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CA BORN TO FIGHT

Account from Incomplete Record

Introduction

Single entry in itself is not an accounting system; rather it denotes lack of system. When records are not maintained by double entry principle of accounting i.e. records are incomplete we refer it as single entry. In single entry problems also, a student is required to ascertain the profit/loss of the concern & its financial position. It can be done by either of the following two methods. Also when account books are destroyed by fire etc. & financial statements are to be prepared from incomplete data, we refer it as a single entry problem.

5.1. How we define single entry system

- Really speaking there is no defined or prescribed accounting which can be referred as Single entry system.
- Hence we can say anything short of books of accounts maintained by double entry system., is commonly known as single entry or incomplete records.

5.2. How do we prepare final accounts in case of single entry system

Usually we may encounter following three types of problems

(a) **Statement of Affairs method :** When only opening & closing balances of Assets & liabilities of a period are given with few details like drawing & capital contribution, then we can ascertain amount of Profit/ Loss (but can't prepare profit & loss a/c) & prepare Balance sheet (Statement of Affair)

(b) **Completed Account Method :** In addition to opening & closing balances of Assets & Liabilities, if some transactions of the year are also given , then by co-relating such data we can convert it into complete double entry accounts & then from it Trading & Profit & Loss Account & Balance sheet can be prepared in the usual way.

(c) **Ratio based questions :** In addition to opening , closing balances & transactions, quite many ratios are given indicating inter-relationship between various accounting figures , By using such ratio we can derive certain missing data & by co-relating the same with given data accounts are completed & then final accounts are prepared in the usual way.

5.3. Explain statement of Affairs method

- When the information given is so incomplete that all the details required for Trading Profit & loss a/c cannot be ascertained then this method is followed.
- The capital of the beginning & end of the year is ascertained, by preparing the statement of affairs (i.e. Balance sheet) of the two dates. By making necessary adjustment in the capital account the amount of profit/loss for the year is derived as follows.

	Combined of all partners
Capital at the end of the year *Add*: Drawings Interest on partners drawings	... ...
Less: Opening capital Addition during the year Interest on capital & salary to partner	... ...
Balance will be profit/loss after interest & salary	

Note: Alternatively this can be done by preparing a capital a/c & recording all this information to get the amount of profit or loss for the year

Capital Account (Combined)

Particulars	Amount	Particulars	Amount
To Drawings	...	By Opening balance	...
To Interest on drawings	...	By Interest on capital	...
To Closing balance	...	By Salary to owners	...
(ascertained from closing balance sheet)		By Cash/bank (addition)	...
		By Net profit (balancing figure)	...
	......		......

Illustrations with solution to Explains the Concept of Profit calculation from Capital

Illustration 1: A person starts business with Rs. 20,000/-. He doesn't maintain any books of accounts. No personal Transactions from business money. No credit sale (i.e. no debtors). No credit purchase (hence no Creditors). He does business from rented place (hence no properties). All goods are immediately sold out (i.e. no stock). At the end of the year he counts the cash & Bank balance which aggregates to Rs. 60,000/-.

Solution:

At the end of the net assets that is cash & Bank balance is Rs. 60,000/-.
That means capital is Rs. 60,000/-.
Hence this increase in capital of Rs.40,000 (60,000 Closing capital – 20,000 Opening capital) is the profit earned.

Illustration 2: Now suppose in above case he withdraws Rs. 2000 p.m. for his household expenses then the cash bank balance at the end will be only Rs. 36,000 (60,000 – 24,000) i.e. Closing capital will be Rs. 36,000.

Solution:

Closing capital	Rs. 36,000
Add back Drawings	24,000
	60,000
Less Opening capital	20,000
Profit earned	40,000

Drawing is an appropriation of profit earned and not a business expense.

Illustration 3: Now suppose in above situation he also received during the year gift from his father Rs. 10,000 which he invested in the business, then closing cash bank balance will be Rs. 46,000/- consequently closing capital will be Rs. 46,000/-

Solution:

Closing capital		46,000
Add back Drawings		24,000
		70,000
Less : Opening capital	20,000	
Addition during the year	10,000	30,000
Profit earned		40,000

Gift from father is not a business income hence if that money is used in the business, it is an additional capital.

Illustration 4: Now suppose in above case there were credit sale, credit purchase, as well as stock holding. At the end of the year he prepared the list of Debtors, Creditors & stock in hand which amounted to Rs. 15,000/-, Rs. 10,000 & Rs. 20,000 respectively. He also found that furniture was purchased for Rs. 10,000/-. In this case the cash bank balance left was 11,000/-.

Solution:

Closing Balance-sheet (to ascertain Closing capital)

Liabilities	Amount Rs.	Assets	Amount Rs.
Creditor	10,000	Furniture	10,000
Capital (Balancing figure)	46,000	Stock	20,000
		Debtors	15,000
		Cash Bank balance	11,000
	56,000		56,000

Closing capital		46,000	
Add back Drawings		24,000	
		70,000	
Less : Opening capital	20,000		
Addition during the year	10,000	30,000	
Profit earned		40,000	

Now suppose depreciation of Rs. 1,000 is to be charged on furniture then the profit will be Rs. 40,000 – Rs. 1,000 = Rs. 39,000/-

Illustration 5: Kusum and Putul are partners in a firm sharing profits and loss as Kusum 3/5 and Putul 2/5. They keep their books on single entry system. On 1/1/2011, the following statement of affairs was extracted from this book.

Liabilities		Rs.	Assets	Rs.
Sundry Creditors		30,000	Plant	30,000
Kusum Loan A/c		25,000	Stock	20,000
Capital Account			Sundry Debtors	35,000
Kusum	25,000		Cash at Bank	15,000
Putul	20,000	45,000		
		1,00,000		1,00,000

On 31.12.2011, the assets and liabilities were as follows:
Plant Rs. 50,000, Stock Rs. 30,000, Debtors Rs. 40,000, Cash Rs. 20,000, Loan A/c Rs. 25,000. Creditor Rs. 25,000, Drawings - Kusum Rs. 6,000 and Putul Rs. 4,000.

You are required to prepare a Profit and Loss statement for the year ended 31.12.2011, and a statement of Affairs as at that date after taking into consideration the following additional information:

1) Plant to be depreciated by 10% p.a.
2) Stock to be reduced to its NRV Rs. 25,000,
3) A reserve for bad debts to be raised @2.5% on Debtors,
4) Interest on partners' capital is to be allowed @5% p.a. and charged @ 10% on Drawings.
5) Allow interest on Kusum's loan @ 6% p.a.

Solution:

Statement of Affairs as on 31.12.2011 (to ascertain Closing capital)

Liabilities	Amount Rs.	Assets		Amount Rs.
Creditors	25,000	Plant :- Opening Balance	30,000	
Kusum's Loan	25,000	(+) addition	20,000	
Capital (Balancing figure)	80.000	(-) Depreciation	4,000	46,000
		Stock	30,000	
		(-) Reduction	5,000	25,000
		Debtors	40,000	
		(-) Provision for Bad Debt	1,000	39,000
		Cash		20,000
	1,30,000			1,30,000

Depreciation:	For full year on opening balance	30,000 X 10%	= 3,000 and
	For half year on addition	20,000 X 10% X 6/12 =	1,000
	Total		4,000

Statement of Profit

Particulars		Amount Rs.
Capital as on 31.12.2011		80,000
Add: Drawings Kusum	6000	
Putul	4000	10,000
		90,000
(-) Opening Capital		45,000
Profit before Interest		45,000
(+) Interest on Drawings Kusum (6,000 X 10% X 6/12)	300	
Putul (4,000 X 10% X 6/12)	200	+ 500
(-) Interest on Loan (25000 x 6%) to Kusum		- 1500
(-) Interest on Capital Kusum (25,000 X 5%)	1250	
Putul (20,000 X 5%)	1000	- 2250
Profit transferred to Kusum - 3/5	25050	
Putul - 2/5	16700	41,750

Alternatively net profit can be ascertained by preparing capital account as follows:

Capital A/c (Combined of Kusum & Putul)

Particulars	Amount Rs.	Particulars	Amount Rs.
To Drawings A/c	10,000	By Opening Balance b/f	45,000
To Interest on Drawings A/c	500	By Interest on Capital A/c	2,250
To Closing Balance c/f	80,000	By Interest on Loan A/c	1,500
		By Profit (Balancing figure)	41,750
	90,500		90,500

Illustration 6: (June 2003 ICWA): The following is the position of Assets and Liabilities of A + B who does not maintain Complete Books of Account. Capital of A at the beginning of the year was Rs. 10,000 more than B and interest on capital is allowable @ 10% of opening Capital:

	1.4.2001	31.3.2002
Cash in hand	2,500.00	5,200.00
Cash at Bank as per Pass Book	15,200.00	20,200.00
Stock at shop at cost	20,000.00	25,000.00
Sundry Debtors	23,000.00	32,000.00
Sundry Creditors	32,000.00	23,000.00
Furniture	6,000.00	6,000.00
Machinery	20,000.00	25,000.00

Additional information:

(a) Partners have drawn A Rs. 3,000 p.m. and B Rs. 2,000 p.m. No interest is chargeable on drawings.

(b) Stock at shop includes goods sold for Rs. 5,000 at a profit of 20% not yet delivered.

(c) Depreciate Furniture 10% and Machinery @ 20% on closing balances.

(d) As on 31st March, 2002 cheque deposited but not credited by Bank Rs. 9,000 and cheque issued not presented for payments of Rs. 6,500. Bank has also debited our accounts by Rs. 200 as Bank charges.

Prepare Statement of Profit & Loss for the year ended 31st March, 2002 and also a Balance Sheet on that date.

Solution:

Explanation:

If you start business with certain amount of capital & at the end of the year your capital has increased that means you have earned profit. If your capital has decreased then you have suffered losses.

But during the year you might have done some personal Transaction through business money like addition to capital or drawings, hence the above profit/loss figure is affected because of such personal transactions & hence is not true business Profit/ Loss.

Hence to get correct business profit/loss made during a period adjust capital contribution & drawings & then compare the capital of closing date with that of opening date.

Thus when Books of accounts / detailed transaction are not known, then also profit/loss can be ascertained. Capital on any date = Assets – Liabilities.

In this illustration details of transactions are not given, only assets & liabilities, balances are given , hence profit & loss account can not be prepared but amount of profit can be ascertained. While preparing statement of Affairs (i.e. Balance sheet) take corrected or adjusted figures of Assets & Liabilities. Bank balance should be as per our records & not as per pass book. Prepare Bank Reconciliation statement to get balance as per our records. If goods have been sold (delivery pending) it should be removed from stock (cost value) & added in Debtors (sales value) 20% profit is assumed to be on sales.

Solution:

Statement of Profit/Loss Calculation

Closing Capital				88,300
Add back Drawings : A	3000 x 12		= 36,000	
B	2000 x 12		= 24,000	60,000
				1,48,300
Less Opening Capital			54,700	
Additional capital contributed			nil	54,700
Profit earned (before interest on capital)				93,600
Less Interest on capital :	A 32350 x 10%		= 3,235	
	B 22,350 x 10%		= 2,235	5,470
Net Profit				88,130
Profit sharing ratio not specified, hence taken as equal				
A's share	88,130 x 50%		= 44,065	
B's share	88,130 x 50%		= 44,065	

Alternative :

Alternatively above working can be done in the form of an account (by preparing capital a/c as follows).

Capital A/c (Prepared to ascertain profit)

Dr. **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Drawings To Closing Balance	60,000 88,300	By Opening Balance By Cash/ Bank (addition during the year if any) By Interest on Capital By Net Profit (Balancing figure)	54,700 Nil 5,470 88,130
	1,48,300		1,48,300

Now Individual capital can be ascertained by preparing capital a/c

Working Note:

Statement of Affairs as on 1.4. 2001

Liabilities	Amount Rs.	Assets	Amount Rs.
Creditors Capital (Balancing figure)	32,000 54,700	Cash in hand Bank Balance Stock Debtors Furniture Machinery	2,500 15,200 20,000 23,000 6,000 20,000
	86,700		86,700

Let us assume Capital of 'B' = X

Then Capital of A will be = X + 10,000

∴ Total Capital is = X + X + 10,000 = 2x + 10,000 = 54,700

∴ 2x = 54,700 – 10,000 = 44,700 ∴ X = 22,350

Thus Opening Capital of A= 32,350 & Capital of B = 22,350

Statement of Affairs as on 31.3. 2002

Liabilities	Amount Rs.	Assets		Amount Rs.
Creditors	23,000	Cash in hand		5,200
Capital (Balancing figure)	88,300	Bank Balance		22,700
		Stock	25,000	
		(-) Goods sold	4,000	21,000
		5,000x80%	32,000	
		Debtors	5,000	37,000
		(+) Sales (not yet	6,000	
		delivered)	600	5,400
		Furniture	25,000	
		(-) Depreciation 10%	5,000	20,000
		Machinery		
		(-) Depreciation 20%		
	1,11,300			1,11,300

Bank Reconciliation Statement as on 31.3.2002

	Dr.	Cr.
Balance as per Pass book (deposit)		20,200
Cheques deposited but not yet credited by Bank		9,000
Cheques issued but not yet presented for payment	6,500	
Balance as per Cash Book	22,700	
	29,200	29,200

Note : 1) If in BRS only those items appear which are pending from Banks side, then the Cash book balance appearing in BRS will be final balance (corrected balance) , hence Bank charges is not shown above. That means the cash book balance Rs.22,700/- is after adjusting Bank Charges.

2) BRS can be prepared in add-less pattern also.

3) There are no reconciliation item as on 1.4.2001, hence cash book balance will be equal to pass book balance.

Capital A/c

	A	B		A	B
To Drawings a/c	36,000	24,000	By Opening balance a/c	32,350	22,350
To Closing balance	43,650	44,650	By Interest on Capital a/c	3,235	2,235
			By P&L a/c (share in profit)	44,065	44,065
	79,650	68,650		79,650	68,650

If question requires to prepare balancesheet as on 31.3.2002 then statement of affairs prepared above will come as it is with the only change now is that write the capitals as above of A & B separately.

5.4. Compare statement of Affair with Balance-sheet.

- Balance sheet is prepared from the information extracted from the books of accounts prepared by Double entry system.
- When a statement of Assets & Liabilities is prepared from the information ascertained otherwise than from the Double entry books of accounts & capital is ascertained as a balancing figure, such statements is known as statement of Affairs.

- Except for the source of figures of assets & liabilities, the statement of affair is same as Balance sheet.

5.5. Explain completed account method.

- When the information given is sufficient, we prepare/ complete all the necessary accounts by double entry method & ascertain the information which is not given by balancing those accounts.
- This gives us sufficient information to prepare Trial balance & subsequently profit & loss account & Balance sheet. Exact procedure will depend on the data given in the question & hence will vary. But following broad guidelines can be given.
  - (a) The opening balance from the opening balance sheet will come in the Current years accounts: assets will have debit balance & liabilities will have credit balance.
  - (b) Make double entry effect i.e. debit as well as credit for the given transactions.
  - (c) Closing balances which are given be written in the concerned account. Remember debit balance (i.e. debit side of the account is more) is written on credit side of the account & credit balance (i.e. credit side of the account is more) is written on the debit side while balancing/closing an account so as totally both sides of an account.
  - (d) By balancing the accounts we get missing information, if it is a transaction complete the double entry, if it is closing balance of that account then write as per(c) above.
  - (e) After doing above all closing balances can be written in the form of a Trial balance & then Final account prepared or alternatively such closing balances of income, expenses, assets & liabilities can be directly written in final accounts.
  - (f) Where ever there are more items prepare account, otherwise the information ascertained (i.e. balance of an account) can be treated as per point (e).
  - (g) When a tallied opening balance sheet ,and receipt payment a/c / cash bank a/c is not given in the question the same may also have to be prepared & missing data if any will be ascertained.
  - (h) The closing balance of stock given in the question is not the balance of any account , rather it is transaction (adjustment) requiring double entry.

Student should prefer to ascertain missing data by preparing accounts & completing proper double entry rather than by doing additions & subtractions

Once you develop proper grip on double entry system of accounting & are able to interprete properly then many information you can ascertain orally (thinking mentally) i.e. without preparing accounts.

5.6. Draft an income account

Any and every income account can be prepared as follows:

Income Account

To Opening Outstanding B/f (Receivable)	...	By Opening Advance b/f	...
To Profit & Loss a/c (Income for the year)	...	By Cash/Bank a/c (Received during the year)	...
To Closing Advance C/f	...	By Closing outstanding C/f (Receivable)	...
Total	...	Total	...

5.7. Draft an expense account.

Any and every expenses account can be prepared as follows:

Expense Account

To Opening Advance B/f (Prepaid)	...	By Opening Outstanding b/f (Payable)	...
To Cash/Bank a/c (Paid during the year)	...	By Profit & Loss a/c (Expense for the year)	...

To Closing outstanding C/f (payable)	...	By Closing Advance C/f (prepaid)	...
Total	...	Total	...

5.8. Draft a fixed asset account.

Fixed Assets A/c

To Opening Balance b/f	...	By Cash/Bank (Sale)	...
To Cash/Bank a/c (Purchases)	...	By P&L a/c (Loss on sale)	...
To P&L a/c (Profit on sale)	...	By Depreciation a/c	...
		By Balance c/f	...
Total	...	Total	...

5.9. Draft Debtors account.

Debtors A/c

To Opening Balance b/f (Receivable)	...	By Cash/Bank/Bill Receivable a/c (Received)	...
To Sales a/c (Credit sale)	...	By Bad debt/Discount allowed a/c	...
		By Balance c/f	...
Total	...	Total	...

5.10. Draft Creditor a/c

Creditors A/c

To Cash/Bank/Bills Payable a/c (Payment)	...	By Opening balance b/f (payable)	...
To Discount received a/c	...	By Purchases a/c (Credit purchase)	...
To Balance c/f			
Total	...	Total	...

5. 11. Draft a Goods/stationary/consumables account.

Any Goods/stationary/consumables account can be prepared as follows:

Goods/stationary/consumables Account

To Opening balance B/f (Opening stock)	...	By Profit & Loss a/c / I&E a/c	
To Cash/Bank a/c (cash purchase during the year)	...	(Consumed/Cost of goods sold)	...
To Creditors a/c (credit purchase)	...	By Closing balance C/f (closing stock)	...
Total	...	Total	...

While preparing any such account , record the given data & then by balancing such a/c missing data is ascertained.

When opening Balance sheet is not given the same should be prepared to ascertain any missing information like opening balance of Capital a/c etc.

Other a/cs. Like assets a/c, loan a/c, goods a/c, cash, Bank a/c, etc. can also be prepared to ascertain missing data if any.

Illustration on ascertaining missing information by preparing relevant account

Illustration 7: (June 1998): Calculate total sales from the following information:

	Rs.
Bills receivable on 1st January,	7,800
Debtors on 1st January,	30,800
Cash received on maturity of bills receivable during the month	20,900
Cash received from debtors	70,000
Bad debts written off	4,800
Returns inwards	8,700
Bills receivable dishonored	1,800
Bills receivable on 31st January,	6,000
Debtors on 31st January,	25,500
Cash sales during the month	15,900

Solution :

Credit sales results in to Debtors & Debtors gives rise to Bills Receivable, hence the following Accounts are prepared to ascertain Credit Sale.

Debtors A/c

Dr. **Cr.**

Particulars	Rs.	Particulars	Rs.
To Opening Balance b/f	30,800	By Cash a/c (collection)	70,000
To Bills Receivable a/c(Bills dishonored)	1,800	By Bad debt a/c	4,800
To Sales a/c (Credit sale – Balancing figure)	97,300	By Sales Return a/c	8,700
		By Bills Receivable a/c (Bills received)	20,900
		By Closing Balance c/f	25,500
	1,29,900		1,29,900

Bills Receivable A/c

To Opening Balance b/f	7,800	By Cash a/c (Bills honoured)	20,900
To Debtors a/c (Bills received – Balancing figure)	20,900	By Debtors a/c (Bill dishonoured)	1,800
		By Closing Balance c/f	6,000
	28,700		28,700

Note : 1st balance Bills Receivable a/c to get the figure of bills received from debtors, account it & then balance debtors a/c to get credit sales.

Credit sale	Rs. 97,300
Cash sale	Rs. 15,900
Total sale	Rs. 1,13,200

Illustration on ascertaining missing information by preparing relevant account

Illustration 8: (ICWA Dec. 2000) Patel is a wholesaler who purchases goods from manufacturers and sells the goods to retailers. On 31st October, he owed manufacturers Rs. 40,00,000 of which 80% was in the form of bills of exchange draw by the manufacturers and accepted by him. His customers owed him Rs. 50,00,000 on that day of which 75% was in the form of bills of exchange drawn by him and accepted by the drawees.
During November, 2000 the following information is collected:

(a) Purchases Rs. 30,00,000
(b) Sales Rs. 34,00,000
(c) Bills of exchange accepted in favour of manufacturers Rs. 35,00,000
(d) Bills of exchange accepted by retailers Rs. 40,00,000
(e) Acceptance honoured by Patel Rs. 31,00,000
(f) Acceptance honoured by retailers Rs. 33,00,000

Patel asks you to show ledger accounts of
(i) Manufacturers, (ii) Retailers, (iii) Bills payable, (iv) Bills receivable.

Solution :

We receive bills (Bills Receivable) from Debtors, then debtors balance gets reduced.
We issue bills (Bills Payable) to creditors, then Creditors balance gets reduced.
Opening balance of all the accounts and all the transaction of the month are given hence by preparing the account we will get closing balance from all this accounts as balancing figure.

In the Books of Patel

Manufacturer/ Supplier / Creditors A/c

Dr. **Cr.**

Particulars	Amount Rs.	Particulars	Amount Rs.
To Bills Payable a/c (Bills accepted/ issued)	35,00,000	By Opening balance b/f (40,00,000 – 32,00,000 BP)	8,00,000
To Closing balance c/f (balance figure)	3,00,000	By Purchases a/c	30,00,000
	38,00,000		38,00,000

Retailers / Customers / Debtors A/c

To Opening Balance b/f (50,00,000 – 37,50,000 BR)	12,50,000	By Bills Receivable a/c (Bills received)	40,00,000
To Sales a/c	34,00,000	By Closing Balance c/f (balance figure)	6,50,000
	46,50,000		46,50,000

Bills Payable A/c

To Cash/Bank a/c (Honoured / paid)	31,00,000	By Opening Balance b/f (40,00,000 x 80%)	32,00,000
To Closing balance c/f (balance figure)	36,00,000	By Manufacturer a/c (Bills accepted/ issued)	35,00,000
	67,00,000		67,00,000

Bills Receivable A/c

To Opening Balance b/f (50,00,000 x 75%)	37,50,000	By Cash/Bank a/c (Bills honoured/ amount received)	33,00,000
To Retailers a/c (Bills received)	40,00,000	By Closing Balance c/f (balance figure)	44,50,000
	77,50,000		77,50,000

Illustration on Completed account method

Illustration 9: Mr. PQ has a small trading business for which the following procedures are followed:

(1) All collections are deposited with the Bank each day.
(2) All Payments except petty expenses are made by Cheque.
(3) To meet petty expenses a cheque of Rs.500 is withdrawn from the Bank on the 1st day of each month.
(4) Mr. PQ makes personal drawings from the Bank.

The following figures are available from Mr. PQ's records:

	Rupees
Cash-in-hand as on 1-1- 2011 ...	320
Cash-in-hand as on 31-12-2011 ...	200
Balance in Bank as on 1-1-2011 ...	2,500
Balance in Bank as on 31-12-2011 (Over draft) ...	5,000
Debtors as on 1-1-2011 ...	20,000
Debtors as on 31-12-2011 ...	30,000
Creditors as on 1-1-2011 ...	20,000
Creditors as on 31-12-2011 ...	30,000
Stock of goods on 1-1-2011 ...	10,000
Stock of goods as on 31-12-2011 ...	30,000
Payments made to Creditors during the year ...	20,000
Sales made during the year ...	30,000

Mr. PQ spent during the year Rs.200 from the Office cash for his personal expenses. Prepare Profit and Loss Account for the year ended on 31st December, 2011 and Balance Sheet as on that date from the above information.

Solution:

Explanation:

Apart from opening & closing balances of Assets & Liabilities some transactions of the year are also given. Hence by correlating them, we can ascertain missing transactions & balances. Thus we can complete it in to Double Entry based Books of Accounts.
In examination what is generally asked is the final accounts hence there is no need to prepare all accounts. Wherever it is observed that an item has single debit or single credit, giving the same balance then to save time instead of preparing account for such item write it directly in Trial balance/ Final a/c. Accounts which has more items should be prepared and ascertain missing information.
Opening balance sheet is not given hence the same should be prepared to ascertain the opening capital (or any other missing figure)
While preparing an account remember that –

- ✓ Opening debit balance will be written on debit side & opening credit balance will be written on credit side.
- ✓ But closing debit balance will be written on credit side & closing credit balance on debit side, so as to balance the sides of the account.
- ✓ All Assets have debit balance & All liabilities have credit balance.
- ✓ Complete double entry for every transaction & post debit & credit to respective accounts.

Working Notes:

Cash a/c

To Opening Balance b/f	320	By Drawing a/c	200
To Bank a/c	6,000	By Petty expenses a/c (balancing figure)	5920
		By Closing Balance c/f	200
	6320		6320

Bank a/c

To Opening Balance b/f	2500	By Cash a/c	6,000
To Debtors a/c	20,000	By Creditors a/c	20,000
To Closing Balance (Over draft) c/f	5000	By Drawings a/c (balancing figure)	1500
	27,500		27,500

Debtors a/c

To Opening Balance b/f	20,000	By Bank a/c (balance figure) (Collection)	20,000
To Sales a/c	30,000	By Closing balance c/f	30,000
	50,000		50,000

Creditors a/c

To Bank a/c	20,000	By Opening Balance b/f	20,000
To Closing Balance c/f	30,000	By Purchases a/c (balancing figure)	30,000
	50,000		50,000

Balance Sheet (Opening) as on 1.1.2011

Opening Capital (Balancing figure)	12,820	Cash	320
Creditors	20,000	Bank	2500
		Debtors	20,000
		Stock	10,000
	32,820		32,820

Trial Balance for the Year Ended 31.12.2011

			Dr.	Cr.
Cash			200	
Bank a/c (over draft)				5,000
Debtors			30,000	
Creditors				30,000
Opening Stock			10,000	
Sales				30,000
Drawings	Through Cash	200		
	(+) Through Bank	1500	1,700	
Purchases			30,000	
Petty expenses			5,920	
Capital				12,820
			77,820	77,820

Adjustment Closing Stock Rs. 30,000
Note: With the help of above Trial Balance & Adjustment, Profit & Loss a/c & Balance Sheet be made.

Trading & Profit & Loss A/c for the year ended on 31.12.2011

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening stock	10,000	By Sales	30,000
To Purchases	30,000	By Closing stock	30,000
To Gross profit c/d	20,000		.
	60,000		60,000
To Petty Expenses	5,920	By Gross profit b/d	20,000
To Net profit	14,080		
	20,000		20,000

Balance-sheet as on 31.12.2011

Liabilities		Amount Rs.	Assets	Amount Rs.
Capital			Cash	200
Opening balance	12,820		Debtors	30,000
+ Net profit	14,080		Stock	30,000
(-) Drawings	1,700	25,200		
Bank Over draft		5,000		
Creditors		30,000		
		60,200		60,200

In the above illustration to give you proper idea of accounting first trial balance is prepared & from it Final Accounts has been prepared.
But in examination to save time you can (rather you should) instead of writing an account balance in Trial balance, write it directly in final accounts.

Illustration 10: Shri Kapoor has a trading business for which the following procedures are followed:

1. All collections are deposited with the Bank each day.
2. To meet petty expenses a Cheque for Rs.1,500 is withdrawn from the Bank on the 1st day of each month.
3. Payments made to Creditors during the year Rs.1,20,000.
4. Personal drawings out of Bank Rs.6,000.
5. Shri Kapoor sells goods at a profit of 25% on sales.
6. Prepare Profit and Loss Account for the year ended 31st December, 2011 and Balance Sheet as on that date from the above information.

The following figures are available from Shri Kapoor's records:

	1-1-2011 (Rs.)	31-12-2011 (Rs.)
Cash-in-hand …	150	300
Balance in Bank …	30,000	21,000
Debtors …	1,00,000	1,25,000
Creditors …	90,000	1,00,000
Stock …	15,000	25,000

Solution:

Shri Kapoor
Profit & Loss A/c For the Year Ended on 31.12.2011

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening stock	15,000	By Sales	1,60,000
To Purchases	1,30,000		
To Gross Profit carried down	40,000	By Closing Stock	25,000
	1,85,000		1,85,000
To Expenses	17,850	By Gross Profit brought down	40,000
To Net Profit	22,150		
	40,000		40,000

Balance sheet as on 31.12.2011

Liabilities & Capital		Amount Rs.	Assets	Amount Rs.
Capital			Cash	300
Opening Balance	55,150		Bank	21,000
(-) Drawings	6,000		Debtors	1,25,000
(+) Net Profit	22,150	71,300	Stock	25,000

Creditors	1,00,000		
	1,71,300		1,71,300

Working Notes:

Bank A/c

Particulars	Rs.	Particulars	Rs.
To Opening Balance b/f To Debtors a/c (collection)	30,000 1,35,000	By Cash a/c (withdrawn 1500 x 12) By Creditors a/c By Drawings a/c By Closing Balance c/f	18,000 1,20,000 6,000 21,000
	1,65,000		1,65,000

Cash A/c

To Opening Balance b/f To Bank a/c (cash withdrawn 1500 x 12)	150 18,000	By Expenses a/c (balancing figure) By Closing Balance c/f	17,850 300
	18,150		18,150

Debtors A/c

To Opening Balance b/f To Sales a/c	1,00,000 1,60,000	By Bank a/c (collection : Balancing figure) By Closing Balance c/f	1,35,000 1,25,000
	2,60,000		2,60,000

Creditors A/c

To Bank a/c To Closing Balance c/f	1,20,000 1,00,000	By Opening Balance b/f By Purchases (Balancing Figure) a/c	90,000 1,30,000
	2,20,000		2,20,000

Opening Balance Sheet

Liabilities	Rs.	Assets	Rs.
Creditors Capital (Balancing figure)	90,000 55,150	Cash in Hand Cash at Bank Debtors Stock	150 30,000 1,00,000 15,000
	1,45,150		1,45,150

Trial Balance (31.12.2011)

Particulars	L.F.	Debit Rs.	Credit Rs.
Drawings		6000	
Cash		300	
Bank		21,000	
Purchase/Sales		1,30,000	1,60,000
Debtors/Creditors		1,25,000	1,00,000
Stock		15,000	
Expenses		17,850	
Capital			55,150
		3,15,150	3,15,150

Calculation of Sales:

Cost of goods sold = Opening Stock + Purchases – Closing Stock
= 15,000 + 1,30,000 – 25,000 = 1,20,000

Gross profit is 25% on sales that means cost is 75 + profit 25 = sale 100.

$\therefore$ Sales during year $\left(= 1,20,000/75 \text{ X}100 \right)$ = 1,60,000

In the above illustration to give you proper idea of accounting first trial balance is prepared & from it Final Accounts has been prepared.
But in examination to save time you can (rather you should) instead of writing an account balance in Trial balance, write it directly in final accounts.

5.12. Explain how to tackle ratio based problems.

- Sometimes in addition to certain Opening & closing balances & transactions , some financial ratios are also given.

- A ratio (which are generally in % or decimal point form) indicates arithmetical relationship between the two financial figures. Hence if one of this figure is known & is put in to that equation of ratio, then by solving it we get the other financial figure. In this manner solve all the given ratio to get the missing data.
- Rest of the procedure will be same as in Q.5 above. Such problems will require proper understanding of ratios which is part of your Cost Account & Financial Management paper hence refer the same.

Some times only ratios & one or two financial figures are given from which missing information is to be ascertained and final account prepared. Such problems will be solved in ratio analysis chapter in Cost Accounting and Financial Management paper refer the same.

Some Important Ratios

5.12.1 Profitability Ratios

(1) $\begin{matrix}\text{Return on Investment (R.O.I)}\\ \text{(Overall profitability ratio)}\end{matrix} = \dfrac{\text{N.P. before Interest and Tax (PBIT)}}{\text{Capital Employed}} \times 100$ **Or**

$$\text{Return on Investment (R.O.I)} = \frac{\text{N.P. after Tax}\left(\text{PAT}\right) + \text{Interest}}{\text{Capital Employed}} \times 100$$

Note – 1st formula is commonly used.

This shows the profit earned as % to capital employed. If ratio is 20% that means on every Rs. 100 invested in business, the operating profit earned is Rs. 20/-. A business is profitable only if its ROI is more than its cost of capital.

(2) $\text{Net Profit Ratio} = \dfrac{\text{N.P. before Interest and Tax (PBIT)}}{\text{Sales}} \times 100$

This shows operating profit earned as % on sales. If ratio is 15% that means on every Rs. 100 sales the net profit is Rs. 15/-. It is the net margin on sales. Higher the ratio better it will be.

(3) $\text{Gross profit ratio} = \dfrac{\text{Gross profit}}{\text{Sales}} \times 100$

It shows the gross profit (i.e. sales – cost of goods sold) as a % to sales. If the ratio is 30% that means on every Rs. 100 sale, gross margin is Rs. 30/- and cost of goods sold is Rs. 70/-.

Note – *(i)*Profitability ratios are usually calculated and used in % form, hence above formulas are multiplied by 100. *(ii)* Similarly a ratio can be calculated for each item of cost/expenses to Sales or to Cost of Sales.

5.12.2 Turnover Ratios

It shows the utilisation of various Assets in making (generating) sales. Higher the ratio better it will be-

(1) $\text{Fixed Asset Turnover Ratio} = \dfrac{\text{Sales}}{\text{Fixed Assets}}$

If this ratio is 2 that means sales is two times the amount of fixed assets. Similarly you can interpret the other ratios as well.

(2) $\text{Capital Turnover Ratio} = \dfrac{\text{Sales}}{\text{Capital Employed}}$

It shows the utilisation of capital employed i.e. Fixed Assets & Working Capital. If this ratio is higher it will also increase ROI. ROI is the result of net profit ratio and capital turnover ratio.

(3) $\text{Current Asset Turnover Ratio} = \dfrac{\text{Sales}}{\text{Current Asets}}$

Note – In ratio no. 1, 2 & 3 in place of sales, alternatively cost of sales can also be used.

(4) $\text{Stock}\left(\text{Inventory}\right)\text{Turnover Ratio} = \dfrac{\text{Cost of goods sold or sale}}{\text{Stock}}$

Stock = Raw Material + Finished Goods + WIP + Stores & Spares

Note: When opening & closing stock is given then we should take average stock for calculation, otherwise closing stock will be considered.

(5) $\text{Stock Velocity Ratio} = \dfrac{12}{\text{Stock Turnover Ratio}}$ **Or**

$$\text{Stock Velocity Ratio} = \frac{\text{Stock}}{\text{Monthly cost of goods sold/ Monthly sales}}$$

This Ratio shows that the Inventory is equivalent to so many months cost of goods sold/ sales i.e. inventory holding period. If the ratio is say 4 that means we are holding stock equal to 4 months cost of goods sold or sale. In ratio no. 4 & 5 cost of goods is preferred, if the same is not known then sales can be used.

(6) $\text{Debtos Turnover Ratio} = \dfrac{\text{Sales}\left(\text{only credit sale if given}\right)}{\text{Debtors}\left(\text{including bills receivable}\right)}$

(7) $\text{Debtors Velocity Ratio}\left(\text{in months}\right) = \dfrac{12}{\text{Debtors Turnover Ratio}} \text{ OR } \dfrac{\text{Debtors}}{\text{Monthly sale}}$

It shows Debt collection period/credit period allowed. Suppose ratio is 3 month, that means debtors are equal to 3 months sale or we are allowing 3 months credit to debtors or we are able to collect money in 3 months from debtors.

(8) $\text{Creditor Turnover Ratio} = \dfrac{\text{Purchases (Only credit purchase if given)}}{\text{Creditors}\left(\text{including bills payable}\right)}$

(9) $\begin{matrix}\text{Creditor Velocity Ratio}\\ \left(\text{in months}\right)\end{matrix} = \dfrac{12}{\text{Creditors Turnover Ratio}} \text{ OR } \dfrac{\text{Creditors}}{\text{Monthly purchases}}$

It shows how many months credit is enjoyed/credit period allowed to us.

Note: Velocity Ratios (number 5, 7 & 9) can be calculated by taking 365 in place of 12 in the above equations then ratio will be in day's. This ratios shows the current assets and current liabilities in terms of time either in month or in days and is used for working capital estimates.

5.12.3 Ratios of Solvency or Ratios showing short term Financial Position/Liquidity ratios.

Liquidity refers to the ability of an organisation to meet its short-term liabilities. An organisation has to meet its current liabilities in the short-term and therefore, it is important that there should be enough current assets to cover the current liabilities. The current assets, loans and advances on the one hand and current liabilities on the other are indicative of the liquidity status. An enterprise is said to be liquid if its current liabilities are covered by current assets. The following two ratios are extensively used to measure liquidity.

(1) $Current\ Ratio = \dfrac{Current\ Assets}{Current\ Liabilities}$

Normally current ratio of 2 (two) is taken as good.

(2) Acid Test Ratio/Quick Ratio/Liquidity Ratio:

$$Liquidty\ Ratio = \frac{Liquid\ Asset\ (i.e. Current\ Assets\ Excluding\ Stock)}{Quick\ Liabilities\left(Current\ liability\ Excluding\ Bank\ over\ draft\right)}$$

It should be always above 1 (one)

Note: Stock generally take long time to get converted into cash hence are not treated as quick or liquid asset. Quick liabilities are that portion of current liabilities which fall due immediately. Since bank overdraft and cash credit can be used as a source of finance as and when required, and the same are not immediately repayable hence, it is not included in the calculation of quick liabilities.

5.12.4 Ratios showing long term Financial Position

Such ratios refers to the organizations financial structure.

(1) $\text{Debt Eqity Ratio} = \dfrac{\text{Long term debts}}{\text{Shareholder's fund}}$

Ratio of two (2) may be good ratio. Lower ratio indicates that there is scope for further debt (loan) financing. In special cases financial institutions permit higher than 2 ratio also.

Or Debt Equity Ratio = $\dfrac{\text{Long term Debt}}{\text{Long term Fund (i.e. shareholders fund + long term Debt)}}$

Note: If earlier formula gives result of 2 then this formula will give ratio 0.67

(2) $\text{Fixed Assets Ratio} = \dfrac{\text{Fixed Assets}}{\text{Long term Funds}}$

It should always be lower than 1 (one), that means fixed assets should be fully financed from long term funds.

5.12.5 Other Ratios

Most of this ratios can also be termed as investors ratio.

(1) $\begin{matrix}\text{Fixed Charges Cover} \\ (\text{Interest cover ratio})\end{matrix} = \dfrac{\text{Profit before interest \& tax (PBIT)}}{\text{Interest}}$

Higher the ratio, higher will be the security to lenders i.e. financiers.

(2) Debt Service Coverage Ratio (DSCR) = $\dfrac{\text{Profit After Tax + Interest on term loan + Depreciation}}{\text{Interest + Loan re-payment}}$

Suppose the ratio is 2 that will means that the cash generated from business is twice the obligation towards lender i.e. twice the amount of interest and loan during that period.

(3) $\begin{matrix}\text{Return on Equity/} \\ \text{shareholders fund (RONW)}\end{matrix} = \dfrac{\text{Profit after Interest, Tax \& Preference Dividend i.e. PAT Pref. Div}}{\text{Equity shareholders fund (Net worth)}}$

(4) $\text{Earning per share} = \dfrac{\text{Profit after Int, Tax \& Pref. Dividend i.e. PAT Pref. Div}}{\text{No. of equity shares}}$

(5) $\text{Price earning ratio (PE ratio)} = \dfrac{\text{Market price}}{\text{Earning per share}}$

It shows market price of a share is how many times its earnings per share.

Note – Ratio can be calculated between any two related figures, hence there is no limit to the number of ratios. Here only some basic and commonly used ratios has been specified. Interpretation of ratios and drawing conclusion from it is a highly skilled job and cannot be expected from B.Com. Part I level students. Hence, the details on that part not included in this chapter.

Illustration 11: From he following information calculate sales and purchases for the current year.
His sales for the year ended 30th June, 2011 were 20% higher than the previous year's. He always sells his goods at cost plus 25%. 20% of the total sales for the year ended 30th June, 2011 are for cash. There were no cash purchases.
On 30^{th} June, 2010, the stock was Rs.40,000 on 1st July, 2010 level was raised to Rs.60,000 and stock was maintained at this new level all throughout the year.
Gross Profit as per last year's audited accounts was Rs.60,000.

Solution:

Calculation of missing information with the help of Ratios

I) Calculation of Sales			**II) Calculation of Purchases**	
Last Years Gross Profit G.P. Ratio is 25% on Cost	60,000		Sale	3,60,000
Last years sales = $\frac{60{,}000 \times 125}{25}$	3,00,000		(-) G. P $\frac{3{,}60{,}000 \times 25}{125}$	72,000
			Cost of goods sold	2,88,000
(+) Increase 20%	60,000		(+) Closing stock	60,000
Current year sales	3,60,000			3,48,000
Cash Sales 20%	72,000		(-) Opening stock	40,000
Balance is Credit Sales	2,88,000		Balance is Purchase	3,08,000

Illustration 12: (Similar in June 2009): The following is the Balance Sheet of Sanjay, a small trader as on 31.3.2010 :
(Figures in Rs. '000)

Liabilities	Rs.	Assets	Rs.
Capital	200	Fixed Assets	145
Creditors	50	Stock	40
		Debtors	50
		Cash on Hand	5
		Cash at Bank	10
	250		250

A fire destroyed the accounting records as well as the closing cash of the trader on 31.3.2011. However, the following information was available:

a) Debtors and creditors on 31.3.2011 showed an increase of 20% as compared to 31.3.2010.
b) Credit Period : Debtors - 1 month Creditors - 2 months
c) Stock was maintained at the same level throughout the year.
d) Cash sales constituted 20% of total sales.
e) All purchases were for credit only.
f) Current ratio as on 31.3.2011 was exactly 2.
g) Total expenses excluding depreciation for the year amounted to Rs. 2,50,000.
h) Depreciation was provided at 10% on the closing value of fixed assets.
i) Bank and cash transactions:
   1) Payments to creditors included Rs. 50,000 by cash.
   2) Receipts from debtors included Rs. 5,90,000 by ways of cheques.
   3) Cash deposited into the bank Rs. 1,20,000.
   4) Personal drawings from bank Rs. 50,000.
   5) Fixed assets purchased and paid by cheques Rs. 2,25,000.

<u>You are required to prepare :</u>
a) The Trading and Profit & Loss Account of Sanjay for the year ended 31.3.2011 and
b) A Balance Sheet on that date.
For your exercise, assume cash destroyed by fire is written off in the Profit & Loss Account.

