies are paid out of firm's funds and this is debited to firm's Profit and Loss Account. Amount received in the form of claim from the life insurance company is credited to all the partners in their profit/loss sharing ratio. In the case of individual policies also, the deceased partner is entitled to his share in the surrender value of policies of all the partners. Other partners are also entitled to their respective share in the amount of policy of the deceased partner. Illustration 11: Brown and Smith are partners. The partnership deed provides inter alia: i) That the Account be balanced on 31st December each year. ii) That the profits are divided as follows: Black 1/2; Brown 1/3 and carried to a Reserve account 1/6. iii) That in the event of the death of a partner, his executors are entitled to be paid: (a) The capital to his credit at the date of death. (b) His proportion of reserve at the date of last balance sheet. (c) His proportion of profit to date of death based on the average profits of the last three completed years. (d) By way of goodwill his proportion of the total profits for the three preceding years. On 31st December, 2012, the Ledger balance was: ` ` Black's Capital 9,000 Brown's Capital 6,000 Reserve 3,000 Creditors 3,000 Bills Receivable 2,000 Investments 5,000 Cash 14,000 21,000 21,000 The profits

for three years were: 2010 Rs. 4200; 2011 Rs. 3900; and 2012 Rs. 4500. Brown died on 1st May, 2013 Show the accounts as between the firm and Brown's died on 1st May, 2013 Solution Effective profit sharing ratio between Black and Brown is 3:2 Brown's share in the profits to the date of death: ` Profit for 2010 4,200 Profit for 2011 3,900 Profit for 2012 4,500 Total Profits 12,600

Partnership Accounts 159 Notes Average = Rs. 12,600/3 = Rs. 4,200 Profit for 4 months upto May 1, 2013 = 4,200 × 1/3 = Rs. 1,400 Brown's share therein = Rs. 1,400 × 2/5 = 560 Brown's share in Goodwill: Goodwill = Rs. 12,600 Brown's share = Rs. 12,600 × 2/5 = Rs. 5,040 Brown's Capital Account Dr. Particulars Amount ` Particulars Cr. Amount ` 2013 May 1 To Brown's Executors' A/c 12,800 2013

May 1

By Balance b/d By Reserve A/c By P&L suspense A/c (Profit upto death) By Goodwill A/c 6,000 1,200 560 5,040 12,800 12,800 Brown's Executors' Account

Dr. Particulars Amount Rs. Particulars Cr. Amount Rs. 2013 May 1 By Brown' capital a/c 12,800 12,800 9.9

Dissolution of partnership firm The Indian Partnership Act, 1932 recognizes the difference between the 'dissolution of partnership' and dissolution of firm'. The dissolution of partnership between all the partners of a firm is called the dissolution of the firm. Thus, it is the complete breakdown of a partnership and partners do not continue them. On the other hand, dissolution of the partnership means a reconstitution of the firm due to the retirement of a partner or the insolvency of a partner or the death of a partner and the remaining partners provide for the continuance of the firm in pursuance of an express or implied agreement to that effect. On dissolution of a firm the firm's assets are realised and the liabilities are discharged because the firm is to be closed, whereas on dissolution of a partnership, the share of the outgoing partner is ascertained and the firm is not closed. 9.10 Modes of Dissolution of Firm The various ways in which a firm may be dissolved are given as under: (1) Dissolution by agreement. A firm is dissolved when all the partners agree that it should be dissolved. A partnership firm is the creation of an agreement; similarly a firm can be dissolved by an agreement. (2) Dissolution on the happening of contingencies. A firm is dissolved in any of the following ways unless there is a contract between the partners to the contrary.

160 Financial Accounting Notes These are: (i) by the expiry of the term of duration of the firm, (ii) by the completion of the adventure for which the firm was constituted, (iii) by the death of a partner, and (iv) by the adjudication of a partner as insolvent. (3) Dissolution by notice of partnership at will. When the partnership is at will, the firm may be dissolved at any time by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. (4) Compulsory dissolution or dissolution by the operation of law. A firm is compulsorily dissolved-different ways as: (i) When all the partners except one become insolvent. (ii) When all the partners become insolvent. (iii) When the business becomes illegal. (iv) Where the number of partners exceed twenty in case of ordinary business or ten in case of banking business. (5) Dissolution by the court. At the suit of a partner, a court may order the dissolution of the firm in different ways as: (i) when a partner becomes of unsound mind, (ii) when a partner suffers from permanent incapacity and becomes incapable of performing his duties as a partner, (iii) when a partner is guilty of misconduct affecting the business of the firm, (iv) when a partner commits wilful or persistent breaches of agreement, (v) when a partner has transferred the whole of his interest in the firm to a third party or when his share has been attached under a decree or sold under process of law, (vi) when the business of the firm cannot be carried on except at a loss, and (vii) when the court is satisfied as to grounds which render it just and equitable to dissolve the firm. 9.11 Preparation of Accounts on Dissolution The mode of settlement of accounts on dissolution of the firm is as follows as given in Section 48 of the Indian Partnership Act, 1932. Section 48 of the Indian Partnership Act, 1932 governs the settlement of accounts on the dissolution of firm. The main points of this section are enumerated below: 1. All the assets of the firm (including the original contribution of the partners, additional contribution of the partners and the additional contribution made to make up deficiencies of capital) must first be applied in paying of all the debts of the firm, i.e., the money due to the third parties. 2. If after paying these liabilities, there is surplus left, the same should be applied in repaying the loans taken from the partners over and above the capital contributed by such partner. If the surplus is not sufficient to pay loans of all the partners, advances should be paid rateably. 3. The residue shall be compared with total of the capitals of the partners. The difference between the residue and the total capital should be transferred to the capital accounts in the ratio in which the partners share the profits and losses. This will make the total of the balances in the capital account equal to cash available and then the cash will be paid to each partner equal to the amount due (after adjusting profit or loss). 9.12 Accounting treatment on Dissolution of a Partnership Firm On dissolution of a firm, the books of account will have to be closed. But this is not possible until all the assets of the firm have been realised in cash or otherwise disposed off (may be taken over by the partners of the erstwhile dissolved firm.) Further, all the liabilities of the firm including partners' loans and capital should be paid off. To close the books of account, following steps have to be followed :- 1. Realisation account is opened and all assets except cash or bank balances are transferred to the debit side of the realisation account at book values. Realisation account Dr To stock
Partnership Accounts 161 Notes
To debtors To investments To plant and machinery, etc. Note :- This way the accounts of these assets will stand closed. The assets against which some fund, reserve or provision is created should be debited to realisation account at gross value. The provision should be credited to the realisation account. This way the relevant account will stand closed. 2. The account of liability to third party (excluding partner's loans and capitals) should be transferred to the credit side of realisation account at book value. The entry will be:- Sundry creditors A/c Dr Bills payable A/c Dr To Realisation A/c 3. When assets are sold for cash, the actual amount received should be debited to cash or bank account and credited to realisation account. If a partner takes asset then following entry is done Partner's Capital A/c Dr To Realisation A/c The account will be credited with the value agreed upon 4. For expenses incurred during the course of the dissolution of the firm, following entry shall be made:- Realisation A/c Dr To cash/bank 5. For liabilities towards third party, following entry shall be done Sundry Creditors A/c Dr To cash/bank If a partner agrees to discharge a liability, then the entry will be Realisation A/c Dr To partner's capital account 6. The difference of two sides of the realisation account now represents profit or loss on realisation. The amount so obtained should be transferred to the capital account of the partners in the ratio in which they share profits. Realisation account will be debited (if credit side is bigger or credited if the debit side is bigger. 7. Partner's loan should then be paid off. The entry will be: Partner's loan Dr To cash/bank 8. If there is reserve fund or profit and loss account in the books, it should be transferred to capital account in the profit sharing ratio. 9. Now the balance, if any, standing to the debit of a partner's capital account will be brought in by him. Cash A/c Dr
162
Financial Accounting Notes
To Partner's Capital A/c 10. The amount standing to the credit of the partner's capital account will then be paid off. Partner's capital A/c To cash account. Note: the above steps will close all the accounts. If an account remains open that means there has been some mistake. Illustration 12:

90%	MATCHING BLOCK 42/50	W

A, B and C were in partnership sharing profits and losses in the proportion of

one-half, one-third and one-sixth respectively. On June 30, 2008 they dissolved the partnership. The following Balance Sheet represented the position of the firm on that date: Balance Sheet as on June 30,2008 Liabilities Amount ` Assets Amount ` Creditors Reserve for Contingencies Bank Loan C's Loan A/c A's Capital B's Capital C's Capital 15,000 5,000 5,000 5,000 30,000 15,000 5,000 Cash at Bank Stock Debtors Bills Receivable Buildings 1,500 25,000 24,000 1,000 28,500 80,000 80,000 Stock, Debtors and Buildings realised Rs. 16,500, Rs. 20,000 and Rs. 18,500 respectively. Bills Receivable were realised in full. Rs. 10,000 was spent in meeting the contingent liabilities for which only Rs. 5,000 were reserved. The Creditors were paid at a discount of Rs. 500. The expenses of realisation amounted to Rs. 600. Close the books of the firm and draw the necessary ledger accounts. Solution Journal Entries 2008 ` ` June 30 Realisation

58%	MATCHING BLOCK 43/50	W

A/c Dr. 78,500 To Stock A/c 25,000 To Sundry Debtors A/c 24,000 To bills Receivable A/c 1,000 (Being

the transfer of Stock, Sundry Debtors, Bills Receivable and Buildings to Realisation A/c at Book value) June 30 Sundry Creditors Dr. 15,000 Reserve for Contingencies Dr. 5,000
Partnership Accounts 163 Notes
Bank Loan A/c Dr. 5,000 To Realisation A/c 25,000 (For various liabilities transferred to Realisation A/c at Book value) June 30 Bank A/c Dr. 56,000 To realisation A/c 56,000 (Being the amount realised on sale of assets) Stock 16,500 Sundry Debtors 20,000 Bills Receivable A/c 1,000 Buildings 18,500 June 30 Realisation A/c Dr. 600 To Bank A/c 600 (Being payment of Realisation Expenses) June 30 Realisation A/c Dr. 29,500 To Bank A/c 29,500 (Being Sundry liabilities paid at discount of Rs. 500) S. Cr. at a Dis. of Rs. 500 14,500 Contingencies 10,000 Bank Loan 5,000 June 30

82%	MATCHING BLOCK 44/50	W

A's Capital A/c Dr. 13,800 B's Capital A/c Dr. 9,200 C's Capital A/c

46%	MATCHING BLOCK 45/50	W

s Capital A/c Dr. 9,200 C's Capital A/c Dr. 4,600 To Realisation A/c 27,600 (Being loss on realisation transferred to Partners' Capital A/c)

June 30 C's Loan A/c Dr. 5,000 To Bank A/c 5,000 (For C's Loan paid) June 30

79%	MATCHING BLOCK 46/50	W

A's Capital A/c Dr. 16,200 B's Capital a/c Dr. 5,800 C's Capital A/c

68%	MATCHING BLOCK 47/50	W

s Capital A/c Dr. 16,200 B's Capital a/c Dr. 5,800 C's Capital A/c

Dr. 400 To Bank A/c 22,400 (Being Balance Paid to partners)
164 Financial Accounting Notes Ledger Realisation Account Dr. Particulars Amount ` Particulars Cr. Amount ` To Sundry Assets A/c To Bank A/c (expenses) To Bank A/c (S. Liabilities Paid) 78,500 600 29,500 By Sundry Liabilities A/c By Bank A/c (Assets realised) By Capital A/c (loss transferred) A ½ B 1/3 C 1/6 25,000 56,000 13,800 9,200 4,600 1,08,600 1,08,600 Bank A/c Dr. Particulars Amount ` Particulars Cr. Amount ` To Balance b/d To Realisation A/c (Sale Proceeds of Assets) 1,500 56,000 By Realisation A/c (expenses) By Realisation A/c (Payment of Liabilities) By C'