Solution:

Trading & Profit & Loss a/c
(For the Year Ended 31.3.2011)

Particulars	**Amount Rs.**	**Particulars**		**Amount Rs.**
To Opening Stock	40,000	By Sales a/c Cash	1,80,000	
To Purchases a/c	3,60,000	Credit	7,20,000	9,00,000
To Gross Profit	5,40,000	By Closing stock		40,000
	9,40,000			9,40,000
To Depreciation a/c	37,000	By Gross Profit		5,40,000
To Sundry Expenses a/c	2,50,000			
To Loss of Cash by fire a/c	10,000			
To Net Profit	2,43,000			
	5,40,000			5,40,000

Balance sheet as on 31.03.2011

Liabilities & Capital		Amount Rs.	Assets		Amount Rs.
Capital -	2,00,000		Fixed Assets	1,45,000	
(-) Drawings	50,000		(+) Addition	2,25,000	
(+) Net Profit -	2,43,000	3,93,000		3,70,000	
Creditors		60,000	(-) Depreciation	37,000	3,33,000
			Debtors		60,000
			Stock		40,000
			Bank		20,000
		4,53,000			4,53,000

Working Notes:

a) Calculation of Sales:

Debtors on 31.3.2010	50,000
(+) Increase (20% of 50,000)	10,000
Debtors on 31.3.2011	60,000
Debtors are = 1 Month Sale (Credit) = 60,000	
∴ Sales (Credit) - 60,000 x 12 = 7,20,000	
∴ Cash Sales $\frac{20}{80}$ x 7,20,000 = 1,80,000	
Total Sales	9,00,000

b) Calculation of Purchases:

Creditors as on 31.3.2010	50,000
(+) Increase (20% of 50,000)	10,000
Creditors as on 31.3.2011	60,000

Closing Creditors = 2 months purchases = Rs. 60,000

∴ 1 month purchase = 60,000 ÷2 = 30,000

∴Total Purchases (as all purchases are made in credit) = 30,000 x 12 = 3,60,000

c) Calculation of Bank balance:

Current Ratio $= \frac{\text{Current Asset}}{\text{Current Liability}}$ (Cash+ Bank + Debtor + Stock) $= \frac{\text{NIL+ Bank+60000+40000}}{60000} = 2 \longrightarrow$ Bank = 20000

Cash a/c

Particulars	Rs.	Particulars	Rs.
To Opening Balance	5,000	By Creditors a/c	50,000
To Sales	1,80,000	By Bank a/c	1,20,000
To Debtors	1,20,000	By Sundry Expense (2,50,000 – 1,25,000)	1,25,000
		By Loss by fire (Balance figure)	10,000
	3,05,000		3,05,000

Bank a/c

Particulars	Rs.	Particulars	Rs.
To Opening Balance	10,000	By Creditors a/c	3,00,000
To Debtors a/c	5,90,000	By Drawings	50,000
To Cash a/c	1,20,000	By Fixed Asset	2,25,000
		By Sundry Expenditure (Balance figure)	1,25,000
		By Closing Balance (as per working using current ratio)	20,000
	7,20,000		7,20,000

Debtors a/c

Particulars	Rs.	Particulars	Rs.
To Opening Balance	50,000	By Bank a/c	5,90,000
To Sales a/c (as per working using ratios)	7,20,000	By Cash (Balance figure)	1,20,000
		By Closing Balance	60,000
	7,70,000		7,70,000

Creditors a/c

Particulars	Rs.	Particulars	Rs.
To Cash a/c	50,000	By Opening Balance	50,000
To Bank a/c (Balance figure)	3,00,000	By Purchases (as per working using ratios)	3,60,000
To Closing Balance	60,000		
	4,10,000		4,10,000

ABRIDGED FORM OF BALANCE SHEET (FOR NON-CORPORATE) TRADING ENTITIES

Name of entity…………..
Balance sheet as at………

Figure for previous year	**Capital and liabilities**	**Figures for current year**	**Figures for previous year**	**Properties and assets**	**Figures for current year**
	CAPITAL Proprietor/ Partners Capital a/c Opening balance Add: Profit, Addition, etc. Less: Loss Drawings, etc. ________ **RESERVES** (Give details under each head) 1. Capital reserves (if any) 2. Other reserves (including retained profits to the extent not already added to the capital, give details) 3. Sinking funds (if any) **LOANS AND BORROWINGS** Secured Unsecured **CURRENT LIABILITIES & PROVISIONS** (Amounts due for payment beyond one year from the date of the balance sheet to be shown separately) **Current liabilities** **Provisions for** 1. For taxation Less: Advance tax paid 2. For provident fund 3. For contingencies 4. Other provisions			**FIXED ASSETS** Distinguishing as far as possible between expenditure upon: a) Goodwill, b) Land, c) Buildings, d) Leaseholds e) Railway sidings f) Plant and machinery g) Furniture and fittings h) Development of property i) Patents, trademarks & designs j) Livestock, k) Vehicles, etc. **Cost** **Less: Depreciation** **ADVANCE AND DEPOSITS ON CAPITAL ACCOUNT** **INVESTMENTS** **LOANS** **CURRENT ASSETS** **Inventories** **Receivables** **Bills of exchange** **Advances on current account** **Cash and bank balances** **MISCELLANEOUS EXPENDITURE** [To the extent not written off or adjusted (specify the nature and amount of each item)] **ACCUMULATED LOSSES, IF ANY** a. Before depreciation b. Depreciation	
	TOTAL RUPEES			**TOTAL RUPEES**	

Note: In case of a Manufacturing entity the above format will be same except that the Inventories will contain the break-up in to Raw material, Work-in-progress, Finished goods, Consumable Stores Spares, loose tools, Others.

PROFORMA OF PROFIT AND LOSS ACCOUNT FOR A TRADING ENTITY

Name of entity……………….

Profit and loss account for the year ending……………

S.No.	Particulars	Last year Rs.	This year Rs.
1.	Sales (net of sales tax) (Income from services may be shown separately)		
2.	Cost of goods sold		
	a. Opening stock Add: Purchases (less return) Less: Closing stock b. Other direct expenses (if any)		
3.	Gross profit (1-2)		
4.	Sales and administrative expenses		
5.	Other income/expenses* Net (±)		
6.	Interest		
7.	Profit before depreciation and tax [(item 3 minus item (4+5+6)]		
8.	Depreciation		
9.	Taxation (for example for registered firms)**		
10.	Profit after depreciation and taxation item 7 minus item (8+9)		

Note: * Any item of expenditure which forms a significant proportion, say 5% or more of the total sales or has special significance otherwise should be shown separately under appropriate heads for example (i) salary (ii) commission (iii) perquisites and money value thereof.

** Registered firms are subject to tax, before the profits is apportioned amongst partners.

PROFORMA OF PROFIT AND LOSS ACCOUNT OF A NON-CORPORATE MANUFACTURING ENTITY

Name of entity………….

Profit and loss account for the year ending……………

S. No.	Particulars	Previous year	Current year
1.	Sales (Income from services may be shown separately)		
2.	Less: Excise duty		
3.	Net Sales (Item no. 1 minus item 2) Add/ Increase / Deduct/Decrease in finished goods Closing stock Less: Opening stock		
4.	Cost of production a. Raw materials consumption i. Opening stock Add: Purchase Less: Closing stock b. Stores and spare consumption c. Salaries and wages d. Other manufacturing expenses, excluding depreciation Sub-total Add: Opening stocks-in-process Deduct: Closing stock-in-process Cost of Production		
5.	Gross profit/loss (item 3 minus item 4)		
6.	Sales and administration expenses		
7.	Interest and other overheads		
8.	Other income/expenses Net (±)		
9.	Profit/Loss before depreciation and tax [(item 5 minus item (6+7+8)]		
10.	Depreciation		
11.	Profit after depreciation		
12.	Taxation		
13.	Profit after tax		

Note:

1. Any item of expenditure which forms a significant proportion, say 5% or more of the total sales or has special significance otherwise should be shown separately under appropriate heads for example (i) salary (ii) commission (iii) perquisites and money value thereof.
2. If audited accounts for the previous year are not available, the fact should be stated.

PRE & POST INCORPORATION PROFIT

Item	*Basis of Apportionment between and Post incorporation period pre*
Gross Profit or Gross Loss	On the basis of turnover in the respective periods. Or On the basis of cost of goods sold in the respective periods in the absence of any information regarding turnover. Or On the basis of time in the respective periods in the absence of any information regarding turnover and cost of goods sold.
Variable expenses linked with Turnover [e.g. Carriage/Cartage outward, Selling and distribution expenses, Commission to selling agents/travelling agents, advertisement expenses, Bad debts (if actual bad debts for the two periods are not given), Brokerage, Sales Promotion.]	On the basis of Turnover in the pre and post incorporation.
Fixed Common charges [e.g. Salaries, Office and Administration Expenses, Rent, Rates and Taxes, Printing and Stationery, Telephone, Telegram and Postage, Depreciation, Miscellaneous Expenses]	On the basis of Time in the pre and post incorporation periods.
Expenses exclusively Incorporation period relating to [e.g. Interest pre-on Vendor's Capital]	Charge to pre-incorporation period but if the purchase consideration is not paid on taking over of business, interest for the subsequent period is charged to post incorporation period.
Expenses exclusively relating to post-incorporation period [e.g. Formation expenses, interest on debentures, director's fees, Directors' remuneration, Preliminary Expenses, Share issue Expenses, Underwriting commission, Discount on issue of securities.	Charge to Post-incorporation period

Audit Fees (i) For Company's Audit under the Companies Act. (ii) For Tax Audit under section 44AB of the Income tax Act, 1961	Charge to Post-incorporation period On the basis of turnover in the respective periods.
Interest on purchase consideration vendor: (i) For the period from the date acquisition of business to date incorporation. (ii) For the period from the date of Incorporation	Charge to Pre-incorporation period Charge to Post-incorporation period

Pre-incorporation profit is a capital profit and will be transferred to Capital Reserve.

"Intelligence without AMBITION is a bird without wings."

Issues in Partnership Accounts

Introduction
Many businesses are constituted (organized) in partnership form. The terms and conditions mutually agreed upon governs their inter relationship among partners as well as accounting. There is Indian partnership Act that also provides certain useful norms.
When change in constitution takes place (i.e. Admission, Retirement, Death or change in profit sharing ratio) partners mutual rights may get disturbed (i.e. somebody will be gainer and somebody will be looser) unless certain adjustment related to unaccounted or undivided old profits/ loss is made. The new ratio has been agreed to apply to future profits/ losses. But if there exists any unaccounted or undivided profit or loss of old period, then that also will get divided in future in new ratio, instead of old ratio, to that extent someone will gain and someone will loose. This is to be adjusted at the time of change in constitution.

General Rules and Profit Sharing

9.1. What is partnership and what is partnership deed

- Partnership is a relationship between two or more persons to do some business activity for mutual benefit. The activity is carried as mutually agreed.
- Partnership deed - To avoid misunderstanding or future disputes, partners may put in writing the details of their mutually agreed terms and conditions to run and manage the partnership. Such document is known as partnership deed.

9.2. Can Minor be partner

- Minor being not eligible to enter into any contract cannot become a partner. But section 30 of partnership Act permits that a minor can be included to the benefit of partnership.
- Hence, minor will not be liable for losses. His share is liable for the acts of the firm, but he is not personally liable.
- When he becomes major, within 6 months he has to decide either to become partner or not.

9.3. What happens if partnership deed is silent on certain issues

- In the absence of any provision in partnership deed, following provision of partnership Act, 1932 are applicable.
  a. Profit/Loss sharing ratio will be equal, (Sec 13(b))
  b. No interest is to be allowed on capital, (Sec 13(c) says that if entitled interest on capital contribution should be paid out of profit only).
  c. No interest is to be charged on drawings,

d. 6% per annum interest is to be given on partner's loan, (Sec 13(d) says that on money advanced over and above capital contribution partner is entitled to interest @6% p.a.)
e. No salary is to be paid to any partner, (Sec 13(a))
f. Interest and salary, if payable, will be paid only if there is profit unless agreement provides otherwise. By comparing sec 13(c) & 13(d) we can conclude that interest on partners loan is to be paid even if there is no profit.

Student should use above, whenever question is silent with regard to this items.

Illustration 1: (June 1999) Black and White are partners started business with capital Rs. 30,000 and Rs. 20,000. Profits for the year ended 31st March, 2006 amounts to Rs. 27,100. It is agreed that 5% interest on capital as such shall be allowable. There is no agreement regarding sharing of profits or partnership salary.

Black is a whole time partner whereas white does not attend business regularly. Black claims Rs. 600 salary p.m. and 60% of balance profit. White advanced Rs. 10,000 loan and he now claims 10% interest.

Show distribution of profit by a statement.

Solution:

- Salary was not agreed among them hence Black’s claim of salary will not be sustainable.
- Interest on Loan was not agreed by them hence as per law 6% interest will be allowed to White & not 10%.
- Interest on Capital was agreed among them @5%, hence will be allowed.
- Profit sharing ratio was not agreed among them hence, they will be treated as equal partners i.e. 50:50, Black’s claim of 60% will not be sustainable.

Profit & Loss Appropriation Account

Particulars	Rs.	Particulars	Rs.
To Interest on Whites Loan a/c White 10,000 X 6% = 600	600	By Net Profit as per P&L a/c	27,100
To Interest on Capital a/c Black 30,000 X 5% = 1,500 White 20,000 X 5% = 1,000	2,500		
To Balance Profit transferred Black 24,000 X 50% = 12,000 White 20,000 X 50% = 12,000	24,000		
	27,100		27,100

9.4. Describe the system of capital account maintenance.

System of capital account maintenance:

- To run the business the partners bring in cash, goods or other assets etc. which is called as their capital.
- Capital Accounts are maintained under two system (methods).
- 1. Fixed capital system & 2. Fluctuating capital system

9.4.1 Fixed Capital System:

- For each partner two accounts will be maintained namely Capital a/c and Current a/c .
- The capital introduced will be credited to capital a/c.
- All other regular adjustments like interest, Salary, drawings, share in profit/losses will be made in the current a/c and
- hence capital A/c remains fixed from year to year unless their is withdrawal of capital or Addition to capital.

Illustration.2: Prepare capital & current account under fixed capital system taking figures of **Illustration 1**

Solution:

Capital Account

Particulars	Black	White	Particulars	Black	White
By Balance c/f	30,000	20,000	By Bank a/c	30,000	20,000
	30,000	20,000		30,000	20,000

Current Account

Particulars	Black	White	Particulars	Black	White
			By Interest on loan a/c	--	600
			By Interest on Capital a/c	1,500	1,000
By Balance c/f	13,500	13,600	By Profit & Loss appropriation a/c	12,000	12,000
	13,500	13,600		13,500	13,600

9.4.2 Fluctuating Capital System:

- In this system only one A/c is maintained for each partner and
- all the adjustments i.e. capital introduced, interest, salary drawings, profit/loss etc. is debited/credited in the same Account.
- Therefore Capital Account balance keeps on fluctuating every time.

Illustration. 3: Prepare capital account under fluctuating capital system taking figures of **Illustration 1**

Solution:

Capital Account

Particulars	Black	White	Particulars	Black	White
			By Bank a/c	30,000	20,000
			By Interest on loan a/c	--	600
			By Interest on Capital a/c	1,500	1,000
By Balance c/f	43,500	33,600	By Profit & Loss appropriation a/c	12,000	12,000
	43,500	33,600		43,500	33,600

9.5. Explain Final Accounts of Partnership firm.

- Final Accounts of a Partnership Firm generally includes following.
  a. Trading, profit and loss A/c.
  b. Profit & Loss Appropriation A/c.
  c. Balance Sheet.

Notes:

i. These are prepared according to the normal principles of accounting (already studied in chapter 1, 5, 6 & 12).

ii. The interest on capital, salary to partners, interest on drawing, interest on partners loan etc. are debited/ credited to P&L Appropriation Account and not to the P&L Account. The balance of profit in P&L appropriation A/c will be then transferred to Partners capital A/cs in profit sharing ratio.

iii. The goods withdrawn by the partners for personal use should be debited to their drawings A/c and credited in trading A/c as separate item or reduced from purchases and not to be clubbed with the sales.

Illustration 4: From the under mentioned Trial Balance of X and Y as on 31st December, 2005, prepare a Trading Account, Profit and Loss Account for the year ended 31-12-2005 and a Balance Sheet as on that date:

Trial Balance

	Rs.		Rs.
Plant and machinery	70,000	Sales	2,50,000
Opening Stock	35,000	Returns	2,000
Purchases	75,000	Bills payable	10,500
Returns	2,800	Creditors	25,000

Land and buildings	60,000	Capital A/c	
Carriage Inwards	1,500	X 80,000	
Carriage Outwards	3,500	Y 75,000	1,55,000
Wages	25,000		
Sundry Debtors	48,000		
Coal and Coke	3,500		
Bad Debts	1,500		
Gas and water	350		
Furniture and fixture	15,400		
Advertisements	15,000		
Rent, Rates and taxes	3,500		
Bills receivable	22,000		
Salaries	16,000		
Drawings:			
X 5,000			
Y 4,000	9,000		
Trading expenses	12,000		
Cash-in-hand	750		
Balance at Bank	22,700		
Total	4,42,500		4,42,500

The following additional information is supplied:

a) The partners share profits and losses as X = 4/5 and Y = 1/5
b) Depreciate Plant and Machinery by 10%;
c) Bad Debts reserve to be raised to 2.5% on sundry debtors;
d) Interest on capital is to be provided at 5% p.a. and on drawings at 6% p.a. (assumed to be drawn on 30th June 2005);
e) Salaries include Rs.3,000 drawn equally by the partners;
f) Advertisement expenses to be written off against revenue over 5 years;
g) Outstanding liabilities to be provided: for wages Rs.2,000; salaries Rs.3,000;
h) Partners are allowed an annual salary of Rs.3,000 each;
i) 50% of the net profits are transferred to Reserved Fund;
j) Closing Stock Rs.10,000.

Solution

Trading and Profit and loss Account for the year ended on 31.12.05

Particulars		Rs.	Particulars		Rs.
To Opening stock		35,000	By Sales	2,50,000	
To Purchases	75,000		(-) Sales return	2,800	2,47,200
(-) Purchase return	2,000	73,000	By Closing stock		10,000
To Carriage inward		1,500			
To Wages	25,000				
(+) wages payable	2,000	27,000			
To Coal & coke		3,500			
To Gas & Water		350			
To Gross profit		1,16,850			
		2,57,200			2,57,200
To Trading expenses		12,000	By Gross profit		1,16,850
To Carriage outward		3,500			
To Bad debts	1,500				
(+) Provision for bad debts	1,200	2,700			
To Rent rate & taxes		3,500			
To Salaries	16,000				
(-) Salary of Partner	3,000				
+ Salary payable	3,000	16,000			
To Depreciation					

Particulars	Rs.	Particulars	Rs.
To Advertisement exp. written off	7,000		
To Net profit trf to P&L Appropriation	3,000		
a/c	69,150		
	1,16,850		1,16,850

Profit & loss Appropriation Account

Particulars		Rs.	Particulars		Rs.
To Interest on capital			By Net profit		69,150
X	4,000		By Interest on drawing		
Y	3,750	7,750	X	150	
To Partners salary: withdrawn	3,000		Y	120	270
(+) outstanding salary X	1,500				
Y	1,500	6,000			
To Reserve fund					
(50% of profit 55,670)					
To Net profit transferred toX	22,268	27,835			
Y	5,567	27,835			69, 420
		69,420			

Balance sheet as on 31.12.05

Liabilities		Amount Rs.	Assets		Amount Rs.
X's Capital	80,000		Land & Building		60,000
(-) Drawing	5,000		Plant & Machinery.	70,000	
+ Interest on capital	4,000		*(-) Depreciation*	7,000	63,000
(-) Interest on drawing	150				
+ Salary payable	1,500		Furniture's & Fixtures		15,400
+ Profit	22,268	1,02,618			
			Closing Stock		10,000
Y's Capital	75,000		Sundry Debtors	48,000	
(-) Drawing	4,000		*(-) Provision for Bad debts*	1,200	46,800
+ Interest on capital	3,750		Bill receivable		22,000
(-) Interest on drawing	120		Cash	750	
+ Salary payable	1,500		Bank	22,700	23,450
+ Profit	5,567	81,697			
Reserve fund		27,835			
Bill payable		10,500	Miscellaneous expenditure (to the extent not written off)		
Wages payable	2,000				
Salary payable	3,000	5,000	Advertisement	15,000	
Creditors		25,000	*(-) 1/5th Written off*	3,000	12,000
		2,52,650			2,52,650

9.6. How do partners share profit/losses

- Usually profit sharing is given by way of ratio like 5:3:2 or in % form like 20%. 40%, 40%, etc.
- If question is silent about profit sharing then consider them as equal partners as per the provision of partnership act. profit should be shared in the ratio of capital only if specifically mentioned in the question, not otherwise.
- Partners can decide mutually any basis or mode of sharing profits and losses there is no limit to it. You have seen concept of direct sharing in Final a/c of Professionals chapter in PE-I level. You will see some illustration on profit sharing by different ways in this chapter also. So whenever question contains some new basis of sharing, read and interpret it correctly and make calculations according to it.

Illustration 5: A, B and C enter into partnership and agree to share profits and losses as under

A - ½th of the profits/losses   B - 1/4th of the profits/losses   C - 1/8th of the profits/losses
Comment on the profits/loss sharing ratio agreed to by the partners.
Solution: The total of the ratios is 7/8 which is less than 8/8 i.e 1. They should change the ratios so that total comes to 8/8 i.e. 1.

Illustration 6: The Chartered Accountants X, Y and Z form a partnership, profits being divisible in the ratio of 3:2:1 subject to the following:
i. Z's share of profit is guaranteed to be not less than Rs. 15,000 p.a.
ii. Y gives guarantee to the effect that gross fees earned by him for the firm shall be equal to his average gross fee of the preceding five years when he was carrying on profession alone (which average works out at Rs. 25,000/-).

The profit for the first year of the Partnership is Rs. 75,000/-. The gross fees earned by Y for the firm are Rs. 16,000/-. You are required to show the distribution of profits.
Solution:

Profit as given	75,000
Shortfall to be contributed by Y (25,000 – 16,000)	9,000
	84,000
Z's share (1/6) Rs. 14,000	
Minimum allowed	15,000
Balance for X and Y	69,000
X's 3/5 41,400	
Y's 2/5 27,600	69,000
	Nil

Summary

Partner	Share	Adjustment	Total
X	41,400		41,400
Y	27,600	- 9,000	18,600
Z	15,000		15,000
	84,000		75,000

Illustration 7: A and B were in partnership sharing profits and losses in the ratio of 3:2. In appreciation of the services of their clerk C. Who was in receipt of a salary of Rs. 2,400 p.a. and a commission of 5% on the net profit after charging such salary and commission. They took him into partnership as from 1st April, 2010, giving him one-eight share of profits.
The agreement provided that any excess over his former remuneration to which, C becomes entitled will be born by A and B in the ratio of 2:3
The profit for the year ended 31st March, 2011, amounted to Rs. 44,400.
Prepare statement showing the distribution of the profit amongst all the partners.
Solution:
(i) Share of 'C' as partner 44,400 x 1/8 = 5,550
(ii) C's remuneration as clerk

Profit	44,400
(-) Salary to clerk	2,400
	42,000
(-) Commission 42000x5/105	2,000
	40,000

Total remuneration to 'C' 2,400 + 2,000 = 4,400
(iii) Excess to 'C' (i) – (ii) = 5,550 – 4,400 = 1,150 to be born by
A : 2/5 x 1150 = 460
B : 3/5 x 1150 = 690 1150
Summary

Partner	Share	Adjustment	Total
A (40,000 x 3/5)	24,000	- 460	23,540
B (40,000 x 2/5)	16,000	- 690	15,310
	40,000		
C	4,400	+ 1,150	5,550
	44,400		44,400

Illustration 8: X,Y & Z start business in partnership, X put in Rs. 20,000 for the whole year, Y Puts Rs. 30,000 at first and increases it to Rs. 40,000 at the end of four months but withdraws Rs. 20,000 at the end of six months, while Z puts Rs. 40,000 at first but withdraws Rs. 10,000 at the end of nine-months. At the end of the year how should they divide a profit of Rs. 79,000 on the basis of effective capital employed by each partner?

Solution

Particulars	Capital o/s	Month	Product
(i) X puts in 20,000	20,000	12	2,40,000
(ii) Y puts in 30,000 at beginning	30,000	4	1,20,000
Adds 10,000 at end of 4 month	40,000	2	80,000
Withdraws 20,000 at end of 6 month	20,000	6	1,20,000
		12	3,20,000
(iii) Z puts in 40,000 at beginning	40,000	9	3,60,000
Withdraws 10,000 at end of 9 month	30,000	3	90,000
		12	4,50,000

Profit = 79,000

To be divided in 2,40,000 : 3,20,000 : 4,50,000 among X, Y & Z. i.e. 24 : 32 : 45

X's share = 79,000 x 24/101 =	18,772
Y's share = 79,000 x 32/101 =	25,030
Z's share = 79,000 x 45/101 =	35,198
	79,000

Change in the Constitution

9.7. What is change in the constitution of the firm

- If any of the following happens, it is said to be change in the constitution of the firm.
  (1) Admission of the new partner,
  (2) Retirement/Death of a partner.
  (3) Change in the profit sharing ratio,

9.8. Illustrate all the cases of change in constitution.

- Whenever there is change in the constitution, the Partners & the Profit sharing Ratio applicable till the date of change will be known as `Old Partners' & Old Ratio' & those applicable after the date of change will be known as `New Partners' & `New Ratio'.

Example

(1) 'A' & `B' sharing profits in 2:3 ratio, admits `C' & the ratio then is 2:3:1

Then, Before Change :	Old Partners	A,B	Old Ratio	2:3
After Change :	New Partners	A,B,C	New Ratio	2:3:1

(2) 'X' `Y' & `Z' are Partners sharing profits in 4:5:3. `Y' retires or dies.

Then, Before Change :	Old Partners	X,Y,Z	Old Ratio	4:5:3
After Change :	New Partners	X,Z	New Ratio	4:3

(Note: After retirement, how X & Z will share is not given, in such cases it will be assumed that they will continue to share in their old ratio).

(3) 'L' `M' & `N' sharing profits in 3:2:5, decides to change the ratio to 4:2:4.

Then, Before Change : Old Partners	L,M,N	Old Ratio	3:2:5
After Change : New Partners	L,M,N	New Ratio	4:2:4

CALCULATION OF NEW PROFIT SHARING RATIO

Illustration 9: Explain calculation of new ratio with some alternatives in case of change in constitution. A & B are sharing in the ratio of 3:2 (i.e. 3/5 & 2/5). They admit C. Calculate new ratio in the following alternative cases.

Solution:

(1) 'C' is admitted with 1/6 share.

'C's share is 1/6th of the total profit.

$\therefore$ Balance profit left for A & B = 1 - 1/6 = 5/6.

Because nothing is specified we will assume that A & B will share balance in old ratio.

$\therefore$ A's share = 5/6 x 3/5 = 3/6 & B's share = 5/6 x 2/5 = 2/6

Thus the new ratio of A B C will be 3/6, 2/6 & 1/6 or 3:2:1

(2) 'C' is admitted with 1/6 share & `A' & `B' decided to share equally in future.

'C' share = 1/6 $\therefore$ Balance is 5/6

which will be shared equally by A & B.

$$\therefore \quad \text{A's share} = \frac{5}{6} \times \frac{1}{2} = \frac{2.5}{6} = \frac{5}{12} \quad \text{and} \quad \text{B's share} = \frac{5}{6} \times \frac{1}{2} = \frac{2.5}{6} = \frac{5}{12}$$

Thus the New Ratio of A B C = 5/12, 5/12, 2/12 OR 5:5:2

(3) 'C' is admitted with 1/6th share, which he purchased from B.

`C's share = 1/6 which will come from B

$\therefore$`B's New share = 2/5 - 1/6 = 7/30

$\therefore$`A's New share will remain as the old share i.e. 3/5.

Thus the New Ratio of A, B, C will be 3/5, 7/30 & 1/6. i.e. 18/30, 7/30, 5/30 i.e., 18:7:5

(4) 'C' is admitted with 1/6th share which he bought from A & B in 2:3 ratio.

`C's share is 1/6

Purchased from `A' 1/6 x 2/5 = 2/30

Purchased from `B' 1/6 x 3/5 = 3/30

$\therefore$ A's share 3/5 - 2/30 = 16/30 & B's share 2/5 - 3/30 = 9/30

Thus the New Ratio of A, B, C will be 16/30, 9/30 & 5/30 i.e. 16:9:5

(5) 'C' is admitted. He purchased 1/3rd of A's share & 2/3rd of B's share.

C's share = Purchased from A + Purchased from B

Purchased from A = 3/5 x 1/3 = 1/5 i.e. 3/15

Purchased from B = 2/5 x 2/3 = 4/15

$\therefore$ A's share = 3/5 - 1/5 = 2/5

B's share = 2/5 - 4/15 = 2/15

C's share = 1/5 + 4/15 = 7/15

Thus the New Ratio of A, B, C will be 6/15, 2/15 & 7/15 i.e. 6:2:7.

Note: 1) When we say new partner is purchasing share that means old partners are selling their share. Similarly in case of death/ retirement, outgoing partner will sell his share and other will purchase it.

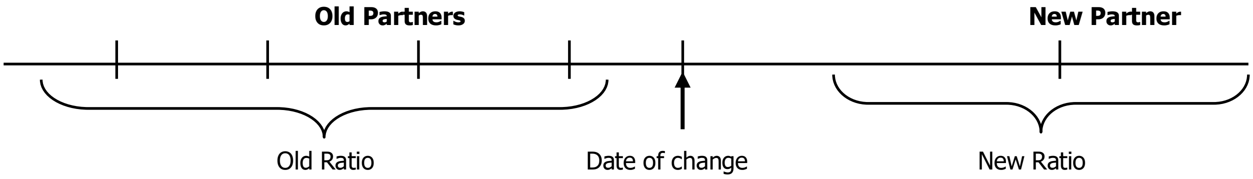
2) Similarly ratios will be worked out in case of Retirement/Death. In such cases wording may be like outgoing partners sells his share or other partner purchases share from the outgoing partner. When nothing is specified, it can be assumed that the remaining partner will continue to share in their old ratio.

9.9. What adjustments are necessary when constitution changes

- When there is a change in the constitution basically six under mentioned adjustments (to the extent applicable) will be required.
  - (a) Goodwill adjustment
  - (b) Revaluation of Assets/Liabilities,
  - (c) transfer of balance of P & L A/c, General reserve or accumulated losses.
  - (d) Adjustment of Profit or loss till the date of change.
  - (e) Joint Life Policy.
  - (f) Some old rectification items, etc.

All the above items have effect of unaccounted or undivided profit/ loss of the period till the date of change referred here as old profit/ loss.

9.10. What is the common factor in above cases and what is its significance



- The common factor in all above i.e. in Admission, Retirement, Death or change in ratio is that Profit Sharing Ratio Changes.
- Hence, if there is any old profit/ loss unaccounted or undivided then the same should be adjusted at the time of change. Otherwise these profits/ losses whenever divided in future, the same will be shared by new partners in New Ratio.
- To that extent some partner will be gainer and the other will be looser. This shouldn't happen hence, we make adjustment at the **time of change**.
- The value of Building, Land or goodwill may be more than the value appearing in account books (in balance sheet) the increase in the value is an example of unaccounted profit.
- Sometime whole of the profit earned is not transferred to capital account, the balance appears in account like general reserve, it is an example of undivided profit.
- Divide old profit/loss among old partners in old ratio.

9.11. What are the old profits or losses referred to above.

Old profits/losses may be classified under the following heads:

1. Goodwill. (Goodwill is an asset but increase in its value otherwise than by purchase will have effect of profit)
2. Revaluation of Assets & Liabilities. (Increase in value of asset over its book value will be a profit and decrease will be a loss. For liability it will be exactly opposite)
3. Old balance of Reserves / Profit & Loss etc. (These are undivided profits/ losses)
4. Joint Life Policy. (Increase in its value/ claim amount over its book value will be a profit)
5. Some old rectification items. (May result into profit/ loss)
6. Profit/loss till the date of change. (When change in constitution takes place other than exactly on year end, then profit/loss from the beginning of year to the date of change is a old profit/ loss)

In accounting profits or losses also means the difference between the book value (i.e. the value/balance as per account books) and the real value (market value or today’s value) of any asset or liability including goodwill, joint life policy etc

9.12. What are the other financial items which are not adjustment of old profits/ losses as described above.

- The Financial transactions like contributing capital in case of admission, repayment of capital in case of retirement/death, sale/realization of any asset, settlement/ payment of any liability etc will be made as given in the question.
- Similarly adjustment of capitals in profit sharing ratio or in any other specified ratio will be made only if required by the question.
- These are not adjustments of old unaccounted profit/loss which is necessarily required to be accounted otherwise mutual rights of partners will be disturbed. These are normal financial transactions not resulting into old profits/ losses.

9.13. What is Ratio of sacrifice and Ratio of gain

- **Ratio of Sacrifice** = Old ratio (-) New Ratio
  Sacrifice to a partner is the reduction in his profit sharing ratio compared to old ratio.
- **Ratio of gain** = New Ratio - old Ratio
  Gain to a partner is the increase in his profit sharing ratio compared to his old ratio.
- When a partner is admitted, he gets some share in profits therefore he is the gainer and one or more old partner may be sacrificer. But not necessary that all old partner will be sacrificer because ratio of some old partner may also increase. Similar can be situation in case of retirement/ death.

Illustration-10: X and Y are partners, sharing profit and loss in the ratio of 4:3. They decide to admit Z. New profit sharing ratio is 7:4:3. Calculate ratio of sacrifice by X and Y.
Solution:

Old ratio : X & Y is 4/7 & 3/7
New ratio : X, Y & Z is 7/14 , 4/14 & 3/14
∴ Sacrifice by X = 4/7 – 7/14 = 8/14 – 7/14 = 1/14
& Sacrifice by Y = 3/7 – 4/14 = 6/14 – 4/14 = 2/14
∴ Sacrifice by X & Y is in 1:2 ratio

Illustration-11: A and B are partners, sharing profit and loss in the ratio of 4:1. They decide to admit C. New profit sharing ratio is 1:1:1. Calculate ratio of sacrifice by A and B.
Solution:

Sacrificed A = 4/5 – 1/3 = 12/15 – 5/15 = 7/15
Sacrificed B = 1/5 – 1/3 = 3/15 – 5/15 = – 2/15
C's gain is 1/3 i.e. 5/15
B has also gained 2/15
And A has sacrificed 7/15

Illustration-12: M/s Ram, Rahul and Rohit sharing profits and losses in proportion 3:2:1
On 31st March, 2006, Ram desired to retire from the firm and the remaining partners decided to carry on sharing the future profits equally. Calculate ratio of Gain
Solution:

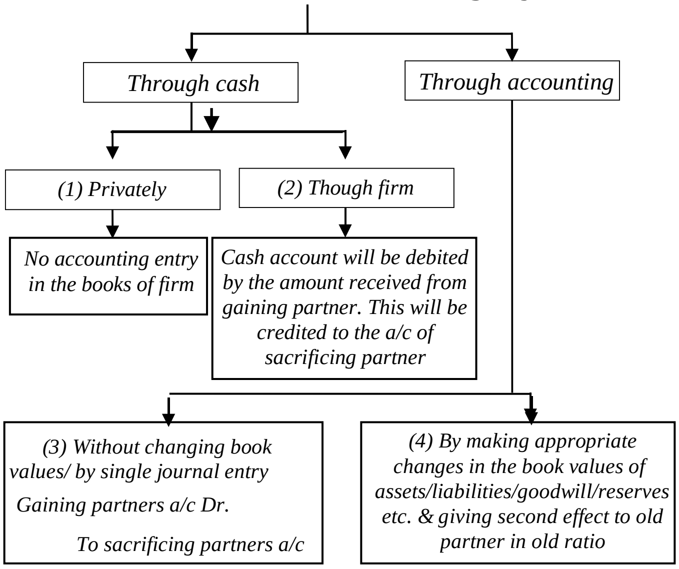
Particulars	Ram	Rahul	Rohit
New ratio	Nil	3/6	3/6
Less Old ratio	3/6	2/6	1/6
Difference (- Indicates sacrifice & + indicates gain)	- 3/6	1/6	2/6

Therefore ratio of Gain between Rahul & Rohit is 1:2

9.14. Describe in brief the alternative modes to make adjustment for change in constitution.

- The above adjustments (item 1 to 6 mentioned in **9.11**) can be made in any of the following ways

Alternative methods for Accounting Adjustment



Note: We will refer the above as method (1) to (4) in our latter discussion.

1. Any one of this method can be applied to all the above items of adjustment (namely goodwill, revaluation, reserves, profits, joint life polity, etc.) or different methods can be applied to different items. Examination questions are mostly solved by method (4) above except goodwill adjustment which is commonly solved by method (2) or (3).
2. All these are for the old unaccounted/ undivided profits or losses i.e. profits or losses upto the date of change. The profit or losses after the date of change in constitution will naturally belong to new partners in new profit sharing ratio.
3. These are equally applicable to admission, retirement, death or change in profit sharing ratio.
4. The amount in method (4) above will be the total old profit/ loss, whereas in method (1), (2) & (3) the amount will be the net amount of gain or sacrifice to partner (it is the difference of old profit/loss divided into old ratio and new ratio)

9.15 Give alternative treatment of goodwill accounting.

- Following are the different ways in which goodwill may be accounted in case of Admission.
  - 1st Alternative goodwill settled by the Partners privately. (method 1)
  - 2nd Alternative the new partner bring in his share in goodwill in the form of cash. (method 2)
  - 3th Alternative (a) Total goodwill of the firm is raised & then written off. (method 3) **or**
  - (b) Goodwill a/c is not to be raised / direct adjustment to be made in capital a/c.
  - (method 3) Net effect of (a) and (b) will be same.
  - 4rd Alternative goodwill to be adjusted without bringing cash. Total goodwill of the firm is to be raised. (method 4)

Notes:

(1) All the above alternatives can be applicable in case of retirement/ death or change in profit sharing ratio also.

(2) Detailed accounting entries for all this alternatives is explained in illustration below.

(3) Alternatives 4 is not <u>in compliance with AS-26</u> which permits raising of goodwill a/c. only when it is purchased. Hence, student should follow it only when specifically required by the question.

Illustration 13: X and Y are in partnership sharing profits and losses as 3:2. They admit Z into the firm, Z paying a premium of Rs. 36,000 for 1/6th share of the profits. As between themselves, X and Y agree to share future profits and losses equally. Draft journal entry showing the appropriation of premium money.

Solution:

Partners	**X**	**Y**	**Z**
Old Ratio	3 or (3/5)	2 or (2/5)	-
New Ratio	5 or (5/12)	5 or (5/12)	2 or (2/12)
Ratio of Sacrifice	X = 3/5 - 5/12	= 11/60	
(Old ratio-New Ratio)	Y = 2/5 - 5/12	= -1/60	
	Z = 0 - 1/6	= -10/60	

This means that 'X' has sacrificed 11/60, whereas 'Y' has gained 1/60 & 'Z' has gained 10/60. 'Z' is bringing Rs. 36,000 as Goodwill for 10/60 share.

$$\therefore \text{Total goodwill of the firm} = \frac{36{,}000 \times 60}{10} = 2{,}16{,}000$$

Y is also gaining (means his new ratio is higher)

$\therefore$ He will also have to contribute towards goodwill to the extent of his gain.

$\therefore$ His contribution = 2,16,000 x 1/60 = 3,600

X has sacrificed in favour of Y and Z $\therefore$ he should get the credit for it.

Goodwill Accounting

1st method: Cash settlement privately: Z&Y both should pay Rs. 36,000/- and Rs. 3,600/- respectively to X in lieu of goodwill. As this is done privately, no entry in the books of firm will be passed.

2nd method: Cash settlement through firm

The new partner brings in cash as his share of goodwill.

1) Cash a/c. Dr. 36,000
    To Goodwill a/c. 36,000
(Cash brought by new Partner `Z' equal to his share in goodwill)

2) Goodwill a/c. Dr. 36,000
    To X's a/c 36,000
(Goodwill is transferred to the old partners, who are making sacrifice)

<u>**Note**</u>: Y has also gained Rs.3,600 (1/60) but he is not bringing cash being an existing partner. $\therefore$ We will adjust from his account.

3) 'Y's A/c. Dr. 3,600
    To `X' a/c 3,600

3rd Method: Adjustment through, accounting but without changing book value: It can be done in either of the following two ways:

(A) Goodwill a/c. is raised and after the admission of new partner it is written off.

1) Goodwill a/c. Dr. 2,16,000
    To X's a/c. 1,29,600
    To Y's a/c. 86,400
(Goodwill raised & credited to old partners in old ratio)

2) X's a/c. Dr. (5/12) 90,000
   Y's a/c. Dr. (5/12) 90,000
   Z's a/c. Dr. (2/12) 36,000

To Goodwill a/c. 2,16,000

(Goodwill written off by debiting to new partners in new ratio).

(B) Goodwill a/c is not to be raised in Books at all.

'Z' a/c. Dr. 36,000

'Y' a/c. Dr. 3,600

To X's a/c 39,600

(Goodwill adjusted by crediting the partner who has sacrificed & debiting the gaining partner)

Goodwill can be adjusted by passing a single entry in this way, without raising goodwill account in the books .

4th Method: Adjustment through accounting by changing book values:

If Z doesn't bring his share of Goodwill in cash then accounting can be done as follows-

Goodwill a/c. is raised and left as it is.

Goodwill a/c Dr. 2,16,000

To `X's a/c. 1,29,600

To `Y's a/c. 86,400

(Goodwill account is raised & credited to old partners in old ratio)

[This method is not in compliance with AS-26, hence students should follow it only when required by the question.]

Note 1) Instead of calculating Ratio of sacrifice or Ratio of Gain, we can directly calculate the amount of goodwill in the ratio of sacrifice or ratio of gain, as follows:

Table of Calculation

	X	Y	Z	Explanation
Cr	1,29,600	86,400	-	Goodwill is credited to old partners in old ratio (what they should get)
Dr	90,000	90,000	36,000	Goodwill is debited to new(all) partners in new ratio (what they will get in future)
	Cr 39,600	Dr 3,600	Dr 36,000	This difference amt. will be automatically in the ratio of gain or ratio of sacrifice.

Note 2) Suppose in the given question New Ratio is 6:4:2 instead of 5:5:2. Then Z has gained 10/60, which has come from X 6/60 and from Y 4/60, hence ratio of sacrifice of X & Y will be 6:4 & Goodwill Rs.36,000 brought by Z will be credited to X as Rs.21,600 & Y Rs.14,400.

Note 3) In the same way goodwill accounting will be done in case of Retirement/ death or change in Profit Sharing Ratio.

9.16. How to treat balance of general reserve, P&L a/c., etc.

- At the time of any change in constitution the balance laying in General Reserve, P&L a/c or other accumulated profits/losses should be transferred to the old partners in their old profit sharing ratio (method 3). It is commonly followed, although other methods can also be followed.

General Reserve a/c. Dr. xxx

To Old Partners Capital a/c. xxx

9.17. Explain the accounting of Revaluation of Assets/Liabilities.

- Revaluation a/c is prepared. All the assets and liabilities on the date of change in constitution are revalued. The revaluation difference is debited/credited to the Revaluation a/c.

(a) If value of asset is increased: (profit)

Asset a/c Dr. (With the increase in the value of asset)

To Revaluation a/c.

(b) If value of asset is decreased: (loss)

Revaluation a/c Dr. (With the decrease in the value of asset)

To Assets a/c

(c) If there is increase in the value of liabilities: (loss)

Revaluation a/c Dr. (With the amount of increase in the liability)

To Liability a/c

(d) If there is decrease in the value of liabilities: (profit)
Liability a/c Dr. (With the amount of decrease in the value of liability)
To Revaluation a/c

- The balance in Revaluation A/c. will be profit (if credit is more) or loss (if debit is more). It will be transferred to the old partners in their old profit sharing ratio. (method 3)

Illustration-14: On 31st March 2006, the Balance Sheet of M/s Ram, Rahul and Rohit stood as follows:

Liabilities	Rs.	Assets	Rs.
Capital Accounts:		Land & Buildings	2,00,000
Ram 3,00,000		Machinery	2,00,000
Rahul 2,00,000		Closing Stock	1,00,000
Rohit 1,00,000		Sundry Debtors	2,00,000
	6,00,000	Cash and Bank Balances	1,00,000
Sundry Creditors	2,00,000		
	8,00,000		8,00,000

It was agreed to revalue the Assets and Liabilities on that date on the following basis:

1. Land and Buildings be appreciated by 30%.
2. Machinery be depreciated by 20%.
3. Closing stock to be valued at Rs. 80,000.
4. Provision for bad debts be made at 5%.
5. Old credit balances of Sundry Creditors Rs. 10,000 be written back.

Prepare Revaluation Account.

Solution:

Revaluation Account

Particulars	Rs.	Particulars	Rs.
To Machinery a/c	40,000	By Land & Building a/c	60,000
To Stock a/c	20,000	By Creditors a/c	10,000
To Provision for bad debt a/c	10,000		
	70,000		70,000

9.18 What is Memorandum Revaluation Account? (Method 3)

- If the value of assets and liabilities are not to be changed in the books of Accounts but at the same time the rights of the partners have to be properly adjusted on the admission/ death/ retirement/ change in profit sharing ratio of the partners. In such a case a Memorandum Revaluation A/c will be prepared.
  (1) It will prepared in the same way as the Revaluation a/c, only difference is that debit/credit to asset/liability a/c's will not be made, whatever is the balance will be the profit or loss to which the old partners are entitled in their old profit sharing ratio.
  (2) Then whatever was credited to Memorandum Revaluation a/c will be taken on debit side. And whatever was debited to the Memorandum Revaluation a/c as per above will be taken on credit side. The balance will be the same amount as in the above, but it will be loss, if earlier there was a profit and vice-versa. This balance is to be transferred to New partners in their new profit sharing ratio.
- The Net difference of (1) & (2) above will be Debited/Credited to Partners a/c. Thus there will be no debit/ credit to asset and liability accounts.
- *In the same way adjustment for Reserves etc can also be made, if the book values are not to be changed (method 3). If instead of book adjustment cash is paid or received equal to the net difference calculated above it becomes method (1) if privately settled and method (2) if cash is paid/received through firm. This amount is in the ratio of gain/ sacrifice.*

Illustration-15: The following is the balance sheet of A and B who share profits and losses as 4/7 and 3/7:

	Rs.		Rs.
Creditors	15,000	Land and Buildings	36,000
Bills payable	5,000	Machinery	20,000
Capital Accounts		Furniture	2,000
A : 45,000		Stock	25,000
B : 35,000	80,000	Sundry Debtors	16,000
		Cash	1,000
	1,00,000		1,00,000

They agree to take C into partnership and the new ratio is 16:12:7 subject to the following among the other terms and conditions:

i. Land and Buildings are to be increased to Rs. 78,000.
ii. Machinery is to be depreciated by 10% and Furniture by Rs. 500.
iii. Stock is to be appreciated by Rs. 1000.
iv. A provision of 2½% is to be made for bad debts and another of Rs. 2500 for outstanding expenses.
v. A trade creditor for Rs. 1600 is not traceable for a number of years and the amount is to be written back.