68%	MATCHING BLOCK 48/50	W

s Loan A/c By A's Capital A/c 16,200 By B's Capital A/c 5,800

82%	MATCHING BLOCK 49/50	W

A's Capital A/c 16,200 By B's Capital A/c 5,800 By C's Capital A/c 600 29,500 5,000 16,200 5,800 400 57,500 57,500

C's Loan A/c Dr. Particulars Amount ` Particulars Cr. Amount ` To Bank A/c 5,000 By Balance c/d of Liabilities) 5,000 5,000 5,000 Partners' Capital Accounts Particulars A B C Particulars A B C To Realisation A/c To Bank A/c 13,800 16,200 9,200 5,800 4,600 400 By Balance B/d 30,000 15,000 5,000 30,00015,0005,000 30,000 15,0005,000 9.12.1 Insolvency of partners If at the time of dissolution, a partner owes a sum of money to the firm. He has to make payment to the firm. However, if he is insolvent, it may not be possible to recover the

Partnership Accounts 165 Notes

whole of the amount. Thus, the sum which is recoverable from an insolvent partner is a loss the question arises, what entry should be made in the books of account of the firm to take care of such a loss, Whether to treat it as an ordinary loss to be shared by the solvent partners in the profit sharing ratio or whether to treat it as an extraordinary loss? To decide the treatment, decision in "Garner vs. Murray" is followed. In this case, the court decided that such loss shouldn't be treated as an ordinary loss. The judgement in this case gave a detail account of the treatment to be done, which is as follows: The solvent partners should bring in cash equal to their share of loss on realisation. The loss due to the insolvency of a partner should be divided among the other partners in the ratio of capitals then standing (i.e.: after partners have brought in cash equal to their share of the loss on realisation) In other words, the loss due to the insolvency of partner has to be borne by the solvent partners in the ratio of their capitals standing just prior to dissolution. Illustration 13: A, B and C were equal partners. On 31st December, 2009, the position was as follows:- ` A's Capital 2,000 Cash 1,500 B's Capital 600 C's Capital 200 Loss on 900 Realisation 2,600 2,600 C is insolvent and can pay nothing. Close the books of the firm. Solution Cash Account

Particulars ` Particulars A Dec 31, To Balance b/d To

A's Capital To B's Capital 1500 300 200 Dec 31, By A's Capital By B's Capital 1,615 485 2,100 2,100 Capital Account Particulars A B C Particulars A B C To Bal b/d To Loss on realization To C's Capital A/c- Loss written off in the ratio of 20:06 To Cash 300 385 1,615 300 115 485 200 300

By Balance B/d By Cash- to make loss on realization By A's Capital By B's Capital 2,000 300 600 300 - 385 115 2,300 900 500 2,300 900 500

166 Financial Accounting Notes 9.13 Summary

The Indian Partnership Act of 1932 contains the main provisions which are applicable to partnership firms working in India. According to this Act "Partnership is the relation between persons who have agreed to share the profit of the business carried on by all or any of them acting for all".

A document in which the terms and conditions of partnership are given is called Partnership Deed.

Capital Accounts of partners may be fixed or fluctuating. If Capital Accounts are fixed, two accounts are prepared for each partner: (i) Partner's Capital Account and (ii) partner's Current Account. In case of

fluctuating capital, only one account is prepared, which is called Capital Account.

Sometimes a running business may require new partner for need of more capital for expansion of business, Need of expertise in managerial or technical field for running the business, For growth of the business by admitting a reputed person as partner

and

to admit a new partner in place of an old retiring partner.

Goodwill means the capacity of the business to earn more than normal profit. In other words, it is the value of reputation of the business.

For the adjustment of various assets and liabilities, a Profit and Loss Adjustment or Revaluation Account is prepared when a new partner is admitted into a partnership concern.

The retiring partner is entitled to his share out of the past accumulated profits and reserves in his profit-sharing ratio. He is also entitled to his share of profit upto the date of his retirement.

Revaluation of assets and liabilities is also required at the time of retirement of a partner in the same way as it is done in case of admission of a partner. The profit or loss which results from revaluation will be transferred to all partners' Capital Accounts in their old profit sharing ratio.