Show Journal entry assuming that the book values of assets and liabilities are not to be disturbed.

Solution:

Question requires that value of the asset and liability should not change i.e. application of method 3. Ascertain profit/loss on revaluation of asset & liability by preparing Memorandum Revaluation account and adjust.

Memorandum Revaluation Account

Particulars	Rs.	Particulars	Rs.
To Machinery	2,000	By Land & Buildings	42,000
To Furniture	500	By Stock	1,000
To Provision for Bad Debts	400	By Trade Creditors	1,600
To Provision for Outstanding Expenses	2,500		
To Profit on Revaluation	39,200		
	44,600		44,600

Adjustment required :-

	A	B	C
Profit credited in the old ratio of 4 : 3	+22,400	+ 16,800	---
Profit written back in the new ratio of 16 : 12 : 7	-17,920	-13,440	- 7,840
Net adjustment	+ 4,480	+ 3,360	-7,840

A, B and C Journal

		Rs.	Rs.
?	C's Capital A/c ... Dr.	7,840	
	To A's Capital A/c		4,480
	To B's Capital A/c		3,360
	(Adjustment for Revaluation of assets and liabilities without altering the book values on admission of C)		

9.19. What is Profit/loss till the date of change in constitution

- In case change in constitution takes place during a Financial year, then profit/loss till the date of change belongs to old partners in old ratio and profit/loss after the date of change belongs to new partners in new ratio.
- Such profit/loss can be ascertained by preparing an Interim P&L a/c for that period otherwise average profit of the earlier years may be taken as basis for calculating profit/loss for the period.
- Generally this adjustment is given in case of death, although it can be applicable in the same way in any other type of change in constitution. In case of death/retirement the outgoing partner is

also entitled to share profits/ losses from the closure of last accounting year till the date of retirement/ death.

- The outgoing partners share in the profit is accounted by way of the following entry. It should be proportionate to the No. of days he was partner in relation to whole year.

  P&L Suspense a/c Dr. (With the amount of his share in the profit)

  To Outgoing Partners a/c

- Alternatively share of all old partners can be accounted.

When the profit sharing ratio in between remaining partners has changed then we must transfer total profit to all old partners a/c. and not the outgoing partners share only.

While preparing balance sheet, 2nd effect of such profit must be taken either on 1) cash or 2) working capital or 3) P&L suspense a/c. as it is can be shown in balance sheet.

9.20. Explain Other Adjustments.

- In addition to the adjustments discussed above some other adjustments/ entries may come if given in the question.
- For Example entry for rectification of some old errors, which gives rise to profit/loss.

9.21. What is joint life policy and what is the purpose of taking it

- A life insurance policy taken by a firm on the life of its partners is known as joint life policy. It can be either
  a) one combined policy on the life of all partners or
  b) separate policy on the life of each partner.
- Expenditure of insurance premium is borne by the firm hence this policies are the firms assets.
- The death's an uncertain and unpredictable event. In case of death of any partner, his family members may be interested to take back their dues. The purpose of joint life policy is to help financial settlement in such eventuality.

Hence, even when question is silent, the claim money received should be utilized to settle the account (dues) of deceased partner.

- In case of combined policy the policy amount (face value/insurance value) will be received if any partner dies. But in case of separate policy, claim will be received of the policy on deceased partner's life only.

9.22 Explain accounting for Joint Life Policy Premium and adjustment in case of change in constitution.

- The firms can take joint life policy on the life of one or more partners. The premium will be paid out of the firm's income. Accounting of such premium can be done in either of the following four ways:

(1) Premium paid is debited in the respective years P&L a/c. No Policy (Asset) a/c is opened. It means that LIP paid & written off by debit to P&L a/c of the year.

P & L a/c Dr. 10,000

To Cash/ Bank a/c 10,000

In such cases whenever claim is received (on death of a partner) from the Insurance Co. the total amount received will be a profit and will be shared by all the old partners. ***OR***

Whenever constitution of the firm is changed otherwise than by death then the Policy (asset) a/c may be created at surrender value by following entry:

Joint Policy a/c Dr. (with the amount of surrender value) xxx

To Revaluation a/c (or can be directly credited to old partners) xxx

(2) Whenever premium is paid the Policy a/c is created at surrender value and the balance is written off by passing following entry.

Policy a/c Dr. (With amount of surrender value) 6,000

P&L a/c Dr. (Premium paid (-) surrender value) 4,000
To Bank/cash a/c (With the amount of premium paid) 10,000
Note: surrender value Rs. 6000 is an assumed figure.

In this case when amount is received (on death of a partner) it will be credited to LIC policy a/c. Balance in Policy account will be profit and will be transferred to old partners in old profit sharing ratio. In case of change other than death, no adjustment will be required because policy already appears at surrender value, hence no profit on revaluation.

(3) Joint life policy reserve account: It is only a modified version of method (1) above. Here also full amount is written off to P & L but still policy account and policy reserve account appear on the asset and liability side of balance sheet at surrender value,

When premium paid -
(a) Policy A/c Dr. 10,000
To Bank A/c 10,000
Equal amount transferred to reserve A/c -
(b) P&L A/c Dr. 10,000
To Joint life policy reserve A/c 10,000
Premium paid in excess of surrender value adjusted -
(c) J.L.P. reserve A/c Dr. 4,000
To policy A/c 4,000

At the time of change in constitution JLP reserve account will be transferred to old partners account in old ratio, alternatively to LIC policy a/c. rest of the treatment will be same as in (1) above.

Note: if this entry (c) is not passed, then full value will appear in balance sheet. Rest of the treatment and its effect will be exactly same. If entry (c) is not passed then policy and reserve both will appear at full value but still effect is same.

(4) Joint life policy reserve account: modified version of (2) above.

When premium paid -
(a) Policy A/c Dr. 10,000
To Bank A/c 10,000
Amount equal to premium transferred to Joint life policy reserve A/c -
(b) P&L A/c Dr. 10,000
To Joint life policy reserve A/c 10,000
Premium paid to the extent of surrender value adjusted -
(c) Joint life policy reserve A/c Dr. 6,000
To P&L A/c 6,000

As a consequence of above P&L is debited with premium in excess of surrender value and net balance of policy a/c. (-) Joint life policy reserve a/c, at any time is equal to surrender value. Thus it is same as (2) above.

At the time of change in constitution the balance of Joint life policy reserve can be either transferred to old partners like other reserves or it can be credited to Joint life policy reserve a/c rest of the accounting is same as in (2) above.

9.23. Draw a chart to explain treatment of Joint life policy.

When premium is paid every year		At the time of change in constitution	Net effect
Joint Life Policy	P&L a/c. Dr. 10000 To Bank a/c. 10000 **or**	1) Death → Claim received → Claim – Book value = Profit = (claim) 2) Other → Revalued at S.V. → R.V. – B.V. (nil) = Profit = (S.V.)	

	JLP a/c. Dr. 6000 P&L a/c. Dr. 4000 To Bank a/c. 10000	1) Death → Claim received → Claim – Book value = Profit = (claim–S.V.) 2) Other → Revalued at S.V. → R.V.(=S.V.) – B.V.(=S.V.) = Profit = (0)

Note:

1. Transfer above profit to old partners in old ratio.
2. Utilize claim money to settle deceased partners a/c.
3. R.V. = Revalued value, S.V. = Surrender value, B.V. = Book value
4. In case J.L.P. reserve is created then B.V. = Policy a/c. – J.L.P. reserve a/c. Alternatively J.L.P. reserve can be separately transferred to old partners a/c in old ratio.

Illustration-16: X, Y and Z were sharing profits and losses in the ratio of 3:2:1 respectively. The firm had insured the partner's lives severally the premium thereof is charged to Profit & Loss a/c. The surrender values of the life policies as at 31st March, 2006 were – X for Rs. 5,000, Y for Rs. 4,000 and Z for Rs. 3,000. The surrender values represents 50% of the sum assured in each case. Y and Z decide to share equally in future. Give the necessary journal entries assuming (a) If X retires on 31.03.2006 (b) If X dies on 31.03.2006.

Solution:

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
31.3.06	**Case (a)**			
	Life policy a/c Dr.		12,000	
	To X's Capital A/c			6,000
	To Y's Capital A/c			4,000
	To Z's Capital A/c			2,000
	(Being the creation of life policy A/c. at surrender value and transfer of consequent profit)			
31.3.06	**Case (b)**			
	Insurance Company's A/c Dr.		10,000	
	To Profit on Life Policy A/c			10,000
	(Being the claim due on X's death recorded by crediting Profit on Life Policy A/c. Policy amount = 5,000 x100/50 = 10,000)			
	Life policy a/c Dr.		7,000	
	To Profit on Life Policy A/c			7,000
	(Being revaluation of life policy on the life of Y & Z at surrender value)			
	Profit on Life Policy A/c Dr.		17,000	
	To X's Capital A/c			8,500
	To Y's Capital A/c			5,667
	To Z's Capital A/c			2,833
	(Being the transfer of balance in Profit on life policy A/c. being old profit)			

Illustration-17: X, Y and Z were sharing profits and losses in the ratio of 1/2: 1/3: 1/6 respectively. The firm had insured the partner's lives severally. The surrender values of the life policies appearing in the balance sheet as at 31st March, 2006 were – X for Rs. 5,000, Y for Rs. 4,000 and Z for Rs. 3,000. The surrender values represents 50% of the sum assured in each case. Y and Z decide to share equally in future. Give the necessary journal entries assuming (a) If X retires on 31.03.2006 (b) If X dies on 31.03.2006.

Solution:

Date	Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)

31.3.06	**Case (a)** No entry is to be passed since policies appear at surrender value and its real value is also surrender value, hence no unaccounted/undivided profit.			
31.3.06	**Case (b)** Insurance Company's A/c Dr. To X's Life Policy A/c (Being the claim due on X's death recorded by crediting X's Life Policy A/c)		10,000	 10,000
	X's Life Policy A/c Dr. To X's Capital A/c To Y's Capital A/c To Z's Capital A/c (Being the transfer of balance in X's life policy A/c. being profit)		5,000	 2,500 1,667 833

9.24 What is goodwill and how is it calculated

- Goodwill is the value of reputation of the firm. It is the total of those benefits which firm enjoys, which help it to earn profit higher than normal profit.
- It is an intangible asset, hence difficult to value when it is self generated. But following are the methods which can be used for valuation.
  a. Average profit method b. Super profit method
  c. Capitalization method d. Annuity method
- The firms goodwill may have value, but in the books of account it may be nil, hence it represents an unaccounted profit therefore at the time of change in constitution it needs to be valued and adjusted by any of the four methods discussed earlier.

9.25 Average Profit Method of goodwill calculation.

- Goodwill is calculated as a certain number of years purchase of the average profit of last few years.
- It should be normal operating profit which can be maintained in future.
- Goodwill = Average Profit (Future Maintainable Profit) X Number of years

Illustration 18: Goodwill of M/s. AB & Co. is to be valued as 3 years purchase of last four years average profit. Profit for 2011 is Rs.12,000 for 2010 Rs.10,000 for 2009 Rs.15,000 and for 2008 Rs.13,000.

Solution:

$$\text{Average Profit per year} = \frac{12{,}000 + 10{,}000 + 13{,}000 + 15{,}000}{4} = 12{,}500$$

Firms Goodwill = 12,500 x 3 = Rs.37,500

Note: Alternatively weighted average can be taken giving highest weightage to the latest year & lowest weightage to the oldest year. Ex: 2008 - 1, 2009 - 2, 2010 - 3 & 2011 - 4.

Year	Profit	Weight	Weighted amount
2008	13,000	1	13,000
2009	15,000	2	30,000
2010	10,000	3	30,000
2011	12,000	4	48,000
		10	1,21,000

Weighted average = 1,21,000 / 10 = Rs. 12,100/-
Goodwill = 12,100 x 3 = Rs. 36,300/-

9.26 Super profit method of Goodwill valuation.

- Super profit is the excess of average profit (profit earned) over the normal profit (i.e. normally expected in the business).
- Goodwill is calculated as certain number of years purchase of super profit.
- Super profit = Average Profit (Future Maintainable Profit) - Normal Profit
- Super profit must be positive otherwise it will be taken as nil and consequently goodwill also nil.
- Goodwill = Super Profit X Number of years

Illustration 19: M/s AB & Co. Wants to value the goodwill as 4 years purchase of the super profit. Their capital employed is Rs. 1,00,000/- The normal rate of return by the similar concerns is 15% P.A. Average profit of the firm is Rs. 20,000. (Future maintainable profit)

Solution:

$$\text{Normal Profit } = 1{,}00{,}000 \times \frac{15}{100} = 15{,}000$$

Super profit = 20,000 - 15,000 = 5,000. $\therefore$ Goodwill = 5,000 x 4 = 20,000

Goodwill have a positive value, hence when profit earned is less than normal profit, we will not calculate negative super profit and consequently negative goodwill, rather in such cases super profit and goodwill both will be considered as nil.

9.27. Capitalization method of Goodwill valuation.

- $\text{Capitalised value of the business} = \frac{\text{Profit Earned}}{\text{Normal rate of Return}} \times 100$
- From this capitalized value the amount of the net assets or capital employed (i.e. fixed assets + current asset - Current liabilities) are subtracted the balance is the value of the goodwill.

Illustration 20: Taking the same figure as in above **Illustration 19.**

Solution:

$$\text{Capitalised value of the business} = \frac{20{,}000}{15} \times 100 = 1{,}33{,}333$$

Goodwill = 133333 - 100000 = Rs. 33,333 ***OR*** $\text{Goodwill} = \frac{\text{Super profit}}{\text{Normal rate}} = \frac{5000}{15} \times 100 = 33{,}333$

9.28. What is Annuity method for goodwill calculation

- In the annuity method the effect of interest on the extra profit to be earned due to goodwill in the future years, is considered.
- Here the interest rate to be considered and the number of years to be considered will be specified.
- Present Value Annuity Factor at that rate of specified number of years will be given.
- Goodwill = Super Profit X Present Value Annuity Factor

Illustration 21: For example in the case of **Illustration 19** above goodwill will be calculated by annuity method. The present value of annuity of Rs.1 for 4 years @10% is 3.169.

Solution:

Goodwill = Super Profit x Cumulative Present value annuity factor = 5,000 × 3.169 = 15,845/-

Future Maintainable Profit: If in any of the above methods the figure of profit earned includes the effect of abnormal/ extra-ordinary/ non-reoccurring profits/losses the same should be eliminated. In fact the profit should be future maintainable profit which can be earned in normal course of business. The past average normal profit is taken as equal to future maintainable profit.

9.29 Calculation by annuity method when different annual profits are to be considered.

- If instead of one figure (average) for all future years, the different figures are given then, each year's figure will be discounted to its present value.
- Goodwill is the sum of present value of this future years super profit.

Illustration 22: Illustrate above and also calculation of discount factor (present value factor) at 10%, using some hypothetical figures.

Solution:

Future year	Expected super profit	Present value factor (discount factor) @10%	Present value	
1	12,000	1÷1.1 = 0.90909	12,000 X .90909	10,909
2	14,000	0.90909 ÷ 1.10 = 0.82645	14,000 X .82645	11,570
3	16,000	0.82645 ÷ 1.10 = 0.75131		12,021
4	18,000	0.75131 ÷ 1.10 = 0.68301		12,294
		PVAF 3.16986	Value of goodwill	46,794

PVAF= Present Value Annuity Factor for 4 years @ 10% rate = 3.16986

After decimal point we have taken value upto 5 digits. Normally up to 3 digits is sufficient.

The concept of present value is not covered in any of the chapters of your syllabus hence it is not being elaborated here. It is a very important & common concept of financial management.

9.30. What is Inference of Goodwill

- 'Inference of Goodwill' is calculation of goodwill when apparently it is not given in the question.
- This is done only when Capitals are said to be in Profit Sharing ratio and the New Partner brings in cash more than the proportionate Capital.
- Then the extra amount contributed is inferred as his contribution towards goodwill.

Illustration 23: Infer the goodwill from the following:

A & B are partners sharing equally with capital of Rs. 50,000 each. C is admitted with 1/3rd share, and contributes Rs. 65,000. Capitals were in profit sharing ratio and they are intended to be kept in profit sharing ratio in future also.

Calculate goodwill if (i) A & B are to withdraw their share in goodwill immediately (ii) They will not withdraw.

Solution:

(i) When A&B will withdraw their share in goodwill

Hence, their capital will remain at Rs. 1,00,000 for 2/3rd share together

∴ Total capital should be = 1,00,000 x 3/ 2 = 1,50,000 &

C's capital should be = 1,50,000 x 1/3 = 50,000

∴ Goodwill is the excess amount contributed = 65,000 – 50,000 = 15,000/-

This will be equally credited to A&B and withdrawn by them. Hence, capital now will be 50,000/- of each of A,B,C.

(ii) If goodwill is to be retained

Capital after admission will be = 50000 + 50000 + 65000 = 1,65,000

∴ Capital of C should be = 165000 x 1/ 3 = 55,000

∴ Goodwill contributed by C = 65000 – 55000 = 10,000 for 1/3rd share

∴ Total goodwill of the firm = 10,000/1 X 3 = 30,000

Share in Goodwill contributed by C, will be credited to A&B Rs. 5000 each. Thus making capital of the three partners as Rs. 55,000 each.

Alternative to (ii) If new partner has not contributed for goodwill.
Capital of C for 1/3rd share is = 65,000
$\therefore$ Capital of firm should be = 65000/1 x 3 = 1,95,000
$\therefore$ Capital of A & B should be = 195000 - 65000 = 1,30,000
Capital of A & B as per books is = 1,00,000 hence balance 30,000 is their unaccounted Goodwill which when credited to them will make their capital 1,30,000.

9.31 Illustrate Calculation of partners share from firms goodwill and vice-a-versa.

(1) Calculation of partners share from total goodwill of the firm: Total goodwill is Rs.1,00,000. There are three partners A, B, & C Sharing profit/losses in the ratio of 2:3:5. Then Share in goodwill of each partner will be calculated as follows.

A's Share = $1,00,000 \times \frac{2}{10}$ = 20,000, B= $1,00,000 \times \frac{3}{10}$ = 30,000, C = $1,00,000 \times \frac{5}{10}$ = 50,000

(2) Calculation of total goodwill from a partners share: Mr. A is admitted as partner with 1/5 share and has brought Rs. 10,000 towards his share in goodwill.

Total goodwill of the firm = $\frac{5}{1} \times$ 10,000 = Rs. 50,000

9.32. What do you mean by Withdrawal of Goodwill by Partners

- Sometimes it will be given in the question that old partners withdraws full or part of the goodwill. It simply means that they are withdrawing Cash equal to either full or part of their share in goodwill.
- In this case also the above accounting of goodwill will remain same and one additional entry for drawings will come as follows:

    Partners a/c. Dr. xxx
        To Cash/Bank a/c. xxx

Thus withdrawal of goodwill has no effect on the goodwill a/c. It is so because goodwill is not a tangible asset which someone can withdraw, in reality partners have withdrawn money equal to share in goodwill.

Illustration. 24: Hari and Ram were in partnership, sharing profits and losses in 4:2 ratio. On 1st January, 2006, Suraj was admitted into partnership on the following terms:
Suraj is to have one-sixth share in the profits/ losses, which he has got from Hari & Ram equally, paying Rs. 40,000 for share in goodwill. Hari & Ram withdraws 50% of their share in goodwill.
Journalise the entries related to goodwill on Suraj's admission.
Solution:

Journal Entries

	Particulars	**Rs.**	**Rs.**
1.1.06	Cash/ Bank a/c. Dr. To Hari a/c To Ram a/c (Suraj pays to the firm for the share of goodwill which he get from Hari & Ram equally i.e. their sacrifice is equal)	40,000	 20,000 20,000
1.1.06	Hari a/c Dr. Ram a/c Dr. To Cash/Bank a/c (Hari & Ram withdraws cash equal to 50% of their share in goodwill)	10,000 10,000	 20,000

9.33 How will you deal with goodwill in books which is worthless

- Suppose goodwill appearing in the balance sheet is stated to be worthless then it will be written off by debiting to old partners in old ratio because it is an old loss.

Illustration. 25: Hari and Ram were in partnership, sharing profits and losses in 4:2 ratio. On 1st January, 2006, Suraj was admitted into partnership on the following terms:
Suraj is to have one-sixth share in the profits/ losses, which he has got from Hari & Ram equally. The Goodwill appears in the books at Rs.30,000/- but the present valuation is agreed as nil.
Journalise the entries related to goodwill on Suraj's admission.
Solution:

Journal Entries

	Particulars	**Rs.**	**Rs.**
1.1.06	Hari a/c Dr. Ram a/c Dr. To Goodwill a/c (Goodwill appearing in the books is worthless hence is an old loss to be born by old partners in old ratio)	20,000 10,000	 30,000

Illustration 26: A, B and C are partners, sharing profit and loss in the ratio of 3:2:1. They decide to admit D for ¼ share on 1.1.2004. For this purpose goodwill is valued at 4 years purchase of annual super profits. Profit of previous three years were as under:
2001 – Rs. 68,000; 2002 – Rs. 75,000; 2003 – Rs. 73,000.
Capital Employed on 1.1.2004 is Rs. 3,00,000.

Normal rate of return is 20%. New profit sharing ratio is 5:3:1:3.
(i) Calculate value of goodwill as per super profit method.
(ii) Find out D's share in goodwill.
(iii) Calculate ratio of sacrifice by A, B and C.
(iv) Pass necessary journal entries, when D brings amount of goodwill in cash.
(v) Pass necessary journal entries, when goodwill is raised and written off in the books.

Solution

(i) Goodwill by Super Profit method:

Annual Average Profit

$$\frac{(68{,}000 + 75{,}000 + 73{,}000)}{3} = \text{Rs.}72{,}000$$

Less Normal Profit

$$\left(3{,}00{,}000 \times \frac{20}{100}\right) = \text{Rs.}60{,}000$$

Annual Super Profit = Rs. 12,000
Value of Goodwill = Rs. 12,000 $\times$ 4 = 48,000

(ii) **D's Share in Goodwill** = 48,000 $\times \frac{1}{4}$ = Rs. 12,000

(iii) **Ratio of Sacrifice:** Old ratio – New Ratio

$$A = \frac{3}{6} - \frac{5}{12} = \frac{1}{12}; B = \frac{2}{6} - \frac{3}{12} = \frac{1}{12}; C = \frac{1}{6} - \frac{1}{12} = \frac{1}{12}$$

A, B and c each has sacrifice 1/12 from his old share, therefore ratio of sacrifice is 1:1:1.

(iv) When New partner (D) brings cash for his share in goodwill:

Particulars	LF	Dr. (Rs.)	Cr. (Rs.)
(A) Cash A/c Dr. To Goodwill a/c		12,000	 12,000

(Being cash brought by D for his share in Goodwill.)			
(B) Goodwill A/c Dr.		12,000	
To A's Capital a/c			4,000
To B's Capital A/c			4,000
To C's Capital A/c			4,000
(Being amount of goodwill brought by D, credited to old partners Capital accounts in the ratio of sacrifice)			

(v) When Goodwill A/c is raised and written off:

(A) Goodwill A/c Dr.		48,000	
To A's Capital A/c			24,000
To B's Capital A/c			16,000
To C's Capital A/c			8,000
(Being Goodwill Account raised by crediting capital accounts of old partners in old ratio)			
(B) A's Capital A/c Dr.		20,000	
B's Capital A/c Dr.		12,000	
C's Capital A/c Dr.		4,000	
D's Capital A/c Dr.		12,000	
To Goodwill A/c			48,000
(Being goodwill account is written off in new profit sharing ratio)			

Illustration 27: Mr. X who is purchasing the business of Mr. Y, provides you the following information:

(a) The profits earned by Mr. Y for various years ending on 31st December, were as under. 2006 Rs. 10,000, 2007 Rs.18,000, 2008 Rs.25,000, 2009 Rs.30,000, 2010 Rs.30,000, 2011 Rs.20,000.
(b) Profits of 2007 included a non-recurring gain of Rs.1,500.
(c) Profits of 2010 were reduced by Rs. 2,000 due to an abnormal loss on account of theft.
(d) Mr. X decided to get the building of the business (which at present is uninsured) insured at a premium of Rs. 1,400 p.a.
(e) At the time of purchasing the business, Mr. X retired as manager from M/s. Reliance and was getting Rs.1,000 per month.
(f) Mr. X decided not to have the manager (who is getting Rs.950 p.m.) of the existing business since he thinks that he can manage the affairs better than the manager.

Calculate the value of goodwill on the basis of three years' purchase of average profits for the last five years as on 1-1-2012.

Solution:

Valuation of Goodwill

A. Calculation of Total Profit	Rs.
Profit for 2007 (Rs.18,000 - Rs.1,500)	16,500
Profit for 2008	25,000
Profit for 2009	30,000
Profit for 2010 (Rs.30,000 + Rs.2,000)	32,000
Profit for 2011	20,000
	1,23,500
B. Average Profit (Rs.1,23,500/5)	24,700
C. Future Adjustments:	
(a) Add: Expenses not likely to be incurred in future:	
Salary of present manager	11,400
(b) Less: Expenses likely to be incurred in future p.a.	
Insurance premium	1,400

Remuneration for alternative employment (Rs.1000 x 12)	12,000
	(2,000)
D. Average Future Maintenable Profit (B - C)	22,700
E. Goodwill (Rs.22,700 x 3)	68,100

9.34 Can there be goodwill of Incoming partner

- Yes. If incoming partner has experience and name in that field then he can also have goodwill. He will get credit for his goodwill like partners of existing firm get credit for their goodwill.
- The debit of it can be kept in goodwill a/c. (i.e. goodwill is raised or it can be written off to new partners in new ratio).

Illustration 28: X and Y are partners in a firm sharing profits and losses in the ratio of 3:2. They admit Z as a partner for 1/4th share. Z acquires his share from X and Y in the ratio of 2:1. Z brings in his personal goodwill worth Rs. 6,000 in the firm. Pass the necessary journal entries under each of the following alternative cases:

Case (a) When adjustments is to be made through Goodwill Account and Goodwill Account is to be written off immediately. Case (b) When adjustment is to be made through capital Accounts.

Solution:

Journal

Particulars	L.F.	Dr. (Rs.)	Cr. (Rs.)
Case (a)			
(i) Goodwill A/c Dr.		6,000	
To Z's Capital A/c			6,000
(Being personal goodwill brought in by Z)			
(ii) X's Capital A/c Dr.		2,600	
Y's Capital Dr.		1,900	
Z's Capital A/c Dr.		1,500	
To Goodwill A/c			6,000
(Being Goodwill Account written off in new ratio)			
Case (b)			
X's Capital A/c		2,600	
Y's Capital A/c		1,900	
To Z's Capital A/c			4,500
[Being old partners contributed towards their share in personal goodwill brought in by Z (i.e. 3/4th of Rs. 6,000)]			

9.35. What will happen if deceased or retired partners dues are not settled immediately

- As per provisions of section 37 of the Partnership Act if full or part amount of outgoing partner is still balance then
  a) He will be entitled to Interest or profit share or nothing as may be mutually agreed among them.
  b) If nothing is agreed then outgoing partner or his representatives have choice to get either of the following till final settlement
  i) Interest @6% p.a. on the balance amount
  ii) Share in the profit earned proportionate to their amount outstanding to total capital.

$$Share\ in\ profit = Total\ profit\ earned \times \frac{Outstanding\ amount\ of\ outgoing\ partner}{Capital\ of\ all\ partner + Balance\ of\ outgoing\ partner}$$

- Normally he will select the better of (i) or (ii). Hence, if required student should calculate both and give higher one. If concern incurs losses then he will opt interest.

Illustration 29: A, B and C were partners sharing profits, and losses in the ratio of 2:2:1. C retired on 1st July, 20X2 on which date the capitals of A.B and C after all necessary adjustments stood at Rs. 73,875, Rs. 63,875 and 42,250 respectively. A and B continued to carry on the business for six months without settling the accounts of C. During the period of six months from 1.7.20X2, a profit of Rs. 20,500 is earned by the use of the firm's property. State which of the two options available u/s 37 of the Indian Partnership Act, 1932 should be exercised by C.

Solution

(i) Share in the subsequent profits attributable to the use of his balance.

$$\frac{Rs.42{,}250}{Rs.1{,}80{,}000} \times Rs.20{,}500 = Rs.4{,}812$$

(ii) Interest @ 6% p.a. on the use of his balance = Rs. 42,250 × 6/12 × 6/100 = Rs. 1,267.50

C should exercise option (i) since the amount payable to him under this option is more as compared to the amount payable to him under option (ii).

Full Illustration on Change in Constitution

ADMISSION OF PARTNER

Illustration-30: Messrs Dalal, Banerji and Malick is a firm sharing profits and losses in the ratio of 2:2:1. Their Balance Sheet as on 31st March, 2006, is shown as below:

Liabilities		**Rs.**	**Assets**	**Rs.**
Sundry Creditors		12,850	Land and Building	25,000
Outstanding Liabilities		1,500	Furniture	6,500
General Reserve		6,500	Stock of Goods	11,750
Capital Account:			Sundry Debtors	5,500
Mr. Dalal	12,000		Cash-in-hand	140
Mr. Banerji	12,000		Cash-at-bank	960
Mr. Malick	5,000	29,000		
		49,850		49,850

The partners have agreed to take Mr. Mistri as a partner with effect from 1st April, 2006 on the following terms:

(a) Mr. Mistri shall bring Rs.5,000 towards his capital,
(b) The value of stock should be increased by Rs.2,500.
(c) Provision for bad and doubtful debts should be provided at 10% of the debtors,
(d) Furniture should be depreciated by 10%.
(e) The value of land and buildings should be enhanced by 20%
(f) The value of the goodwill be fixed at Rs.15,000.
(g) General Reserve will be transferred to the Partners' Capital Accounts.
(h) The new profit sharing ratio of Dalal, Banerji, Malick and Mistri shall be 5:5:3:2,
(i) The goodwill account shall be written back to the Partners' Accounts in accordance with the new profit sharing proportion.
(j) The Outstanding liabilities include Rs.1,000 due to Mr. Sen which has been paid by Mr. Dalal. Necessary entries were not made in the books.

Prepare (i) Revaluation Account, (ii) The Capital Accounts of the partners, and (ii) The Balance Sheet of the firm as newly constituted.

Solution:

Dr. **Revaluation Account** **Cr.**

Particulars		Rs.	Particulars	Rs.
To Provision for bad & doubtful debts		550	By Stock in trade	2,500
To Furniture and fittings		650	By Land and Building	5,000
To Profit on Revaluation transferred to				
Dalal	2,520			

Banerji	2,520			
Malick	1,260	6,300		
		7,500		7,500

Capital Accounts of Partners

Particulars	Dalal Rs.	Banerji Rs.	Malick Rs.	Mistri Rs.	Particulars	Dalal Rs.	Banerji Rs.	Malick Rs.	Mistri Rs.
To Goodwill	5000	5000	3000	2000	By Bal.b/d.	12000	12000	5000	--
					By Gen. Reserve	2600	2600	1300	--
					By Cash	--	--	--	5000
					By Goodwill	6000	6000	3000	--
					By Outstadg Liab.	1000	--	--	--
To Balance c/d	19120	18120	7560	3000	By Revaluaion	2520	2520	1260	--
	24120	23120	10560	5000		24120	23120	10560	5000

Balance Sheet of M/s. Dalal, Malick and Mistri as on 1-4-2006

Liabilities		Rs.	Assets		Rs.
Sundry Creditors		12,850	Land and Building		30,000
Outstanding Liabilities		500	Furniture		5,850
Capital Accounts of Partners			Stock of Goods		14,250
Mr. Dalal	19,120		Sundry Debtors	5,500	
Mr. Banerji	18,120		Less: Provision	550	4,950
Mr. Malick	7,560		Cash-in-hand		140
Mr. Mistri	3,000	47,800	Cash-at-bank		5,960
		61,150			61,150

RETIREMENT OF A PARTNER

Illustration-31: A, B, C were in partnership sharing profits and losses in the ratio of 3:2:1. The Balance Sheet of the firm as on 31-3-2006 was as under:

Liabilities		**Rs.**	**Assets**	**Rs.**
Capital Accounts:			Goodwill	40,000
A	1,50,000		Fixtures	30,000
B	1,00,000		Stock	1,70,000
C	50,000	3,00,000	Sundry Debtors	90,000
Sundry Creditors		40,000	Cash	10,000
		3,40,000		3,40,000

A on account of ill health, gave notice that he wished to retire from the firm. A retirement agreement was, therefore, entered into as on 31.3.2006, the terms of which were as follows:

a) The Profit and Loss Account for the year ended 31.3.2006, which showed a net profit of Rs. 42,000 was to be re-opened. B was to be credited with Rs. 6,000 as bonus, in consideration of the extra work, which had devolved upon him during the year. The profit sharing basis was to be revised and the revised ratio to be 2:3:1 as and from 1st April, 2005.

b) Goodwill was to be valued at two year's purchase of the average profits of five years. Profits for these five years ending on 31st March were as under:

	Rs.
31.3.2002	15,000
31.3.2003	23,000
31.3.2004	25,000
31.3.2005	35,000
31.3.2006	42,000

c) Fixtures are to be valued at Rs. 39,800 and a provision of 2% was to be made for doubtful debts and the remaining assets were to be taken at their book value.

d) That the amount payable to A shall be paid by B.

B and C agreed, as between themselves, to continue the business, sharing profits and losses in the ratio of 3:1 and decided to eliminate goodwill from Balance Sheet, to retain fixtures in the books at the revised value and increase the provision for doubtful debts to 6%. Total capital of the firm will be Rs. 3 lakhs as before to be maintained in the new ratio as between B and C.
You are required to give the necessary entries to give effect to the above arrangements. Prepare Capital Account of Partners, Cash Account and Balance Sheet of B and C after giving effect to the above arrangements on the retirement of A.

Solution:

Journal Entries

	Particulars		Dr. Rs.	Cr. Rs.
(i)	A's capital account	Dr.	21,000	
	B's capital account	Dr.	14,000	
	C's capital account	Dr.	7,000	
	To Profit and loss adjustment account			42,000
	(Profit of last year written back for making adjustment)			
(ii)	Profit and loss adjustment account	Dr.	6,000	
	To B's capital account			6,000
	(Bonus credited to B's capital account)			
(iii)	Profit and loss adjustment a/c	Dr.	36,000	
	To A's capital account			12,000
	To B's capital account			18,000
	To C's capital account			6,000
	(Distribution of profits in the new ratio)			
(iv)	Goodwill account (56,000-40,000)	Dr.	16,000	
	Fixtures account	Dr.	9,800	
	To Provision for bad debts account			1,800
	To A's capital account			8,000
	To B's capital account			12,000
	To C's capital account			4,000
	(Revaluation of assets on A's retirement)			
(v)	B's capital account	Dr.	44,700	
	C's capital account	Dr.	14,900	
	To Goodwill account			56,000
	To Provision for bad debts account			3,600
	(Written off goodwill and raising provision for bad debts)			
(vi)	A's capital account	Dr.	1,49,000	
	To B's capital account			1,49,000
	(Amount payable to A paid by B)			

Partners' Capital Accounts

Particulars	A Rs.	B Rs.	C Rs.	Particulars	A Rs.	B Rs.	C Rs.
To P&L Adjustment A/c (Profit reversed)	21,000	14,000	7,000	By Balance b/d	1,50,000	1,00,000	50,000
To Goodwill & Provision for bad debts	-	44,700	14,900	By P&L Adjustment A/c (Bonus)	-	6,000	-
To B's Capital A/c	1,49,000	-	-	By P&L Adjustment A/c	12,000	18,000	6,000
To Cash A/c (excess repaid)	-	1,300	-	By Goodwill and Fixtures	8,000	12,000	4,000

To Balance c/d (adjusted capital)	-	2,25,000	75,000	By A's Capital A/c By Cash A/c (short fall recovered)	- -	1,49,000 -	- 36,900
	1,70,000	2,85,000	96,900		1,70,000	2,85,000	96,900

Cash Account

	Rs.		Rs.
To Balance b/d	10,000	By B's Capital A/c	1,300
To C's Capital A/c	36,900	By Balance c/d	45,600
	46,900		46,900

Balance Sheet of B and C

As on 31st March, 2006 (after retirement of A)

Liabilities		**Amount Rs.**	**Assets**		**Amount Rs.**
Capital Accounts:			Fixtures		39,800
B	2,25,000		Stock		1,70,000
C	75,000	3,00,000	Sundry debtors	90,000	
Sundry Creditors		40,000	Less: Provision for bad debts	5,400	84,600
			Cash		45,600
		3,40,000			3,40,000

Working note: Calculation of goodwill

Average of last five year's profits

Year ended on	Profit (Rs.)
31.3.2002	15,000
31.3.2003	23,000
31.3.2004	25,000
31.3.2005	35,000
31.3.2006	42,000
	1,40,000

$$\text{Average proit} = \text{Rs.}\frac{1,40,000}{5} = \text{Rs.}28,000$$

Goodwill at two years purchase: Rs. 28,000 × 2 = Rs. 56,000

- Goodwill already appears in the books at Rs.40,000 hence now increased by Rs.16,000 and included together with revaluation of other assets and liabilities. Alternatively it can be accounted separately.
- Capital is required to be Rs.3,00,000 in new ratio, the balance is accordingly written in capital account and the difference then is repaid or recovered as the case may be.

RETIREMENT CUM ADMISSION

Illustration-32: (Nov. 1996, May 2002) Dowell & Co. is a partnership firm with partners Mr. A, Mr. B and Mr. C, sharing profits and losses in the ratio of 10:6:4. The Balance Sheet of the firm as at 31st March, 2006 is as under:

Liabilities		Rs.	Assets	Rs.
Capital:			Land	10,000
Mr. A	80,000		Buildings	2,00,000
Mr. B	20,000		Plant and Machinery	1,30,000
Mr. C	30,000	1,30,000	Furniture	43,000
Reserves (Un-appropriated Profit)		20,000	Investments	12,000

Long Term Debt	3,00,000	Stock	1,30,000
Bank Overdraft	44,000	Debtors	1,39,000
Trade Creditors	1,70,000		
Total	6,64,000	Total	6,64,000

It was mutually agreed that Mr. B will retire from partnership and in his place Mr. D will be admitted as a partner with effect from 1st April, 2006. For this purpose, the following adjustments are to be made:

i. Goodwill is to be valued at Rs.1 lakh but the same will not appear as an asset in the books of the reconstituted firm.

ii. Buildings and Plant & Machinery are to be depreciated by 5 percent and 20 percent respectively. Investments are to be taken over by the retiring partner at Rs.15,000. Provision of 20 percent is to be made on debtors to cover doubtful debts.

iii. In the reconstituted firm, the total capital will be Rs.2 lakhs which will be contributed by Mr. A, Mr. C and Mr. D in their new profit sharing ratio, which is 2:2:1.

iv. The surplus funds, if any, will be used for repaying the Bank Overdraft.

v. The amount due to the retiring partner shall be transferred to his loan account.

You are to prepare:

(a) Revaluation A/c; (b) Partner's Capital Accounts;
(c) Bank Account; and (d) Balance Sheet of the reconstituted firm as on 1st April, 2006.

Solution

Capital Account

Particulars	A	B	C	D	Particulars	A	B	C	D
To A&B a/c (Goodwill adjustment)	--	--	20,000	20,000	By Balance b/f	80,000	20,000	30,000	--
To Investment a/c	--	15,000	--	--	By Reserve a/c	10,000	6,000	4,000	--
To Revaluation a/c	30,400	18,240	12,160	--	By C&D a/c (Goodwill adjustment)	10,000	30,000	--	--
To B's loan a/c.	--	22,760	--						
To Balance c/d	69,600	--	1,840	--	By Balance c/d	--	--	--	20,000
To Balance b/f	--	--	--	20,000	By Balance b/f	69,600	--	1,840	--
To Closing balance c/d	80,000		80,000	40,000	By Cash/Bank a/c	10,400		78,160	60,000
Total	80,000	--	80,000	60,000	Total	80,000	--	80,000	60,000

Rs.2,00,000 capital balance is written in new ratio 2:2:1 and the shortfall in capital account then is contributed by the new partners A, C & D

Revaluation Account

Particulars	Rs.	Particulars	Rs.
To Building a/c	10,000	By Investment a/c (profit)	3,000
To Plant and Machinery a/c	26,000	By Loss a/c: A 30,400	
To Provision for bad debt a/c	27,800	B 18,240	
		C 12,160	60,800
	63,800		63,800

Cash/Bank Account

Particulars	Rs.	Particulars	Rs.
To A a/c.	10,400	By Bank over draft a/c	44,000
To C a/c.	78,160	By Balance c/f	1,04,560
To D a/c.	60,000		
	1,48,560		1,48,560

Table of Goodwill Adjustment

	A	B	C	D
Credit in old ratio	50,000	30,000	20,000	--
Debit in new ratio	40,000	--	40,000	20,000

Difference (i.e. sacrifice/gain)	Cr. 10,000	Cr. 30,000	Dr. 20,000	Dr. 20,000

C's a/c Dr. 20,000
D's a/c Dr. 20,000
To A's a/c 10,000
To B's a/c 30,000

Balance Sheet as on 1st April 2006

Liabilities		Rs.	Assets		Rs.
Capital			Land		10,000
A	80,000		Building		1,90,000
C	80,000		Plant and machinery		1,04,000
D	40,000	2,00,000	Furniture		43,000
Long term debt		3,00,000	Stock		1,30,000
Creditors		1,70,000	Debtors	1,39,000	
B's loan		22,760	(-) Provision	27,800	1,11,200
			Cash/Bank		1,04,560
		6,92,760			6,92,760

DEATH OF A PARTNER

Illustration-33: Firm ABC consist of 3 partners A B and C, sharing profits and losses in the ratio 5:3:2 respectively. The partner A died on February 20, 2006, Profit and Loss Account for the period upto date of death and Balance sheet as on that date were prepared. The Balance sheet as on that date was as given by the side.

Liabilities		Rs.	Assets	Rs.
Capital			Goodwill	6,000
A	12,000		Machinery	35,000
B	16,000		Furniture	6,000
C	12,000		Stock	9.000
		40,000	Debtors	15,000
Loan from A		5,000	Cash in hand	3,000
General Reserve		7,000		
Creditors		22,000		
		74,000		74,000

In addition to the assets shown above, the firm had 3 life policies in the name of each partner, for insured value of 20,000 each, the premium of which were charged to Profit & Loss Account.
According to the partnership deed, on death of partner, the asset and liabilities are to be revalued by a valuer. The re-valued figures were :

1) Goodwill 21,000 Machinery 45,000 Debtors are subject and to a provision for doubtful debts at 10% and Furniture at 7,000.
2) Provision for taxation to be created for Rs. 1,500.
3) Death-claim for policy in the name of A will be realised in full & the surrender values of the other 2 policies were Rs. 7500 each.

The business will be continued by B & C , henceforth sharing profits and losses equally. The net balance due to A is transferred to a Loan account which will be paid off later.
Show Capital Account, Revaluation Account and the new Balance Sheet of the firm.

Solution:

Journal Entries

Sr. No.	PARTICULARS		DEBIT Rs.	CREDIT Rs.
1.	Reserve Account	Dr.	7,000	
	To A Account			3,500
	To B Account			2,100
	To C Account			1,400
	(Reserves transferred in old ratio)			

Sr. No.	PARTICULARS		DEBIT Rs.	CREDIT Rs.
2.	Goodwill Account	Dr.	15,000	
	To A Account			7,500
	To B Account			4,500
	To C Account			3,000
	(Goodwill raised and credited to partners in old ratio)			
3.	Machinery Account	Dr.	10,000	
	Furniture Account	Dr.	1,000	
	To Revaluation Account			11,000
	(Asset value appreciated)			
4.	Revaluation Account	Dr.	3,000	
	To Provision for BDD			1,500
	To Tax provision a/c			1,500
	(Provision increased)			
5.	Revaluation Account	Dr.	8,000	
	To A Account			4,000
	To B Account			2,400
	To C Account			1,600
	(Profit on revaluation transferred in old ratio)			
6.	Cash Account	Dr.	20,000	
	To profit on JLP Account			20,000
	(Claim received due to 'A's death)			
7.	A Account	Dr.	20,000	
	To Cash / Bank Account			20,000
	(Claim money utilised to settle A's Account)			
8.	Joint Life Policy Account		15,000	
	To profit on JLP Account			15,000
	(Two policies revalued)			
9.	Profit on Joint Life Policy Account	Dr.	35,000	
	To A Account			17,500
	To B Account			10,500
	To C Account			7,000
	(Profit transferred in old ratio)			

Capital Account

Particulars	A	B	C	Particulars	A	B	C
To Cash / Bank A/c (Claim money utilised)	20,000	--	--	By Balance b/d	12,000	16,000	12,000
				By Reserve A/c	3,500	2,100	1,400
				By Goodwill A/c	7,500	4,500	3,000
To A's Loan a/c	24,500	--	--	By Revaluation A/c	4,000	2,400	1,600
To Balance c/d	--	35,500	25,000	By Joint Life Policy (profit)	17,500	10,500	7,000
	44,500	35,500	25,000		44,500	35,500	25,000

Revaluation Account

Particulars	Rs.	Particulars	Rs.
To Provision for doubtful debts	1,500	By Machinery Account	10,000
To Provision for taxation A/c	1,500	By Furniture Account	1,000
To Profit tr to Capital A/c			

Particulars	Rs.	Particulars	Rs.
A 4,000 B 2,400 C 1,600	8,000		
	11,000		11,000

A's (Legal heirs/representatives) Loan Account

Particulars	Rs.	Particulars	Rs.
To Balance c/d	29,500	By Balance b/d	5,000
		By A's Capital a/c	24,500
	29,500		29,500

Profit on Joint Life Policy Account

To profit trf to capital Account A 17,500 B 10,500 C 7,000	35,000	By Cash / Bank Account (Claim on A's policy)	20,000
		By Joint Life Policy A/c (Revaluation) (2 Joint life policy of B & C) (7500 x 2)	15,000
	35,000		35,000

Balance Sheet

Liabilities	**Rs.**	**Assets**	**Rs.**
Capital Account		Goodwill A/c (6,000 + 15,000)	21,000
B 35,500		Machinery Account	45,000
C 25,000		Furniture Account	7,000
	60,500	Stock Account	9,000
Loan from A Account	29,500	Debtors Account 15,000	
Provision for tax	1,500	(-) Provision for BDD 1,500	13,500
Creditors	22,000	Cash in hand	3,000
		Joint Life Policy Account	15,000
	1,13,500		1,13,500

CHANGE IN PROFIT SHARING RATIO

Illustration-34: A,B and C are partners in a firm sharing profits and losses as 8:5:3. The Balance Sheet as at 31st December,2005 was as follows:

Liabilities	Rs.	Assets	Rs.
Sundry Creditors	1,50,000	Cash	40,000
General Reserve	80,000	Bills Receivable	50,000
Partner's Loan Accounts:		Sundry Debtors	60,000
A	40,000	Stock	1,20,000
B	30,000	Fixed Assets	2,80,000
Partner's Capital Accounts:			
A	1,00,000		
B	80,000		
C	70,000		
	5,50,000		5,50,000

From 1st January, 2006 they agreed to alter their profit-sharing ratio as 5:6:5. It is also decided that:

a) The fixed assets should be valued at Rs.3,31,000;
b) A provision of 5% on sundry debtors be made for doubtful debts;
c) The goodwill of the firm at this date be valued at three year's purchase of the average net profit of the last five years before charging insurance premium; and
d) The stock be reduced to Rs.1,12,000.

There is a joint life insurance policy for Rs.2,00,000 for which an annual premium of Rs.10,000 is paid, the premium being charged to Profit and Loss Account. The surrender value of the policy on 31st December, 2005 was Rs. 78,000.

The net profits of the firm for the last five years were Rs.14,000, Rs.17,000, Rs.20,000 , Rs.22,000 and Rs.27,000.
Goodwill and the surrender value of the joint life policy was not to appear in the books.
Draft Journal Entries necessary to adjust the capital accounts of the partners and prepare the revised Balance Sheet.

Solution:

M/s A,B and C
Journal Entries

			Rs.	Rs.
1.1.06	Fixed Assets A/c Dr. To Revaluation A/c (Being increase in the value of fixed assets)		51,000	 51,000
	Revaluation A/c Dr. To Stock A/c To Provision for Doubtful Debts A/c (Being reduction in the value of stock and provision for doubtful debts @ 5% created on sundry debtors)		11,000	 8,000 3,000
	Revaluation A/c Dr. To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being transfer of profit on revaluation to partners in their old profit sharing ratio of 8:5:3)		40,000	 20,000 12,500 7,500
	General Reserve A/c Dr. To A's capital A/c To B's capital A/c To C's capital A/c (Being transfer of general reserve in old ratio of 8:5:3)		80,000	 40,000 25,000 15,000
	B's capital A/c C's capital A/c To A's Capital A/c (Being adjustment for goodwill and joint life policy without raising the same in the books. For calculation refer working note)		10,500 21,000	 31,500

Balance sheet (revised)
As on 1st January, 2006

Liabilities		Rs.	Assets		Rs.
Sundry Creditors		1,50,000	Cash		40,000
Partner's Loan Accounts:			Bills Receivable		50,000
A	40,000		Sundry Debtors	60,000	
B	30,000		Less: Provision	3,000	
		70,000			57,000
Partner's Capital Accounts:			Stock		1,12,000
A	1,91,500				
B	1,07,000				
C	71,500				
		3,70,000	Fixed Assets		3,31,000
		5,90,000			5,90,000

Working Note:

<u>Adjustment for Goodwill and joint Life Policy</u>

	Rs.
Profit for 5 years (14,000+ 17,000+20,000+22,000+27,000)	1,00,000
Average profit per year (1,00,000÷5)	20,000
Add: Insurance premium per annum	10,000
Average profit before charging premium	30,000
Value of goodwill at three year's purchase (3×30,000)	90,000
Add: Surrender value of joint life policy	78,000

Total amount of unaccounted profit requiring adjustment without changing book value	1,68,000

	A Rs.	B Rs.	C Rs.
Raised goodwill & joint Life Policy in old profit sharing ratio 8:5:3	84,000 (Cr.)	52,500(Cr.)	31,500(Cr.)
Less: Written off in new profit sharing ratio of 5:6:5	52,500 (Dr.)	63,000(Dr.)	52,500(Dr.)
Net effect in Capital Accounts	31,500(Cr.)	10,500(Dr.)	21,000(Dr.)

Internal Reconstruction

16.1. What is Internal Reconstruction , explain its procedure

- It is an arrangement whereby a company makes changes in its Capital Structure and book value of other Assets & Liabilities without closing (Liquidating) the company.
- The scheme is prepared with the approval of Shareholders, Debenture holders & other creditors whose interest is affected and is sanctioned by the Court.
- It is normally adopted when company has accumulated losses, fictitious assets or its other assets are having market values lower then the book values.
- As per the scheme the Equity Share Capital/ Pref. Share Capital/ Debentures and other liabilities are reduced by agreed amount and this balance including reserves, profits or appreciation's if any is used to write off fictitious assets like P & L A/c (Dr. Balance), Discount/Commission on shares/ Debentures, Preliminary Expenses, Goodwill, Useless patents, trade marks etc. and to reduce other assets to their proper values.
- Any balance left then is transferred to Capital Reserve A/c.
- Amount written off of fixed Assets should be shown in Balance Sheet for 5 years.
- The word '& Reduced' should be added after the name of the Company only if so ordered by the Court.
- Apart from above the scheme may contain raising of finance by calls on shares etc. and repayment of certain liabilities for which necessary entries will come according to the exact nature of transactions given in the question.

16.2. Draft the journal Entries for internal Reconstruction

Entries:

(1) Equity Share/Preference share/Debentures/other liabilities A/c Dr.
To Capital Red./Reconstruction/Reorganisation A/c
(with the amount of Reduction agreed)

(2) Capital Reduction/Reconstruction/Reorganisation A/c Dr.
∗To P & L A/c. (Debit Balance)
∗To Discount/Common Shares/Debentures A/c
∗To Preliminary Expenses A/c
To Goodwill A/c
To Stock, Plant and Machinery, Building etc. A/c.
(Amount of Capital reduction utilised to write-off various losses & Assets)

∗ *Such items should be written-off even in absence of any direction in the question to write it off.*

(iii) Capital Reduction/Reconstruction a/c balance left if any transferred to Capital Reserve
Reorganisation A/c Dr.

To Capital Reserve A/c

Note 1: When the description of Capital A/c. (Like Pref. share/debenture) is changed altogether then old capital A/c should be debited with full amount, amount of reduction should be credited to Capital Reduction A/c and Balance should be credited to New Capital A/c.

Example. 6% Pref. Share of Rs.100/- each changed to 8% Pref. shares of Rs.75 each then Entry:

6% Pref. Share Capital A/c.	Dr.	100	
To Capital Reduction A/c.			25
To 8% Pref. Share Capital A/c.			75

Note 2: In addition to the above which are the usual items, entry for other items like part payment to creditors, calls on partly paid shares, issue of further shares etc. will come according to information as may be given in the question.

Illustration 1: (Adopted from Nov. 1987) : The Directors of Hardluck Ltd. decided to recommend to the shareholders certain steps to put the affairs of the company back on the rails. On 30th June, 2011 the Balance Sheet of the Company was as under:

Liability	**Rs.**	**Assets**	**Rs.**
Share Capital:		Fixed Assets:	
Authorised:		Goodwill at Cost	22,600
1,00,000 Equity Share of Re.1 each	1,00,000	Freehold property at cost 50000	
		Less: Depreciation 8500	41,500
Issued and Paid:		Plant and Machinery:	
Issued and Paid 85,000 equity shares		At Cost 119000	
of Re.1 each fully paid	85,000	*Less:* Depreciation 59000	60,000
Reserve and Surplus:		Investments:	
Share Premium	15,000	Share at cost in associated companies	30,000
Current Liabilities:		Other quoted investments at cost	16,000
Trade Creditors 64,500		Current Assets:	
Bank Overdraft 56,500		Stock 23,000	
Loan from Bank 60,000	1,81,000	Debtors 19,900	42,900
		Profit and Loss Account	68,000
	2,81,000		**2,81,000**

The scheme of reconstruction as approved by the competent authorities, was as under:

1) The issued ordinary shares were reduced to 5 paise each paid up. The unpaid value of the share was subsequently called by the company and paid by all the shareholders.
2) The balance of unissued capital was allotted to the Bank in part discharge of the loan. The balance due was paid in cash.
3) The authorised capital of the company is to be increased by another 50,000 shares and these are to be issued to the existing shareholder as right issue, the amount due from the shareholders was realised.
4) Trade creditors to give up 20% of their claims and the balance due to them to be converted into 12% secured Debentures of Rs.100 each.
5) Interest of Rs.6,500 on Overdraft to be waived by the Bank and the balance overdraft to be paid off.
6) All amounts available, including share premium to be utilised to write off losses, goodwill and the value of shares in associated companies.

Show the journal entries to record the above and also draw the Balance Sheet of the company after the scheme is fully implemented. All workings should form part of your answer.

Solution:

Journal of Hardluck Ltd.

Particulars	Debit	Credit
1. Equity Capital a/c Dr.	80,750	

Particulars	Debit	Credit
To Reconstruction A/c. (85000 X 0.95) (Rs. 1 equity share written down to 0.05 per share)		80,750
Bank a/c Dr. To Equity capital a/c (0.95 called and received on each share)	80,750	80,750
2. Bank loan a/c Dr. To Equity share capital a/c To Cash /bank a/c (Banks loan settled)	60,000	15,000 45,000
3. Cash /bank a/c Dr. To Equity Share capital a/c (Rights shares allotted)	50,000	50,000
4. Creditors a/c Dr. To Reconstruction a/c To 12% Debenture a/c (Creditors settled by allotting debentures for 80% value)	64,500	12,900 51,600
5. Bank O/D a/c Dr. To Reconstruction a/c To Cash /bank a/c (Bank OD settled, Bank gave up claim for interest)	56,500	6,500 50,000
6. Reconstruction a/c Dr. Share premium a/c Dr. To P & L a/c To Goodwill a/c To Investment in associate Co. (Balancing Figure) (Balance of reconstruction a/c. and share premium account utilised to write off P&L account, goodwill and value in investment a/c.)	1,00,150 15,000	68,000 22,600 24,550

Reconstruction Account

Particulars	Amount	Particulars	Amount
To P & L a/c	68,000	By Equity Share Capital	80,750
To Goodwill a/c	22,600	By Creditor	12,900
To Investment in associate a/c	24,550	By Bank Overdraft	6,500
(balance figure)		By Share Premium	15,000
	1,15,150		1,15,150

Balance Sheet of M/S Harkluck Ltd. (& Reduced)
As On 30.06.2011

	Particulars	Notes		Rs.
	1	3	4	5
I.	**EQUITY AND LIABILITIES**			
(1)	**Shareholders' funds**			
	Share capital			1,50,000
(2)	Share application money pending allotment			--
(3)	**Non-current liabilities**			
	Long-term borrowings: Debenture			51,600

(4)	**Current liabilities**			-
	TOTAL			**2,01,600**
II.	**ASSETS**			
(1)	**Non-current assets**			
	Fixed assets : Tangible			
	Freehold property	41,500		
	Plant & Machinery	60,000	1,01,500	
	Non-current investment (in Associate)		5,450	1,06,950
(2)	**Current assets**			
	Current Investment		16,000	
	Stock in trade		23,000	
	Trade receivables		19,900	
	Cash and cash equivalents		35,750	94,650
	TOTAL			**2,01,600**

Illustration 2: The Balance Sheet of BCR Ltd. as on 31st October, 2011 appears as below:

Balance Sheet as at October, 31, 2011

Liabilities		**Rs.**
Share Capital:		
1,50,000 equity shares of Rs.10 each fully paid		15,00,000
5,000 11% preference shares of Rs.100 each fully paid		5,00,000
Secured Loans:		
11% Debentures		5,00,000
Interest accrued and due on debentures		1,10,000
Bank Overdrafts		6,30,000
Unsecured Loans	5,00,000	
Interest accrued and due	1,50,000	6,50,000
Current Liabilities		5,00,000
		43,90,000
Assets		
Fixed Assets at cost	20,00,000	
Less: Depreciation Reserve	15,00,000	5,00,000
Stock and Stores		6,00,000
Receivables		14,50,000
Other Current Assets		2,00,000
Miscellaneous Expenditure: Profit & Loss A/c.		16,40,000
		43,90,000

A scheme of reconstruction has been agreed amongst the shareholders and the creditors, with the following salient features:

a) Interest due on unsecured loans is waived.

b) 50% of the interest due on the debentures is waived.

c) The 11% preference shareholder's right are to be reduced to 50% and converted into 15% Debentures of Rs.100 each.

d) Current liabilities would be reduced by Rs. 50,000 on account of provisions no longer required.

e) The bank agrees to the arrangement and to increase the cash credit/overdraft limits by Rs.1,00,000 upon the shareholders agreeing to bring in a like amount by way of new equity.

f) Besides additional subscription as above, the equity shareholders agree to convert the existing equity share into new 10 - rupee shares of total value Rs. 5,00,000.

g) The debit balance in the Profit and Loss Account is to be wiped out, Rs, 2,60,000 provided for doubtful debts and the value of fixed assets increased by Rs. 4,00,000.

Redraft the Balance Sheet of the company based on the above scheme of reconstruction.

Solution:

Journal of BCR Ltd.

Particulars	Debit	Credit

Particulars	Debit	Credit
1. Interest accrued a/c Dr. To Reconstruction a/c (Interest payable on loan is waived)	1,50,000	 1,50,000
2. Interest accrued on debenture a/c Dr. To Reconstruction a/c (Interest on debenture 50% waived)	55,000	 55,000
3. Pref. share Capital a/c Dr. To Reconstruction a/c To Debenture a/c (Preference share holders settled by giving debenture for 50% dues)	5,00,000	 2,50,000 2,50,000
4. Current liability a/c Dr. To Reconstruction a/c (Provision not required written off)	50,000	 50,000
5. Cash / bank a/c Dr. To Equity share Capital a/c (Share capital allotted as a condition by Bank to increase OD limit)	1,00,000	 1,00,000
6. Equity share Capital a/c Dr. To New Equity Share capital a/c To Reconstruction a/c (Rs.15 lac equity share, converted into new Rs.5 lac share capital)	15,00,000	 5,00,000 10,00,000
7. Fixed Asset a/c Dr. To Reconstruction a/c (Fixed asset appreciated)	4,00,000	 4,00,000
8. Reconstruction a/c Dr. To P & L a/c To Provision for Bad Debt a/c (Losses written off against reconstructions account)	19,00,000	 16,40,000 2,60,000
9. Reconstruction a/c Dr. To Capital Reserve a/c (Balance of reconstruction account transferred to capital reserve)	5,000	 5,000

Note: Increasing the bank overdraft limit is not a transaction in it self and hence no entry. When this limit will be used to make payments then balance will increase.

Reconstruction Account

Particulars	**Amount**	**Particulars**	**Amount**
To P & L a/c	16,40,000	By Interest Accrued on loan a/c	1,50,000
To Provision for bad debt a/c	2,60,000	By Interest Accrued on debenture	55,000
To Capital Reserve a/c	5,000	By Preference Share Capital	2,50,000
(balance figure)		By Current liability	50,000
		By Equity Share Capital	10,00,000
		By Fixed Asset	4,00,000
	1,15,150		1,15,150

Balance Sheet of M/S BCR Ltd. (& Reduced)
As On 31.10.2011

	Particulars	**Notes**		**Rs.**
	1	3	4	5
I.	**EQUITY AND LIABILITIES**			

(1)	**Shareholders' funds**			
	Share capital		6,00,000	
	Reserves and surplus : Capital Reserve		5,000	6,05,000
(2)	Share application money pending allotment			--
(3)	**Non-current liabilities**			
	Long-term borrowings			
	Secured : Debenture		7,50,000	
	Unsecured : Loan		5,00,000	12,50,000
(4)	**Current liabilities**			
	Short term borrowings		6,30,000	
	Trade Payables		4,50,000	
	Other current liability : Interest accrued		55,000	11,35,000
	TOTAL			**29,90,000**
II.	**ASSETS**			
(1)	**Non-current assets**			
	Fixed assets			9,00,000
(2)	**Current assets**			
	Stock in trade		6,00,000	
	Trade receivables	14,50,000		
	(-) R.D.D.	2,60,000	11,90,000	
	Cash and cash equivalents		1,00,000	
	Other Current Asset		2,00,000	20,90,000
	TOTAL			**29,90,000**

Illustration 3: Fair-weather Limited ran into a patch of bad financial management and its affairs were handed over to a Receiver appointed by the debenture-holders. Its statement of affairs was as given below:

Assets	**Book Value**	**Expected to realise**
Land and Building	8,00,000	10,00,000
Plant and Machinery	12,00,000	7,00,000
Stock-in-trade	8,00,000	5,50,000
Trade Debtors	9,50,000	4,75,000
Cash	1,50,000	1,50,000
	39,00,000	28,75,000
Deduct : 7% First Mortgage Debentures		12,50,000
		16,25,000
Deduct : 8% Second Mortgage Debentures		20,00,000
Deficiency regarding second debentures		3,75,000
Unsecured Creditor		4,50,000
Deficiency regarding unsecured creditor		8,25,000
Contributories:		
40,000 Equity Shares of Rs.10 each fully paid-up	4,00,000	
60,000 Equity Shares of Rs.10 each Rs.5 paid-up	3,00,000	7,00,000
Deficiency regarding contributories		15,25,000

All the mortgage debentures are held between two groups of individuals X and Y as indicated below:

	X and his friends	**Y and his friends**
	Rs.	**Rs.**
First Mortgage Debentures	7,50,000	5,00,000
Second Mortgage Debentures	12,50,000	7,50,000

In addition, X and Y rank as unsecured creditors to the extent of Rs.1,50,000 and Rs.1,00,000 respectively. Each of X and Y also hold 10,000 fully paid equity shares and 4,000 partly paid equity shares in the Company.

<u>The following scheme of re-construction was agreed upon:</u>

(i) The partly paid-up equity shares would be fully paid up by making a call, after the shares are fully paid, all equity shares except to the extent indicated otherwise below, would be reduced to shares of Rs.1 each fully paid-up.

(ii) X will give up all his claims regarding debentures and other credits, surrender all his equity shares and would receive in return 10% mortgage debentures of Rs.18 lakhs and cash of Rs. 89,000.

(iii) Y will give up all his claims on debentures and credits. He will bring in cash of Rs. 75,000 and in consideration would be issued with 10% mortgage debentures of Rs.10 lakhs.

(iv) The rest of the sundry creditors agree to give up 12 & ½ of their claims, get equity shares of Rs.1 each fully paid up allotted to them for 30% of their claims and await discharge of the balance in due course.

Pass journal entries (narration's need not be given) to give effect to the above proposal and prepare the Balance Sheet after re-construction. Workings should form part of your answer.

Solution:

BALANCE SHEET (Before Reconstruction)

Liabilities	Amount	Assets	Amount
Equity Share Capital (Fully Paid)	4,00,000	Book value of Assets	39,00,000
Equity Share (Partly Paid)	3,00,000		
7% Debentures	12,50,000	P & L Account (Bal. Fig.)	5,00,000
8% Debentures	20,00,000		
Creditors	4,50,000		
	44,00,000		44,00,000

Journal of Fair-weather Limited

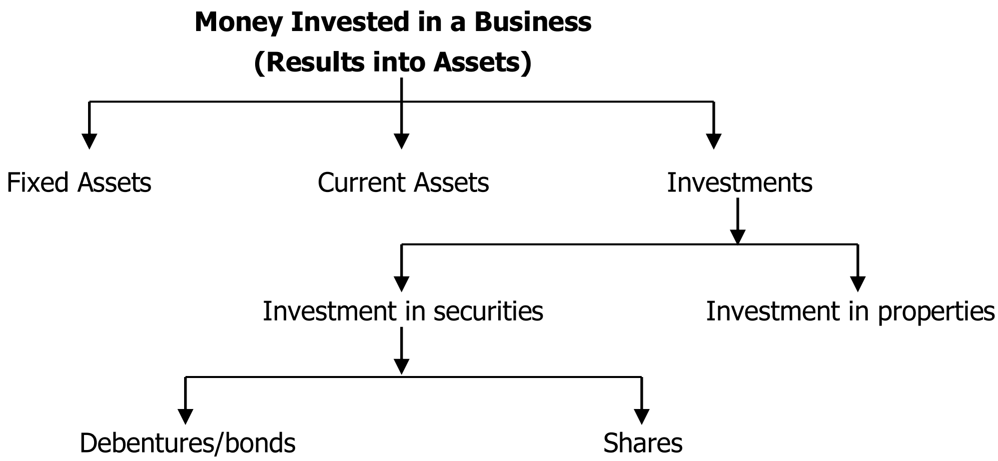
	Particulars	Debit	Credit
1.	Bank a/c Dr. To Equity Share Capital a/c (Final call of Rs. 5 on 60,000 shares made and received)	3,00,000	 3,00,000
2.	Equity Share Capital a/c Dr. To Reconstruction a/c (86,000 shares reduced by Rs. 9 each)	7,74,000	 7,74,000
3.	7% Debentures a/c Dr. 8% Debentures a/c Dr. Equity share Capital a/c Dr. Creditors a/c Dr. To 10% Debentures a/c To Bank a/c To Reconstruction a/c (Arrangement with X & his friends)	7,50,000 12,50,000 1,40,000 1,50,000	 18,00,000 89,000 4,01,000
4.	7% Debentures a/c Dr. 8% Debentures a/c Dr. Creditors a/c Dr. Bank a/c Dr. To 10% Debentures a/c To Reconstruction a/c (Arrangement with Y & his friends)	5,00,000 7,50,000 1,00,000 75,000	 10,00,000 4,25,000
5.	Creditors a/c Dr. To Reconstruction a/c To Equity Share Capital a/c (Balance creditors gave up 12.5% of their dues on receiving equity shares for 30% of dues)	85,000	 25,000 60,000

6.	Land & Building a/c Dr. To Reconstruction a/c (Land and Building appreciated)	2,00,000	 2,00,000
7.	Reconstruction a/c Dr. To Plant & Machinery a/c To Stock a/c To Debtors a/c To P & L a/c (Losses and over valuation of assets written off to reconstruction a/c)	17,25,000	 5,00,000 2,50,000 4,75,000 5,00,000
8.	Reconstruction a/c Dr. To Capital Reserve a/c (Balance of reconstruction a/c transferred)	1,00,000	 1,00,000

Balance Sheet of M/S Fair Weather Ltd. (After Reconstruction)
As On ....

	Particulars	Notes		Rs.
	1	3	4	5
I.	**EQUITY AND LIABILITIES**			
(1)	**Shareholders' funds**			
	Share capital : Equity		1,46,000	
	Reserves and surplus: : Capital Reserve		1,00,000	2,46,000
(2)	Share application money pending allotment			--
(3)	**Non-current liabilities**			
	Long-term borrowings : 10% Debenture			28,00,000
(4)	**Current liabilities**			
	Trade Payables			1,15,000
	TOTAL			**31,61,000**
II.	**ASSETS**			
(1)	**Non-current assets**			
	Fixed assets : Tangible			
	Land & Building		10,00,000	
	Plant & Machinery		7,00,000	17,00,000
(2)	**Current assets**			
	Stock in trade		5,50,000	
	Trade receivables		4,75,000	
	Cash and cash equivalents		4,36,000	14,61,000
	TOTAL			**31,61,000**

Investment Accounts



13.1. What is investment

- Investment is an asset held for earning income by way of interest, dividend, rent etc. and by way of appreciation in its value.
- Investment can be the nature of properties like land building or securities.
- In this chapter we are concerned with accounting of investment in securities.

13.2. Explain preparation of Investment Account.

- Investment account is prepared for each type of Security separately.
- It is debited with opening balance & purchases and is credited on sale of security.
- The Balance left is carried to next year as an asset.
- The profit or loss on sale is ascertained and transferred to the Profit & Loss Account.
- For amount, three columns on each side (i.e. on debit and credit side) is maintained-1st for face value/nominal value, 2nd for Interest/Income and 3rd for principle amount. This is basically with the objective to have proper control on each security and its income.

Investment account is an account in the books of the party who has invested money in the security and not in the books of company who has issued the security.

Format of Investment Account

Date	Particulars	Face Value	Income	Investment	Date	Particulars	Face Value	Income	Investment
	Total					**Total**			

Journal Entry

Date	Particulars	Dr. Rs.	Cr. Rs.
	1. On Purchase of investment Investment A/c Dr. (Ex-interest value) Income/Interest A/c Dr. (Interest amount) To Bank A/c (Cum-interest value)		
	2. On Sale of investment Bank A/c Dr. (Cum-interest value) To Investment A/c (Ex-interest value) To Income/Interest A/c (Interest amount)		
	3. Profit on Sale transferred Investment A/c Dr. To Profit & Loss A/c		
	4. Loss on Sale transferred Profit & Loss A/c Dr. To Investment A/c		
	5. Opening Accrued Interest transferred Income/Interest A/c Dr. To Opening Accrued Interest A/c		
	6. Closing Accrued Interest recognized Closing Accrued Interest A/c Dr. To Income/Interest A/c		
	7. Periodic Interest/Dividend received Bank A/c Dr. To Income/Interest A/c (Interest amount)		
	8. Interest/income transferred Income/Interest A/c Dr. To Profit & Loss A/c		

13.3. What is included in purchase & sale price

- Purchase cost of securities includes Brokerage, Stamp charges etc. paid and

- the sale value is taken net of Brokerage, Stamp charges paid.
- Calculation of brokerage is usually on purchase/sale price.

Illustration 1 : X sales to Y 500 shares at a price of Rs. 60/- Y pays Brokerage 1% & stamp duty Rs. 300/-. X pays Brokerage 1%.

Solution:

Date	**Calculation**	**For Y (Buyer)**	**For X (Seller)**
	Purchase / Sale value 500@ 60 Brokerage 1% Stamp duty	30,000 + 300 + 300	30,000 1% − 300 −
		Cost 30,600	Net Sale 29,700

Journal Entry:

Books of Y (Buyer)	**Books of X (Seller)**
Investment a/c - Dr. 30,600	Bank a/c - Dr. 29,700
To Bank a/c - 30,600	To Investment a/c - 29,700

13.4. How investments are valued as per AS-13

- AS-13 classifies investments in to current & long term.
- Current investment is an investment which is readily realizable and is intended to be held for not more than 1 year. Long term investment is one which is not current investment.
- Current investments are valued at cost or fair value whichever is lower. It is prudent to value it scrip wise but category wise is permissible.
- But in case it as long-term investment then it is valued at cost, except when there is permanent (other than temporary) fall in its value, then diminution shall be provided scrip wise.
- Under appropriate circumstances, market value or NRV may provide evidence of fair value.
- Market value is amount obtainable from sale of investment in open market, net of expenses necessary to complete the sale.
- Cost of securities sold and in stock etc. are valued on weighted average basis.
- If investments are held as stock-in-trade then these can be valued on FIFO basis also.
- If nothing is given we can take it on Average basis by giving note..

Illustration 2: On 1st April, 2010 X, Y, and Co. held 9% Debentures in Banbury Ltd. of the face value of Rs. 10,000 at cost of Rs. 8,000 Market Value on that date was Rs. 9,000. Interest is payable on 31st December every year. On 1st December, 2010 debentures of nominal value of Rs. 6,000 were purchased for Rs.5,000 ex-interest and on 31st December, 2010 Debentures of Nominal Value of Rs.2,000 were sold-cum-interest for Rs.1,900. On 1st January, 2011 Debentures of nominal value of Rs.6,000 were bought at Rs.5,800. The market value of the Debentures on 31st March, 2011 was at Rs. 90.

Make out Investment A/c. in the books of X, Y, and Company showing profits or loss on sale of Investment. Stocks on 31st March each year are valued at lower of cost and market price.

Solution: **In The Books of X, Y & Co.**

9% Debentures in Banbury Ltd. A/c

Date	Particulars	Face Value	Interest	Amt	Date	Particulars	Face Value	Interest	Amt.
01.04.10	To opening bal. b/f	10,000	225	8,000	31.12.10	By bank a/c (Sale)	2,000	180	1,720
01.12.10	To bank (Purchase) a/c	6,000	495	5,000	31.12.10	By bank a/c (int.)	-	1,260	-
01.01.11	To bank (Purchase) a/c	6,000	-	5,800	31.03.11	By balance c/f	20,000	450	17,200
31.03.11	To Profit on sale a/c	-	-	120					

31.03.11	To Interest tr. to P&L a/c	-	1,170	-					
		22,000	1,890	18,920			22,000	1,890	18,920

Working Notes:

(1) Closing stock valuation (FIFO)		**Rs.**
Face value 8,000	Out of Opening lot $8{,}000 \times \frac{8{,}000}{10{,}000}$	6,400
6,000	Purchase of 1.12.10	5,000
6,000	Purchase of 1.1.11	5,800
20,000	Cost	17,200
	Market value (200 $\times$ 90)	18,000
	Valued at lower of cost & market value	17,200
	For alternative see point **(6)**	

(2) Accrued interest on 1.4.2010 = 10,000 x 9% x 3/12 = 225

(3) Interest received on 31.12.2010 = 14,000 x 9% = 1,260

(4) On purchases of 1.1.2011 no accrued period hence, no interest.

(5) Accrued interest on 31.3.2011 = 20,000 x 9% x 3/12 = 450

(6) Cost of Closing balance on weighted average = $\frac{18800}{22000} \times 20000 = \text{Rs.}17091$,

M.V. is Rs. 18,000/- hence stock will be valued at Rs. 17,091.
Then profit on sale will be Rs. 11 instead of Rs. 120.

Note: Market value Rs.90 is assumed to be ex-interest. If it is cum-interest then deduct 3 month's accrued interest to make it comparable with the cost.

13.5. Mention some Special point about Interest on Investment

- Interest/ Dividend is always calculated on face value/nominal value and not on the market price or cost price.
- Interest on Debentures is paid by the Company periodically say quarterly, half yearly or yearly. Interest for the entire period is received by the person who is the holder or owner of the security on due date.
- Whether the security is purchased ex-interest or cum-interest, interest for the accrued period is always debited in the interest column (Accrued period means period from last due date to the date of purchase)
- Similarly when security is sold ex-interest or cum-interest, interest for the accrued period shall always be credited in the interest column.

13.6. Explain the terms cum-interest & Ex-interest

(1) cum-interest: It means the price is inclusive of interest for the accrued period (from the last due date to till the date of purchase/ sale). Interest and principle amount therefore should be segregated. In case of purchase, interest and principle amount will be taken in the respective column on debit side. In case of sale, these will come on credit side.

(2) Ex-interest: It means the sale/ purchase price doesn't include interest for accrued period and the same is received/paid separately i.e. in addition to the price quoted.

(3) If at the time of purchase or sale of security, it is not mentioned whether the purchase or sale is ex-interest or cum-interest, it may be presumed as ex-interest and a specific note about assumption should be given.

Illustration 3: 1,000 12% Debentures of Reliance Ltd. which pays interest on every 31st March & 30th Sept., are purchased by A from B on 31st July at Rs. 107 cum-interest & again 500 debenture on 30th November at Rs.102 Ex-interest. Pass entries.

Solution:

	Books of 'A' (Purchaser)	Books of 'B' (Seller)
31.7. Cum-interest	Investment a/c - Dr.1,03,000 Interest a/c - Dr. 4,000 To Bank a/c 1,07,000	Bank a/c - Dr. 1,07,000 To Investment a/c 1,03,000 To Interest a/c 4,000
Cum Interest value (total value) 1,000 x 107 = 1,07,000 (-) Interest (1st April to 31st July) (1,00,000 x 12% x 4/12) = 4,000 Ex-Interest Value (Value of investment) = 1,03,000		
30.11 Ex-interest	Investment a/c - Dr. 51,000 Interest a/c - Dr. 1,000 To Bank a/c 52,000	Bank a/c - Dr. 52,000 To Investment a/c 51,000 To Interest a/c 1,000
Ex- Interest value (Investment value) (102 x 500) = 51,000 + Interest (1st Oct. to 30th Nov) (50,000 x 12% x 2/12) = 1,000 Cum-Interest Value (total Value) = 52,000		

Student must have observed that Investment a/c is always debited or credited with ex-interest value, interest a/c with interest amount & Bank a/c with cum-interest value.

13.7. Explain accounting for accrued interest at the beginning & end of year

- Always remember to pass entry for accrued interest at the beginning and end of accounting year as follows:

  (In case of fixed interest bearing securities)

  i) Investment a/c (Interest Column) Dr.
     To Interest Accrued a/c
     (The opening balance of interest accrued is reversed)

  ii) Interest Accrued a/c Dr.
     To Investment a/c (Interest Column)
     (Interest accrued on investment till the end of accounting year is accounted)

Illustration 4: 1,000 12% Debentures of Rs.100 each of Reliance Ltd. which pays interest on every 31st December & 30th June, are held by A Ltd. as on 1.04.2010. As on 31.03.2011 the number of Debentures held was 1,500. Calculate Opening and Closing accrued interest & Pass entries.

Solution:

Journal Entry in the Books of A Ltd.

Date	Particulars	Dr. Rs.	Cr. Rs.
1.4.10	**Opening Accrued Interest from 1.1 to 31.3.10 transferred** Income/Interest A/c Dr.		

	To Opening Accrued Interest A/c (1,000 X 100 X 12% X 3/12 = 3,000)		
31.3.11	**Closing Accrued Interest from 1.1 to 31.3.11 recognized** Closing Accrued Interest A/c Dr. To Income/Interest A/c (1,500 X 100 X 12% X 3/12 = 4,500)		

13.8. How will you deal with Dividend income

- **Dividend for earlier period (Pre-acquisition dividend):** Dividend received for a period earlier to the date of acquisition of shares is a capital receipt and should be credited to Investment a/c (principle column) so that the cost of Investment gets reduced. This dividend is treated as being paid out of pre-acquisition profit.
- **Dividend for later period (Post-acquisition dividend):** Dividend received for a period later to the date of acquisition of shares is a revenue income and should be credited to Income a/c (Income column).
- **If such allocation of dividend being out of pre-acquisition profit can be made only arbitrarily, then it should be reduced from cost only if it clearly represent being out of pre-acquisition profit otherwise treat it as income.**
- Dividend for a period is assumed to be evenly distributed over the period.
- Dividend income should be accounted only when it is declared by the Company and not before.

Illustration 5: 1000 shares of Rs. 100 each purchased on 1.7.2010 at a cost of Rs. 1,50,000 through a broker who is entitled for 2% brokerage and stamp duties for transfer is Rs. 5,000.

On 1.10.2011, 20% dividend is received from the above company for the year 1.4.2010 to 31.3.2011

Solution:

Journal Entry in the Books of Investor

Date	Particulars	Dr. Rs.	Cr. Rs.
1.7.2010	**Investment in shares made** (Face value 1,000 X 100 = 1,00,000) Investment in shares A/c Dr. To Bank A/c (Purchase cost 1,50,000 + Brokerage 3,000 + Stamp duty 5000)	1,58,000	 1,58,000
1.10.2011	**Dividend received** Bank a/c (1,00,000 x 20%) Dr. To Investment a/c (pre-acquisition dividend 1.4 to 30.6.10) To Dividend Income a/c (post-acquisition 1.7.10 to 31.3.11)	20,000	 5,000 15,000

13.9. What is Right shares.

- Rights shares are the shares offered to the existing members in proportion to their existing shareholding.
- According to section 81, the directors of the company are under obligation to make offer of the new shares (known as right shares) to the existing members of the company in proportion to their shareholding.
- Sec 81 grants the existing shareholders the *right of pre-emption*, namely , the right to be first offered the share before they are offered to the general public.

13.9.1. When this right accrues

- The right accrues where the company proposes to issue further shares
  - after the expiry of two years from the date of incorporation of the company or
  - after one year from the date of the first allotment of shares, whichever is earlier.
- Thus if a company makes issue after the above specified time it will be right issue unless the members decide otherwise.
- The company must give notice to each of the equity shareholders giving him the option to take the shares offered by the company against specified money per share.
- A minimum of 14 days notice must be given for exercise of his option.
- The notice must also state that the shareholder shall have the right to renounce the offer, in whole or in part, in favour of some other person who need not be a member of the company.

13.10. Explain accounting for Right shares.

- **Right share:** If right shares are subscribed the cost will be debited to investment account.
- **Rights sold:** Sale value of rights sold is credited to P & L a/c
- unless the shares on which rights are received were purchased cum-rights at a higher price & the prices after rights are lower, in that case proceeds of rights will be credited to principle column being a capital receipt and hence cost of other shares will get reduced.
- Credit to investment account shall be only to the extent it is necessary to bring its cost to ex-right value.

Rights Shares Offered (Treatment there of)

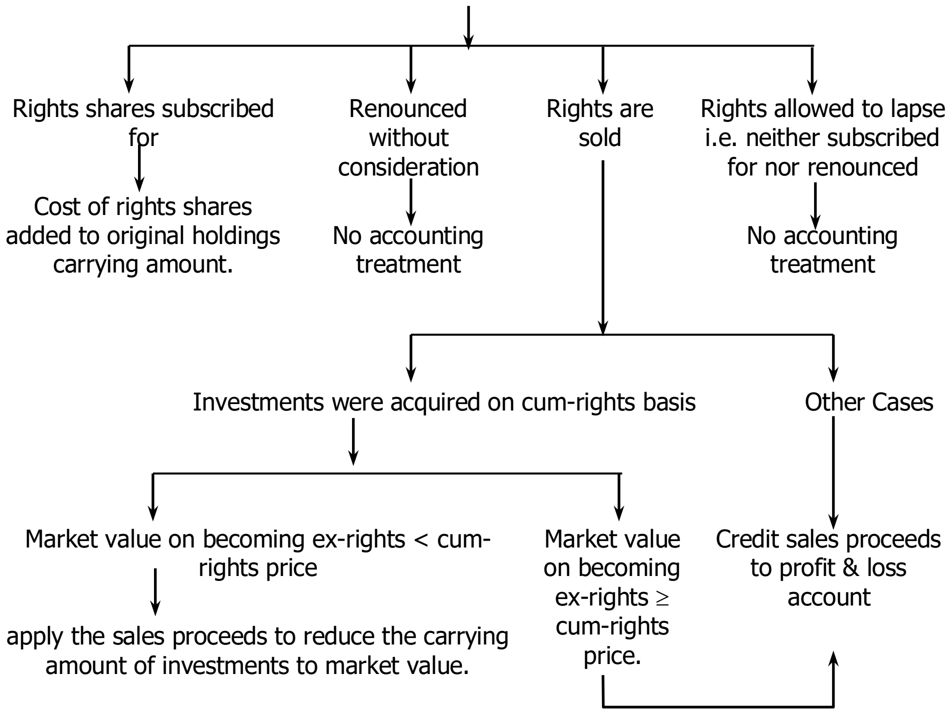


Illustration 6: 'A' holds 1000 shares at a cost of Rs. 20, aggregating to Rs. 20,000/- he receives a right offer @ 1:2 i.e. right for 500 shares at Rs. 15 each. He allows the right to lapse

Solution:

No entry

Illustration 7: ' In illustration (6) above, if he subscribes for the rights

Solution:

Investment a/c Dr.	7,500	
To Bank a/c		7,500
(This will be clubbed with original holding and hence total will be 1500 shares at a cost of Rs. 27,500)		

Illustration 8: ' In illustration (6) if he sells the right at Rs. 3 each, & the original lot was purchased ex-right (i.e. old holding)

Solution:

Bank a/c Dr.	1,500	
To Income from rights sale a/c (P&L a/c)		1,500
(This entry will be irrespective of what is the market price after rights issue i.e. price may be lower or higher than Rs. 20)		

Illustration 9: ' In illustration (6) if he sells the right at Rs. 3 each. The original lot was purchased cum-right (i.e. recent purchase). And If the market value of shares ex-right (i.e. after the right allotment is completed and old + new shares are traded in the market) is Rs. 20 or more.

Solution:

Bank a/c Dr.	1,500	
To Income a/c (P&L a/c)		1,500

Illustration 10: ' In illustration (6) if he sells the right at Rs. 3 each. The original lot was purchased cum-right (i.e. recent purchase). And If the market value of shares ex-right is Rs. 18.50 or less (M.V. of the holding will be Rs. 18,500/- or less)

Solution:

Bank a/c Dr.	1,500	
To Investment a/c		1,500

Illustration 11: ' In illustration (6) if he sells the right at Rs. 3 each. The original lot was purchased cum-right (i.e. recent purchase). And If the market value of shares ex-right is Rs. 19 (M.V. of the holding will be Rs. 19,000/-)

Solution:

Bank a/c Dr.	1,500	
To Investment a/c		1,000
To Income a/c (P&L a/c)		500

13.11. What is Bonus Shares

- A company may, if its articles so provide, capitalize profits by issuing fully paid shares to the members. Such shares are known as bonus shares.
- The details about provisions of bonus issue are covered in Chapter 9 Shares para 9.12.

13.12. Explain accounting for Bonus shares, in the books of investor

- When Bonus shares are received, entry is made only in the face value column.
- In the principle column nothing comes as this shares are received free of cost.
- As the number of shares gets increased on bonus issue, the cost of other shares gets reduced because same amount of cost will be divided by larger number of shares.

Illustration 12: 'M' holds 500 Equity shares at Tata Ltd. at Rs. 300 each. Company declares Bonus @ 1: 5. Explain effect for M.

Solution:

	Cost of Holding of 'M' before Bonus + Bonus Shares (500 ÷ 5 x 1)	500 100	@ 300 Free	1,50,000 –
	Cost of holding after Bonus	600		1,50,000
	i.e. Cost now is 1,50,000 ÷ 600 = Rs. 250 each.			

Note: Refer AS-13 'Accounting for Investment' for meaning, classification and other details.

Investment in Debenture Account in detail

Illustration 13: Jaipur Investments Ltd. hold 1,000 15 percent Debentures of Rs100 each in Udaipur Industries Ltd. as on 1st April, 2010, at a cost of Rs. 1,05,000. Interest is payable on 30th June and 31st December each year. On 1st May, 2010, 500 debentures are purchased-cum-interest at Rs. 54,300. On 30th November, 2010, 400 debentures are purchased ex-interest at Rs. 38,400. On 31st December, 2010, 400 debentures are sold-cum-interest for Rs. 55,000. Prepare Investment A/c., Valuing holding on 31st March, 2011 at cost (applying FIFO method).