The accounting treatment at the time of death of a partner is same as at the time of retirement. Main difference between the two is that of closing of the account of business. Deceased partner's capital account is credited with his opening capital, interest on capital up to his death, his share in undistributed profits, revaluation profits,
and firm'
s profits from the date of the last balance sheet up to his death and with his share
of
goodwill. Dissolution means termination of a partnership agreement. Dissolution of partnership means a change in the relationship of the partners. Dissolution of partnership firm means that the firm comes to an end and ceases to function as a firm. Any partnership may be dissolved on account of many reasons. On dissolution of the firm, the settlement of accounts among partners is done in accordance with the partnership deed. In the absence of any agreement, the rules stated in Section 48 of the Partnership Act shall apply when the partnership firm is dissolved, a Realisation Account is opened for disposing of all the assets of the firm and making payments to all the creditors. 9.14
Check Your Progress Multiple Choice Questions 1. The main account for dealing with partnership dissolution would be: (a) Appropriation (b) Revaluation (c) Dissolution (d) Realisation 2. The rule in Garner v. Murray deals with: (a) How the debts of insolvent partners are to be cleared (b) Writing goodwill off against reserves (c) Rules for align the admittance of new partners (d) How profits are to be divided if no prior partnership agreement exists
Partnership Accounts 167 Notes 3. If partners maintain both fixed capital and current accounts, which of the following would normally be credited to a partner's capital account? (a) Goodwill being written off (b) Losses on revaluation (c) Profits on revaluation (d) Interest on capital 4. What is the minimum number of partners required to commence a partnership business? (a) 20 (b) 10 (c) 2 (d) 4 5. The written agreement of partnership is most commonly referred to as: (a) Agreement (b) Partnership deed (c) Partnership contract (d) Partnership Act 6. Where there is no partnership agreement exists between partners, what will be the profit sharing ratio between the partners? (a) Equal (b) Unequal (c) It will depend on a partner's capital (d) It will depend on the experience of a partner 7. The partnership may come to an end due to the: (a) Death of a partner (b) Insolvency of partner (c) By giving notice (d) All of the above 8. An account operated to ascertain the loss or gain at the death of a partner is called: (a) Realization account (b) Revaluation account (c) Execution account (d) Deceased partner A/c 9. Loss on realization is distributed among partners: (a) According to profit and loss ratio (b) According to capital ratio (c) As decided among them (d) None of above 10. Balance of realization A/c is transferred to the capital A/c of the partners in: (a) Capital ratio (b) Profit sharing ratio (c) Interest ratio (d) Equally
168 Financial Accounting Notes 9.15 Questions and Exercises 1. Explain the meaning and features of partnership. 2. Discuss the concept of partnership deed. 3. Differentiate between fixed and fluctuating capital system. 4. Explain the need for revaluation of assets and liabilities after the admission of a partner. 5.
What is goodwill? Explain the different methods of treating goodwill in accounts at the retirement of a partner. 6. Differentiate between dissolution of partnership and dissolution of firm. State how and under what circumstances a firm may be dissolved. 7. Give the entries needed to close the books of the firm upon its dissolution. 8.
P, Q and R are in the partnership and on 1st January, 2012 their respective capitals were Rs. 20,000, Rs, 12,000 and Rs, 10,000. Q is entitled to a salary of Rs. 2,500 and R Rs. 2,000 per annum, payable before division of profits. Interest is allowed on capital @ 5% per annum but is not charged on drawings. Of the net divisible profits of first Rs. 10,000; P is entitled to 40%, Q to 35% and R to 25% and over that amount profits are shared equally. The profit for the year ended 31st December, 2012 after debiting partnership salaries, but before charging interest on capitals, was Rs. 18,000 and partners had withdrawn Rs. 800 each. Prepare partners' accounts for the year. 9.
Ravi, Shanker and Sastry are partners sharing profits and losses as 6:5:4. They have a Joint Life Policy for Rs. 2,00,000 on which they pay Rs. 7,500 per annum as premium and debit the same to Profit and Loss Account as premium. Accounts are closed annually on 31 December. Shanker died on 1st April, 2010 and his legal representatives are entitled to : i) His capital as appearing in the last Balance Sheet. ii) Interest on capital at 6 per cent per annum to the date of death. iii) His share of profit calculated till date of his death on the basis of the previous year's profit; and iv) His share of goodwill calculated as two years purchase on the average of the last three years' profit before inclusion of the policy premium as business expense. Shanker's drawing in 2010 amounted to Rs. 3000. His capital shown in 2009 Balance Sheet was Rs. 80000. The profit for the three years 2007, 2008 and 2009 after inclusion of the policy premium as business expense amounted to Rs. 65000, Rs. 64000 and Rs. 69000 respectively. Prepare Shanker's Capital Account. 10.

68%	MATCHING BLOCK 50/50	W

The Balance Sheet of a firm on 31st March, 2012 was as follows :- Liabilities Amount ` Assets Amount `

A'

s Capital B's Capital C's Capital S. Creditors 5,000 4,000 3,000 2,000 Freehold Prop Investment Book Debts Cash at Bank 8,000 2,000 1,000 3,000 14,000 14,000 The Partnership was dissolved as on 31 March, 2012. The sundry creditors were paid at a discount of 5%
A agreed to takeover the Freehold Property at Rs. 9,000. B
Partnership Accounts 169 Notes
the investments at Rs. 1,500 and C the book debts at Rs. 600. The expenses of realization came to Rs. 110. Close the books of the firm. 9.16
Key Terms ?
Partnership: It is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. ? Partnership Deed: A document which contains details of an express written agreement between the partners is called partnership deed. ?
Sacrificing Ratio: It means the forgoing a fraction of share in favour of a new partner by the old over. ? Goodwill: Goodwill is the value of the reputation of a firm in respect of profits expected in future over and above the normal rate of profits. ?
Gaining Ratio: The ratio in which the continuing partners acquire the outgoing partner's share is called as gaining ratio. ? Surrender value: It is the value which is payable immediately to the insured on surrendering all rights of the policy (policies) to the insurer. ? Memorandum Revaluation Account: Sometimes it may be derived not to alter the value of assets and liabilities in the books, a Memorandum Revaluation Account will be opened.
Check Your Progress: Answers 1. (d) Realisation 2. (a) How the debts of insolvent partners are to be cleared 3. (c) Profits on revaluation 4. (c) 2 5. (b) Partnership deed 6. (a) Equal 7. (d) All of the above 8. (b) Revaluation account 9. (a) According to profit and loss ratio 10. (b) Profit sharing ratio 9.17 Further Readings ? Maheshwari S.N.,
Studies in Advanced Accounting, Sultan Chand and Sons, New Delhi. ? Gupta Shashi K., Aggarwal Nisha and Gupta Neeti, Financial Accounting,
Kalyani Publishers, Ludhiana. ? Tulsian P.C., Financial Accounting, Pearson Education, New Delhi. ? W. Albrecht, Stice Earl, Stice James, Financial Accounting, Cengage Learning.

Hit and source - focused comparison, Side by Side

Submitted text As student entered the text in the submitted document.

Matching text As the text appears in the source.

1/50	SUBMITTED TEXT 13 WORDS	100% MATCHING TEXT 13 WORDS
	Debit all expenses and losses ? Credit all incomes and gains 1.6	Debit All Expenses and Losses, Credit all Incomes and Gains.

W https://scripbox.com/pf/golden-rules-of-accounting/

2/50	SUBMITTED TEXT 13 WORDS	100% MATCHING TEXT 13 WORDS
	Debit all expenses and losses ? Credit all incomes and gains 1.6	Debit All Expenses and Losses, Credit All Incomes and Gains

W https://quickbooks.intuit.com/in/resources/accounting/types-of-accounts/

3/50	SUBMITTED TEXT 44 WORDS	61% MATCHING TEXT 44 WORDS
	A/c Dr Cash A/c Dr To Creditors A/c To Bank Loan A/c To Capital A/c (Being	A/c Dr. MN Ltd. A/c Dr. To Purchase A/c To PQ Ltd. A/c To Suspense A/c (Being

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

4/50	SUBMITTED TEXT	89 WORDS	30% MATCHING TEXT	89 WORDS

To Cash A/c To Cash A/c To Karan To Bank A/c C C C C 2 225 60,00 0 2,000 1,000 42,00 0 2,000 1,125 201 5 Feb 5 " 7 " 11 " 18 " 20 " 25 " 28 " 28 By Bank A/c By Bank A/c By Luxman & Co By Purchases A/c By Cash A/c By Furniture A/c By Salaries A/c By Balance c/d

To Balance A/c 12,000 By Freight Inwards A/c 30,000 To Sundry Debtors A/c 5,85,000 By Furniture A/c 10,000 To Bills Receivable A/c 61,250 By Investment A/c 19,000 To Miscellaneous Income A/c 5,000 By Expenses A/c 95,000 By Creditors A/c 3,92,000 By Drawings [` 70,000+ ` 21,000] [Additional By Balance c/d 26,250 6,63,250 6,63,250 (6)

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

5/50	SUBMITTED TEXT	33 WORDS	35% MATCHING TEXT	33 WORDS

A/c Dr. To Bills Receivable A/c Bills Payable A/c Dr. To Drawer's A/c Interest Drawee's A/c Dr. To Interest A/c

A/c 10,000 To Bills Receivable A/c 61,250 By Investment A/c 19,000 To Miscellaneous Income A/c 5,000 By Expenses A/c 95,000 By Creditors A/c 3,92,000

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

6/50	SUBMITTED TEXT	57 WORDS	35% MATCHING TEXT	57 WORDS

A/c Dr To Sales A/c (Being cash received from sales, deposited into bank) 2,200 2,200 June 19 Drawings A/c Dr Insurance Premium A/c Dr To Bank A/c (Being

A/c Dr. To Trading A/c (Being goods - in - transit were recorded in books) 1,234 1,234 Machinery A/c Dr. Suspense A/c Dr. To Freight A/c (Being

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

7/50	SUBMITTED TEXT	119 WORDS	28% MATCHING TEXT	119 WORDS

Trading and Profit and Loss Account for the Year ended 31 st December, 2014 To Opening stock 11,500 By Sales 60,000 To Purchases 39,000 Less: Returns i/w 800 Less: Returns o/w 500 59,200 38,500 By Closing stock 25,000 To Carriage Inwards 600 To Wages 2,800 To Gross Profit c/d 30,800 84,200 84,200 To Stationery 650 By Gross profit b/d 30,800 To

Trading and Profit and Loss Account of ABC enterprise for the year ended 31st March, 2017 Dr. Cr. Particulars ` ` Particulars ` To Opening Inventory 80,000 By Sales 6,08,750 To Purchases 4,56,000 By Closing inventory 70,000 Less: For advertising (9,000) 4,47,000 To Freight Inwards 30,000 To Gross Profit c/d 1,21,750 6,78,750 6,78,750 To Sundry expenses 92,000 By Gross Profit b/d 1,21,750 To

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

8/50	SUBMITTED TEXT	81 WORDS	29% MATCHING TEXT	81 WORDS

Account Dr Cr Date Particulars Amount (` ) Date Particulars Amount ( `) 2012 2012 Dec 31 To Plant A/c 1,000 Dec., 31 By Profit & Loss A/c 1,000 2013 2013 Dec 31 To Plant A/c 1,000 Dec 31 By Profit & Loss A/c 1,000 2014 2014 Dec 31 To Plant A/c 1,000 Dec 31 By Profit & Loss A/c 1,000

Account Dr. Cr. Particulars ` Particulars ` To Prepaid Expenses A/c (on 01.04.16) 6,000 By Outstanding Expenses A/c (on 01.04.16) 20,000 To Bank A/c 95,000 By Profit and Loss A/c (Bal. Figure) 92,000 To Outstanding Expenses/c (on 31.03.17) 18,000 By Prepaid Expenses A/c (

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

9/50	SUBMITTED TEXT	38 WORDS	43% MATCHING TEXT	38 WORDS

To Balance c/d 76,500 Dec 31 By Depreciation A/c 7,650 Dec 31 By Balance c/d 68,850 76,500 76,500 2011 2011 Jan 1 To Balance b/d 68,850 Dec 31 By Depreciation A/c 6,885

To Balance c/d (2% on ` 58,000 - `2,900) 1,102 31.12.2016 By Profit & Loss A/c 1,502 2,302 2,302 31.12.2017 To Discount 500 01.01.2017 By Balance b/d 1,102 31.12.2017 To Balance c/d (2% on ` 40,000 - `2,000) 760 31.12.2017 By Profit & Loss A/c 158 1,260 1,260 3.

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

10/50	SUBMITTED TEXT	130 WORDS	24% MATCHING TEXT	130 WORDS

Account Dr Cr Date Particulars Amount (` ) Date Particulars Amount ( `) 2010 2010 Jan 1 To Bank A/c 12,00,000 Dec 31 By Balance c/d 12,00,000 12,00,000 12,00,000 2011 2011 Jan 1 To Balance b/d 12,00,000 Dec 31 By Balance c/d 12,00,000 12,00,000 12,00,000 2012 2012 Jan 1 To Balance b/d 12,00,000 Dec 31 By Balance c/d 12,00,000 12,00,000 12,00,000 2013 2013 Jan 1 To Balance b/d 12,00,000 Dec 31 By Depreciation Fund A/c 12,00,000 12,00,000 12,00,000 Depreciation Fund Account Dr Cr Date Particulars Amount (RS.) Date Particulars

Account Dr. Cr. Date Particulars ` Date Particulars ` 31.12.2016 To Bad Debts A/c 800 01.01.2016 By Balance b/d 4,550 31.12.2016 To Profit & Loss A/c 850 31.12.2016 To Balance c/d (5% on ` 58,000) 2,900 4,550 4,550 31.12.2017 To Bad Debts A/c 1,500 01.01.2017 By Balance b/d 2,900 31.12.2017 To Balance c/d (5% on ` 40,000) 2,000 31.12.2017 By Profit & Loss A/c 600 3,500 3,500 Reserve for on Debtors Account Dr. Cr. Date Particulars ` Date Particulars ` 31.12.2016