Solution: **Investment in Debenture Of Udaipur Ind. Ltd. a/c**

Date	Particulars	F.V.	Interest	Investment	Date	Particulars	F.V.	Interest	Investment
1.4	To Opening Balance b/f	1,00,000	3,750	1,05,000	30.6	By Bank a/c	–	11,250	–
					31.12	By Bank a/c	40,000	3,000	52,000
1.5	To Bank a/c	50,000	2,500	51,800	31.12	By Bank a/c	–	11,250	–
30.11	To Bank a/c	40,000	2,500	38,400	31.3	By Accrued Interest a/c	–	5,625	--
31.12	To Profit on sale a/c	--	--	10,000	31.3	By Balance c/f	1,50,000	--	1,53,200
31.3	To Interest Income a/c	--	22,375	--					
		1,90,000	31,125	2,05,200			1,90,000	31,125	2,05,200

Working Notes:

1. Purchase on 1.5

Cum Interest Value	= 54,300
(-) Interest for 4 months $\left(\frac{15}{100} \text{ x } 50{,}000 \text{ x } \frac{4}{12}\right)$	= 2,500
Ex. Interest value (Cost)	51,800

2. Explanation for adjusting opening accrued interest in interest account:

Interest accrued for 3 months (1.1.10 to 31.3.10) is not the income of current year but is of previous year and it must have been accounted in the previous year as income as per mercantile system. Entry in previous year would have been as follows:

Interest Accrued a/c - Dr. 3,750

To Interest a/c 3,750 → Nominal a/c hence it will be credited to P&L a/c

(Closing Balance will be transferred to this current year)

This year interest will be received for 6 months (1.1.10 to 30.6.10) but actually this year's interest income is for 3 months (1.4.10 to 30.6.10)

Opening balance of 3 months interest accrued a/c will be shown in debit side & 6 months interest received will be credited to that a/c. Thus automatically 3 months income will get credited.

3. Half Yearly Interest Received on 30.6 :

$$1{,}50{,}000 \text{ x } \frac{15}{100} \text{ x } \frac{6}{12} = \frac{22{,}500}{2} = 11{,}250$$

4. Purchase on 30.11

Ex-Interest value	38,400
(-) Interest (40,000 x 15% x $\frac{5}{12}$)	2,500
Cum Interest Value	40,900

5. Sale on 31.12

Cum Interest Value	55,000
(-) Interest $\left(\frac{15}{100} \text{ x } 40{,}000 \text{ x } \frac{1}{2}\right)$	3,000
Ex-Interest Value	52,000

6. Cost of Investment (Closing Balance on FIFO)

	Face Value	Cost
1st	$60{,}000 \text{ x } \frac{1{,}05{,}000}{1{,}00{,}000}$	63,000
2nd	50,000	51,800
3rd	40,000	38,400
	1,50,000	1,53,200

Hire Purchase and Instalment Sale Transactions

Introduction

Hire Purchase is a system of selling goods, where price is paid in installment over a period of time. Hire vendor on delivery merely gives the possession to buyer. The ownership passes only when last installment is paid. Purchaser can return the goods any time but will not get any refund. The vendor can reposes the goods if buyer fails to pay the installments on due date. The price of the material is payable in installment together with interest.

8.1. What is Hire purchase sale

- Hire purchase sale is an arrangement whereby Vendor delivers possession to the buyer against the price to be paid in installment over an agreed period together with interest.
- The ownership passes to the buyer on payment of last installment. In case of default in payment the vendor has right to repossess the goods.

The vendor has legal right for the installments which has already fallen due before repossession, but unless otherwise specified in the question, while solving problems we consider it as Bad debt.

Buyer is not liable for the installments which has not yet fallen due if he returns the goods.

Looking to the nature of Hire purchase transaction, we can conclude that for the buyer goods so purchased will be in the nature of Fixed Assets & not goods for resale or consumables.

8.2. What is Installment sale

- In the installment system of sale the possession as well ownership immediately passes to the buyer.
- The buyer makes the payment by installment including interest.
- If buyer fails to pay the installment the vendor can not repossess the goods but will have to file the suit in the court for recovery of payment.

8.3. What is Cash Price

- It is the price at which the goods is sold/bought in the market for immediate payment.
- Cash price = Cost + Profit → for seller (vendor)
- Cash price = Cost→ for buyer (purchaser)

Illustration1: A ltd. Manufactures T.V. for Rs. 10,000/- & sells it to 'B' on immediate payment term at Rs12,500

Solution : Cash price of T.V. is Rs. 12,500/- for 'A' it is selling price & for 'B' it is cost price.

8.4. What is Hire Purchase price

- It is cash price *plus* interest.
- Hire purchase Price = Cash Price + Interest

Illustration 2 : In above illustration if hire purchase term is down payment Rs. 5,000/- & three annual installment of Rs. 4,000 each.

Solution : Hire purchase price will be 5,000 + (4,000 x3) = Rs. 17,000/-

Interest will be = 17,000-12,500 = Rs. 4,500/-

The amount of installment given in the question is to be properly understood, whether it is inclusive of interest or only principle amount & interest to be added separately.

8.5. State what are the ways in which Calculation of Interest/ Cash Price is given.

- For accounting hire purchase transaction we need cash price and interest figures separately.
- The information given in the question may be in any of the following three ways. (a) Cash price, installment & Interest rate is given (b) Cash price & Hire purchase price (installments) is given (i.e. interest rate not given) (c) Hire purchase price & Interest rate is given (i.e. cash price not given).

8.6. Explain the calculation when cash price and interest rate is given.

- In such cases the interest for every period is calculated by applying the rate of interest to the amount outstanding (cash price) at the beginning of that period.
- From this total amount, the installment (cash price portion only) paid will be deducted. In the next period the interest will be calculated on such balance amount of the cash price.
- Interest for the last period is taken as the difference between the last installment paid and balance of cash price in the account at that time, whenever installment including interest is given.

Illustration 3 : Hire purchase price Rs. 35,132 to be paid as down payment Rs. 5,132/- & balance in three equal annual installment. Rate of Interest is 10% cash price is 30,000/-

Solution :

Date	Opening Balance	Interest @ 10%	Total	Installment	Closing Balance
At zero point	30,000	-	30,000	5,132	24,868
Year 1	24,868	2,487	27,355	10,000	17,355
Year 2	17,355	1,736	19,091	10,000	9,091
Year 3	9,091	909	10,000	10,000	-

8.7.1 Explain calculation when Hire purchase price & cash price is given.

or

What is Progression method or sum of digits method.

- When Hire Purchase price and Cash price is given, the interest amount will be the difference between the Hire purchase price and the cash price.

- This total interest is to be distributed over the total period in the ratio of amount or No. of installments outstanding at the beginning of each period. It is also called progression method/ sum of digits method

Illustration 4: Hire purchase price is Rs. 3000 cash price Rs. 2400 payable in 3 equal annual installments.

Solution: Total interest = H.P. price - cash price = Rs. 3,000 - Rs. 2,400 = Rs. 600

Interest of Rs. 600 will be apportioned in the ratio 3:2:1 over 1st, 2nd & 3rd year Rs. 300 for 1st year, Rs. 200 for 2nd year. Rs. 100 for 3rd year.

8.7.2 In above case if installment amounts are not equal, then how calculation will be made

- If installments are not of uniform (equal) amounts, then instead of number of installments, the amount outstanding shall be taken as basis for apportionment of interest.

Illustration 5 : Cash price is Rs. 2,400/- Hire purchase is Rs. 3,000 payable as Rs 1,200, Rs. 1,000 & Rs. 800 payable at the end of every year.

Solution : Interest = Rs. 3,000 – Rs. 2,400 = Rs. 600/- to be apportioned as follows :

Year	Outstanding at the beginning	Installment	Closing O/S	Interest
1st year	3,000	1,200	1,800	600 ÷ 5600 x 3000 =Rs. 321
2nd year	1,800	1,000	800	600 ÷ 5600 x 1800 =Rs. 193
3rd year	800	800	-	600 ÷ 5600 x 800 =Rs. 86
	5,600	3,000		600

The calculation in above two illustration is only an approximate allocation of interest & is acceptable for solving the problem. Although accurate calculation can be done by ascertaining implicit interest rate by IRR (Internal Rate of Return) method & then calculate period wise interest as in illustration3. IRR calculation is part of your Financial Management syllabus.

8.8. Explain how cash price will be calculated (Reverse Calculation)

- Calculation of Cash price when Hire purchase price, Installment and Rate of Interest is given.
- The cash price can be calculated as follows by making reverse calculations.
- Start with last installment which includes principle amount outstanding and interest on it for that period.
- Deduct last period interest from it to get opening balance of this period which is the closing balance of previous period. Add to this the (last but one) installment to get outstanding which includes principle & interest of that period.
- Repeat the same process, until you reach to first installment.

Illustration 6: Hire purchase price is Rs.3000, Interest is charged 10% p.a. amount payable in 3 equal annual installments. Calculate cash price.

Solution :

Installment (1)	Cl. Bal. after Payment (2)	Installment Rs. (3)	Total (2+3) (4)	Interest included in installment (5)	Opening balance (6)
3rd	Nil	1000	1000	1000/110 x 10 = 91	909
2nd	909	1000	1909	1909/110 x 10 = 174	1735
1st	1735	1000	2735	2735/110 x 10 = 249	2486
		3000		514	

Rs. 2486 is cash price. If any down payment i.e. initial payment is made then it should be added to this amount to get the total cash price.

Alternative calculation using Discount Factor: It can also be calculated by multiplying the amount with the discount factor of the respective year (as studied by you for present value calculation in financial management). The above calculation is shown below:

Year (1)	PVF at 10% (2)	Installment Rs. (3)	Cash Price Portion (2) X (3) = (4)	Interest portion (3) – (4) = (5)
1	.909	1000	1000 x .909 = 909	91
2	.826	1000	1000 x .826 = 826	174
3	.751	1000	1000 x .751 = 751	249
		3000	2486	514

8.9. Explain how cash price will be calculated, when interest rate not known.

- Calculation of Cash price when Hire purchase price & Installments are given and each installment includes equal amount of cash price.
- Difference between any two consecutive installment will be equal to the interest of the last period (i.e. last installment) say 'a'. On that basis interest can be calculated as follows:
- Interest in 1^{st} Installment = a X n where 'n' = number of total installments.
- Interest in 2^{nd} Installment = a X (n-1)
- Interest in 3^{rd} Installment = a X (n-2) and so on.

Illustration 7: Down payment is Rs.50,000, Balance hire purchase price payable in 4 annual installments of Rs.1,40,000, Rs.1,30,000, Rs.1,20,000, Rs.1,10,000, which includes equal amount of cash price portion. Calculate cash price.

Solution : a = Rs.1,40,000 - Rs.1,30,000 = Rs.10,000 **n** = 4

Year (1)	Installment Rs. (2)	Interest Portion (3)	Cash Price portion (2) – (3) = (4)
1	1,40,000	10,000 x 4 = 40,000	1,00,000
2	1,30,000	10,000 x 3 = 30,000	1,00,000
3	1,20,000	10,000 x 2 = 20,000	1,00,000
4	1,10,000	10,000 x 1 = 10,000	1,00,000
Down Payment	50,000	0	50,000
	H.P. 5,50,000	1,00,000	4,50,000

Thus interest works out to be 10%.

AS-19 Accounting for leases includes hire purchase transaction also. It is applicable on assets leased on or after 1.4.2001. Hire purchase sale is a case of finance lease & should be dealt with accordingly.

ACCOUNTING IN THE PURCHASER'S (LESSEE) BOOK

8.10. Explain main features of accounting in Hire purchasers books.

- Main features for the Hire purchaser (Lessee) will be as follows :
  - (a) The item purchased will be recognized as Fixed Assets
  - (b) Asset & Liability (towards Vendor / Lessor) will be accounted at cash price.
  - (c) Fixed Asset will be depreciated as per AS-6 Depreciation Accounting.
  - (d) Amount of installment paid will include interest & balance will reduce liability.

(e) Interest will be charged as an expense in Profit & Loss account except if it can be capitalized as per AS-16 Borrowing cost. (Interest cost for the period when asset is being made ready can be capitalized as per AS-16)

*There are **three methods** in which the accounting can be done.*

8.11. Explain the accounting entries in the books of Hire purchaser when Asset is shown at full cost, & Interest is accounted every year. 1st METHOD

(1) In the first year on the purchase of Asset:
Asset A/c Dr. with the total cash price
To Hire Vendor's A/c

(2) Down Payment:
Hire vendor's a/c Dr. with down payment/ signing amount paid
To Bank/Cash a/c

(3) Interest charged at the end of every year :
Interest a/c Dr. with amount of interest payable for that year
To Hire vendor's a/c

(4) Payment of Installment every year:
Hire vendor's a/c Dr. with installment plus interest amount paid
To Bank/Cash a/c

(5) Depreciation charged at the end of the every year:
Depreciation a/c Dr. Dep. to be charged at the end of every year, at the rate & method specified.
To Asset A/c. / Depreciation Provision a/c.

Credit balance in hire vendor account to be shown on the liability side. As per AS-19, it is not to be shown as deduction from asset.

Illustration 8: On July 1, 2002 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. 8,200. Rs. 7,440 and Rs. 6,300 commencing from December 31, 2002. The vendor charged interest at 10% per annum calculated on half- yearly rests.
Eastern Printers closes books annually on December 31, and provide depreciation at 10% per annum on diminishing balances in each year. Determine the cash price of the machine and show the Journal entry and necessary ledger accounts in the books of Eastern Printers.
Solution:

Calculation of Cash Price (Reverse calculation from last to first)

Date	Closing Balance	Installment	Total	Interest		Opening Balance
31.12.03	Nil	6,300	6,300	$\frac{5}{105} X 6300$ =	300	6,000
30.6.03	6000	7,440	13,440	$\frac{5}{105} X 13440$ =	640	12,800
31.12.02	12800	8,200	21,000	$\frac{5}{105} X 21000$ =	1000	20,000
1.7.02	20,000	Down Payment 10,000	30,000			30,000
		31,940			1,940	cash price

Note: Interest rate is 10% p.a. ∴ for 6 month it is 5%

In the books of Eastern Printers (Purchaser)

Method – I :

Asset is accounted at Cash price & Interest Accrued periodically.

Journal Entries for the Year ended on 31.12.2002

Date	Particulars		Dr. Rs.	Cr. Rs.
1.07.2002	On the purchase of Asset: with the total cash price			
	Machine A/c	Dr.	30,000	
	To Hire Vendor's A/c			30,000
1.07.2002	Down Payment: with down payment/ signing amount paid			
	Hire vendor's a/c	Dr.	10,000	
	To Bank/Cash a/c			10,000
31.12.2002	Interest charged at the end of period : with amount of interest			
	Interest a/c	Dr.	1,000	
	To Hire vendor's a/c			1,000
31.12.2002	Payment of Installment : with installment plus interest amount paid			
	Hire vendor's a/c	Dr.	8,200	
	To Bank/Cash a/c			8,200
31.12.2002	Depreciation charged at the end of the every year:			
	Depreciation a/c	Dr.	1,500	
	To Machine A/c.			1,500

Journal Entries for the Year ended on 31.12.2003

Date	Particulars		Dr. Rs.	Cr. Rs.
30.06.2003	Interest charged at the end of period : with amount of interest			
	Interest a/c	Dr.	640	
	To Hire vendor's a/c			640
30.06.2003	Payment of Installment : with installment plus interest amount paid			
	Hire vendor's a/c	Dr.	7,440	
	To Bank/Cash a/c			7,440
31.12.2003	Interest charged at the end of period : with amount of interest			
	Interest a/c	Dr.	300	
	To Hire vendor's a/c			300
31.12.2003	Payment of Installment : with installment plus interest amount paid			
	Hire vendor's a/c	Dr.	6,300	
	To Bank/Cash a/c			6,300
31.12.2003	Depreciation charged at the end of the every year:			
	Depreciation a/c	Dr.	2,850	
	To Machine A/c.			2,850

Machine A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1.7.02	To Vendor A/c	30,000	31.12.02 31.12.02	By Depreciation A/c By Balance c/f	1,500 28,500
		30,000			30,000
1.1.03	To Balance B/f	28,500	31.12.03 31.12.03	By Depreciation A/c By Balance c/f	2,850 25,650
		28,500			28,500
1.1.04	To Balance b/f	25,650			

Vendor A/c

1.7.02 31.12.02 31.12.02	To Bank A/c (Down Payment) To Bank A/c (1st installment) To Balance c/f	10,000 8,200 12,800	01.07.02 31.12.02	By Machine A/c By Interest A/c	30,000 1,000
		31,000			31,000
30.06.03 31.12.03	To Bank A/c To Bank A/c	7,440 6,300	1.1.03 30.06.03 31.12.03	By Balance b/f By Interest By Interest	12,800 640 300
		13,740			13,740

Interest A/c

31.12.02	To Vendor A/c	1,000	31.12.02	By Profit & Loss A/c	1,000
		1,000			1,000
30.06.03	To Vendor A/c	640			
31.12.03	To Vendor A/c	300	31.12.03	By Profit & Loss A/c	940
		940			940

Depreciation A/c

31.12.02	To Machine A/c	1,500	31.12.02	By Transfer to P&L a/c	1,500
31.12.03	To Machine a/c	2,850	31.12.03	By Transfer to P&L a/c	2,850

8.12. Give Accounting entries by 2nd METHOD: Interest suspense A/c. Method

(1) In the first year at the time of purchase :

Asset A/c	Dr. With cash price
Interest suspense a/c	Dr. With total interest for full period as included in hire purchase price
To Hire vendor a/c	With total Hire Purchase price

(2) Payment of down payment:

Hire vendor A/c	Dr. payment of down payment
To Bank/cash a/c	

(3) Interest transferred at the end of every year:

Interest A/c	Dr. Amt. of interest for that year transferred.
To Interest Suspense A/c	

(4) Payment of Installment every year:

Hire vendor A/c	Dr. payment of installment including interest
To Bank/cash	

(5) Depreciation charged at the end of every year:

Depreciation a/c Dr. Dep. charged, calculated at given rate & method specified.

To Asset a/c/ Depreciation provision a/c.

Credit balance of vendor account after deducting debit balance of interest suspense account be shown on the liability side. Final figures every year will be same as in 1st method.

Debit balance of Depreciation a/c & Interest a/c will be charged to profit & loss a/c every year in both above methods.

Illustration 9: Using the figure of the above **illustration 8**, show the Journal entry and necessary ledger accounts in the books of Eastern Printers by Interest Suspense Account method.

Solution:

Method -II:-

Interest Suspense Account Method

Journal Entries for the Year ended on 31.12.2002

Date	Particulars			Dr. Rs.	Cr. Rs.
1.07.2002	On the purchase of Asset: with the total Hire purchase price				
	Machine A/c Interest Suspense A/c	Dr. Dr.		30,000 1,940	
	To Hire Vendor's A/c				31,940
1.07.2002	Down Payment: with down payment/ signing amount paid				
	Hire vendor's a/c	Dr.		10,000	
	To Bank/Cash a/c				10,000
31.12.2002	Interest charged at the end of period : with amount of interest				
	Interest a/c	Dr.		1,000	
	To Interest Suspense a/c				1,000
31.12.2002	Payment of Installment : with installment plus interest amount paid				
	Hire vendor's a/c	Dr.		8,200	
	To Bank/Cash a/c				8,200
31.12.2002	Depreciation charged at the end of the every year:				
	Depreciation a/c	Dr.		1,500	
	To Machine A/c.				1,500

Journal Entries for the Year ended on 31.12.2003

Date	Particulars			Dr. Rs.	Cr. Rs.
30.06.2003	Interest charged at the end of period : with amount of interest				
	Interest a/c	Dr.		640	
	To Interest Suspense a/c				640
30.06.2003	Payment of Installment : with installment plus interest amount paid				
	Hire vendor's a/c	Dr.		7,440	
	To Bank/Cash a/c				7,440
31.12.2003	Interest charged at the end of period : with amount of interest				

	Interest a/c	Dr.	300	
	To Interest Suspense a/c			300
31.12.2003	Payment of Installment : with installment plus interest amount paid			
	Hire vendor's a/c	Dr.	6,300	
	To Bank/Cash a/c			6,300
31.12.2003	Depreciation charged at the end of the every year:			
	Depreciation a/c	Dr.	2,850	
	To Machine A/c.			2,850

Machine A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1.7.02	To Vendor A/c	30,000	31.12.02 31.12.02	By Depreciation A/c By Balance c/f	1,500 28,500
		30,000			30,000
1.1.03	To Balance B/f	28,500	31.12.03 31.12.03	By Depreciation A/c By Balance c/f	2,850 25,650
		28,500			28,500
1.1.04	To Balance b/f	25,650			

Depreciation A/c

31.12.02	To Machine A/c	1,500	31.12.02	By Transfer to P&L a/c	1,500
31.12.03	To Machine a/c	2,850	31.12.03	By Transfer to P&L a/c	2,850

Vendor A/c

1.7.02 31.12.02 31.12.02	To Bank A/c (Down Payment) To Bank A/c (1st Installment) To Balance c/f	10,000 8,200 13,740	1.7.02	By Machine a/c By Interest Suspense a/c	30,000 1,940
		31,940			31,940
30.06.03	To Bank A/c (2nd Installment)	7,440	1.1.03	By Balance b/f	13,740
31.12.03	To Bank A/c (3rd Installment)	6,300			
		13,740			13,740

Interest Suspense A/c (Treating like deferred Expenses)

1.7.02	To Vendor A/c	1,940	31.12.02 31.12.02	By Interest A/c By Balance c/f	1,000 940
		1,940			1,940
1.1.03	To Balance b/f	940	30.06.03 31.12.03	By Interest By Interest	640 300
		940			940

Interest A/c

31.12.02	To Interest Suspense A/c	1,000	31.12.02	By Profit & Loss A/c	1,000
		1,000			1,000
30.06.03 31.12.03	To Interest Suspense A/c To Interest Suspense A/c	640 300	31.12.03	By Profit & Loss A/c	940
		940			940

8.13. What is asset accrual method 3rd METHOD: Asset is debited as and when the cash price is paid (Asset Accrual method)

- Asset is not recorded at full value immediately on purchase but debited as and when the amount is paid/due towards cash price/principal amount.

(1) When Down Payment is made:
Asset A/c — Dr. Actual amount paid on signing the agreement
To Bank/cash

(2) On payment of installment every year:
Asset a/c — Dr. With cash price included in installment
Interest a/c — Dr. With interest included in installment
To Bank/ cash — With installment amount.

If installment is due but paid later on then in above entry credit vendor a/c and when payment is made debit vendor a/c and credit cash/bank a/c.

(3) Depreciation (at the end of every year):
Depreciation A/c — Dr.
To Asset/Depreciation provision a/c.

Depreciation is to be charged in the first year on total cash price and not on the amount paid towards Asset. i.e. installment paid. In subsequent year depreciation is to be charged on w.d.v. based on total cash price.

It is not a common method and to be followed only if SPECIFICALLY ASKED. This method is not in accordance with provisions of AS-19 hence not to be followed. AS-19 requires asset to be accounted at full cash price at the time of purchase, hence 1st and 2nd method are as per AS-19.

Illustration 10: Using the figure of the above **illustration 8**, show the Journal entry and necessary ledger accounts in the books of Eastern Printers by Asset Accrual method.
Solution:
Method – III :

Asset Accrual Method

Journal Entries for the Year ended on 31.12.2002

Date	**Particulars**		**Dr. Rs.**	**Cr. Rs.**
1.07.2002	Down Payment: with down payment/ signing amount paid			
	Machine a/c	Dr.	10,000	
	To Bank/Cash a/c			10,000
31.12.2002	Payment of Installment : with installment plus interest amount paid			
	Machine a/c Interest a/c	Dr. Dr.	7,200 1,000	
	To Bank/Cash a/c			8,200
31.12.2002	Depreciation charged at the end of the every year:			
	Depreciation a/c	Dr.	1,500	
	To Machine A/c.			1,500

Journal Entries for the Year ended on 31.12.2003

Date	**Particulars**		**Dr. Rs.**	**Cr. Rs.**
30.06.2003	Payment of Installment : with installment plus interest amount paid			

	Machine a/c Interest a/c	Dr. Dr.	6,800 640	
	To Bank/Cash a/c			7,440
31.12.2003	Payment of Installment : with installment plus interest amount paid			
	Machine a/c Interest a/c	Dr. Dr.	6,000 300	
	To Bank/Cash a/c			6,300
31.12.2003	Depreciation charged at the end of the every year:			
	Depreciation a/c	Dr.	2,850	
	To Machine A/c.			2,850

Machine A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1.7.02 31.12.02	To Bank A/c To Bank A/c	10,000 7,200	31.12.02 31.12.02	By Depreciation A/c By Balance c/f	1,500 15,700
		17,200			17,200
1.1.03 30.06.03 31.12.03	To Bank b/f A/c To Bank A/c To Bank A/c	15,700 6,800 6,000	 31.12.03 31.12.03	 By Depreciation A/c By Balance c/f	 2,850 25,650
		28,500			28,500

Interest A/c

31.12.02	To Bank A/c	1,000	31.12.02	By Profit & Loss A/c	1,000
		1,000			1,000
30.06.03 31.12.03	To Bank A/c To Bank A/c	640 300	31.12.03	By Profit & Loss A/c	940
		940			940

Depreciation A/c

31.12.02	To Machine A/c	1,500	31.12.02	By Transfer to P&L a/c	1,500
31.12.03	To Machine a/c	2,850	31.12.03	By Transfer to P&L a/c	2,850

8.14. Can Hire purchaser return the item purchased

- Yes hire purchaser can any time return the item purchased. He will be liable for the amount due upto that time but will not be liable for the installment not fallen due.
- In this case he will remove the asset & liability from his books & the difference will be loss to be charged to Profit & Loss account.

8.15. What is repossession

- If buyer fails to pay any due installment then Vendor can reposes the goods because he is still the Legal owner Effect will be same as above.

8.16. Explain Entries for goods repossessed: (In the books of the purchaser)

- There can be two situation (1) Full Repossession or (2) Partial Repossession.

(1) When whole of the goods are re-possessed:

Vendors a/c To Asset A/c	Dr.	Balance of vendor a/c after providing interest till the date of repossession transferred because it is no more payable.

- In the Asset a/c Depreciation till the date of Re-possession should be credited. The balance now left in the Asset a/c will be transferred to P & L a/c.

Note: The Vendor has legal right to recover the installments (cash price + interest) which has become due till the time of repossession and hence if given in the question, that much credit balance may be left in the Vendor's A/c.

Illustration 11: The Hire purchaser defaulted in the payment when the amount outstanding against the machine purchase was Rs.27,000 including interest accrued till that date and the balance in Machine a/c after depreciation till that date was Rs.51,000. The Vendor repossessed the whole of machinery. Pass journal entry.
Solution:
Journal Entry for Full Repossession:

Date	Particulars		Dr. Rs.	Cr. Rs.
	Vendor a/c Loss on Repossession a/c	Dr. Dr.	27,000 24,000	
	To Machine a/c			51,000

Illustration 12: The Hire purchaser defaulted in the payment when the amount outstanding in Vendor account was Rs.30,000 and the balance in Machine a/c after depreciation till that date was Rs.51,000. Interest suspense account has balance Rs.3,000 after adjusting accrued interest. The Vendor repossessed the whole of machinery. Pass journal entry.
Solution:
Journal Entry for Full Repossession: Interest Suspense A/c method:

Date	Particulars		Dr. Rs.	Cr. Rs.
	Vendor a/c Loss on Repossession a/c	Dr. Dr.	30,000 24,000	
	To Machine a/c To Interest Suspense A/c			51,000 3,000

(2) When part of the goods are reposed at agreed value:

Vendors A/c To Asset A/c	Dr.	With agreed amount
P & L A/c. To Asset A/c	Dr.	Difference between the w.d.v. of goods reposed and the agreed amount being loss on repossession.

Note: Agreed amount may be specified in the question or a rate of depreciation (usually higher rate) will be specified on the basis of which WDV will be calculated and that will be the agreed value.

Illustration 13: The Hire purchaser defaulted in the payment when the amount outstanding against the three similar machine purchased was Rs.27,000 including interest accrued till that date and the balance in Machine a/c after depreciation till that date was Rs.51,000. The Vendor repossessed one of the machinery adjusting Rs.12,000 for this and balance is paid by Purchaser forthwith. Pass journal entry.
Solution:
Journal Entry for Partial Repossession:

Date	Particulars		Dr. Rs.	Cr. Rs.
	Vendor a/c Loss on Repossession a/c	Dr. Dr.	12,000 5,000	
	To Machine a/c (51,000/3 X 1)			17,000
	Vendor a/c Dr. To Cash/Bank a/c (27,000 – 12,000)		15,000	15,000

Illustration 14: The Hire purchaser who purchased the three similar machine, defaulted in the payment when the amount outstanding in Vendor account was Rs.30,000 and the balance in Machine a/c after depreciation till that date was Rs.51,000. Interest suspense account has balance Rs.3,000 after adjusting accrued interest. The Vendor repossessed one of the machinery adjusting Rs.12,000 for this and balance is paid by Purchaser forthwith. Pass journal entry.

Solution:

Journal Entry for Partial Repossession: Interest Suspense A/c method:

Date	Particulars			Dr. Rs.	Cr. Rs.
	Vendor a/c Loss on Repossession a/c	Dr. Dr.		12,000 5,000	
	To Machine a/c (51,000/3 X 1)				17,000
	Vendor a/c Dr. To Cash/Bank a/c (30,000 – 3,000 – 12,000) To Interest Suspense A/c (Vendor's balance Rs.30,000 includes future interest of Rs.3,000 which will get cancelled because account is being settled now.)			18,000	 15,000 3,000

ACCOUNTING IN THE BOOKS OF HIRE VENDOR (SELLER) (LESSOR)

8.17. Explain the features of accounting in the books of Vendor (Lessor)

- As per AS-19 the Vendor (Seller/ Lessor) will account as follows :
  - (a) The sale & receivable will be recognized at cash price (Fair Value)
  - (b) Interest will be recognized as income in the period on accrual basis.
  - (c) Installment received will be including interest & balance towards reduction of receivable.
  - (d) Profit on sale will get recognized in the year of sale it self.
  - (e) Initial direct expense of Hire purchase/ lease shall be recognized in the year of sale in case of manufacture or dealer. In case of others it can be recognized in the year of sale or deferred over lease/Hire purchase period.

8.18. What are the methods of Accounting in the books of Vendor/ Seller/ Lessor.

- *Accounting in the books of Hire vendor can be done by any of the following methods.*

(A) Sale Method (B) Interest suspense Method.
(C) Hire purchase Trading Account Method. (D) Stock/Debtor Method.

The A & B methods are followed in case of large value items where number of items sold will be less and in each transactions individual calculation can be made. C & D methods are followed in case of low value items where number of items sold are very large and combined details are given.

Now C & D methods are excluded from IPCC syllabus hence the same are not included in this book.

(A) Sale Method

8.19. Give entries for sale method (Cash price method)

Entries will be as follows:

(1) When the articles are sold (on the date of sale)
Purchaser's a/cDr. with cash price
To Hire purchase Sale a/c

(2) Purchaser's A/c Dr. Interest due for the period
To Interest a/c

(3) Receipt of Installment : (every year)/down payment received.
Cash/ Bank A/c Dr.
To Purchaser's a/c

Note: At year end hire-purchase sale a/c will be transferred to trading a/c and interest to P & L a/c.

(4) When goods are repossessed:

Good repossessed A/c (Repossessed Goods A/c.)	Dr.	Cash installment not yet due
Bad Debts A/c.	Dr.	Installment due but not received
To Purchaser's A/c		Total amount outstanding.

Illustration 15: On 1st April, 2009 a ABC car company sold to Arya Bros., a motor car on hire-purchase basis. The total hire-purchase price was Rs. 4,60,000 with down payment of Rs. 1,60,000. Balance amount was to be paid in three annual installments of Rs. 1,00,000 each. The first installment payable on 31st March, 2010. The cash price of the car was Rs. 4,00,000.
Account for the hire purchase transaction in the books of ABC car company, for all the years, assuming books of accounts are closed on 31st March every year.

Solution:

Interest = Rs. 4,60,000 – Rs. 4,00,000 = Rs. 60,000/- to be apportioned as follows :

Year	Outstanding at the beginning	Installment	Closing O/S	Interest apportioned by sum of digits method.
At 0 year	4,60,000	1,60,000	3,00,000	
1st year	3,00,000	1,00,000	2,00,000	60,000 ÷ 600000 x 300000 =Rs.30,000
2nd year	2,00,000	1,00,000	1,00,000	60,000 ÷ 600000 x 200000 =Rs.20,000
3rd year	1,00,000	1,00,000	Nil	60,000 ÷ 600000 x 100000 =Rs.10,000
	6,00,000			60,000

Hire Purchase Sale Method

Journal Entry in the books of Vendor M/s ABC car company: Year 2009-10

Date	Particulars		Dr. Rs.	Cr. Rs.
01.04.2009	Arya Bros a/c To Hire Purchase Sale a/c (Goods sold on hire purchase basis)	Dr.	4,00,000	 4,00,000
01.04.2009	Bank a/c To Arya Bros a/c (Down payment received)	Dr.	1,60,000	 1,60,000
31.03.2010	Arya Bros a/c To Interest a/c (Interest due)	Dr.	30,000	 30,000
31.03.2010	Bank a/c To Arya Bros a/c (Installment received)	Dr.	1,00,000	 1,00,000
31.03.2010	Hire Purchase Sale a/c To Trading a/c (Hire purchase sale income transferred to trading a/c)	Dr.	4,00,000	 4,00,000
31.03.2010	Interest a/c To Profit & loss a/c (Interest income transferred to Profit & loss a/c)	Dr.	30,000	 30,000

Journal Entry in the books of Vendor M/s ABC car company: Year 2010-11

Date	Particulars		Dr. Rs.	Cr. Rs.
31.03.2011	Arya Bros a/c To Interest a/c	Dr.	20,000	 20,000
31.03.2011	Bank a/c	Dr.	1,00,000	

	To Arya Bros a/c (Installment received)			1,00,000
31.03.2011	Interest a/c To Profit & loss a/c (Interest income transferred to Profit & loss a/c)	Dr.	20,000	20,000

Journal Entry in the books of Vendor M/s ABC car company: Year 2011-12

Date	Particulars		Dr. Rs.	Cr. Rs.
31.03.2012	Arya Bros a/c To Interest a/c	Dr.	10,000	10,000
31.03.2012	Bank a/c To Arya Bros a/c (Installment received)	Dr.	1,00,000	1,00,000
31.03.2012	Interest a/c To Profit & loss a/c (Interest income transferred to Profit & loss a/c)	Dr.	10,000	10,000

In the Books of ABC Car Company (Vendor)

Hire Purchase Sale A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
31.03.2010	To Trading A/c	4,00,000	01.04.2009	By Arya Bros A/c	4,00,000
		4,00,000			4,00,000

Arya Bros A/c

01.04.2009	To Hire Purchase Sale A/c	4,00,000	01.04.2009	By Bank A/c	1,60,000
31.03.2010	To Interest A/c	30,000	31.03.2010	By Bank	1,00,000
				By Balance c/f	1,70,000
		4,30,000			4,30,000
01.04.2010	To Balance b/f	1,70,000	31.03.2011	By Bank	1,00,000
31.03.2011	To Interest A/c	20,000		By Balance c/f	90,000
		1,90,000			1,90,000
01.04.2011	To Balance b/f	90,000			
31.03.2012	To Interest A/c	10,000	31.03.2012	By Bank	1,00,000
		1,00,000			1,00,000

Interest A/c

31.03.2010	To Profit & Loss A/c	30,000	31.03.2010	By Arya Bros A/c	30,000
		30,000			30,000
31.03.2011	To Profit & Loss A/c	20,000	31.03.2011	By Arya Bros A/c	20,000
		20,000			20,000
31.03.2012	To Profit & Loss A/c	10,000	31.03.2012	By Arya Bros A/c	10,000
		10,000			10,000

8.20. Explain accounting of Goods Repossessed Account

- On repossession the goods repossessed a/c will be debited by the amount of installments (cash price portion) not yet due & hence cancelled.
- Any expenses incurred on repairs etc. of this repossessed goods will be debited to goods repossessed A/c.
- If the agreed value of reposed goods is given then the difference between this value and the balance as per repossessed goods a/c. is the profit or loss on repossession and it will be transferred to P & L a/c.

- The effect of this entry will be that the goods repossessed a/c will be shown at agreed value or revalued price.
- On the sale of such repossessed goods this account will be credited with the sale proceeds then the balance will be profit/loss on sale of repossessed goods and it will be transferred to P & L a/c.

Illustration 16: The Hire purchaser defaulted in the payment when the amount outstanding against the machine purchase was Rs.27,000 including interest accrued till that date. The outstanding includes due but not collected Rs.4,000 and balance not yet due. The Vendor repossessed the whole of machinery and valued it at Rs.20,000. After repairing it at a cost of Rs.2,000 the same was sold for Rs.26,000. Pass journal entry.

Solution:

Journal Entry for Full Repossession: In the Books of Vendor

Date	Particulars		Dr. Rs.	Cr. Rs.
	Goods Repossessed a/c (amount not yet due) Bad Debt a/c (amount due but not collected) To Hire Purchaser a/c (Goods repossessed on default by the buyer)	Dr. Dr.	23,000 4,000	 27,000
	Loss on repossession a/c To Goods repossessed a/c (Repossessed goods revalued at Rs.20,000 and loss recognized)	Dr.	3,000	 3,000
	Goods Repossessed a/c To Cash / Bank a/c (Repossessed goods repaired)	Dr.	2,000	 2,000
	Cash / Bank a/c To Goods Repossessed a/c To Profit on sale of repossessed goods a/c (Repossessed goods sold)	Dr.	26,000	 22,000 4,000

Goods Repossessed A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Hire Purchaser A/c	23,000		By Loss on Repossession A/c (Valued at 20,000 hence loss)	3,000
	To Cash (Repairs)	2,000		By Bank A/c (sold)	26,000
	To Profit on Sale	4,000			
		29,000			29,000

Hire Purchaser A/c

	To Balance b/f	27,000		By Goods Repossessed a/c	23,000
				By Bad debt a/c	4,000
		27,000			27,000

Illustration 17: (Adopted May 1990) Delhi Motors sold to X Transport Ltd. three tempos costing Rs. 50,000 each on the hire-purchase system on 1-1-2008. Payment was to be made Rs. 20,000 down and the remainder in three equal annual installments payable on 31-12-2008, 31-12-2009 and 31-12-2010 together with interest @ 9%. X Transport Ltd. paid the installment due at the end of the first year i.e. 31-12-2008 but could not pay the next on 31-12-2009. Delhi Motors repossessed all the tempos and valued them at Rs.20,000. After repairing them at a cost of Rs.5,000. The same were sold for Rs.28,000. Show the necessary accounts in the books of Delhi Motors for the years 2009.

Solution:

Accounting of full repossession by the Vendor M/s Delhi Motors

Calculation of Interest of total Hire Purchase

Year	Opening Balance	Interest @ 9%	Total	Repayment Principle + Interest	Closing Balance
At zero point	1,50,000	--	1,50,000	60,000 + Nil = 60,000	90,000
Year 1 31.12.08	90,000	8,100	98,100	30,000 + 8,100 = 38,100	60,000
Year 2 31.12.09	60,000	5,400	65,400	30,000 + 5,400 = 35,400	30,000
Year 3 31.12.10	30,000	2,700	32,700	30,000 + 2,700 = 32,700	Nil
		16,200		Hire Purchase Price 1,66,200	

Date of default 31.12.09 the following balances were outstanding in Vendors Books
Hire Purchasers A/c Dr. Rs.65,400 (Due 35,400 and not due 30,000)

Goods Repossessed A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.2009	To X Transport Ltd A/c	30,000	31.12.2009	By Loss on Repossession A/c (Valued at 20,000 hence loss)	10,000
31.12.2009	To Cash (Repairs)	5,000	31.12.2009	By Bank A/c (sold)	28,000
31.12.2009	To Profit on Sale	3,000			
		38,000			38,000

X Transport Ltd. A/c

01.01.2009	To Balance b/f	60,000	31.12.2009	By Goods Repossessed a/c	30,000
31.12.2009	To Interest a/c	5,400		By Bad debt a/c	35,400
		65,400			65,400

Illustration 18: Hindusthan Auto Ltd. sold to Bombay Roadways Ltd. three trucks costing Rs. 1,00,000 each on 1st January, 2008 on the hire purchase system.
<u>The terms were:</u>
Payment on delivery Rs. 25,000 for each truck and balance of the principal amount by 3 equal installments plus interest at 15% per annum to be paid at the end of each year.
Bombay Roadways Ltd. paid the installments due on 31st December, 2008 and 31st December, 2009 but could not pay the final installment.
Hindusthan Auto Ltd. re-possessed two trucks adjusting values of Rs.50,000 against the amount due. After repairing them at a cost of Rs.5,000. The same were sold for Rs.70,000.
<u>You are required to:</u>
Write up the ledger accounts in the books of Hindustan Auto Ltd. showing the repossession.
Solution:

Accounting of Partial repossession by the Vendor M/s Hinduthan Auto Ltd.

Calculation of Interest of total Hire Purchase

Year	Opening Balance	Interest @ 15%	Total	Repayment Principle + Interest	Closing Balance
At zero point	3,00,000	--	3,00,000	75,000 + Nil = 75,000	2,25,000
Year 1 31.12.2008	2,25,000	33,750	2,58,750	75,000 + 33,750 = 1,08,750	1,50,000
Year 2 31.12.2009	1,50,000	22,500	1,72,500	75,000 + 22,500 = 97,500	75,000
Year 3 31.12.2010	75,000	11,250	86,250	75,000 + 11,250 = 86,250	Nil
		67,500		Hire Purchase Price 3,67,500	

Date of default 31.12.10 the following balances were outstanding in Vendors Books
Hire Purchasers A/c Dr. Rs.86,250 (Due 86,250)

Goods Repossessed A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.2010	To Bombay Roadways Ltd A/c	50,000			
31.12.2010	To Cash (Repairs)	5,000	31.12.2010	By Bank A/c (sold)	70,000
31.12.2010	To Profit on Sale	15,000			
		70,000			70,000

Bombay Roadways Ltd. A/c

01.01.2010	To Balance b/f	75,000	31.12.2010	By Goods Repossessed a/c	50,000
31.12.2010	To Interest a/c	11,250		By Bank a/c or Balance c/f	36,250
		86,250			86,250

(B) Interest Suspense A/c. Method

8.21. Give entries for Interest Suspense method in the books of Vendor.

Entries for Interest Suspense a/c method:

(1) When goods are sold
Purchaser's A/c Dr. — Hire purchase price
To Hire purchase sale A/c. — Cash price
To Interest suspense A/c. — Total interest included in H.P. price

(2) Interest for the year is recognized
Interest suspense A/c Dr. — (Interest for the year transferred to interest / P & L A/c.)
To Interest A/c

(3) When Installment / Down payment is received.
Cash/Bank A/c Dr.
To Purchaser's A/c

Note: The purchasers account balance less interest suspense account balance will be shown as receivable in balance sheet. At the year end Hire Purchase Sale A/c. will be transferred to Trading A/c. and interest to P & L A/c.

(4) When goods are repossessed

Goods Repossessed A/c	Dr.	(with installment of cash price)not yet due
Bad Debts A/c	Dr.	(installment of cash price +int. due but not received)
Interest suspense A/c	Dr.	(Balance amount in the A/c)
To Purchaser's A/c		(Total amount balance in purchasers account)

Note: Rest of the treatment for repossessed goods is same as given in the sale method.

Illustration 19: Solve above **illustration 15** in the books of ABC Car Company by Interest Suspense Method.

Solution:

Interest Suspense Method :

Journal Entry in the books of Vendor M/s ABC car company: Year 2009-10

Date	Particulars		Dr. Rs.	Cr. Rs.
01.04.2009	Arya Bros a/c To Hire Purchase Sale a/c To Interest Suspense a/c (Goods sold on hire purchase basis)	Dr.	4,60,000	 4,00,000 60,000

01.04.2009	Bank a/c To Arya Bros a/c (Down payment received)	Dr.	1,60,000	1,60,000
31.03.2010	Interest Suspense a/c To Interest a/c (Interest due transferred)	Dr.	30,000	30,000
31.03.2010	Bank a/c To Arya Bros a/c (Installment received)	Dr.	1,00,000	1,00,000
31.03.2010	Hire Purchase Sale a/c To Trading a/c (Hire purchase sale income transferred to trading a/c)	Dr.	4,00,000	4,00,000
31.03.2010	Interest a/c To Profit & loss a/c (Interest income transferred to Profit & loss a/c)	Dr.	30,000	30,000

Journal Entry in the books of Vendor M/s ABC car company: Year 2010-11

Date	Particulars		Dr. Rs.	Cr. Rs.
31.03.2011	Interest Suspense a/c To Interest a/c (Interest due transferred)	Dr.	20,000	20,000
31.03.2011	Bank a/c To Arya Bros a/c (Installment received)	Dr.	1,00,000	1,00,000
31.03.2011	Interest a/c To Profit & loss a/c (Interest income transferred to Profit & loss a/c)	Dr.	20,000	20,000

Journal Entry in the books of Vendor M/s ABC car company: Year 2011-12

Date	Particulars		Dr. Rs.	Cr. Rs.
31.03.2012	Interest Suspense a/c To Interest a/c (Interest due transferred)	Dr.	10,000	10,000
31.03.2012	Bank a/c To Arya Bros a/c (Installment received)	Dr.	1,00,000	1,00,000
31.03.2012	Interest a/c To Profit & loss a/c (Interest income transferred to Profit & loss a/c)	Dr.	10,000	10,000

In the Books of ABC Car Company (Vendor)
Hire Purchase Sale A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
31.03.2010	To Trading A/c	4,00,000	01.04.2009	By Arya Bros A/c	4,00,000
		4,00,000			4,00,000

Arya Bros A/c

01.04.2009	To Hire Purchase Sale A/c	4,00,000	01.04.2009	By Bank A/c	1,60,000
	To Interest Suspense A/c	60,000	31.03.2010	By Bank	1,00,000
				By Balance c/f	2,00,000
		4,60,000			4,60,000
01.04.2010	To Balance b/f	2,00,000	31.03.2011	By Bank	1,00,000
				By Balance c/f	1,00,000
		2,00,000			2,00,000
01.04.2011	To Balance b/f	1,00,000			

			31.03.2012	By Bank	1,00,000
		1,00,000			1,00,000

Interest Suspense A/c

31.03.2010	To Interest A/c To Balance c/f	30,000 30,000	01.04.2009	By Arya Bros A/c	60,000
		60,000			60,000
31.03.2011	To Interest A/c To Balance c/f	20,000 10,000	01.04.2010	By Balance b/f	30,000
		30,000			30,000
31.03.2012	To Interest A/c	10,000	01.04.2011	By Balance b/f	10,000
		10,000			10,000

Interest A/c

31.03.2010	To Profit & Loss A/c	30,000	31.03.2010	By Interest Suspense A/c	30,000
		30,000			30,000
31.03.2011	To Profit & Loss A/c	20,000	31.03.2011	By Interest Suspense A/c	20,000
		20,000			20,000
31.03.2012	To Profit & Loss A/c	10,000	31.03.2012	By Interest Suspense A/c	10,000
		10,000			10,000

Illustration 20: The Hire purchaser defaulted in the payment when the amount outstanding against the machine purchase was Rs.30,000 including interest accrued till that date. The outstanding includes due but not collected Rs.4,000 and balance not yet due. Interest suspense account has balance Rs.3,000 after adjusting accrued interest. The Vendor repossessed the whole of machinery and valued it at Rs.20,000. After repairing it at a cost of Rs.2,000 the same was sold for Rs.26,000. Pass journal entry.