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

11/50 **SUBMITTED TEXT** 90 WORDS **28% MATCHING TEXT** 90 WORDS

A/c 2,51,081.28 2,51,081.28 2,51,081.28 2011 2011 Dec 31 To Depreciation Fund A/c 2,51,081.28 Dec 31 By Profit & Loss A/c 2,51,081.28 2,51,081.28 2,51,081.28 2012 2012 Dec 31 To Depreciation Fund A/c 2,51,081.28 Dec 31 By Profit & Loss A/c 2,51,081.28 2,51,081.28 2,51,081.28 2013 2013 Dec 31 To Depreciation Fund A/c 2,51,081.28 Dec 31 By Profit & Loss A/c 2,51,081.28 2,51,081.28 2,51,081.28 74

A/c 30,000 To Sundry Debtors A/c 5,85,000 By Furniture A/c 10,000 To Bills Receivable A/c 61,250 By Investment A/c 19,000 To Miscellaneous Income A/c 5,000 By Expenses A/c 95,000

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

12/50 **SUBMITTED TEXT** 75 WORDS **19% MATCHING TEXT** 75 WORDS

Particulars ` Particulars ` To Joint Bank A/c (Commission) 20,000 By Joint Venture A/c (Expenses) 7,600 To Shares A/c 7,200 By Joint Bank A/c (Commission) 60,000 To Joint Bank A/c (Final Settlement) 70,000 By Joint Venture A/c (Profit) 29,600 97,200 97,200 Joint Venture 107 Notes Y's Account Particulars ` Particulars ` To Joint Bank A/c (Commission) 25,000 By Joint Bank A/c (

Particulars ` Particulars ` To Prepaid Expenses A/c (on 01.04.16) 6,000 By Outstanding Expenses A/c (on 01.04.16) 20,000 To Bank A/c 95,000 By Profit and Loss A/c (Bal. Figure) 92,000 To Outstanding Expenses/c (on 31.03.17) 18,000 By Prepaid Expenses A/c (On 31.03.17) 7,000 1,19,000 1,19,000 (7) Bills on 31 st March, 2017 Bills Receivable Account Dr. Cr. Particulars ` Particulars ` To Debtors A/c 1,00,000 By Creditors A/c 20,000

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

13/50 **SUBMITTED TEXT** 31 WORDS **40% MATCHING TEXT** 31 WORDS

A/c By Mach. A/c By Purchase s A/c By Salaries A/c By Off. Exp A/c By Advert. A/c By Vikas By Drawings A/c By Rent A/c By Balance c/d

A/c 5,85,000 By Furniture A/c 10,000 To Bills Receivable A/c 61,250 By Investment A/c 19,000 To Miscellaneous Income A/c 5,000 By Expenses A/c 95,000 By Creditors A/c 3,92,000 By Drawings [` 70,000+ ` 21,000] [Additional Drawings] 91,000 By Balance c/d 26,250 6,63,250 6,63,250 (6)

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

14/50 **SUBMITTED TEXT** 23 WORDS **100% MATCHING TEXT** 23 WORDS

is: (a) Real Account (b) Nominal Account (c) Personal Account (d) None of the above 3.

is (A) Real Account (B) Nominal account (C) Personal account (D) None of the above

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

15/50 **SUBMITTED TEXT** 18 WORDS **50% MATCHING TEXT** 18 WORDS

a/c Dr Interest a/c Dr To hire vendor a/c Interest a/c Dr To interest suspense a/c 04

A/c Dr. MN Ltd. A/c Dr. To Purchase A/c To PQ Ltd. A/c To Suspense A/c (

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

16/50	SUBMITTED TEXT	16 WORDS	84%	MATCHING TEXT	16 WORDS
Profit and Loss Account for the year ended............. Particulars Amount (`) Particulars Amount (`) To			PROFIT AND LOSS APPROPRIATION FOR THE YEAR 2017 Particulars Amount Particulars Amount To		

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

17/50	SUBMITTED TEXT	18 WORDS	95%	MATCHING TEXT	18 WORDS
Account is: (a) Real Account (b) Nominal Account (c) Personal Account (d)			account is a : • a) Real account • b) Nominal account • c) Personal account • d)		

W https://edurev.in/question/753342/Share-allotment-account-is-a-a-Real-accountb-Nomin

18/50	SUBMITTED TEXT	73 WORDS	14%	MATCHING TEXT	73 WORDS
a/c Asset a/c Dr Interest a/c Dr To hire vendor a/c Interest a/c Dr To interest suspense a/c 04 When the installment is paid Hire vendor a/c Dr To bank a/c Hire vendor a/c Dr To bank a/c Vendors a/c Dr To bank a/c 05 When the depreciation is charged Depreciation a/c Dr To asset a/c Depreciation a/c Dr To asset a/c Depreciation a/c Dr To asset a/c 126			A/c 3) A/c 4) Freight A/c 5) Wages A/c 6) Goodwill A/c 7) Copyright A/c 8) Outstanding income A/c 9) Bank charges A/c 10) Outstanding expenses A/c 11) Sundry income A/c 12) Income receivable A/c 13) Export duty A/c 14) Furniture A/c 15) Import duty A/c 16) Free sample distribution A/c 17) Sundry expenses A/c 18) Discount A/c 19) Drawings A/c 20) Fixed deposit A/c 21)		

W https://www.meritnation.com/cbse-class-11-commerce/accountancy/b.keeping_&_account/meaning-and-fu ...