Solution:

Journal Entry for Full Repossession: Interest Suspense A/c method:

Date	Particulars		Dr. Rs.	Cr. Rs.
	Goods Repossessed a/c (amount not yet due less interest suspense) Bad Debt a/c (amount due but not collected) Interest Suspense A/c To Hire Purchaser a/c (Goods repossessed on default by the buyer)	Dr. Dr. Dr.	23,000 4,000 3,000	30,000
	Loss on repossession a/c To Goods repossessed a/c (Repossessed goods revalued at Rs.20,000 and loss recognized)	Dr.	3,000	3,000
	Goods Repossessed a/c To Cash / Bank a/c (Repossessed goods repaired)	Dr.	2,000	2,000
	Cash / Bank a/c To Goods Repossessed a/c To Profit on sale of repossessed goods a/c (Repossessed goods sold)	Dr.	26,000	22,000 4,000

Goods Repossessed A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
	To Hire Purchaser A/c	23,000		By Loss on Repossession A/c	

				(Valued at 20,000 hence loss)	3,000
	To Cash (Repairs)	2,000		By Bank A/c (sold)	26,000
	To Profit on Sale	4,000			
		29,000			29,000

Hire Purchaser A/c

	To Balance b/f	30,000		By Goods Repossessed a/c	23,000
				By Interest Suspense a/c	3,000
				By Bad debt a/c	4,000
		30,000			30,000

8.22. Explain the accounting of <u>Provision against free maintenance</u>

- Some times the supplier gives guarantee of free maintenance for a certain period. The sale price will be higher so as to include some amount for such free maintenance.
- Therefore based on estimated maintenance expenses to be incurred during such period a provision is created by following entry.

Sales/ H.P. sales A/c Dr.
To Maintenance Suspense A/c

- Because sales are made through out the year we can take middle of the year as point of sale. Therefore if guarantee is for one year it will mean half period in the first accounting year and balance half in the next years.
- Similarly if it is two years guarantee then half of the first years guarantee will be in first accounting year balance half be in the second accounting year and of the second years guarantee half will be in the second accounting year and balance half in the third accounting year.
- Actual maintenance expenses when incurred will be debited to maintenance suspense A/c. Suppose if actual expenses are more than the provision for that year, then balance (excess) should be provided from P & L A/c., so that provision to be carried forward will not get reduced. But if actual expenses are less then the surplus should be C/f as provision and not to be transferred to P & L A/c. But at the end of guarantee period such surplus will be transferred to P & L A/c.

Illustration 21: Fine Radios Ltd., sell radio sets for cash as well as on hire purchase basis. Cash price is Rs.400 and hire purchase price Rs.500, payable in 20 installments of Rs.25 each. The price includes free maintenance for 2 years; experience indicates that Rs.20 is the cost of maintenance in the first year andRs.40 in the second year. During 1993, 200 sets were sold for cash and 300 on hire purchase basis. Actual maintenance cost were:- Rs.3,500 in 1993, Rs.16800, in 1994 Rs.8000 in 1995.

Solution:

Provision For Maintenance A/c

Dr. **Cr.**

	Particulars	Rs.		Particulars	Rs.
1993	To Cash A/c	3,500	1993	By Sales / HP Sales A/c	30,000
	To Balance c/f	26,500			
		30,000			30,000
1994	To Cash A/c	16,800	1994	By Balance b/d	26,500
	To Balance c/f	10,000		By Profit & Loss A/c (Excess of expense over prov. transferred)	300
		26,800			26,800
1995	To Cash A/c	8,000	1995	By Balance b/d	10,000
	To Profit & Loss (Surplus provision)	2,000			
		10,000			10,000

Accounting for Lease: For meaning, calculations and accounting refer notes on Accounting Standard AS-19 and illustrations given therein. As per AS-19, accounting of lease, hire purchase transactions are in the nature of finance lease and be accounted accordingly.

Some Advanced Illustrations

Illustration 22: Bombay Roadways Ltd. purchased three trucks costing Rs. 1,00,000 each from Hindusthan Auto Ltd. on 1st January, 1989 on the hire purchase system.

The terms were:

Payment on delivery Rs. 25,000 for each truck and balance of the principal amount by 3 equal installments plus interest at 15% per annum to be paid at the end of each year.

Bombay Roadways Ltd. writes off 25% depreciation each year on the diminishing balance method.

Bombay Roadways Ltd. paid the installments due on 31st December, 1989 and 31st December, 1990 but could not pay the final installment.

Hindusthan Auto Ltd. re-possessed two trucks adjusting values against the amount due. The re-possession was done on 1st January, 1992 on the basis of 40% depreciation on the diminishing balance method.

You are required to:

a) Write up the ledger accounts in the books of Bombay Roadways Ltd. showing the above transactions upto 1.1.1992, and
b) Show the disclosure of the balances arising from the above in the Balance Sheet of Bombay Roadways Ltd. as on 31st December, 1991.

Solution:

In the books of Bombay Roadways Ltd. (Purchaser)
Trucks A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.89	To Hindustan Auto's A/c	3,00,000	31.12.89 31.12.89	By Depreciation A/c By Balance C/f	75,000 2,25,000
		3,00,000			3,00,000
1.1.90	To Balance B/f	2,25,000	31.12.90 31.12.90	By Depreciation A/c By Balance C/f	56,250 1,68,750
		2,25,000			2,25,000
1.1.91	To Balance B/f	1,68,750	31.12.91	By Depreciation A/c	42,188
			31.12.91	By Hindustan Auto's A/c (value of repossessed truck) By Profit & Loss A/c (Loss) By Balance C/f	43,200 41,175 42,187
		1,68,750			1,68,750

Hindustan Auto's (Vendor) A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.89 31.12.89	To Bank A/c (Down Payment) To Bank A/c (75,000+33,750) To Balance c/f	75,000 1,08,750 1,50,000	1.1.89 31.12.89	By Trucks A/c By Interest A/c	3,00,000 33,750
		3,33,750			3,33,750
31.12.90	To Bank A/c (75,000+22,500) To Balance c/f	97,500 75,000	1.1.90 31.12.90	By Balance b/f By Interest A/c	1,50,000 22,500

		1,72,500			1,72,500
31.12.91	To Trucks A/c Balance c/f	43,200 43,050	1.1.91 31.12.91	By Balance b/f By Interest A/c	75,000 11,250
		86,250			86,250
1.1.92	To Bank A/c	43,050	1.1.92	By Balance b/f	43,050
		43,050			43,050

Partial Repossession :-

		Depreciation – 40%	Depreciation –25%
1.1.89	Cost – 2 trucks	2,00,000	2,00,000
31.12.89	Depreciation	80,000	50,000
1.1.90	Balance	1,20,000	1,50,000
31.12.90	Depreciation	48,000	37,500
1.1.91	Balance	72,000	1,12,500
31.12.91	Depreciation	28,800	28,125
1.1.92	Balance	43,200	84,375

Loss on Repossession = (Book value 84,375 – Agreed value 43,200) = 41,175

As per AS – 4 "Contingencies and events occurring after the Balancesheet date" the condition of repossession i.e. default on payment has occurred on 31.12.91 itself and the later event has confirmed the repossession, hence repossession of trucks should be accounted for in the books of Bombay Roadways Ltd on 31.12.1991 itself.

Illustration 23: On 1st January 1992, A sells a truck to B, on the installment payment system on the following condition:

1) The purchase price of the truck is Rs. 1,00,000
2) This amount is payable to A in four equal installments along with 12% interest per annum on the outstanding balance. The first installment being payable on the date of sale.

B, in turn, hires out the truck to A for a monthly hire of Rs. 3,000 per month from1st January 1992. the hire charges are to be adjusted at the end of each year against the amount due to A on account of principal and interest, any difference being settled in cash.

B charges 20% depreciation (on the written down value method) on the truck.

All payments are made as per the agreement. On 1-1-1995, the truck is sold by B to A for Rs. 15,000 in cash.

Show in B's books, the Truck Account, the Interest suspense Account, the Hire Charges Account, the Interest Account and A's Account.

Solution:

In the Books of 'B' (Purchaser)
Trucks A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.92	To A's a/c	1,00,000	31.12.92	By Depreciation A/c By Balance C/f	20,000 80,000
		1,00,000			1,00,000
1.1.93	To Balance B/f	80,000	31.12.93	By Depreciation A/c By Balance C/f	16,000 64,000
		80,000			80,000
1.1.94	To Balance B/f	64,000	31.12.94	By Depreciation A/c By Balance c/f	12,800 51,200
		64,000			64,000
1.1.95	To Balance B/f	51,200	1.1.95	By Bank a/c By loss on sale	15,000 36,200
		51,200			51,200

Interest Suspense A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.92	To A A/c	18,000	31.12.92	By Interest A/c By Balance C/f	9,000 9,000
		18,000			18,000
1.1.93	To Balance B/f	9,000	31.12.93	By Interest A/c By Balance C/f	6,000 3,000
		9,000			9,000
1.1.94	To Balance B/f	3,000	31.12.94	By Interest A/c	3,000
		3,000			3,000

Interest A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.92	To Interest Suspense A/c	9,000	31.12.92	By Profit & Loss A/c	9,000
		9,000			9,000
31.12.93	To Interest Suspense A/c	6,000	31.12.93	By Profit & Loss A/c	6,000
		6,000			6,000
31.12.94	To Interest Suspense A/c	3,000	31.12.94	By Profit & Loss A/c	3,000
		3,000			3,000

Hire Charges A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.92	To Profit & Loss A/c	36,000	31.12.92	By A's A/c	36,000
		36,000			36,000
31.12.93	To Profit & Loss A/c	36,000	31.12.93	By A's A/c	36,000
		36,000			36,000
31.12.94	To Profit & Loss A/c	36,000	31.12.94	By A's A/c	36,000
		36,000			36,000

A's A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.92 31.12.92	To Bank A/c To Hire charges A/c To Balance C/f	25,000 36,000 59,000	1.1.92 1.1.92 31.12.92	By Truck A/c By Interest Suspense A/c By Bank a/c (Net Received)	1,00,000 18,000 2,000
		1,20,000			1,20,000
31.12.93	To Hire charges A/c To Balance C/f	36,000 28,000	1.1.93 31.12.93	By Balance B/f By Bank A/c	59,000 5,000
		64,000			64,000
31.12.94	To Hire charges A/c	36,000	1.1.94 31.12.94	By Balance B/f By Bank A/c	28,000 8,000
		36,000			36,000

Working of Net Payable/Receivable:

Date	Principle Opening	Amount Paid	Amount Closing	Interest @12%	Total Due	Hire Charges	Net Due
1.1.92	1,00,000	25,000	75,000	–	25,000	–	25,000 Payable
31.12.92	75,000	25,000	50,000	9,000	34,000	36,000	2,000 Recoverable
31.12.93	50,000	25,000	25,000	6,000	31,000	36,000	5,000 Recoverable
31.12.94	25,000	25,000	25,000	3,000	28,000	36,000	8,000 Recoverable

		1,00,000		18,000			

ACCOUNTING IN THE BOOKS OF HIRE VENDOR

Illustration 24: On 1st January 1993, Ashok acquired furniture on the hire-purchase system from Real Aids Ltd., agreeing to pay four semi-annual installment of Rs. 800 each, commencing on 30th June 1993. The cash price of the items was Rs. 3,010 and an interest of 5% per annum was chargeable.

On 30th September 1993, Ashok expresses his inability to continue and Real Aids seized the property. It was agreed that Ashok would pay the due proportion of the installment upto the date of seizure and also a further sum of Rs. 200 towards depreciation. At the time of repossession, Real Aids valued the furniture at Rs. 1,500. The company after incurring Rs. 200 towards repairs of the furniture sold the items for Rs. 1,800 on 15th October 1993.

Show the ledger accounts as they would appear in the books of Real Aids Ltd. working out the profit or loss on the transaction, assuming that the Company passes hire-purchase transactions through its books as sales.

Solution:

In the Books of Real-Aids Ltd. (Vendor)

Hire Purchase Sale Method

Hire Purchase Sale A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.93	To Trading A/c	3,010	1.1.93	By Ashok A/c	3,010
		3,010			3,010

Ashok A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.93	To Hire Purchase Sale A/c	3,010	30.6.93	By Bank A/c	800
30.6.93	To Interest A/c	75	30.9.93	By Bank (400+200) A/c	600
30.9.93	To Interest A/c	29		By Goods repossessed A/c (Balance transfer)	1,714
		3,114			3,114

Interest A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.93	To Profit & Loss A/c	104	30.6.93	By Ashok A/c	75
			30.9.93	By Ashok A/c	29
		104			104

Goods Repossessed A/c

Dr. **Cr.**

Date	Particulars	Rs.	Date	Particulars	Rs.
30.9.93	To Ashok A/c	1,714	30.9.93	By Loss on Repossession A/c	214
30.9.93	To Cash (Repairs) a/c	200	15.10.93	By Bank A/c	1,800
15.10.93	To Profit on Sale a/c	100			
		2,014			2,014

Interest Suspense Method :

Ashok A/c

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.93	To Hire Purchase Sale A/c	3,010	30.6.93	By Bank A/c	800
1.1.93	To Interest Suspense A/c (3200-3010)	190	30.9.93	By Bank A/c	600
			30.9.93	By Interest Suspense A/c	86
			30.9.93	By Goods Repossession A/c	1,714
		3,200			3,200

Dr. Cr.

Interest Suspense A/c

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
30.06.93	To Interest A/c	75	1.1.93	By Ashok A/c	190
30.09.93	To Interest A/c	29			
30.09.93	To Ashok A/c	86			
		190			190

Interest A/c

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
31.12.93	To Profit & Loss A/c	104	30.06.93	By Interest Suspense A/c	75
			30.09.93	By Interest Suspense A/c	29
		104			104

Note: Goods repossessed a/c will be same as in previous method.

Working of Interest:

1. Hire Purchase Price 800 X 4 = 3,200
Cash Price = 3,010
Total Interest 190

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2. Debit balance in Ashok a/c on 1.1.93 is 3,010.

Interest charged from 1.1.93 to 30.6.93 = 3,010 x $\frac{5}{100}$ x $\frac{6}{12}$ = 75

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3. Debit balance in Ashok a/c on 1.7.93 is 2,285 (i.e. 3010 + 75 – 800).

Interest charged from 1.7.93 to 30.9.93 = 2,285 x $\frac{5}{100}$ x $\frac{3}{12}$ = 29

Account Current

INTRODUCTION

Write short note on Account Current. **(Nov. 2005, May 2008)**

- Account Current is a statement rendered by one party to other giving details of transactions with that party together with the details of interest calculation. It is prepared just like an account by providing additional coloumns for interest calculation on both sides i.e., debit & credit sides.
- Account current serves the purpose that not only the other party can verify transaction but also the interest calculations. It is prepared for a particular period.

4.1. Is statement of account and account current the same thing

- No, Statement of account is simply the copy of ledger account of a person in our books sent to him for confirmations of correctness.
- Account current is a statement prepared in the pattern of ledger account containing details of all transactions with that party with additional columns to give details of interest calculation.

4.2. What are the alternatives for presenting account current

- It can be prepared in the following 3 ways.
  a) Account current by products of each transaction method (it is most common).
  b) Account current by product of balance method. (It is followed by Banks etc.)
  c) Account current prepared with the help of Interest tables.

4.3. EXPLAIN THE PREPARATION OF ACCOUNT CURRENT BY EACH OF THE THREE METHODS.

4.3.1 Explain the preparation of <u>Account current by product of transaction method.</u>

1. It is prepared in 'T' pattern that is with debit-credit as two sides and balanced at the end of that period.
2. It is simply the account of that person in our books.
3. Prepare account as usual by debiting the account whenever that person is receiver and crediting the account whenever that person is giver.
4. Mention due date of each of debit and credit items.
5. Days are calculated from the due date of each transaction (item) to the period end, in both debit and credit sides.
6. Day are multiplied with the respective amount to calculate products.

7. Interest is recoverable on total of product of debit side and is payable on total credit products for one day. Alternatively interest can be calculated for net products.

Account Current by Product of Transaction Method

Illustration 1: (June 1995) From the following information, prepare account current on 30th September, 2011 to be submitted by M to F.

2011		
July 1	Debit balance b/f	13,500
5	Sold goods to F	9,000
15	Received cash from F	13,500
August 4	Sold goods to F	19,200
16	Received cash from F	9,000
September 1	Bought goods from F	21,000
2	Paid cash to F	7,500
12	Sold goods to F	9,600
15	Paid cash to F	6,000

Interest is to be taken into account @ 10% per annum; it may be calculated to the nearest rupee.

Solution:

<u>Steps for preparation</u>

1. Prepare a/c. of 'F' in our (M's) books (i.e. entity is M) in usual way but keeping three extra columns on both debit and credit side.
2. Date of transaction itself will be taken as due date unless information about credit period etc. is given. Suppose in above case it is mentioned that on sales we allow one month credit to 'F' then sale of 5.7 will have due date as 5.8 and so on.
3. Days are from the due date to the end of account current period i.e. 30.9.2011 in this case. For 1.7.2011 opening balance → 31 days of July + 31 days of August and 30 days of September = 92 days are taken. Opening balance of 1.7 is in fact balance from 30.6.2011, hence even 1st July is included. But suppose there is sale on 1.7.2011 then days will be = 30+31+30=91 days that means 1st July transaction's 1 day will be completed on 2nd July and so on. Or in other words ignore the date of transaction/due date.
4. Product is multiplication of amount with respective days.

Account current rendered (sent/submitted) by 'M' to 'F' or
'F' in Account current with 'M'
For the period 1.7.2011 to 30.9.2011

Date	Particulars	Rs.	Due date	Days	Product	Date	Particulars	Rs.	Due date	Days	Product
1.7	To Balance b/f	13,500	1.7	92	12,42,000	15.7	By Cash a/c.	13,500	15.7	77	10,39,500
5.7	To Sales a/c.	9,000	5.7	87	7,83,000	16.8	By Cash a/c.	9,000	16.8	45	4,05,000
4.8	To Sales a/c.	19,200	4.8	57	10,94,400	1.9	By Purchase a/c.	21,000	1.9	29	6,09,000
2.9	To Cash a/c.	7,500	2.9	28	2,10,000						
12.9	To Sales a/c.	9,600	12.9	18	1,72,800						
15.9	To Cash a/c.	6,000	15.9	15	90,000						
30.9	To Interest a/c.	422			--	30.9	By Balance c/d.	21,722			
		65,222			35,92,200			65,222			20,53,500

Interest recoverable for 1 day on debit products	35,92,200
Interest payable for 1 day on credit products	<u>20,53,500</u>
Net interest recoverable for 1 day on net debit products	15,38,700

$$Interest = 15,38,700 \times \frac{10}{100} \times \frac{1}{365} = Rs. 422$$

Entry → F a/c. Dr. 422

To Interest a/c. 422

4.3.2 Explain the preparation of <u>Account current by product of balance method</u>

1. It is simply the account of that person in our books.
2. Prepare account as usual by debiting the account whenever that person is receiver and crediting the account whenever that person is giver.
3. It is prepared in debit, credit and balance pattern, (Bank Pass book type).
4. Wherein after every entry, new balance is calculated (transactions get merged and result into new balance each time).
5. Here due date of each transaction must be same as date of transaction otherwise this format will not work.
6. Days is calculated for each balance (debit or credit) from the date of previous balance to the date of this balance.
7. Day are multiplied with the respective amount of balance to calculate products.
8. Product will be debit product if balance is debit and it will be credit product if balance is credit.
9. Interest is recoverable on total of debit product and is payable on total of credit products for one day. Alternatively interest can be calculated for net products.

Account Current by Product of Balance Method (Pass book style)

Illustration 2: From the information given in **Illustration 1**, prepare account current on 30th September, 2011 to be submitted by M to F by Product of balance method.
Solution:

<u>Steps for preparation</u>

1. Prepare a/c. of 'F' in our (M's) books in passbook style or vertical pattern and with extra columns for days and products.
2. Days for a balance means for how many days that balance was in existence. For this the effect of a transaction on the balance is considered from the next day. (In previous method you have seen that for transaction of 5.7 one day will be completed on 6.7 and so on).
   For 1.7.2011 balance days are from 1.7.2011 (including it) to 5.7 = 5 days
   For 5.7.2011 balance days are from 6.7.2011 (including it) to 15.7 = 10 days
3. Debit balance multiplied by days will be debit product and credit balance multiplied by days will be credit product.

<u>Special note:</u> When the date of transaction and due dates are different then this method cannot be applied. Because on the date of transaction itself the balance will get changed, whereas it is not yet due, hence its effect for interest should come from due date and not from date of transaction.

Account current rendered (sent/submitted) by 'M' to 'F' or
'F' in Account current with 'M'
For the period 1.7.2011 to 30.9.2011

Date	Particulars	Debit	Credit	Balance		Days	Product	
				Dr/Cr.	Rs.		Debit	credit
1.7	To Balance b/f			Dr.	13,500	5	67,500	
5.7	To Sales a/c.	9,000		Dr.	22,500	10	2,25,000	
15.7	By Cash a/c.		13,500	Dr.	9,000	20	1,80,000	
4.8	To Sales a/c.	19,200		Dr.	28,200	12	3,38,400	
16.8	By Cash a/c.		9,000	Dr.	19,200	16	3,07,200	
1.9	By Purchase a/c.		21,000	Cr.	1,800	1	--	1,800
2.9	To Cash a/c.	7,500		Dr.	5,700	10	57,000	
12.9	To Sales a/c.	9,600		Dr.	15,300	3	45,900	
15.9	To Cash a/c.	6,000		Dr.	21,300	15	3,19,500	
30.9	To Interest a/c.	422		Dr.	21,722	92	15,40,500	1,800

Net product on which interest is recoverable = $15{,}40{,}500 - 1800 = 15{,}38{,}700$

$$Interest = 15,38,700 \times \frac{10}{100} \times \frac{1}{365} = Rs.422$$

Entry → F a/c. Dr. 422

To Interest a/c. 422

4.3.3. Explain the preparation of <u>Account current by interest table</u>

1. In either of the above case if instead of calculating product, the interest is calculated from interest table and written in the account current it will be known as Interest table method.
2. Viewing interest table for each item may be more time consuming and error prone for students.
3. Alternatively products are calculated and then interest from interest table is calculated instead of on calculator.

Special Note: This may not be asked in the exam, otherwise they will have to provide interest table. But even if it is asked a student can calculate interest with the help of calculator (on the corresponding amount for respective days at the specified rate) and write in place of products. Total it to get interest recoverable (debit side) and interest payable (credit side) and then net it.

4.4. Is there any specific period for account current.

- No. It is decided mutually by the parties concerned. *Interest* is calculated for a specified period say quarterly, 6 monthly or annually on all the transactions of that period.
- The interest so calculated either payable or recoverable is accounted in that a/c. at the end of that period.

4.5. How is the days counted for calculating products in account current

- Normally the days should be counted from the due date of transaction to the last date of that period. In case of bills of exchange the due date should be taken as starting point and not the date of accounting, similarly in case of sale-purchase the Invoice date should be considered.
- If credit period is given then due date should be calculated. Whenever due date is not given the date of transaction itself will be taken as due date for calculation of days.

Illustration 3: Due date is 10.1.04 and period ends on 31.3.04. Calculate days.

Solution: Then the days will be 21 days of January + 29 days of February + 31 days of March i.e. total 81 days.

Illustration 4: From the following particulars, calculate days for preparing an account current by product of transaction method as on 31st March, 2011

		Rs.
Jan 1	Opening Balance	2,000
10	2 months Bill drawn	5,000
16	Purchased goods supplier allows 1 month credit	3,000
29	Sold goods on 1 month credit	1,000
Feb 10	Paid cash	1,700
15	Received cheque dated 20.2.11	2,500
March 18	Sold goods payment due on 25.03.11	6,000

Solution:

Calculation of Days (from the due date to the end of the period i.e. 31.3.2011)

Date of Transaction	Transaction	Due date	Days for Account current			
			Jan	Feb	March	Total
Jan 1	Opening Balance	*1.1	31	28	31	90
10	2 months Bill drawn	**13.3	-	-	18	18
16	Purchased goods on 1 month credit	16.2	-	12	31	43

29	Sold goods on 1 month credit	***28.2	-	-	31	31
Feb 10	Paid cash	10.2	-	18	31	49
15	Received cheque dated 20.2.11	20.2	-	8	31	39
March 18	Sold goods due on 25.03.11	25.3	-	-	6	6

*For opening balance 1st Jan will also be counted because in effect it is brought from 31st December.

**It is bill of exchange hence 2 month + 3 days of grace are added.

***From 29th Jan 1 month will be completed on 29th Feb but because Feb 2011 do not have 29 days hence last date of the month that is 28th Feb is taken.

4.6. Why 1 (one) days interest is calculated on the products

- Interest is calculated on a certain amount for a certain period. The product is the multiplication of this two things, that means the relevant number of days has already been multiplied, hence now on product only 1 days interest is calculated.
- (Student will be knowing it that days say 30 x 1 = 30 but 30 x 0 = 0 that means by multiplying with one we are not changing any value) for e.g. 10 days interest on Rs. 5,000 will be same as calculating 1 day interest on Rs. 50,000 (i.e. 10 x 5,000) at a given rate of interest of say 3% per month, i.e. interest = Rs .50 as follows.

$$Rs.5{,}000 \times \frac{3}{100} \times \frac{10\,days}{30} = 50 \qquad or \qquad Rs.50{,}000 \times \frac{3}{100} \times \frac{1\,day}{30} = 50$$

Illustration 4: From the following particulars, of an account current to be rendered by A to B as on 31st March, 2011, calculate interest @18% p.a.

Particulars	Debit	Credit
Total of Product as per Account current	Rs. 4,88,900	Rs. 1,69,500

Solution:

Product is the multiplication of amount and days that means the corresponding days for which interest was applicable on the said amount has already been multiplied hence now interest for only one day is calculated on the aforesaid amount of product.

Calculation of Interest from Account Current

Interest recoverable for 1 day on Rs. 4,88,900
Interest Payable for 1 day on Rs. 1,69,500
Net Interest recoverable for 1 day on Rs. 3,19,400

Interest = 3,19,400 x $\frac{18}{100}$ x $\frac{1}{365}$ = 158

Entry: 31.03.2011 B's A/c Dr. 158
To Interest A/c 158

4.7. How, interest receivable or payable is decided

- Debit items or debit balance in a personal account means recoverable from him (i.e. our money is with him) and hence for any delay interest is recoverable from them. Thus, on debit product interest is recoverable.
- Likewise credit items or credit balance in a personal account means payable to him (i.e. his money is with us) and hence for any delay interest is payable to them. Thus on credit product interest is payable to them.

Interest is recoverable on debit products for One (1) day and payable on credit products for one (1) day.

4.8. What if different rates are applicable for interest recoverable and payable

- If the rate for interest recoverable and interest payable is different then net products are not to be calculated.
- Interest will be calculated on debit products at the interest recoverable rate, and on credit products interest will be calculated at payable rate. Although it is not common.
- If it is stated that rate on debit balance and on credit balance are different, then account current by product of balances method will have to be prepared and then apply respective rates to debit products and credit products. In this case account current by product of transaction method will not be correct.

4.9. What is red ink interest

In Account current Red ink interest is treated as negative interest. True or false **(May 2003)** [**Answer:** True]

The interest charged by Banker to customer on overdrawn Account is called Red ink interest. True or false **(Nov. 2005)** [**Answer:** False]

Write short note on Red ink interest. **(May 2004, Nov. 2007)**

- In account current interest is calculated on every transaction from its due date to the end of that period. When the due date is not given the date of transaction itself will be taken as due date.
- In case the due date falls beyond the end of that period, then no interest is to be given on it upto the period end.
- But the negative interest (opposite interest) from the end of period to the due date should be calculated, & written in red ink on the side of transaction so that this Red ink products will be deducted from the other products of that side, OR alternatively to give this effect this products can be written by the same ink but on the Opposite side of that transaction.
- **Ex.** Account current is for the period 1.1.04 to 31.3.04. Due date of a particular transaction is say 20th April, then the red ink days (opposite days/ negative days) will be 20 days.

Illustration 5: Following are the transaction between Sanjay and Ravi. Both allows one month credit to each other on sale/ purchases.

		Rs.
Jan 1	Balance due from Sanjay	2,000
Feb 16	Purchased goods from him	12,000
28	Sold goods to him	20,000
March 16	Received a cheque	6,000
April 20	Sold him goods (invoiced on May 3)	20,000
June 16	Purchased goods from him (invoiced on July 10)	30,000
Sept. 23	Paid him cash	6,000
Oct. 24	Accepted his bill for 3 months	10,000
Nov 26	Received his acceptance for 2 months	16,000

Prepare an account current of Sanjay with Ravi upto 31.12.03 reckoning interest @14% p.a. on the balance due.

Solution:

Account Current by Red Ink Interest method.

It is simply adjustment of interest effect on those items which fall due beyond the cut off date (last date) of the Account current. To adjust it opposite effect needs to be given now. Which can be indicated by minus sign or by writing on opposite side as contra product or by writing by red ink hence the name red ink interest method.

Special Note: For transactions of April 20 & June 16, Invoice date is also given. For calculating due date we have added 1 month credit period to the date of transaction, alternatively 1 month can be added to the date of invoice.

Product of Transaction Method (Red Ink Interest Method)

Sanjay in Account Current with Ravi for the period 1.1.03 to 31.12.03

Date	Particular	Amt	Due date	Days	Product	Date	Particular	Amt	Due Date	Days	Product
1.1	To opening balance a/c	2,000	1.1	365	7,30,000	16.2	By Purchase a/c	12,000	16.3	290	34,80,000
						16.3	By Bank a/c	6,000	16.3	290	17,40,000
28.2	To Sales a/c	20,000	28.3	278	55,60,000	16.6	By Purchase a/c	30,000	16.7	168	50,40,000
20.4	To Sales a/c	20,000	20.5	225	45,00,000	26.11	By B.R. a/c	16,000	29.10	–	
23.9	To Cash a/c	6,000	23.9	99	5,94,000		Contra product				
24.10	To B.P. a/c	10,000	27.1				B.P. a/c10,000		27.1	27	2,70,000
	Contra Product										
	B.R 16,000		29.1	29	4,64,000						
31.12	To Interest	506									
31.12	To Balance c/f	5,494									
		64,000			1,18,48,000			64,000			1,05,30,000

Working Notes:

Calculation of Interest

Interest recoverable on 1,18,48,000 – 1,05,30,000 = 13,18,000

Interest = 13,18,000 x $\frac{14}{100} \times \frac{1}{365}$ = Rs. 506

Entry for interest due: Sanjay a/c Dr. 506

To Interest a/c 506

Important points Regarding Due date -

1. When in case of sale, purchase, credit period is given the same will be added to date of transaction to get due date. Where invoice date is given (like in this question) the same will be taken as due date.
2. In case of bill of exchange/ promissory note due date will be calculated by adding the period + 3 days of grace.
3. In case of sales/ purchase return the due date of sale/ purchase should be taken for return also because it is only a cancellation entry, hence interest effect should also get cancelled.

Red Interest/ Contra Product: When due date of a transaction falls beyond the cut off date (i.e. 31.12.2003 in this case), there are no days from due date to cut off date rather there are reverse or opposite days from due date to cut off date. Such days are either written on same side by (-) sign or in red ink (followed by bank, hence the name red ink interest) or the same effect is created by writing the products on opposite side known as contra product.

4.10. Can any problem be tackled in any type of current account

- No. When due date and date of transaction of even one transaction is different, then account current will have to be prepared by product of transaction method.
- In product of balance method the transaction as soon as takes place losses its identity and gets merged with balance and hence if its due date is some other date, then that adjustment can not be made in this format.
- Thus product of balance method can be applied only if date of transaction and due date are same for each item. Product of transaction method can be used in any situation.

Illustration 6: From the following Prepare account current of A in the books of B as at 30.9.2011 Interest @12% p.a.

		Rs.

July 1	Balance due to B	3,000
1	A buys goods; payment due July 15	4,000
8	Return of goods bought on July 1	400
13	B/R from A, due August 31, discounted with banker @15% p.a. on 15th July	6,000
August 31	B/R returned dishonored, noting charged Rs. 20	20
Sept 1	Purchases by B, payment due 15th September	6,040
30	A remits cash	250

Solution:

Product of Balance Method not applicable in this question:
You can observe that there are transaction whose due date are different than the date of transaction, hence product of balance method can not be applied. Because effect of a transaction on the balance will come on the date of transaction itself when we record it, whereas for interest it should be considered from the due date only.

'A' in Account Current with 'B' (Product of Transaction Method)
for the period 1.7.03 to 30.9.03

Date	Particular	Amt	Due date	Days	Product	Date	Particular	Amt	Due Date	Days	Product
1.7	To Opening balance	3,000	1.7	92	2,76,000	1.7	By Sale return a/c	400	15.7	77	30,800
1.7	To Sales a/c	4,000	15.7	77	3,08,000	13.7	By B.R. a/c	6000	31.8	30	1,80,000
31.8	To Cash a/c	6,020	31.8	30	1,80,600	1.9	By Purchase a/c	6040	15.9	15	90,600
30.9	To Interest a/c	152				30.9	By Cash a/c	250	30.9	0	0
						30.9	By Balance c/f	482			
		13,172			7,64,600			13,172			3,01,400

Calculation of Interest

Net product on which interest is recoverable = 7,64,600 – 3,01,400 = 4,63,200

Interest = 4,63,200 x $\frac{12}{100} \text{x} \frac{1}{365} = 152$

Entry for interest due:- A's a/c Dr. 152
To Interest a/c 152

4.11 EPOQUE OR BACKWARD CALCULATION METHOD

1. In product of transaction method the days are calculated from due date to the end of period.
2. Hence when due date was beyond the end of period we have taken negative days (contra product).
3. In backward method the days are calculated from due date to the starting of period hence the name backward calculation.
4. Ascertain closing balance before interest because product for this balance from closing date to opening date are to be calculated.
5. Product on opening balance will be nil (zero) because product for this balance from opening date to opening date are to be calculated.
6. The only plus point of this method is that even if due dates are beyond cut off date negative/ contra days will not come.

7. But while deciding whether interest is receivable or payable the interpretation will be reverse of what you have done in earlier method i.e.
   If debit products are there interest is payable and
   If credit products are there interest is recoverable.

Special note - There is no special benefit of this method. Any problem can be solved by product of transaction method. We don't recommend it to student. For your information only we are giving illustration by this method also.

Illustration 7: (June 1998) The following are the transactions that took place between X and Y during the period from 1st January to 30th June, 2011:

		Rs.
(i)	Balance due to X by Y as at 1st January	602
(ii)	sold by X to Y on 17th January	884
(iii)	Goods sold by Y to X on 16th February (invoice dated 1st April)	1,296
(iv)	Goods returned by X to Y on 18th February (out of goods purchased on 16th February)	112
(v)	Goods sold by Y to X on 24th March (invoice dated 1st May)	712
(vi)	Bill drawn by Y on X at 3 months accepted by the latter on 22nd April	300
(vii)	Cash paid by X to Y on 29th April	500
(viii)	Goods sold by X to Y on 17th May (invoice dated 1st June)	542
(ix)	Goods sold by Y to X on 22nd June (invoice dated 1st August)	456

Draw up an account current upto 30th June, 2011 to be rendered by X to Y charging interest at 15% per annum.

Solution:

Account Current by Product of Transaction Method
(Epoque/Backward Calculation Method)

Y's in Account current with X
For the period 1.1.2011 to 30.6.2011

Date	Particulars	Rs.	Due date	Days	Product	Date	Particulars	Rs.	Due date	Days	Product
1.1	To Balance b/d	602	1.1	0	--	16.2	By Purchase a/c.	1,296	1.4	91	1,17,936
17.1	To Sales a/c.	884	17.1	17	15,028	24.3	By Purchase a/c.	712	1.5	121	86,152
18.2	To Purchase return	112	1.4	91	10,192	22.6	By Purchase a/c.	456	1.8	213	97,128
22.4	To Bills payable	300	25.7	206	61,800	30.6	By Balance c/d	476	30.6	181	86,156
29.4	To Cash a/c.	500	29.4	119	59,500						
17.5	To Sales a/c.	542	1.6	152	82,384						
		2,940			2,28,904			2,940			3,87,372
30.6	To Balance b/d.	476									
	To Interest a/c.	65				30.6	By Balance c/f	541			
		541						541			

$$Interest\ recoverable\ an\ 3,87,372 - 2,28,904 = 1,58,468$$

$$Interest = 1,58,468 \times \frac{15}{100} \times \frac{1}{365} = Rs. 65$$

Note: You must have noted that in this case balance before interest is also required to be worked out at the end of the period, product on same is also calculated for 181 days i.e. 1.1.2011 to 30.6.2011.

If you wish to practice, apply it on other questions and compare the result which must be same.

Some Advanced Illustrations

Illustration 8: Ram had a bank balance of Rs. 20,700 in his account with SBI on 1.9.2003. His other transactions during the month of September are as follows:

	Date	Rs.		Date	Rs.
Deposits	4.9.2003	13,000	Withdrawal	6.9.2003	17,000
	15.9.2003	13,500		13.9.2003	18,000
	27.9.2003	14,000		25.9.2003	12,000

Prepare account current of Ram with SBI on 30.9.03 as per Product of Balance Method assuming interest @15% p.a.

Solution: **Account Current by Product of Balances Method**

'Ram' in Account Current with 'SBI' (Ram's a/c in the books of 'SBI')

for the period 1.9.03 to 30.9.03

Dt	Particulars	Debit	Credit	Balance		Days	Product	
				Dr/Cr	Amt.		Debit	Credit
1.9	To Balance b/f			Cr.	20,700	4		82,800
4.9	By Cash a/c		13,000	Cr.	33,700	2		67,400
6.9	To Cash a/c	17,000		Cr.	16,700	7		1,16,900
13.9	To Cash a/c	18,000		Dr.	1,300	2	2,600	
15.9	By Cash a/c		13,500	Cr.	12,200	10		1,22,000
25.9	To Cash a/c	12,000		Cr.	200	2		400
27.9	By Cash a/c		14,000	Cr.	14,200	3		42,600
30.9	By Interest a/c		177	Cr.	14,377	-		-
						30	2,600	4,32,100

Working Notes:

Calculation of Interest

Net Interest payable on 4,32,100 – 2,600 = 4,29,500

Interest = 4,29,500 x $\frac{15}{100} \times \frac{1}{365}$ = Rs. 177

Entry for interest due:- Interest a/c Dr. 177

To Ram a/c 177

Explanation:

1. This is passbook i.e. customers a/c in the books of bank exact opposite of bank a/c in customers book.

2. Here days are the days for which that balance exist. For any transaction 1 day is completed on next date like for transaction of 4.9., 1 day is completed on 5.9. Hence upto 4.9 previous balance is considered and 1 day of new balance Rs. 33,700 is counted from 5.9, so on and so forth.

Illustration 9: Following transactions took place between X & Y during the months of April, 1999.

Date	Details	Amount (Rs.)
01/04/99	Amount payable by X to Y	10,000
07/04/99	Received acceptance of X to Y for 2 months	5,000
10/04/99	Bill Receivable (Accepted by Y on 7/2/99) is honoured on this due date	10,000
10/04/99	X sold goods to Y (invoice dt. 10/5/99)	5,000
12/04/99	X received cheque from Y dated 15/5/99)	7,500
15/04/99	Y sold goods to X (invoice dt. 15/5/99)	6,000
20/04/99	X returned goods sold by Y on 15/4/99	1,000
20/04/99	Bill accepted by Y is dishonoured on this due date.	5,000

You are required to make an account current by products method to be rendered by X to Y as on 30/04/99 taking interest into a/c @ 10% p.a.

Solution:

Product of Transaction Method

Y's in Account current with X's

Date	Particulars	Rs.	Due date	Days	Product	Date	Particulars	Rs.	Due date	Days	Product
7.4	To Bill Payable a/c.	5,000	10.6	--	--	1.4	By Balance b/d.	10,000	1.4	30	3,00,000
10.4	To Sales a/c.	5,000	10.5	--	--	12.4	By Bank a/c.	7,500	15.5	--	
20.4	To Purchase Return a/c.	1,000	15.5	--	--	15.4	By Purchase a/c	6,000	15.5	--	
20.4	To Bill Receivable a/c.	5,000	20.4	10	50,000		Contra				
	Contra						B.P. 5,000	--	10.6	41	2,05,000
	12.4 Bank 7,500	--	15.5	15	1,12,500		Sales 5,000	--	10.5	10	50,000
	15.4 Purchase 6,000	--	15.5	15	90,000		Purchase 1,000	--	15.5	15	15,000
30.4	To Balance c/f	7,587				30.4	By Interest a/c.	87			
		23,587			2,52,500			23,587			5,70,000

Interest payable on 5,70,000 – 2,52,500 = 3,17,500

$$Interest = 3,17,500 \times \frac{10}{100} \times \frac{1}{365} = Rs.\ 87$$

Special Note: In case of transactions where invoice date is given, but no credit period specified, take date of invoice as the due date.

Accounting in Computerised Environment

Introduction:

With the advent of information technology and the e-age scenario, computers not only rule the Information Systems management area, but also provide a complete end-to-end management solution in the field of accountancy.

Various performance boosters such as speed, accuracy, storage capacity etc. associated with the use of computers have brought significant changes in the methodologies by which accounting data used to be processed earlier (manually). However, it is to be noted that the same principles of debit and credit that we apply for recording income or expenditure, purchase or sale of assets or creation or discharge of liability in a manual accounting system is equally applicable in a computerized environment.

Certain precautions, methodologies and techniques are to be adopted while maintaining accounts in a computerized environment.

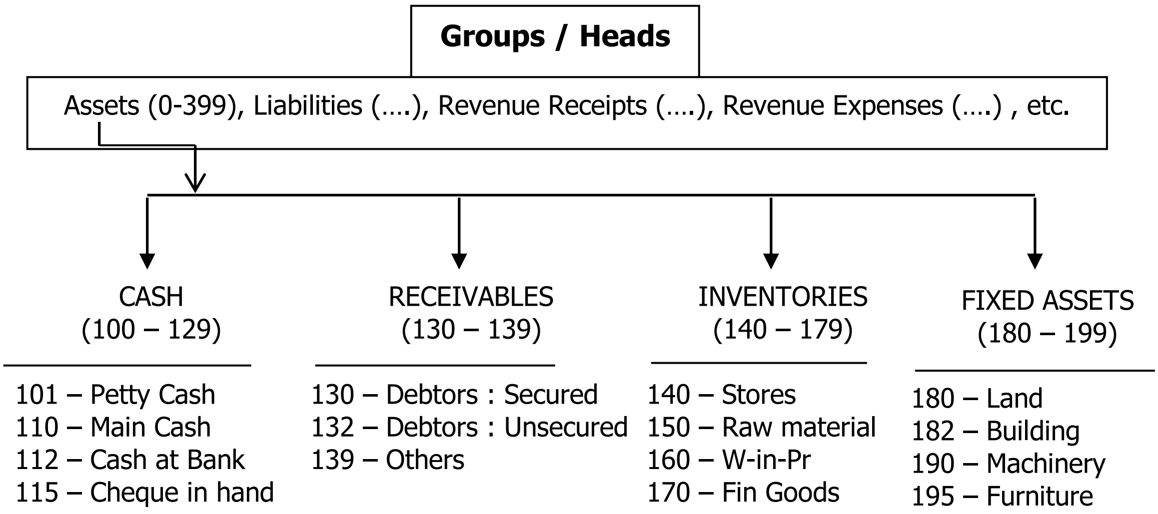
17.1. Significance of a Computerised Accounting System:

"In business today, the accounts which were earlier maintained in a manual form are replaced with computerized accounts." Explain the significance of computerized accounting system in modern time. **[May, 2011]**

- Earlier manual accounts replaced with computerised accounts.
- Processing speed is substantially higher.
- Elimination of difficulties, like balancing of trial balance etc.
- Saving of time as no postings are to be made, once voucher is entered system will automatically do posting. After every transaction you can get a revised Profit and loss account and Balancesheet.
- Issues concerning controls, security and integrity of computer system now demand more attention.
- Unauthorised access, hacking etc. a threat to computer usage.