19/50	SUBMITTED TEXT	82 WORDS	12%	MATCHING TEXT	82 WORDS
a/c Dr To Interest a/c Asset a/c Dr Interest a/c Dr To hire vendor a/c Interest suspense a/c Dr To Interest a/c 04 When the installment is received Bank a/c Dr To hire-purchaser a/c Hire vendor a/c Dr To bank a/c Bank a/c Dr To purchaser a/c 05 When the interest is transferred to p/l a/c Interest a/c Dr To Profit / loss a/c Profit / loss a/c Dr To interest a/c To depreciation a/c Interest a/c			A/c 1) Life Insurance Premium A/c 11) Sundry Income A/c 4) Freight A/c 6) Goodwill A/c 27) Loan A/c 2) Mr. Kulkarni's Capital A/c 21) Profit on Sale of Furniture A/c 5) Wages A/c 7) Copyright A/c 19) Drawings A/c 9) Bank Charges A/c 8) Outstanding Income A/c 13) Export Duty A/c 12) Income Receivable A/c 15) Import Duty A/c 14)Furniture A/c 16) Free Sample Distribution A/c 20) Fixed Deposit A/c 17) Sundry Expenses A/c 22) Office Equipment A/c 18) Discount A/c 23)		

W https://www.meritnation.com/cbse-class-11-commerce/accountancy/b.keeping_&_account/meaning-and-fu ...

20/50	SUBMITTED TEXT	12 WORDS	100% MATCHING TEXT	12 WORDS

are partners sharing profits and losses in the ratio of 3:2.

are partners sharing profits and losses in the ratio of 4/9:1/3:2/9.

W https://www.toppr.com/ask/en-us/question/a-b-and-c-are-partners-in-the-ratio-of-3-2-1-w-is/

21/50	SUBMITTED TEXT	33 WORDS	37% MATCHING TEXT	33 WORDS

and A are partners sharing profits and losses in the ratio of 3:2. They admit B as a partner for one fourth share in the future profits. Calculate the new profit- sharing ratio

and are partners a firm sharing profits in the ratio of 3:2. They admitted Mary as a new partner for 1/4 share. The new profit sharing ratio

W https://www.doubtnut.com/question-answer-accounts/amar-and-bahadur-are-partners-in-a-firm-sharing ...

22/50	SUBMITTED TEXT	21 WORDS	71% MATCHING TEXT	21 WORDS

A and B are partners sharing profits or losses in the ratio of 4:3. C is admitted and the new

A and B are partners sharing profits in the ratio of 2:12:1. C is admitted for 1/5th share. The new

W https://www.toppr.com/ask/en-us/question/a-b-and-c-are-partners-in-the-ratio-of-3-2-1-w-is/

23/50	SUBMITTED TEXT	29 WORDS	72% MATCHING TEXT	29 WORDS

and Sushil are partners in a firm sharing profit in the ratio 5 : 3. They admitted Gaurav as a new partner for 1/4th share in the profit.

and Kamla are partners in a firm sharing profits in the ratio fo `4:1` respectively. They admitted Bimal as a new partner for 1/4 share in the profit,

W https://www.doubtnut.com/question-answer-accounts/amar-and-bahadur-are-partners-in-a-firm-sharing ...

24/50	SUBMITTED TEXT	35 WORDS	73% MATCHING TEXT	35 WORDS

capital) Goodwill A/c Dr. 30,000 To Tanya's Capital A/c 15,000 To Sushil's Capital A/c 15,000

Capital A/c Dr. To A's Capital A/c To B's Capital c 12,000 12,000 20,000 4,000 3.

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

25/50	SUBMITTED TEXT	15 WORDS	88% MATCHING TEXT	15 WORDS

are partners sharing profits and losses in the ratio of 4:3:2. H retires and

are partners sharing profits and losses in the ratio of 4/9:1/3:2/9. B retires and

W https://www.toppr.com/ask/en-us/question/a-b-and-c-are-partners-in-the-ratio-of-3-2-1-w-is/

26/50	SUBMITTED TEXT	31 WORDS	100% MATCHING TEXT	31 WORDS

A/c Dr. 43,200 To A's Capital A/c 19,200 To B's Capital A/c 14,400

A/c Dr. To s Capital A/c To B's Capital A/c 12,000 12,000 20,000 4,000 3.

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

27/50	SUBMITTED TEXT	33 WORDS	83%	MATCHING TEXT	33 WORDS

To A's Capital A/c 19,200 To B's Capital A/c 14,400 To C's Capital A/c 9,600 (

to- A's capital A/c-24,000 B's capital A/c-24,000 C's capital A/c-12,000 60,000

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

28/50	SUBMITTED TEXT	31 WORDS	100%	MATCHING TEXT	31 WORDS

A/c Dr. 43,200 To A's Capital A/c 19,200 To B's Capital A/c 14,400

A/c Dr. To s Capital A/c To B's Capital A/c 12,000 12,000 20,000 4,000 3.

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

29/50	SUBMITTED TEXT	33 WORDS	83%	MATCHING TEXT	33 WORDS

To A's Capital A/c 19,200 To B's Capital A/c 14,400 To C's Capital A/c 9,600 (

to- A's capital A/c-24,000 B's capital A/c-24,000 C's capital A/c-12,000 60,000

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

30/50	SUBMITTED TEXT	16 WORDS	78%	MATCHING TEXT	16 WORDS

s Capital A/c Dr. 27,000 C's Capital A/c Dr. 16,200 To Goodwill A/

s Capital A/c Dr. Q's Capital A/c Dr. To A'

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

31/50	SUBMITTED TEXT	22 WORDS	78%	MATCHING TEXT	22 WORDS

s Capital A/c Dr. 7,800 C's Capital A/c Dr. 6,600 To Goodwill A/

s Capital A/c Dr. Q's Capital A/c Dr. To A'

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

32/50	SUBMITTED TEXT	33 WORDS	58%	MATCHING TEXT	33 WORDS

A's Capital A/c Dr. 7,800 C's Capital A/c Dr. 6,600 To B's Capital A/c 14,400 (

A's capital A/c- 16000 B's capital A/c-16,000 Less:deficiency-(2000) C's capital A/c-8000

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

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33/50	SUBMITTED TEXT	42 WORDS	59%	MATCHING TEXT	42 WORDS

s Capital A/c Dr. 7,800 C's Capital A/c Dr. 6,600 To B's Capital A/c 14,400 (Being due to B adjusted between A and C

s Capital A/c Dr. Q's Capital A/c Dr. To A's Capital A/c To B's Capital A/c 12,000 12,000 20,000 4,000 3.