17.2. Codification and Grouping of Accounts: Advantages

- Various Accounting Softwares are available which work on a coded or even non-coded accounting system.
- Coded system is more convenient where number of account heads are more and complexity is high.
- Coding system reduces possibility of same account existing in several names due to spelling mistakes or abbreviations used.
- Grouping and codification dependant upon type of organisation.



Let us go for another example where only 4 digit account codes have been used. The system could be that the first digit in the code will indicate whether it is revenue receipt or capital receipt or revenue expenditure or a capital expenditure or loans and advances or share holder fund. Thus if the first digit is '0' or '1', the Head of Account will represent Revenue Receipt; '2' or '3' will represent Revenue Expenditure; '4' or '5' Capital Expenditure; '6' or '7' Loans and Advances Head; and '8' will represent Shareholders Fund.

Adding 2 to the first digit of the Revenue Receipt will give the Code Number allotted to corresponding Revenue Expenditure Head; adding another 2–the Capital Expenditure Head and another 2–the Loans and Advances Head of Accounts; e.g.

0401 represents the Receipt Head for car manufacture

2401 represents the Revenue Expenditure Head for car manufacture

4401 represents the Capital Outlay on car manufacture

6401 represents Loans for car manufacture.

17.2.1. Hierarchy of Ledgers:

- Once the classification of accounts into various groups is complete and codification is done after formation of major, minor, sub and detailed heads the same is required to be inserted into the computer system.
- Account master files are created with codes and description of the accounts. Some accounting software allows ledgers and subsidiary ledgers to be created from the main ledgers.
- The subsidiary ledgers can further be subdivided to sub subsidiary ledgers thereby allowing grouping under various profit centres.
- These are particularly useful where accounts are maintained without codes.
- In a coded system this is easily achieved by allotting codes to major, minor, sub and detailed heads and thereafter obtaining reports based on these codes.

17.3. Selection criteria for pre-packaged accounting softwares:

Explain the factors to be considered before selecting the pre-packaged accounting software.**[May,2008]**
Mention, four advantages and four disadvantages of pre-packaged accounting software.**[May,2009]**

What are the advantages of pre-packaged accounting software? **[May,2010]**

Market is full of ready-made accounting software. What factors will you consider to choose one of them for your enterprise? **[Nov,2009]**

- Fulfilment of business requirements
- Completeness of reports, level of analysis required
- Ease to use
- Cost
- Reputation of the vendor, After sales services available
- Regular updates and its cost

Advantages of pre-packaged accounting software:

- Easy to Install
- Relatively Inexpensive
- Simple back-up procedure
- Flexibility of report formats
- Very effective for small and medium size businesses

Disadvantages:

- Does not cover peculiarities of specific business
- Does not cover all functional area: May cover only accounting or accounting & inventory etc.
- Customisation may not be possible in most such softwares
- Report generated is not sufficient or serve the specific purpose
- Lack of security
- Bugs in the software

Considering all the factors a small organisation may be able to fulfil its need from spreadsheet say Excell, a medium size organisation may go for a accounting software like Tally, Fact etc and Large organisation may develop for it a customised ERP system to cover all its accounting and finance issues wholly integrated in one.

17.4. Customised Accounting Software:

What are the advantages of customised accounting packages? **[Nov,2008]**

What do you mean by Customised Accounting Software? **[Nov,2009]**

- Customised accounting software is one where the software is developed on the basis of requirement specifications provided by the organisation.
- The choice of customised accounting software could be because of the typical nature of the business or else the functionality desired to be computerised is not available in any of the pre-packaged accounting software.
- An organisation desiring to have an integrated software package covering most of the functional area may have the financial module as part of the entire customised system.

Advantages:

- Covers specific functional areas
- Input screen can be as per input documents
- Reports generated as per specific requirements
- System design can match organisational structure of the entity

- Selection of input devices as per entity's choice (e.g.: Bar Code scanner can be used to capture product data)

Disadvantages:

- Difficult to convey exact requirement specification
- Inadequate testing may allow bugs undetected
- Incomplete documentation
- Requirement specifications are incomplete or ambiguous resulting in a defective or incomplete system
- Inadequate testing results in bugs remaining in the software
- Frequent changes made to the system with inadequate change in management procedure resulting in system compromise
- Vendor unwilling to give support of the software due to other commitments
- Vendor not willing to part with the source code or enter into an escrow agreement
- Control measures are inadequate
- Delay in completion of the software due to problems with the vendor or inadequate project management
- Lack of vendor support
- Inadequate control measures
- Delay in software completion

The choice of customised accounting packages is made on the basis of the vendor proposals. The proposals are evaluated as to the suitability, completeness, cost, and vendor profiles. Generally preference is given to a vendor who has a very good track record of deliverables.

17.5. Enterprise Resource Planning (ERP)

What are the advantages and disadvantages of ERP package? **[May,2007]**

- An Enterprise Resource Planning system is a fully integrated business management system covering functional areas of an enterprise like Logistics, Production, Finance, Accounting and Human Resources.
- It organizes and integrates operation processes and information flows to make optimum use of resources such as men, material, money and machine.
- ERP is a global, tightly integrated closed loop business solution package and is multifaceted. Enterprise resource planning promises one database, one application, and one user interface for the entire enterprise.

Major Features of ERP

- Provides multi-platform, multi-facility, multi-currency, etc facilities
- Supports strategic and business planning activities
- Has end-to-end supply chain management
- Provides intelligent business tools
- Provides complete integration of systems
- Better project management
- Automatic introduction of latest technologies like EFT, EDI, Internet, etc.

Advantages:

- Standardised processes and procedures
- Standardised reporting

- Duplication of data entry is avoided
- Greater information is available through the package

Disadvantages:

- Lesser flexibility
- Implementation hurdles
- Very expensive
- Complexity of the software

Selection criteria for an ERP System:

- Functional requirement of the organisation
- Reports available in the ERP
- Background of the vendors
- Cost comparisons'

17.6. Outsourcing of Accounting Function:

What are the advantages of outsourcing the accounting functions? **[Nov,2007]**

A large size multi department's hospital decided to outsource the accounting functions. Hospital invited proposals from vendors through open tender and received three proposals. How will you select the vendor? **[Nov.2010]**

- Recently a growing trend has developed for outsourcing the accounting function to a third party.
- The consideration for doing this is to save cost and to utilise the expertise of the outsourced party.
- The third party maintains the accounting software and the client data, does the processing and hands over the report from time to time.

Advantages:

- Saving in time
- Utilization of expertise of third party
- Professionally maintained and stored data
- Employees leaving job from key accounting positions does not hamper organisation

Disadvantages:

- Confidentiality of data always a concern and security of data
- Service may be inadequate sometimes
- Delay in obtaining services
- Dependability on outsider

Q.1.: (Nov.11) Explain the factors to be considered before selecting the pre-packaged accounting software.

Solution:

- **Selection criteria for pre-packaged accounting software:**
  - Fulfilment of business requirements
  - Completeness of reports
  - Ease to use
  - Cost
  - Reputation of the vendor

- Regular updates

Advantages of pre-packaged accounting software:

- Easy to Install
- Relatively Inexpensive
- Simple back-up procedure
- Flexibility of report formats
- Very effective for small and medium size businesses

Disadvantages:

- Does not cover peculiarities of specific business
- Does not cover all functional area
- Customisation may not be possible in most such softwares
- Report generated is not sufficient or serve the purpose
- Lack of security
- Bugs in the software

Q.2.: (May 2012) "ERP package is gaining popularity in big organizations". Briefly explain the advantages of using an ERP package, in the light of above statement.

Solution:

Advantages ERP Packages: These are made to the needs of an specific orgnisation hence covers all functions of the orgnisation and are therefore generally costly that's the reason these are more useful in big orgnisations.

(1) Standardised processes and procedures. An ERP is a generalised package which covers most of the common functionalities of any specific module.

(2) Standardised reporting:

Majority of the desired reports are available in an ERP package. These reports are standardised across industry and are generally acceptable to the users.

(3) Duplication of data entry is avoided as it is an integrated package

(4) Greater information is available through the package.

Q.3.: (Nov. 2012) Write any four disadvantages of Pre-packaged Accounting Software.

Solution

Disadvantage of Pre-packaged Accounting Software:

- Does not cover peculiarities of specific business
- Does not cover all functional area
- Customisation may not be possible in most such softwares
- Report generated is not sufficient or serve the purpose
- Lack of security
- Bugs in the software

Q.4.: (May 2013) What is an Enterprise Resource Planning (ERP) software? What are the factors which you will take into consideration while choosing an ERP software?

Solution:

Enterprise Resource Planning (ERP) is:

- An Enterprise Resource Planning system is a fully integrated business management system covering functional areas of an enterprise like Logistics, Production, Finance, Accounting and Human Resources.
- It organizes and integrates operation processes and information flows to make optimum use of resources such as men, material, money and machine.

- ERP is a global, tightly integrated closed loop business solution package and is multifaceted. Enterprise resource planning promises one database, one application, and one user interface for the entire enterprise.

Selection criteria for an ERP System:

- Functional requirement of the organisation
- Reports available in the ERP
- Background of the vendors
- Cost comparisons'

Q.5.: (Nov. 2013) Explain the reason due to which the manual accounting system was replaced by the computerized accounting system in modern time.

Solution:

With the advent of information technology and the e-age scenario, computers not only rule the Information Systems management area, but also provide a complete end-to-end management solution in the field of accountancy.

Various performance boosters such as speed, accuracy, storage capacity etc. associated with the use of computers have brought significant changes in the methodologies by which accounting data used to be processed earlier (manually). However, it is to be noted that the same principles of debit and credit that we apply for recording income or expenditure, purchase or sale of assets or creation or discharge of liability in a manual accounting system is equally applicable in a computerized environment.

Manual accounts are replaced by computerised accounts in modern times due to following reasons:

- Processing speed is substantially higher.
- Elimination of difficulties, like balancing of trial balance etc.
- Saving of time as no postings are to be made, once voucher is entered, system will automatically do posting. After every transaction you can get a revised Profit and loss account and Balancesheet.
- Issues concerning controls, security and integrity of computer system now demand more attention.

Amalgamation

Provisions in very brief of Companies Act 2013, regarding Compromise, Arrangement, Merger & Amalgamation:

(These are all procedural aspects and the accounting will be as per AS-14 only as was done till now)

Company can Compromise or make arrangement with creditors (including debenture holders) or members or a class of creditor or members. U/s 230, 231, 232.

A company can make compromise or arrangements. Arrangements includes re-orgnisation of share capital by consolidation of shares of different classes or division of shares in to shares of different classes or by both.

Such compromise or arrangement shall be agreed to (at a meeting convened by Tribunal) by three fourth ($3/4^{th}$) in value of creditors or a class of creditors or members or a class of members and if sanctioned by Tribunal it will be binding on all.

If at least 90% in value agree to scheme by an affidavit then Tribunal may dispense with calling of the meeting.

If Tribunal is satisfied that compromise or arrangement as sanctioned can not be implemented and company is unable to pay its debts as per the scheme, then it can order winding up.

Compromise or arrangement proposed may be part of a scheme of reconstruction of a company or merger or amalgamation of two or more company, then Tribunal will order accordingly.

When an existing company takes over business of one or more companies, it is known as **merger by absorption** & here transferor & transferee both are referred as merging companies.

When a new company is formed to take over business of two or more companies, it is known as **merger by formation of new company** & here transferor companies are referred as merging companies.

A scheme involves **division** (commonly known as demerger) when property & liabilities of a company are divided & transferred to two or more companies which may be an existing company or a new company.

Merger & Amalgamation of Companies U/s 233, 234, 235, 236 & 237.

U/s 233(1) Merger or amalgamation between (i) two or more small companies (ii) holding company & its wholly owned subsidiary company or (iii) such other class or classes of companies as may be prescribed.

Objections to proposed scheme from Registrar & official liquidator shall be invited & considered at general meeting and scheme be approved by members or a class of members holding at least 90% of the total number of shares.

Each company to file declaration of solvency to the registrar. Scheme shall be approved by at least 90% in value of the creditor or a class of creditor of the respective company.

Copy of this approved scheme to be filed to Central Govt., Registrar & official liquidator. The central govt after considering the objections & suggestions received from Registrar & official liquidator, shall register and issue confirmation to the companies or may refer it to the Tribunal to consider the scheme u/s 232. Tribunal may pass or order u/s 232 or may confirm the scheme.

Amalgamation involving Foreign Co.: U/s 234 Central govt may make rules in consultation with RBI for amalgamation with foreign companies. Rest of the provisions of this chapter shall apply as it is.

Acquisition of shares of shareholders dissenting to the scheme of Amalgamation: U/s 235 Scheme shall be approved by holder of not less than 90% in value of share whose transfer is involved (other than the shares held by transferee company or its nominee or its subsidiary company), then transferee can give notice to dissenting shareholder to acquire their shares at the same terms as those of the consenting shareholders then (unless otherwise ordered by Tribunal on an application by dissenting shareholder) transferee shall be entitled and bond to acquire those shares.

Purchase of Minority shareholding: U/s 236 An acquirer or a person or a group of person becoming holder of 90% of issued equity share capital of a company, then they shall notify the company of their intention to buy the remaining equity share capital. Price to be determined by a registered valuer. The minority shareholder can themselves offer their shares.

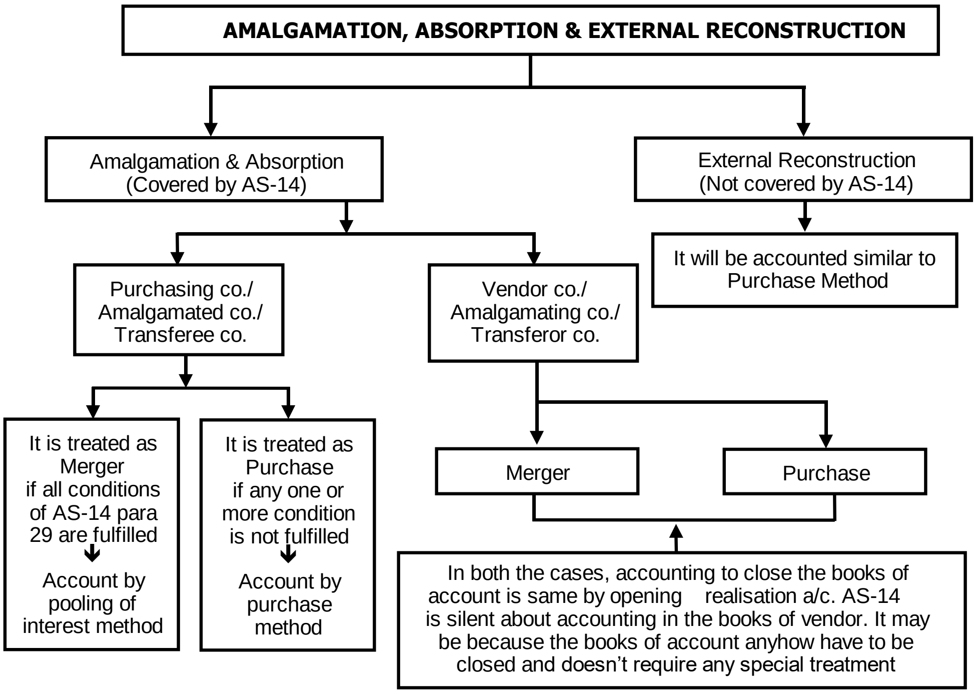
Power of Central Govt. order amalgamation of companies in public interest: U/s 237 When Central Govt. is satisfied that it is essential in the public interest that two or more companies shall amalgamate, it may order (to be notified in official gazette) for amalgamation in to a single company with such terms & conditions as may be specified.

Every member, creditor or debenture holder of transferor company shall have as nearly as may be the same interest and rights in the transferee company as it had in the transferor company. If such interest & rights are less then they will be entitled for compensation.

AMALGAMATION

Nature of arrangement	Before	After
Amalgamation Absorption External Reconstruction	A Ltd. + B Ltd. M Ltd. + N Ltd. X Ltd.	→ C Ltd. → M Ltd. → New X Ltd.
Companies known as	↑ Vendor company Transferor company Amalgamating company (Except M Ltd.)	↑ Purchaser company Transferee company Amalgamated company

Note: It doesn't include takeover of control by acquisition of shares of acquired co. or acquisition of some or all assets of other co. whereby that other co. doesn't get dissolved.



INTRODUCTION

A Company can purchase/ acquire/take-over the business of (1) Proprietory concern/ partnership firms or (2) Another company. This in general is known as **purchase/ acquisition/ take over** of the business. And the acquisition of business of a company by another company is specifically known as **Amalgamation/ Absorption/ External reconstruction**.

15.1. Explain the term Amalgamation Absorption & Reconstruction

- **Amalgamation:** When a new company (Amalgamated company/purchasing company) is formed to take-over the business of two or more existing companies (amalgamating company/vendor company), it is called amalgamation.

  Example: A ltd and B ltd two existing companies are merged in to form a new company C Ltd is an example of Amalgamation. Here X Ltd will be liquidated. Here A Ltd & B Ltd will be dissolved.

- **Absorption :** When an existing company takes over the business of one or more existing companies, it is called absorption.(In AS-14 the absorption is also referred to as amalgamation only)

  Example: M ltd and N ltd are two existing companies and want to merge in to one. M Ltd acquires the business of N ltd this is an example of Absorption. Here N Ltd will be dissolved.

Note : In Amalgamation & Absorption there is combing of two or more business & are covered by AS-14

- **External Reconstruction:** When a new company is formed to take over an existing company it is known as external reconstruction.

  Example: Business of X ltd is transferred in to a new X Ltd is an example of External reconstruction. Here X Ltd will be dissolved.
- Here there is only one business getting converted in to new name, no combining of business, hence not an Amalgamation as per AS-14.

- **Internal Reconstruction:** It is an arrangement whereby a company makes changes in its Capital Structure and book value of other Assets & Liabilities without closing (Liquidating) the company.

  Example: Z ltd reduces its capital and liability and uses this credit to writes off accumulated assets and reduce assets to its proper value. This is an example of internal reconstruction.

Purchasing Company = Amalgamated Company = Transferee Company
Vendor Company = Amalgamating Company = Transferor Company

PURCHASE CONSIDERATION

15.2. What is purchase consideration (pc)

- AS-14 defines consideration for the amalgamation means the aggregate of the shares & other securities issued and the payment made in the form of cash or other assets by the transferee co. to the shareholders of the transferor co. (Therefore payment to debenture holders/creditors etc can be excluded from the figure of purchase consideration and be accounted separately.)
- Shares & other securities issued be valued at fair value which may be value fixed by statutory authorities.

- Other assets given up as consideration should be valued at market value but if market value is not ascertainable then the net book value of such asset can be taken.

15.3. Explain the usual ways of calculating purchase consideration

15.3.1. Purchase consideration is the amount (price) to be paid by Purchasing Co. to Vendor Co. Students may encounter different situations in the exam, to tackle the same following points are relevant. Details about consideration may be given in question in either of the following 3 ways.

1) Calculated **lump-sum** amount may be given.

2) **Payment Basis**: What are the payments to be made will be given like how many shares, debentures etc to be issued & how much cash to be paid will be given. Then the aggregate value of all such items(considering issue at par, premium or discount as the case may be) will be the purchase consideration.

P.C. = (No. of shares X issue price) + (No. of debentures X issue price) + cash / other assets etc.

Illustration 1: A Limited agreed to acquire the business of E Limited as on 31st December, 2011. when E Limited had capitals as under:

10,000 6% Preference shares of Rs.10 each = Rs.1,00,000
20,000 Equity shares of Rs.10 each = Rs.2,00,000
& 7% Debentures of = Rs.1,00,000

The consideration payable by A Limited was agreed as under:

1. The preference Share-holders of E Limited were to be allotted at 8% preference Shares of Rs. 1,10,000.
2. Equity Share-holders to be allotted six Equity Shares of Rs.10 each issued at a premium of 10% and Rs.3 cash against every five shares held.
3. 7% Debenture holders of E Limited to be paid 8% premium by 9% Debenture at 10% Discount. Calculate Purchase consideration on Payment basis.

Solution:

Computation of Purchase consideration (By Payment Method)

For Whom		**Amount**	**In the form of**
For Pref. shareholder: Their Capital 1,00,000 Premium payable to them 10,000		1,10,000	8% Pref. shares at par
For Equity shareholder $\frac{20{,}000}{5} \times 6 = 24{,}000 \text{ share @ } 11$		2,64,000	Equity share: Capital – 2,40,000; Premium – 24,000
Cash given $\frac{20000}{5} x3$		12,000	Cash
Purchase consideration as per in AS-14		**3,86,000**	
For 7% Debenture Holder			9 % Debentures
Debenture Capital	1,00,000		Debenture Capital : 1,20,000
+ 8% premium payable to them	8,000	1,08,000	Discount on debenture – 12,000
		4,94,000	Net Value 1,08,000

As per AS-14 Purchase consideration is what is payable to the shareholders of transferor company, and hence it can be accounted at Rs.3,86,000 and liability of debenture holders of A be taken over together with other liability and discharged by E by allotting its debenture to them.

3) **Assets taken over Basis**: If (1) OR (2) as above is not given then this method will be applicable.

P.C.= Assets taken at agreed value + Goodwill if to be considered (-) Liabilities taken over

Fictitious assets or Exp. not w/off should not be added and General Reserve, funds etc. which represents undistributed profit should not be deducted while calculating P.C. as above.

Illustration 2: B. Ltd. had the following Balance-Sheet as on 31st March, 2011. C Ltd is acquiring B Ltd.

B. Ltd.

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital 50000 shares of Rs.100 each	50,00,000	Fixed Assets	83,00,000
Capital Reserve	10,00,000	Current Assets	69,00,000
General Reserve	36,00,000		
Unsecured Loans	22,00,000	Investment	17,00,000
Sundry Creditors	42,00,000		
Provision for taxation	11,00,000	Good Will	2,00,000
	171,00,000		171,00,000

For the purposes of the amalgamation the goodwill of B. Ltd. is considered valueless. There are also arrears of depreciation in B. Ltd. amounting to Rs.4,00,000. Calculate Purchase consideration on net asset basis.

Solution:

<u>Purchase Consideration: On Net Asset Basis</u>

Fixed Asset (83,00,000 – 4,00,000)		79,00,000
Current Asset		69,00,000
Investment		17,00,000
		1,65,00,000
Less Liabilities:		
Loans	22,00,000	
Creditors	42,00,000	
Provision for Taxation	11,00,000	75,00,000
Purchase Consideration for acquiring 'B' Ltd.		90,00,000

15.3.2. Note Some Special Points regarding Purchase Consideration:

1) When inter company share holding is involved, then calculation of purchase consideration & accounting will require certain adjustments which is dealt with separately in this chapter.
2) For calculating share exchange ratio/share swap the shares of both the Co's (i.e. acquiring/amalgamated /purchaser co.) and (acquired/amalgamating co./ vendor) can be calculated on (a) Market value (b) Book value basis (c) Intrinsic Value basis or (d) EPS X P.E. ratio basis or any combination of this.

   These terms are explained below:

   - Earning Per Share (EPS) = Profit After Tax (PAT) & after preference dividend ÷ Number of Equity Shares
   - Price Earning Ratio(PE Ratio) = Market Price ÷ EPS
   - Market Price = EPS X PE Ratio
   - Book Value (Intrinsic Value) per share = Net Worth ÷ No. of Equity Shares
   - Return on Equity(ROE) = PAT & after preference dividend ÷ Net Worth X 100
   - Dividend Pay Out Ratio = Dividend ÷ PAT X 100
   - Retention Ratio = 100% - Dividend Pay Out Ratio
   - EPS Growth Rate = ROE X Retention Ratio
   - Worth of a Shareholder = No. of Shares held X Market Price

ACCOUNTING FOR AMALGAMATIONS

- The Institute of Chartered Accountants of India has issued *Accounting Standard-14 (AS-14). "Accounting for Amalgamations"* which states the procedures for accounting for amalgamations (with effect from1.4.1995).
- It may be noted that there will be changes only in accounting procedures with regard to amalgamation and absorption.
- For reconstruction, both external and internal, there will be no change and the same accounting procedures as earlier will follow (Earlier only Purchase Method was there) .
- The salient features of the accounting standard and accounting procedures are covered in this book.

15.4. Explain meaning of amalgamation as defined in As –14 :

- ***The Amalgamation is defined in the Standard as:*** Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 1956 or any other statute, which may be applicable to, companies.
- In the fact, amalgamation may take the shape of merging of one company with another or merging of two or more companies to form a new company. In case of amalgamation, the amalgamating company/ies) is/are dissolved without winding up and gets merged with the amalgamated company.
- In the notes above we have seen that amalgamation means merging of two or more companies to form a new company and absorption means taking over of the business of one or more companies by another existing company. However, in terms of this Accounting Standard, this distinction between amalgamation and absorption is not of any significance.

15.5. What are the types of amalgamation

Briefly explain the types of amalgamation ***(May 2012)***

- *Accounting problems of amalgamation are dealt with in AS-14 according to the type of amalgamation.*
- ***Types of Amalgamation:*** Amalgamation for accounting purposes can be classified into two categories.
  - (i) Amalgamation in the nature of merger, and
  - (ii) Amalgamation in the nature of purchase.

15.6. What is *Amalgamation in the Nature of* merger

What are the conditions that are to be satisfied for 'Amalgamation in the nature of merger' is an Amalgamation? **[Nov,2006] [May,2001]**
As per Accounting Standard-14, what are the conditions which must be satisfied for an amalgamation in the nature of merger? **[Nov,2009]**

- Amalgamation in the Nature of Merger is a type of amalgamation, which satisfies all the following conditions.

(i) All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.

(ii) Shareholders holding not less than 90 percent of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.

(iii) The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.

(iv) The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.

(v) No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.

- In this type of amalgamation, there is genuine pooling of assets and liabilities of the combining entities. In addition, equity shareholders of the combining entities continue to have a proportionate share in the combined entity.
- The accounting treatment of such amalgamations should ensure that the resultant figures of assets, liabilities, capital and reserves more or less represent the sum of the relevant figures of the amalgamating companies.

15.7. What is amalgamation in the nature of purchase

- Amalgamation may be considered in the nature of purchase when any one or more of the five conditions specified for amalgamations in the nature of merger is not satisfied.
- These are amalgamations which are in effect a mode by which one company acquires another company and hence, the equity shareholders of the combining entities do not continue to have a proportionate share in the equity of the combined entity or the business of the acquired company is not intended to be continued after the amalgamation.

15.8. What are the Methods of Accounting for Amalgamations

Distinguish between **(i)** The pooling of interests method and **(ii)** The purchase method of recording transactions relating to amalgamation. **[May,2002]**
Briefly explain the methods of accounting for amalgamation as per Accounting standard-14 **[May,2004]**
What are the two main methods of accounting amalgamation of companies? **[Nov,2007]**
Name two methods of accounting for amalgamations as contemplated by AS-14. **[May,2009]**

- It may be noted that the Accounting Standard deals with the accounting mechanism only in the books of the transferee company.
- So far as the books of the transferor company are concerned, the normal procedures of accounting through the realisation accounts as explained later in this book will be followed for both the types of amalgamations.
- The accounting procedures for amalgamation in the books of the transferee company will differ depending upon the type of amalgamation. There are two methods of accounting.
  (i) Pooling of Interest Method; and
  (ii) Purchase Method.

IN THE BOOKS OF PURCHASING COMPANY (Transferee Company)

15.9. What is Pooling of Interest Method

- This method of accounting is applicable for amalgamation in the nature of merger.
- In this case, the amalgamation is accounted for as if the separate business of the amalgamating companies were intended to be carried on by the transferee (i.e. amalgamated) company.
- Accordingly, only minimal changes are made in aggregating the individual financial statements of the amalgamating companies.

- The following factors should be taken into consideration while making accounting entries in this method.
    1. In the books of the transferee company, the assets, liabilities and reserves (whether capital or arising on revaluation) of the transferor company should be recorded at their existing carrying amounts and in the same form as at the date of amalgamation.
    2. The balance of the Profit and Loss Account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to general reserve, if any.
    3. This reflects the fact that the entries are simply merged together. No goodwill account should be accounted for.
    4. The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted against the reserves of transferee company.
- The purpose is that all items (including reserves) of the transferor company should be recorded at their book value and in the same form as on the date of amalgamation.

15.10. Give Draft entries in case of pooling of interest method

- *The following **journal entries** are appropriate for incorporating the financial statements of the Transferor Company in the books of transferee Co. (Purchaser Co.)*

(1) On amalgamation of the business entry for purchase consideration due.

Business Purchase A/c Dr. (with the amount of purchase consideration)
To Liquidator of Transferor Company a/c

(2) When assets, liabilities and reserves are taken-over from the transferor company and incorporated in the books.

Sundry Assets A/c (individually) Dr. (book value)
To Sundry Liabilities A/c (individually) (book balance)
To Profit and Loss A/c (book balance)
To Reserves A/c (book balance)
To Business Purchase A/c (book value)

The difference between the debits and credits is adjusted in the reserves of the transferee company.

If it is credit short credit it to capital reserve. If it is debit short and there is capital reserve balance adjust against it otherwise adjust against revenue reserves. If revenue reserves are also exhausted then if profit & loss account balance is there, transfer it to reserves and then adjust the difference against it.

(3) When the purchase consideration is satisfied.

Liquidator of Transferor Company a/c Dr. (Purchase consideration amount)
To Share Capital a/c (Share capital issued)
To Share Premium a/c (premium amount)
(or debit Discount on issue of shares)
To Cash a/c (for fractional shares & dissenting shareholders)
To Non-cash Consideration a/c (fair value-for dissenting shareholders)

(4) For Liquidation expenses paid.

P & L a/c/General Reserve a/c Dr.
To Cash/Bank a/c

If acquisition/ Winding up expenses are paid & borne by Purchasing Co.

Illustration 3: The following are the Balance Sheet of A Co. Ltd. and B Co. Ltd. as on 30th September, 2011.

A Co. Ltd.

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital-		Buildings	1,50,000
50,000 Equity Shares of Rs.10 each, fully paid-up	5,00,000	Machinery	5,50,000
		Stock	80,000
General Reserve	1,70,000	Debtors	70,000
Profit and Loss A/c.	30,000	Cash	15,000
12% Debentures of Rs.100 each	1,00,000		
Trade Creditors	50,000		
Employees Provident Fund	15,000		
	8,65,000		8,65,000

B Co. Ltd.

Liabilities	**Rs.**	**Assets**	**Rs.**
Share Capital		Machinery	2,50,000
30,000 Equity Shares of Rs.10 each	3,00,000	Stock	40,000
		Debtors 50,000	
Trade Creditors	40,000	Less: Prov. for Doubtful Debt 5,000	45,000
		Cash	5,000
	3,40,000		3,40,000

The two companies agree to amalgamate and form a new company called C. Co. Ltd. which takes over all the assets and liabilities of both the companies on 1st October, 2011.

The purchase consideration is agreed at Rs. 6,61,500 and Rs. 3,15,000 for A Co. Ltd. and B Co. Ltd. and show the opening entries in the books of C. Co. Ltd. Also prepare the opening Balance Sheet in the books of C. Co. Ltd. as on 1st October, 2011. The authorised capital of C Co. Ltd. is 2,00,000 equity shares of Rs.10 each.

Solution:

Amalgamation treated as Merger in the Books of C Co. Ltd. (Purchaser Co.)
(Accounted by Pooling of Interest Method)

1	Business Purchase a/c Dr.	9,76,500	
	To Liquidator of A Co. Ltd a/c		6,61,500
	To Liquidator of B Co. Ltd. a/c		3,15,000
	(Purchase consideration due)		
2	Building a/c Dr.	1,50,000	
	Machine a/c Dr. (5,50,000 + 2,50,000)	8,00,000	
	Stock a/c Dr. (80,000 + 40,000)	1,20,000	
	Debtors a/c Dr. (70,000 + 50,000)	1,20,000	
	Cash a/c Dr. (15,000 + 5,000)	20,000	
	To Business Purchaser a/c		9,76,500
	To Creditors a/c (50,000 + 40,000)		90,000
	To Debentures a/c		1,00,000
	To Employee Provident Fund a/c		15,000
	To Provision for Bad Debt a/c		5,000
	To General Reserve a/c 1,70,000 + 30,000 - 1,76,500 (Bal fig)		23,500

	(Asset, Liabilities and Profit, Reserves of vendor co. recorded)		
3	Liquidator of A Co. Ltd a/c Dr. To Equity share capital a/c (Purchase consideration paid)	6,61,500	6,61,500
4	Liquidator of B Co. Ltd a/c Dr. To Equity Share Capital a/c (Purchase consideration paid)	3,15,000	3,15,000

Balance Sheet of 'C' Co. Ltd.
As On 01.10.2011

	Particulars	Notes		Rs.
	1	3	4	5
I.	**EQUITY AND LIABILITIES**			
(1)	**Shareholders' funds**			
	Share capital		9,76,500	
	Reserves and surplus: General Reserve		23,500	10,00,000
(2)	Share application money pending allotment			--
(3)	**Non-current liabilities**			
	Long-term borrowings: 12% Debenture			1,00,000
(4)	**Current liabilities**			
	Trade Payables		90,000	
	Employee Provident Fund		15,000	1,05,000
	TOTAL			**12,05,000**
II.	**ASSETS**			
(1)	**Non-current assets**			
	Fixed assets: Building		1,50,000	
	Machinery		8,00,000	9,50,000
(2)	**Current assets**			
	Stock in trade		1,20,000	
	Trade receivables 1,20,000			
	Less: Provision 5,000		1,15,000	
	Cash and cash equivalents		20,000	2,55,000
	TOTAL			**12,05,000**

Here if the shares were given to Vendors of Rs.8,00,000 i.e. equal to the paid up capital of Vendor Co. then there would not have arisen any difference in entry no. 2, to be adjusted in the reserves.

As a consequence in the balancesheet share capital will be less and reserves more by Rs.1,76,500.

But even when Rs.8,00,000 shares are given they should be divided among the share holders of the two co. in the Ratio of their net worth i.e. in the ratio of 6,61,500 : 3,15,000.

15.11. Explain Purchase Method :

- This method of accounting is applicable for amalgamation in the nature of purchase.
- This will also be followed for external reconstruction etc., which are not covered by AS-14.
- The following factors should be considered while making accounting entries in this method:

(i) In the books of the transferee company the assets and liabilities of the Transferor Company should be incorporated at their existing carrying amount **or**

(ii) Or the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values.

(iii) The reserves (whether capital or revenue or arising on revaluation) of the transferor company other than the statutory reserves should not be included in the financial statements of the transferee company.

(iv) Any excess of the purchase consideration over the value of net assets of the Transferor Company should be treated as goodwill and debited to goodwill account.

(v) On the other hand, if the purchase consideration is lower than the value of net assets acquired, the difference should be credited to capital reserve.

15.12. Give journal Entries in case of purchase method

- *The following* ***journal entries*** *are appropriate for incorporating the financial statements of the Transferor Company in the books of transferee Co. (Purchaser Co.)*

1)	Business Purchase a/c Dr. To Vendors a/c	With value of purchase consideration payable.
2)	Assets a/c Dr.	All assets taken over with their respective values which Purchasing Co.. wants to show/Agreed value.
	To Business Purchase a/c	Amount of Purchase consideration (as in entry 1)
	To Liabilities A/c.	Value at which take-over the liabilities.
	In the above entry – If debit is short, the difference (it is the extra purchase consideration paid) is Debited to Goodwill a/c If Credit is short, the difference (it is less purchase consideration, hence capital profit) is credited to Capital Reserve a/c	
3)	Vendor's a/c Dr. Share/Debenture Discount A/c Dr. To Equity Share capital a/c To Preference Sh. capital a/c To Debenture a/c To Share/Debenture premium a/c To Cash a/c	Purchase Consideration discharged by issue of shares / Debentures (at par, premium or discount) and cash payment
4)	Goodwill/Capital Reserve a/c Dr. To Cash a/c	If acquisition / Winding up expenses are paid & borne by Purchasing Co.

Statutory Reserves: (Following entries required only in case of 'Purchase Method'.)

5) If it becomes necessary to carry forward any statutory reserve of the transferor in the books of the transferee for legal compliance, it is accounted by debiting 'Amalgamation Adjustment Account' and crediting 'Statutory Reserve Account'.

Amalgamation Adjustment a/c Dr. (with the amount)

To Statutory Reserve a/c.

6) The Amalgamation Adjustment Account should be disclosed as a part of other current or non-current asset (depending on the period) in the balance sheet.

7) When the identity of the statutory reserve is no longer required to be maintained, both Statutory Reserve Account and Amalgamation Adjustment Account should be reversed.

Statutory Reserve a/c Dr.

To Amalgamation Adjustment a/c

Note:

1) As per AS-14 Goodwill account should be written off over a period generally not exceeding 5 years unless higher period can be justified.

2) When shares/debentures are allotted by Purchasing Company at premium or at discount, then at the time of passing the entries in the books of purchasing Company, share capital/debenture A/c will be credited with its face value and Vendors A/c will be debited with the total issue price. If issue price is more than face value, the difference will be credited to share premium A/c and if the issue price is less, the difference will be debited to Discount A/c.

3) Once the No. of shares to be allotted are worked out based on their intrinsic values (fair value), then whether they are recorded at their intrinsic value (fair value) or at par value, will not make any difference because the Vendor Company will receive the same number of shares and they have got the same market value whether we account in the books at intrinsic value or at Face value.

By recording the shares at Face value the Purchasing Co. is benefited because they don't create Share Premium A/c (a restricted reserve) which can be used only as per the specific provisions of the Act and the other effect will be that the capital Reserve will get increased or Goodwill will get reduced on take-over.

Such condition of accounting at par should be included in the amalgamation scheme itself.

Companies Act 2013 prohibits issue of shares at discount except sweat equity shares.

Illustration 4: The Indo-Gulf Co. Ltd. sells its business to the Continental Co. Ltd. as on December 31, 2011, on which date its Balance Sheet was as under:

Liabilities	Rs.	Assets	Rs.
Paid-up Capital 2000 shares	2,00,000	Freehold property	1,50,000
Of Rs.100 each		Good Will	50,000
Debentures	1,00,000	Plant and Tools	83,000
Trade Creditors	30,000	Stock	35,000
Reserve Fund	50,000	Bills Receivable	4,500
Profit & Loss Account	20,000	Sundry Debtors	27,500
		Cash at Bank	50,000
	4,00,000		**4,00,000**

The Continental Co. Ltd. agreed to take over the Assets (exclusive of cash at Bank and Goodwill) at 10 percent less than the book value, to pay Rs. 75,000 for Goodwill, and to take over the Debentures.

The purchase consideration was to be discharged by the allotment to the Indo-Gulf Ltd. of 1,500 shares of Rs.100 each at premium of Rs.10 per share and the balance in cash.

The cost of the liquidation amounted to Rs. 3,000. Show the necessary journal entries recording the transactions in the books of the Continental Co. Ltd and Balance-sheet ignoring its existing figures.

Solution:

In the Books of continental Co. Ltd (Purchaser Company)

Accounting by Purchase Method

1.	Business Purchase a/c Dr. To Liquidator of Indo-Gulf Ltd. a/c (Purchase consideration due)	2,45,000	2,45,000

2.	Freehold Property a/c Dr. Plant a/c Dr. Stock a/c Dr. Bills Receivable a/c Dr. Debtors a/c Dr. Goodwill a/c Dr. To Business Purchase a/c To Debenture a/c (Asset, Liabilities acquired are recorded)	1,35,000 74,700 31,500 4,050 24,750 75,000	 2,45,000 1,00,000
3.	Liquidator of Indo-Gulf a/c Dr. To Equity share Capital a/c To Share Premium a/c To Cash / Bank a/c (Purchase consideration paid)	2,45,000	 1,50,000 15,000 80,000

Balance Sheet of M/S Continental Ltd.
As On 31.12.2011

	Particulars	Notes		Rs.
	1	3	4	5
I.	**EQUITY AND LIABILITIES**			
(1)	**Shareholders' funds**			
	Share capital		1,50,000	
	Reserves and surplus: Share Premium		15,000	1,65,000
(2)	Share application money pending allotment			--
(3)	**Non-current liabilities**			
	Long-term borrowings: Debenture			1,00,000
(4)	**Current liabilities**			
	Short term Borrowing: Overdraft			80,000
	TOTAL			**3,45,000**
II.	**ASSETS**			
(1)	**Non-current assets**			
	Fixed assets			
	Tangible : Freehold property 1,35,000			
	Plant & Tools 74,700		2,09,700	
	Intangible : Goodwill		75,000	2,84,700
(2)	**Current assets**			
	Stock in trade		31,500	
	Trade receivables		24,750	
	Bills Receivable		4,050	60,300
	TOTAL			**3,45,000**

Working Notes:

1) Purchase Consideration (Net Asset Basis)

Freehold property	1,35,000		
Plants	74,700	**Purchase Consideration to be paid as follows**	
Stock	31,500		
Bills Receivable	4,050	Equity shares 1500 x 110	1,65,000
Debtors	24,750	Cash (Balance)	80,000
Goodwill	75,000		

(–) Debentures	3,45,000 1,00,000		
	2,45,000		2,45,000

15.13 Table of Comparison - Accounting in the books of Purchasing Company

Sr. No.	Item	Amalgamation in the nature of Merger (Pooling of interest method)	Amalgamation in the nature of Purchase (Purchase method)
1.	Assets & Liability of transferor	• All are taken over • Accounted at book value	• All or some are taken over • Accounted at book value or revalued value (fair value)
2.	Reserve of transferor	All are recorded as it is	Not recorded
3.	Statutory reserve of transferor	Already included in (2) above, therefore no separate entry required.	Amalgamation adj. A/c. Dr. To statutory Res. A/c.
4.	Goodwill/ capital reserve	Difference between P.C. & paid up capital of transferor co. is adjusted in reserves	Difference between P.C. & net asses taken over is either goodwill or capital reserve
5.	Liquidation or amalgamation exp. incurred by transferee co.	Reserves/ Profit & Loss a/c. Dr. To cash/bank a/c.	Goodwill/capital reserve a/c. Dr. To cash/bank a/c
6.	Stock reserve on inter co. stock	Reserves/ Profit & Loss a/c. Dr. To stock reserve/ stock a/c.	Goodwill/capital reserve a/c. Dr. To stock reserve/stock a/c.
7.	Inter co. debt. (mutual debt) cancelled	BP/creditor/loan Dr. To BR/Debtor/loan a/c.	BP/creditor/loan Dr. To BR/Debtor/loan a/c.

Note: Point no. 5, 6 & 7 are not specified in AS-14.

ENTRIES IN THE BOOK OF VENDOR (Transferor Company) TO CLOSE THE BOOKS

(In both the cases i.e. amalgamation in the nature of merger & amalgamation in the nature Purchase, accounting will be same in the books of vendor. AS-14 is silent regarding accounting in the books of Vendor/Transferor)

15.14. Draft journal Entries in the Books of Vendor (Transferor) co.

1) All assets to be transferred to realisation account at book values except cash/Bank balance unless these are taken over by the Purchasing Co.

   Realisation a/c Dr.

   To Assets a/c.

---

2) All liabilities are to be transferred to realisation a/c except Partners capital/share capital, Reserves,

   P& L a/c etc.

   Liabilities a/c Dr.

   To Realisation a/c.

---

3) The amount of purchase consideration due.
Purchasing Co. A/c. Dr.
To Realisation a/c

---

4) Assets & Liabilities not taken over by Purchasing Company will be realised/ paid separately.
Cash a/c Dr. Assets sold
To Realisation A/c.
Realisation a/c Dr. Liabilities paid
To Cash A/c.

---

5) Expense of take over/winding up are also to be debited to realisation a/c., if Vendor Co. is to bear the expenses.
Realisation a/c Dr.
To Cash a/c.