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

34/50	SUBMITTED TEXT	15 WORDS	100%	MATCHING TEXT	15 WORDS

in partnership sharing profits and losses in the ratio of 3: 2: 1, respectively.

in partnership sharing profits and losses In the ratio of 4 : 2 : 1 respectively.

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

35/50	SUBMITTED TEXT	34 WORDS	100%	MATCHING TEXT	34 WORDS

A/c Dr. 6,600 To A's Capital A/c 3,300 To B's Capital A/c 2,200

A/c Dr. To s Capital A/c To B's Capital A/c 12,000 12,000 20,000 4,000 3.

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

36/50	SUBMITTED TEXT	21 WORDS	63%	MATCHING TEXT	21 WORDS

and N are partners in a firm sharing profits and losses in the ratio of 3: 2. A new partner

and Bahadur are partners in a firm sharing profits in the ratio of 3:2. They admitted Mary as a new partner

W https://www.doubtnut.com/question-answer-accounts/amar-and-bahadur-are-partners-in-a-firm-sharing ...

37/50	SUBMITTED TEXT	36 WORDS	83%	MATCHING TEXT	36 WORDS

To A's Capital A/c 3,300 To B's Capital A/c 2,200 To C's Capital A/c 1,100 (

to- A's capital A/c-24,000 B's capital A/c-24,000 C's capital A/c-12,000 60,000

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

38/50	SUBMITTED TEXT	33 WORDS	58%	MATCHING TEXT	33 WORDS

A's Capital A/c Dr. 2,250 C's Capital A/c Dr. 750 To B's Capital A/c 3,000 (

A's capital A/c- 16000 B's capital A/c-16,000 Less:deficiency-(2000) C's capital A/c-8000

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

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39/50	SUBMITTED TEXT	35 WORDS	77% MATCHING TEXT	35 WORDS

s Capital A/c Dr. 2,250 C's Capital A/c Dr. 750 To B's Capital A/c 3,000 (Being B's

s Capital A/c Dr. Q's Capital A/c Dr. To A's Capital A/c To B's

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

40/50	SUBMITTED TEXT	23 WORDS	64% MATCHING TEXT	23 WORDS

A, B, and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1.

a) Rohan and Mohan are partners in a firm sharing profits in the ratio of `5:3`

W https://www.doubtnut.com/question-answer-accounts/amar-and-bahadur-are-partners-in-a-firm-sharing ...

41/50	SUBMITTED TEXT	23 WORDS	64% MATCHING TEXT	23 WORDS

A, B and C are partners in a firm sharing profits and losses in the ratio of 3 : 2 : 1.

a) Rohan and Mohan are partners in a firm sharing profits in the ratio of `5:3`

W https://www.doubtnut.com/question-answer-accounts/amar-and-bahadur-are-partners-in-a-firm-sharing ...

42/50	SUBMITTED TEXT	16 WORDS	90% MATCHING TEXT	16 WORDS

A, B and C were in partnership sharing profits and losses in the proportion of

A, B and C were in partnership sharing profits and losses In the ratio of 4 : 2 : 1

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

43/50	SUBMITTED TEXT	45 WORDS	58% MATCHING TEXT	45 WORDS

A/c Dr. 78,500 To Stock A/c 25,000 To Sundry Debtors A/c 24,000 To bills Receivable A/c 1,000 (Being

A/c Dr. To Purchase A/c To PQ Ltd. A/c To Suspense A/c (Being

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

44/50	SUBMITTED TEXT	24 WORDS	82% MATCHING TEXT	24 WORDS

A's Capital A/c Dr. 13,800 B's Capital A/c Dr. 9,200 C's Capital A/c

A's capital A/c-24,000 B's capital A/c-24,000 C's capital A/c-12,000 60,000

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

45/50	SUBMITTED TEXT	43 WORDS	46% MATCHING TEXT	43 WORDS

s Capital A/c Dr. 9,200 C's Capital A/c Dr. 4,600 To Realisation A/c 27,600 (Being loss on realisation transferred to Partners' Capital A/c)

s Capital A/c Dr. Q's Capital Dr. To A's Capital A/c To B's Capital A/c 12,000 12,000 20,000 4,000 3.

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

Ouriginal by Turnitin

46/50	SUBMITTED TEXT	24 WORDS	79%	MATCHING TEXT	24 WORDS

A’s Capital A/c Dr. 16,200 B’s Capital a/c Dr. 5,800 C’s Capital A/c

A's capital A/c- 16000 B's capital A/c-16,000 Less:deficiency-(2000) C's capital A/c-8000

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

47/50	SUBMITTED TEXT	24 WORDS	68%	MATCHING TEXT	24 WORDS

s Capital A/c Dr. 16,200 B’s Capital a/c Dr. 5,800 C’s Capital A/c

s Capital A/c Dr. To A's Capital A/c To B's Capital A/c 12,000 12,000 20,000 4,000 3.

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

48/50	SUBMITTED TEXT	15 WORDS	68%	MATCHING TEXT	15 WORDS

s Loan A/c By A’s Capital A/c 16,200 By B’s Capital A/c 5,800

s Capital A/c Dr. To A' s Capital A/c To B's Capital A/c 12,000 12,000 20,000 4,000 3.

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf

49/50	SUBMITTED TEXT	25 WORDS	82%	MATCHING TEXT	25 WORDS

A’s Capital A/c 16,200 By B’s Capital A/c 5,800 By C’s Capital A/c 600 29,500 5,000 16,200 5,800 400 57,500 57,500

A's capital A/c-24,000 B's capital A/c-24,000 C's capital A/c-12,000 60,000

W https://www.toppr.com/ask/question/a-b-and-c-are-partners-in-a-firm-their-profit-sharing-ratio-is-2/

50/50	SUBMITTED TEXT	21 WORDS	68%	MATCHING TEXT	21 WORDS

The Balance Sheet of a firm on 31st March, 2012 was as follows :- Liabilities Amount ` Assets Amount `

The Balance Sheet of the firm as at 31st March, 2017 was as under: Liabilities Amount (`) Assets Amount (`)

W https://icmai.in/upload/suggestedanswer/June-18/Syl2016/P5.pdf