---

6) Capital a/c /Equity share capital a/c, Reserves-Surpluses, P&L a/c (Cr.), Realisation a/c (Cr.) etc. will be transferred (Credited) to Partners/Equity shareholders A/c.

P & L a/c(Dr.), Miscellaneous Expenses & Balance of Realisation a/c(Dr.) will also be transferred(Debited) to Partners/Equity shareholders a/c.

Note: The Profit, Reserves and Surplus or losses etc. of a Company belongs to its equity shareholders in proportion to the No. of shares held by them.

---

7) Preference Share Capital & Debenture Capital if any will be transferred to Preference Share Holder/ Debenture Holders a/c. Whenever the preference shares or debentures of the Vendor Co. are to be settled at premium that means they will be paid something more than their capital. In such cases, while transferring this capital to the holder a/c following entry to be passed.

Preference share/Debentures A/c Dr. (nominal value)

Realisation A/c Dr. (amount of premium payable)

To Preference shareholders/Debenture holders A/c. (with total amount due to them).

---

8) On receipt of Purchase consideration.

Shares a/c Dr.

Debentures a/c Dr.

Cash a/c Dr.

To Purchasing Co. a/c

---

9) Preference Shareholder/Debenture holders A/c. will be settled by giving them share, Debentures or Cash as may be given in the question.

---

10) Balance Shares, Debentures and Cash will be distributed to Partners/Equity Shareholders.

With this all the accounts will get closed.

As per AS-14 payments to debenture holders by purchasing (transferee) co. will not form part of purchase consideration therefore instead of accounting as per 7) & 9) above the debenture capital will also be transferred to realisation account and will be directly paid by purchasing company.

Illustration 5: Using the figures of **illustration 4** Show the necessary Accounts in the books of the Indo-Gulf Co. Ltd. and show the necessary journal entries recording the transactions.
Solution:

In the Journal of Indo Gulf Ltd (Vendor Company)

1.	Realisation A/c Dr. To Freehold Property a/c To Plant a/c To Stock a/c To Bills Receivable a/c To Debtors a/c To Goodwill a/c (Asset transferred to realisation a/c)	3,50,000	 1,50,000 83,000 35,000 4,500 27,500 50,000
2.	Debenture a/c Dr. Creditor a/c Dr. To Realisation a/c (Liabilities transferred to realisation a/c)	1,00,000 30,000	 1,30,000
3.	Equity Share Capital a/c Dr. Reserves a/c Dr. Profit & Loss a/c Dr. To Equity Shareholder a/c (Capital & Profit reserves transferred to shareholders a/c)	2,00,000 50,000 20,000	 2,70,000
4.	Continental Ltd a/c Dr. To Realisation a/c (Purchase consideration due)	2,45,000	 2,45,000
5.	Equity shares in Continental ltd a/c Dr. Cash / Bank a/c Dr. To Continental Ltd. a/c (Purchase consideration received)	1,65,000 80,000	 2,45,000
6.	Realisation a/c Dr. To Cash/Bank a/c (Realisation expense paid)	3,000	 3,000
7.	Realisation a/c Dr. To Cash/Bank a/c (Creditors paid)	30,000	 30,000
8.	Equity Share holders a/c Dr. To Realisation a/c (Loss on realisation transferred to shareholders)	8,000	 8,000
9.	Equity Share holders a/c Dr. To Equity shares in Continental ltd a/c To Cash/Bank a/c (Final dues paid to shareholders)	2,62,000	 1,65,000 97,000

In the Ledger of Indo Gulf ltd. (Vender Company)
Realisation a/c

Particulars	Rs.	Particulars	Rs.

To Fixed Deposit a/c	1,50,000	By Debentures a/c	1,00,000
To Goodwill a/c	50,000	By Creditors a/c	30,000
To Plant a/c	83,000	By Continental Ltd. a/c (purchase consideration due)	2,45,000
To Stock a/c	35,000		
To Bills Receivable a/c	4,500	By loss on Realization tr. to shareholders a/c	8,000
To Debtors a/c	27,500		
To Cash Bank a/c (expenses paid)	3,000		
To Cash Bank a/c (creditors paid)	30,000		
	3,83,000		3,83,000

Equity Shareholders a/c

Particulars	Rs.	Particulars	Rs.
To Realization loss	8,000	By Share Capital a/c	2,00,000
To Cash	97,000	By Reserves	50,000
To Share in Continental Ltd. a/c	1,65,000	By Profit & Loss a/c	20,000
	2,70,000		2,70,000

Continental Ltd. a/c

Particulars	Rs.	Particulars		Rs.
To Realization a/c	2,45,000	By Shares a/c	1,65,000	
		By Cash Bank a/c	80,000	2,45,000
	2,45,000			2,45,000

Cash / Bank a/c

Particulars	Rs.	Particulars	Rs.
To Balance b/f	50,000	By Realization a/c (expenses)	3,000
To Continental Ltd. a/c	80,000	By Realization a/c (creditors)	30,000
		By Shareholders a/c	97,000
	1,30,000		1,30,000

Shares in continental ltd. a/c

Particulars	Rs.	Particulars	Rs.
To Continental Ltd a/c	1,65,000	By Share holders a/c	1,65,000
	1,65,000		1,65,000

15.15. Explain INTEREST TO VENDORS:

- If the settlement is not done immediately then if agreed, interest at given rate may be paid from the Date of purchase till the date of settlement, on the amount of purchase consideration.
- It will be Debited to Interest to vendors A/c & will be transferred to Profit & Loss a/c. Vendor company will credit it to realisation a/c as income.

15.16. Explain accounting for INTER COMPANY OWINGS:

- Sometimes it happens that the Purchasing Company owes to the Vendor Company or Vendor Company owes to the Purchasing Company in either case, after the take-over the Purchasing Company will have equal amount in debtors and creditors, or Bill Receivable & Bills payable relating to the inter company owings which is cancelled by passing following entry in the books of Purchasing Company.

Creditors A/c./B.P. A/c. Dr. With the amount relating to inter co-owings.

To Debtors A/c/B.R. A/c.

Illustration 6: Ajanta Limited agreed to acquire the business of Elora Limited as on 31st December, 2011. Debtors of Elora Limited included Rs. 10,000 due from Ajanta Limited. Pass entry.

Solution:

Entry in the Books of Ajanta Ltd. (Purchaser)

	Creditor a/c Dr. To Debtor a/c (Mutual debt cancelled)	10,000	10,000

15.17. Explain adjustment for INTER COMPANY STOCK:

Give the journal entry to be passed for accounting unrealized profit on stock, under amalgamation. **[May,2009]**

At the time of takeover it is possible that:

(1) Vendor Company has in stock goods purchased from Purchasing Company which are at selling price i.e. it includes profit of purchasing company this stock will now be taken over by the Purchasing Company **or**

(2) Purchasing company may have in stock goods purchased from Vendor comapny which includes profit element of vendor company. In either case the closing stock is valued at a higher price i.e. it includes unrealised profit, such unrealised profit is eliminated from stock by passing following entry in Purchasing Co.'s books.

In case of Pooling of Interest Method

General Reserve/ Profit & Loss A/c. Dr.

To Stock Reserve A/c or Stock A/c. with the amount of unrealised profit

In case of Purchase Method

Goodwill/Capital Reserve A/c. Dr.

To Stock Reserve or Stock A/c. with the amount of unrealised profit

Illustration 7: Ajanta Limited agreed to acquire the business of Elora Limited as on 31st December, 2011. Stock of Elora Ltd. includes Goods worth Rs. 50,000/- purchased from Ajanta Ltd., which invoices the same at Cost + 25%. Pass entry.

Solution:

Entry in the Books of Ajanta Ltd. (Purchaser)

	Goodwill a/c / Capital Reserve a/c Dr. To Stock Reserve a/c (Unrealised profit in inter-co. stock adjusted) 50,000 ÷ 125 x 25 = 10,000	10,000	10,000

1. Inter company owing &/or inter co. stock will make no change in the accounting in the books of Vendor where all assets and liabilities will be transferred to realisation a/c. at its book value.
2. If the bill received from the other company, is got discounted, then it no more remains an inter company debt.

ENTRIES WHEN SAME BOOKS OF A/C. IS CONTINUED

(i.e. Vendor's books of accounts are used by the Purchasing Co.)

15.18. What will happen if purchaser continued the Books of Accounts of vendor

- Assets and liabilities taken at different values are adjusted (i.e. brought up to that agreed value) by giving the other effect to P & L Adj. A/c./Revaluation A/c. which is then transferred to Partners Capital A/c./ Share holders A/c.
  (1) Assets and Liabilities not take-over are either sold/settled separately or are transferred to Partners Capital A/c. in the ratio of their capital, but worthless assets are transferred in the profit sharing ratio. In case Vendor is a Co. such assets will be realised and liabilities will be paid and ultimate balance in this A/cs. will be transferred to Shareholders A/c. Reserves/ P &

L A/c. balance/ Preliminary/other expenses not yet Written off etc. will also be transferred to Partners Capital A/c./Share holders A/c.

(2) On the payment of purchase consideration Partners Capital A/c, Shareholders A/c. will be debited & Cash Bank A/c., Share Capital A/c., Debenture A/c. etc. will be credited.

Note:

1. In this case there will be no need to close Vendor CO's. Books.
2. In case of pooling of interest method only share capital account should be transferred to shareholders account and P.C. should be debited to this account. Any difference debit/credit will be adjusted in profit & loss / General reserve account.

Illustration 8: Atul and Behari, who have been carrying on a partnership business sharing in 2:1 ratio, agree on conversion of the firm into a private limited company with effect from April 1, 2011.

The agreement, among other things, includes the following terms:

(a) Goodwill of the firm is to be valued at Rs.1,20,000.

(b) Certain assets are to be revalued at their current realisable values as indicated below:

Furniture's	Rs.39,000
Car	Rs.13,000
Plant and Equipment	Rs.4,00,000

(c) The new company to be called Atul Behari (P) Ltd. Shall issue shares of Rs.10 each to the partners in consideration of take-over of the business.

The Balance Sheet of Atul and Behari on 31st March, 2011 immediately before putting the agreement into effect, reads as below:

Balance Sheet as at 31-3-2011

Liabilities	**Rs.**	**Assets**	**Rs.**
Sundry Creditors	1,60,000	Cash and Bank	50,000
		Sundry Debtors	60,000
Cash Credit from Bank	1,52,000	Stock and Stores	2,00,000
Partners' Capitals:		Furniture	50,000
Atul	2,30,000	Motor Car	12,000
Behari	1,30,000	Plant and Machinery	3,00,000
	6,72,000		6,72,000

You are required:

(a) to calculate the number of shares to be allotted by the new company by way of purchase consideration and suggest the equitable distribution thereof between the partners;

(b) Company wants to continue the same books of account of Vendor firm and

(c) to prepare the Balance Sheet of the new company assuming the agreement is implemented.

Solution:

Calculation of Purchase consideration

Assets taken over	
Cash and bank (assumed to have been taken over)	50,000
Debtors	60,000
Stock and stores	2,00,000
Furniture	39,000
Motor car	13,000
Plant & Machinery	4,00,000
Goodwill	1,20,000
	8,82,000
Less: Liabilities taken over	
Creditors	1,60,000
Cash credit from Bank	1,52,000
Purchase consideration	5,70,000

No. of equity shares to be issued = 5,70,000 ÷ 10 = 57,000

This shares should be distributed among the partners in their profit sharing ratio i.e. in 2:1, so as to maintain their profit sharing rights in company as well. Thus 38,000 shares amounting to Rs.3,80,000 to Atul & 19,000 shares amounting to Rs.1,90,000 to Behari be distributed and difference if any in their account can be settled by them mutually in cash etc.

Entry when Company wants to continue the same books of account of Vendor firm

Particulars	Dr. Rs.	Cr. Rs.
Goodwill A/c Dr. Machinery A/c Dr. Motor Car A/c Dr. To Furniture A/c To Atul A/c To Behari A/c (Asset, liabilities brought at the agreed value and resulting profit credited to partners in 2:1 ratio)	1,20,000 1,00,000 1,000	 11,000 1,40,000 70,000
Atul A/c Dr. Behari A/c Dr. To Equity Share Capital A/c (Shares allotted as purchase consideration in 2:1 ratio)	3,80,000 1,90,000	 5,70,000
Behari A/c Dr. To Atul A/c (Balance in partners account is mutually settled by them)	10,000	 10,000

Capital Account

Particulars	Atul	Behari	Particulars	Atul	Behari
To Equity Share Capital	3,80,000	1,90,000	By Balance b/f	2,30,000	1,30,000
To Atul A/c	--	10,000	By Profit on revaluation	1,40,000	70,000
			By Behari A/c	10,000	--
	3,80,000	2,00,000		3,80,000	2,00,000

Balance Sheet of M/S Atul Behari (P) Ltd.
As On 01.04.2011

	Particulars		Notes		Rs.
	1		3	4	5
I.	**EQUITY AND LIABILITIES**				
(1)	**Shareholders' funds**				
	Share capital				5,70,000
(2)	Share application money pending allotment				--
(3)	**Non-current liabilities**				
	Long-term borrowings: Loans				
(4)	**Current liabilities**				
	Short term Borrowing: Cash credit			1,52,000	
	Trade Payables			1,60,000	3,12,000
	TOTAL				**8,82,000**
II.	**ASSETS**				
(1)	**Non-current assets**				
	Fixed assets				
	Tangible : Plant & Machinery	4,00,000			
	Motor Car	13,000			
	Furniture	39,000		4,52,000	

	Intangible : Goodwill		1,20,000	5,72,000
(2)	**Current assets**			
	Stock in trade		2,00,000	
	Trade receivables		60,000	
	Cash and cash equivalents		50,000	3,10,000
	TOTAL			**8,82,000**

DISTRIBUTION OF SHARES/DEBENTURES ETC. BETWEEN PARTNERS WHEN VENDOR IS A FIRM

15.19. How shares will be distribution among the partners

- The ultimate balances in the Capital A/c. after transferring Profit/Loss on realisation are to be settled by distributing shares, debentures cash etc. among partners. Generally, the objective is to make distribution in such a way so as to maintain same rights between them as to profit sharing, interest etc. in the Company as was in the firm.
  (1) Partners Capital are to be adjusted according to profit sharing ratio, taking that partners capital as base, who has minimum capital as compared to his profit sharing ratio & excess capital of the other partners is to be found out. Equity shares are to be issued equal to the amount of adjusted capital. For the excess capital pref. shares to be issued bearing such rate of dividend as was the rate of interest on capital. But if the No. of Equity shares to be issued is already given then these are to be distributed to the partners in their profit sharing ratio and for the balance of Capital, Pref. Share/Cash may be distributed.
  (2) If Partners loan A/c. is also there then that much debentures may be issued bearing the same rate of interest as was payable on loan.

Illustration 9: Ram, Rahim and Rogers carry on business in partnership under the style of M/s. R & Co. sharing Profits & Losses in the ratio of 5:3:2. They have floated R Pvt. Ltd. for the purpose of takeover of their business. The following is the Balance Sheet of the firm as on 30th September, 2011:

M/s. R & Co.
Balance Sheet as on 30-9-2011

Liabilities		**Rs.**	**Assets**		**Rs.**
Creditors		50,000	Cash		6,000
			Bank		14,000
Capitals:			Debtors	60,000	
Ram	1,01,000		Less: Prov. for doubtful debts	2,000	58,000
Rahim	1,51,000		Stock		42,000
Rogers	1,33,000	3,85,000	Fixed Assets:		
			Written Down Value		3,00,000
			Expenditure in relation to R Pvt. Ltd.:		
			Formation Expenses	12,000	
			Bank A/c. in the name of R Pvt. Ltd. Deposit of par value of 300 equity shares of Rs.10 each subscribed equally by Ram, Rahim and Rogers as subscribers to the Memorandum of Articles of Association	3,000	15,000

	4,35,000		4,35,000

On that day R Pvt. Ltd. took over the business for a total consideration of Rs.5,00,000. The purchase consideration was to be discharged by the allotment of equity shares of Rs.10 each at par in the profit sharing ratio and 15% debentures of Rs.100 each at par for surplus capital.

The Directors of R Pvt. Ltd. revalued the fixed assets of R & Co. at Rs. 4,00,000.

You are asked to:

(a) State the number of equity shares and debentures allotted by R Pvt. Ltd. to Ram, Rahim and Rogers.

(b) Show journal entries in connection with the above transactions in the books of R Pvt. Ltd.

Solution:

Calculation of Shares and Debentures to be allotted:

	Ram	Rahim	Roger	Total
1. Capital Balance	1,01,000	1,51,000	1,33,000	3,85,000
2. (+) Profit on realization (W.N.1)	57,500	34,500	23,000	1,15,000
3. Total	1,58,500	1,85,500	1,56,000	5,00,000
4. Profit sharing Ratio	5	3	2	
5. Capital per share of profit (3 ÷ 4)	31,700	61,833	78,000	
6. Adjusted Capital for which Equity shares given (W.N.2 & 3)	1,58,500	95,100	63,400	3,17,000
7. Surplus Capital (3 - 6) for which 15% debentures of Rs.100 each at par value to be given.	—	90,400	92,600	1,83,000
8. Number of Equity share (6 ÷ Rs.10)	15,850	9,510	6,340	31,700
9. Number of Debentures (7 ÷ Rs.100)	--	904	926	1,830

W.N.1 :- Capital Rs. 3,85,000 means net assets as per books is Rs. 3,85,000 and purchase consideration is Rs. 5,00,000 thus there is profit on realization of Rs. 1,15,000.

W.N.2 :- Adjusted capital is calculated taking lowest capital i.e. Rams capital as base like Rahims adjusted capital is = 31,700 x 3 = 95,100. Lowest is taken as base so that we can get surplus/excess capital of other partners.

W.N.3 :- Equity shares will be given equal to the amount of Adjusted capital so that their profit sharing will remain same as was in the firm. For surplus/excess capital Preference share or Debenture can be given.

In the Books of R Pvt. Ltd. (Purchaser Co.)

1.	Business Purchase a/c Dr. To R & Co. a/c (Purchase consideration due)	5,00,000	 5,00,000
2.	Cash a/c Dr. Bank a/c Dr. (14,000 + 3,000) Debtors a/c Dr. Stock a/c Dr. Fixed Asset a/c Dr. Preliminary expense a/c Dr. Goodwill a/c Dr. (Balancing figure) To Business Purchase a/c To Creditors a/c To Provision for Bad Debt a/c (Assets, liabilities acquired recorded)	6,000 17,000 60,000 42,000 4,00,000 12,000 15,000	 5,00,000 50,000 2,000
3.	R & Co. a/c Dr. To Equity share Capital a/c To 15% Debentures a/c (Purchase consideration paid)	5,00,000	 3,17,000 1,83,000

Balance Sheet of M/S R Pvt. Ltd.
As On 30.09.2011

	Particulars	Notes		Rs.
	1	3	4	5
I.	**EQUITY AND LIABILITIES**			
(1)	**Shareholders' funds**			
	Share capital		3,17,000	
	Reserves & Surplus: P&L A/c (Dr. Balance)		(-)12,000	4,05,000
(2)	Share application money pending allotment			--
(3)	**Non-current liabilities**			
	Long-term borrowings: Debenture			1,83,000
(4)	**Current liabilities**			
	Trade Payables			50,000
	TOTAL			**5,38,000**
II.	**ASSETS**			
(1)	**Non-current assets**			
	Fixed assets : Tangible		4,00,000	
	Intangible : Goodwill		15,000	4,15,000
(2)	**Current assets**			
	Stock in trade		42,000	
	Trade receivables 60,000			
	Less Provision 2,000		58,000	
	Cash and cash equivalents (6,000 + 17,000)		23,000	1,23,000
	TOTAL			**5,38,000**

* As per AS-26 Preliminary Expense should be written off. Hence Profit & Loss A/c (Dr. balance) is shown in Reserve & Surplus.

DEBTORS & CREDITORS TAKEN OVER ON VENDOR'S BEHALF

15.20. Explain accounting if vendor's Debtors & creditors are being settled on behalf of vendor by purchaser

- Sometimes Purchasing Co. doesn't take over the debtors and creditors but agrees to collect debts and pay creditors on behalf of Vendor then entries will be as follows in the books of Purchaser Co.

(1) At the time of acquisition
Vendor's Debtor A/c. Dr. with Book value of debtors
To Vendor's Creditors A/c. with Book value of creditor
To Vendor's A/c with difference

(2) On Collection from debtors
Cash/Bank A/c. Dr. Actual Amount collected
To Vendors Debtors A/c

(3) On Payments to Creditors
Vendors Creditors A/c. Dr.
To Cash/Bank A/c Amount Paid

(4) Ultimate balance in Debtors/Creditors A/c is transferred to Vendors A/c (Balance will be due to Discount/ Bad debts etc.)

(5) Commission if any, company is entitled to get from Vendors for this services.
Vendors A/c. Dr.
To Commission A/c.

(6) Ultimate balance in Vendors A/c. is settled.
Vendors A/c. Dr.
To Cash/Bank A/c
To Share Capital A/c
To Debenture A/c

Illustration 10: Atul and Behari, who have been carrying on a partnership business, agree on conversion of the firm into a private limited company with effect from April 1, 2011.

The agreement, among other things, includes the following terms:

The new company shall not assume the debtors and the creditors but shall assist the vendor-firm in realisation and settlement and will be entitled for commission of 3% on collection from debtors and 2% on amount paid to creditors.

Debtors were Rs.2,20,000 but ultimate collection was Rs.2,00,000

Creditors aggregated to Rs.1,60,000 which were settled at Rs.1,50,000.

Pass necessary entries for above in the books of Company.

Solution:

Entry in the books of Company for Vendor's Debtor & Creditor

Particulars	Dr. Rs.	Cr. Rs.
Vendor Debtor A/c Dr. To Vendor Creditor A/c To Vendor A/c (Balancing figure) (Vendors debtor creditor recorded for collection & settlement)	2,20,000	 1,60,000 60,000
Bank A/c Dr. Vendor A/c Dr. (Bad debt/Discount) To Vendor Debtors A/c (Vendors debtor realised)	2,00,000 20,000	 2,20,000
Vendor Creditor A/c Dr. To Bank A/c To Vendor A/c (Discount) (Vendor creditors settled)	1,60,000	 1,50,000 10,000

Amalgamation

Vendor A/c Dr. To Commission A/c (Commission due 2,00,000 X 3% + 1,50,000 X 2%)	9,000	 9,000
Vendor A/c Dr. To Bank A/c (Vendor's account settled)	41,000	 41,000

Average Due Date

INTRODUCTION

Average due date is the weighted average of given any number of dates with equal or unequal amounts. It is a single equivalent date for those different dates, hence anything (like interest) to be measured from those respective dates can be alternatively measured from this average due date.

If a party has to pay different amounts due on different dates to the same party then if they want to settle, such total amount on the particular date without loosing or gaining anything by way of interest then such a date is called as the Average due date. This amount due may be on account of Bill of Exchange, Loans or any other transactions.

3.1. What is due date

A date on which a transaction (like sale, purchase, loan installment) or bills/ promissory notes etc. falls due for settlement (i.e. due for receipt or payment) is known as due date.

3.2. How is due date calculated

- We get due date by adding the credit/ bill period on the relevant date + 3 days of grace if applicable.
- Relevant date in case of bills of exchange may be date of bill or date of acceptance, as specified in the terms of the bill, in other cases it will be the date of transaction.

1. For calculating the due dates of the bill, `after date' means after the date of bill and `after sight'/after acceptance means after the date of presenting the bill or the date of accepting the bill.

   Date of Bill = Date of Drawing Bill = Date of Signing Bill

   Date of Sight = Date of Presentation = Date of Acceptance
2. While calculating due date (also known as **date of maturity**), 3 days of grace is added only in case of Bills of Exchange or Promissory Note, but not in case of general transactions.

Illustration 1. Calculate due date of a 3 month bill dated 10.8.03.

Ans. Due date = 10.8.03 + 3 month + 3 days = 13.11.03

Illustration 2. Goods sold on 10.1.04 on 2 month credit.

Ans. due date = 10.1.04 + 2 month = 10.3.04

Remember 3 days of grace are applicable only in case of bills of exchange or promissory notes.

3.3. How the effect of holidays is taken while ascertaining due date

a. In case of Bills of Exchange & Promissory Notes if the due date falls on a Public Holiday (As per Negotiable Instrument Act) then the due date will be the <u>preceding</u> working day. Sunday is a public holiday.
b. In case of other Emergency Holidays, subsequent working day will be taken as due date
c. In case of transactions other then Bills of Exch. & Promissory Notes the due date can always be taken on working day, subsequent to Public Holiday or Emergency Holiday (or unforseen holiday).

Effect of holidays on due dates (i.e. what to do if the due date falls on holiday)

Due date relates to	Holiday is	Date to be considered as due date
1. Bills of exchange/ promissory notes	a. Public holiday	Preceding (previous) working day
	b. Emergency holiday (unscheduled/ sudden)	Subsequent (next) working day
2. Other cases like, sale, purchase, etc.	a. Public holiday	Subsequent (next) working day
	b. Emergency holiday	-- do --

Illustration 3: A draws a 3 month bill on B on 12.05.2011 calculate its due date.
Solution: Due date = 12.05.2011 + 3 month + 3 days of grace = 15.08.2011 but because 15.08.2011 is a public holiday the due date will be preceding working day i.e. 14.08.2011.
Presuming it is a holiday like Sunday then due date will be 13.08.2011 the preceding working day.

Illustration 4: X draws a 4 month bill on Y on 10.05.2011 calculate its due date if on original due date a sudden holiday is declared.
Solution: Due date = 10.05.2011 + 4 month + 3 days of grace = 13.09.2011 but because on 13.09.2011 a sudden holiday is declared, the due date will be next working day i.e. 14.09.2011 Presuming it is a holiday like Sunday then due date will be 15.09.2011 the next working day.

Illustration 5: Ram sales goods on 2 month credit to Shyam on 26.11.2011 calculate its due date.
Solution: Due date = 26.11.2011 + 2 month = 26.01.2012 but because 26.01.2012 is a public holiday the due date will be next working day i.e. 27.01.2012.
Presuming it is a holiday like Sunday then due date will be 28.01.2012 the next working day.

Illustration 6: Irfan sales goods on 60 days credit to John on 10.05.2011 calculate its due date if on original due date a sudden holiday is declared.
Solution: Due date = 10.05.2011 + 60 days = 09.07.2011 but because on 09.07.2011 a sudden holiday is declared, the due date will be next working day i.e. 10.07.2011 Presuming it is a holiday like Sunday then due date will be 11.07.2011 the next working day.

3.4. What is average due date & When it can be used.

Define Average due date. List out the various instances when average due date can be used. **[May,2014]**

Average due date is the weighted average date of different due dates relating to various transaction (debit and/or credit) due between the same parties.
Average due date can be used anywhere, when items of same nature and between same parties are to be represented by a single date for convenience of interest calculation &/or settlement.
Ex: 1. Payments due on different date by a debtor to a creditor. 2. Receivable and payables both due between parties. 3. Bills receivable and Bills payables falling due on different dates to be settled by a single new bill. 4. Interest on drawings made on different date. 5. Loans repayable in equal periodic installment. 6. Loans distributed in equal periodic installment. Etc.

3.5. Briefly explain the process of calculating average due date.

Process of calculating average due date

1. Find out the due dates of all the bills/transactions if not already given.
2. Select any one date as the base date preferably the earliest date, although any date even other than due date can be taken. (Answer will be same irrespective of the base date selected)
3. Calculate the days of difference between each due date and the base date. If the due date is prior to base date then `minus' sign will be marked against the days.
   Base date → (to) due date = + days
   Due date → (to) base date = (–) days
4. The days [calculated in No.(3) above] should be multiplied with the amounts of respective bills/transactions.
5. The total (sum), of the products [calculated in (4) above] will be divided by the total of amount of bills/transactions.
6. The resultant figure in No.(5) above shows that the average due date is so many days away from the base date or if the sign is minus, so many days before the base date.
7. The days will be added or subtracted (if minus) from the base date to get the Average due date.

Average Due Date of normal trade transaction

Illustration 7: Find out Average Due Date from the following:

Rs. 6,000/-	due on	05/02/96,
Rs. 3,200/-	due on	07/04/96,
Rs. 5,700/-	due on	15/07/96,
Rs. 7,000/-	due on	18/09/96

Solution: Let the base date be 5.2.96

DUE DATE	AMOUNT	DAY FROM BASE DATE	PRODUCT (Amt x days)
5.2.96	6,000	0	0
7.4.96	3,200	62	1,98,400
15.7.96	5,700	161	9,17,700
18.9.96	7,000	226	15,82,000
	21,900		26,98,100

$$\text{Average due date} = \text{Base date} + \frac{\text{Sum of Product}}{\text{Sum of Amount}}$$

$$= 5.2.96 + \frac{26,98,100}{21,900} = 5.2.96 + 123\text{ days} = 7\text{th June}, 1996$$

Working of days from Base date to Due date

DUE DATE	FEB (from 5.2)	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	TOTAL
7.4.96	24	31	7	-	-	-	-	-	62
15.7.96	24	31	30	31	30	15	-	-	161
18.9.96	24	31	30	31	30	31	31	18	226

How to check leap year: 1996 ÷ 4 = 499 → It is clear division that means , 1996 is a leap year comprising of 366 days with February of 29 days.

Average Due Date of Bills of exchange

Illustration 8: A trader having accepted bills falling due on different dates now desires to have his bills cancelled & to accept a new bill for the whole amount payable on the average due date. Calculate Av. Due date.

Date of Bill	Date of Acceptance	Amount	Term/ usence of bill

01/03/99	03/03/99	400.00	2 months from date bill
06/03/99	10/03/99	300.00	3 months from date of Acceptance.
05/04/99	10/04/99	200.00	2 months after sight
15/04/99	20/04/99	325.00	1 months from date of signing.
10/05/99	12/05/99	500.00	60 days from date of bill.

Solution: Let the base date be 4.5.99

DUE DATE	AMOUNT	DAYS FROM BASE DATE	PRODUCT (Amt x days)
4.5.99	400	0	0
13.6.99	300	40	12,000
13.6.99	200	40	8,000
18.5.99	325	14	4,550
12.7.99	500	69	34,500
	1,725		59,050

$$\text{Average due date} = \text{Base date} + \frac{\text{Sum of Product}}{\text{Sum of Amount}}$$

$$= 4.5.99 + \frac{59050}{1725} = 4.5.99 + 34.23 \text{ days} = 7\text{th June} 99$$

Working of days from Base date to Due date

DUE DATE	MAY (From 4.5)	JUNE	JULY	TOTAL
13.6	27	13	-	40
13.6	27	13	-	40
18.5.	14	-	-	14
12.7.	27	30	12	69

3.6. Explain calculation of average due date when debit & credit both balances are there.

Calculation of Average Due Date will be same as studied in earlier section. But here there are debit (receivable) & credit (payable) both balances which are opposite to each other, hence while calculating sum of amount the same will get netted and similarly their products will also be debit & credit and hence will also get netted.

Average Due Date when debit & credit both balances are there

Illustration 9: Two traders X & Y buy goods from one another each allowing the other 1 months credit. At the end of 3 months the details are as follows; calculate the date upon which the balance should be paid so that no interest is due to either X or Y.

Goods sold by X to Y -> i) 18/04/96 Rs. 60. ii) 15/05/96 RS. 70, iii) 16/06/96 Rs. 80.

Goods sold by Y to X -> i) 23/03/96 Rs. 52, ii) 24/05/96 Rs. 50.

Solution:

Let base date be 23.4.96 (student can take any other date as base date, the ultimate answer will be same)

DUE DATE	AMOUNT	DAYS FROM BASE DATE 23.4.1996	PRODUCT
X to receive from Y			
18.5.96	60	25	1,500
15.6.96	70	53	3,710
16.7.96	80	84	6,720
	210		11,930
X to pay to Y			

23.4.96	52	0	0
24.6.96	50	62	3,100
	102		3,100
X to receive from Y (Net)	108		8,830

Therefore,

$$\text{Average due date} = \text{Base date} + \frac{\text{Difference of Sum of Product}}{\text{Difference of Sum of Amount}}$$

$$= 23.4 + \frac{8,830}{108} = 23.4.96 + 81.76 = 23.4. + 82 \text{ days} = 14\text{h July },1996$$

Therefore 14th July is the average due date.

Note: Due date of each transaction is calculated by adding credit period of one month. These are not bills of exchange/ promissory notes, hence days of grace will not be added.

3.7. Explain simple calculation of average due date and when it can be done.

Calculation of Average Due Date where amount is lent in Single Installment & repayment is made in number of equal installments, can be made as follows. Amount of various installments must be same.

$$\text{Average Due Date} = \text{Date of lending} + \frac{\text{Sum of days (months or years) from the date of lending to the date of repayment of each instalment}}{\text{Number of instalments}}$$

Note: If time gap between installments is given in years then use years, if given in months use months otherwise use days.

Average Due Date Calculation when amounts are equal

Illustration 10: Rs. 10,000 lent (advanced) by Das Bros. to kumar & Sons. on 1st Jan.2009, is repayable in 5 equal annual installments commencing on 1st January 2010, Find the Average Due Date & Calculate Interest at 5% p.a. which Das Bros. will recover from Kumar & Sons.

Solution: $\text{Average due date} = \text{Date of lending} + \frac{\text{Sum of years each instalment is away from date of lending}}{\text{Number of instalments}}$

$$\text{Average due date} = 1.1.2009 + \frac{1+2+3+4+5}{5} = 1.1.2009 + 3 \; years = 1.1.2012$$

$$\text{Interest} = 10000 \times \frac{5}{100} \times 3\,(1.1.2009 \; to \; 1.1.12) = 1500$$

Cross verification of formula: Base date 1.1.2009 is taken to prove above formula.

Due date **(1)**	Amount **(2)**	Years **(3)**	Product **(4)**
1.1.2010	2,000	1	2,000 x 1
1.1.2011	2,000	2	2,000 x 2
1.1.2012	2,000	3	2,000 x 3
1.1.2013	2,000	4	2,000 x 4
1.1.2014	2,000	5	2,000 x 5
	2,000 x 5		2,000 (1+2+3+4+5)

$$\text{Average due date} = \text{Date of lending} + \frac{\text{Sum of years each instalment is away}}{\text{Number of instalment}}$$

$$\text{Average due date} = 1.1.2009 + \frac{2,000(1+2+3+4+5)}{2000 \times 5} = 1.1.2009 + \frac{1+2+3+4+5}{5} = 1.1.2012$$

3.8. Explain base date.

In the calculation of average due date, only the due date of the first transaction must be taken as the base date. True or False **(Nov. 2003)** [**Answer:** False. Any date can be taken as base date]

- While calculating average due date of may due dates, any date out of the given date or other wise is selected as base date, so as to give effect of weightage of the amounts of each due date.
- If an earliest date is taken as base date then the days (of difference from base date to each due date) will be all positive and consequently the calculations will be simplified. If the last date is taken base date then all days will be negative.
- But irrespective of the base date selected, the answer (average due date) of a given data will be always same.

3.9. How interest/ rebate can be calculated with average due date

If total amount is paid after the 'Average due date' then the payer will be liable to pay interest on total amount for the period delay and if the amount is paid before the `Average due date' then the payer will get rebate (discount) for the early payment.

Illustration 11: Amit purchased goods from Sumit, the average due date for payment in cash is 10.08.2011 and the total amount due is Rs.50,000.

How much amount should be paid by Amit to Sumit if total payment is made on following dates & interest is to be considered at the rate of 12% p.a.i) on average due date ii) 25th August; iii) 30th July.

Solution:

Amit to pay to Sumit following amounts.

(i) If the full amount Rs.50,000 is paid on average due date i.e. 10th August then there is neither delay nor an early payment, hence no interest / rebate. Amount to be paid is Rs.50,000

(ii) If total amount is paid on 25th August then there is delay of 15 days, hence interest will be charged.

$$Interest = 50,000 \times \frac{12}{100} \times \frac{15}{365} = Rs.\,246.58$$

Total payment = 50,000 + 246.58 = 50,246.58

(iii) If that payment is made on 30th July then it is an early payment by 11 days.

Hence rebate will be granted Rebate $= 50,000 \times \frac{12}{100} \times \frac{11}{365} = Rs.180.82$

Total amount = 50,000 – 180.82 = 49,819.18

3.10. Why no interest charged/ taken if settlement is done on average due date

In case of normal trading transactions, the time (credit period) given upto due date is free of interest and the average due date is only equivalent (representative) of these due dates, hence if there is no interest for settlement of individual transaction on respective due date, likewise there will be no interest on settlement on average due date because both are equal.

3.11. How average due date is used for calculating interest on drawings

- Drawings are made by partner/ proprietor on different dates during the year and it is settled (adjusted against capital account) at the end of the year.
- Hence interest whenever applicable is calculated from the date of drawing to the year end date on each amount.
- When we calculate average due date, it is the average date (equivalent date) of total drawings made hence interest on total amount of drawing is calculated from the average due date to the year end date.

Illustration 12: (CS Dec. 1994) A partner has withdrawn the following sums of money during the half-year ended 30th June, 2011:

	Rs.
January 15	300
February, 28	250
March, 10	150
March, 26	200
April, 20	400
May, 16	300
June, 18	500

Interest is to be charged at 8% per annum. Find out the average due date and calculate the amount of interest to be debited to the partner.

Solution:

Due date (date of drawing) **(1)**	Amount (of drawing) **(2)**	Day from base date (15.1.2011) to due date **(3)**		Product (2 x 3) **(4)**
January 15, 2011	300		0	0
February 28	250	16+28	44	11,000
March 10	150	16+28+10	54	8,100
March 26	200	16+28+26	70	14,000
April 20	400	16+28+31+20	95	38,000
May 16	300	16+28+31+30+16	121	36,300
June 18	500	16+28+31+30+31+18	154	77,000
	2,100			1,84,400

Average due date = 15.1.2011 + (1,84,400 ÷ 2,100)

= 15.1.2011 + 88 days

= 13th April 2011

Average due date is the representative date of all the due dates. That means we can say that drawing Rs. 2100 is made on 13.4.2011.

Interest on drawings is calculated from the date of drawing to the end of period.

∴ Here interest will be calculated from 13.4.2011 to 30.6.2011 = 78 days

∴ Interest = $2100 \times \frac{8}{100} \times \frac{78}{365} = Rs. 35.90$ *say Rs. 36/-*

Note: Even if we calculate individually on each drawing amount, from the date of drawing to 30.6.1994, the total interest will be Rs. 35.90 only.

3.12. How simple interest can be calculated when loan is repaid on different dates

- Calculate the average due date of loan installments repaid. Simple interest will be from the date of lending (granting) to the average due date on the total amount of loan.
- **Note:** In normal cases the interest is by compounding i.e. interest on each due date is added to loan and amount repaid is deducted, then on the remaining balance this process is repeated on next due date. Such compounded interest can not be calculated by this average date concept.

Illustration 13: Rs. 50,000 lent (advanced) by Ambani Bros. to Tata Sons. on 1st Jan.2011, is repayable in 5 equal annual installments commencing on 1st January 2012, Find the Average Due Date & Calculate Interest payable at 15% p.a.

Solution: $\text{Average due date} = \text{Date of lending} + \dfrac{\text{Sum of years each instalment is away}}{\text{Number of instalment}}$

$$\text{Average due date} = 1.1.2011 + \frac{1+2+3+4+5}{5} = 1.1.2011 + 3\ years = 1.1.2014$$

$$\text{Interest} = 50{,}000 \times \frac{15}{100} \times 3\,(1.1.2011\ to\ 1.1.2014) = 22{,}500.$$ This is simple interest.

Illustration 14: Mr. A lends Rs. 25,000 to Mr. B on 1st Jan.,2000. Calculate the average due date and interest, if interest @ 18% p.a. to be charged by A in each of the following alternative cases:

a. If the amount is repayable in 5 equal annual installments commencing from 1st January, 2001.
b. If the amount is repayable in 5 half yearly equal installments commencing from 1st January, 2001.
c. If the amount is repayable in three equal installments at an interval of two years commencing from 30th June, 2002.
d. If the amount is repayable in 5 equal installments as under:- I(01.01.2001); II(1.7.2001); III(1.7.2002); IV(01.01.2003); V (01.01.2004)

Solution: Period is in years or months, from the date of lending (i.e. 1.1.2000) to the due date of installment.

Case (a)

$$\text{Average Due Date} = \text{Date of Lending} + \frac{\text{Sum of Year's Digits}}{\text{Number of Instalments}}$$

$$= 01.01.2000 + \frac{1+2+3+4+5}{5}$$

= 01.01.2000 + 3 years = 1st Jan, 2003

$$\text{Interest} = \text{Rs. } 25{,}000 \times 3 \times \frac{18}{100} = \text{Rs. } 13{,}500$$

Case (b)

$$\text{Average Due Date} = \text{Date of Lending} + \frac{\text{Sum of Month's Digits}}{\text{Number of Instalments}}$$

$$= 01.01.2000 + \frac{12+18+24+30+36}{5} = 01.01.2000 + \frac{120}{5}\text{ months}$$

= 01.01.2000 + 24 Months = 1st Jan, 2002

$$\text{Interest} = \text{Rs. } 25{,}000 \times \frac{24}{12} \times \frac{18}{100} = \text{Rs.}9{,}000$$

Case (c)

$$\text{Average Due Date} = \text{Date of Lending} + \frac{\text{Sum of Year's Digits}}{\text{Number of Instalments}}$$

$$= 01.01.2000 + \frac{2.5+4.5+6.5}{3} = 01.01.2000 + 4.5 \text{ years}$$

= 1st July, 2004

$$\text{Interest} = \text{Rs. } 25{,}000 \times 4.5 \times \frac{18}{100} = \text{Rs. } 20{,}250$$

Case (d)

$$\text{Average Due Date} = \text{Date of Lending} + \frac{\text{Sum of Month's Digits}}{\text{Number of Instalments}}$$

$$= 01.01.2000 + \frac{12 + 18 + 30 + 36 + 48}{5} = 01.01.2000 + 28.8 \text{ months}$$

(28.8 month means 28 month complete and .8 portion of 29th month i.e. 31X.8= 25 days)

= 26th May, 2002

$$\text{Interest} = \text{Rs. } 25{,}000 \times \frac{28.8}{12} \times \frac{18}{100} = \text{Rs.}10{,}800$$

3.13. How to decide about taking 365 days or 366 days or How to decide whether February has 28 days or 29 days.

- The year of which February is involved in our calculation should be divided by 4. If it is perfectly divided then the year is a leap year having February of 29 days and year contains 366 days. Otherwise i.e. if the year divided by 4 gives result in fraction then the February is of 28 days and year is of 365 days.

Illustration 15:

i) year 2003 → 2003/4 = 500.75 thus it is non leap year with February 28 days

ii) year 2004 → 2004/4 = 501 thus it is a leap year with February of 29 days and year contains 366 days.

iii) If the period under consideration is 1.4.2003 to 31.3.2004 it has February of 2004 hence year will have 366 days.

NOT FOR PROFIT ORGANISATION

- **Meaning and Characteristics of Not-for-Profit Organisation**

Not-for -Profit Organisations refer to the organisations that are for used for the welfare of the society and are set up as charitable institutions which function without any profit motive. Their main aim is to provide service to a specific group or the public at large. Normally, they do not manufacture, purchase or sell goods and may not have credit transactions. Hence they need not maintain many books of account (as the trading concerns do) and Trading and Profit and Loss Account. The funds raised by such organisations are credited to capital fund or general fund. The major sources of their income usually are subscriptions from their members donations, grants-in-aid, income from investments, etc. The main objective of keeping records in such organisations is to meet the statutory requirement and help them in exercising control over utilisation of their funds. They also have to prepare the financial statements at the end of each accounting period (usually a financial year) and ascertain their income and expenditure and the financial position, and submit them to the statutory authority called Registrar of Societies.

- ***The main characteristics of such organisations are***:

1. Such organisations are formed for providing service to a specific group or public at large such as education, health care, recreation, sports and so on without any consideration of caste, creed and colour. Its sole aim is to provide service either free of cost or at nominal cost, and not to earn profit.
2. These are organised as charitable trusts/societies and subscribers to such organisation are called members.
3. Their affairs are usually managed by a managing/executive committee elected by its members.
4. The main sources of income of such organisations are: (i) subscriptions from members, (ii) donations, (iii) legacies, (iv) grant-in-aid, (v) income from investments, etc.
5. The funds raised by such organisations through various sources are credited to capital fund or general fund.
6. The surplus generated in the form of excess of income over expenditure is not distributed amongst the members. It is simply added in the capital fund.
7. The Not-for-Profit Organisations earn their reputation on the basis of their contributions to the welfare of the society rather than on the customers' or owners' satisfaction.
8. The accounting information provided by such organisations is meant for the present and potential contributors and to meet the statutory requirement.

- ***Final Accounts or Financial Statements:*** The Not-for-Profit Organisations are also required to prepare financial statements at the end of the each accounting period. Although these organisations are non-profit making entities and they are not required to make Trading and Profit & Loss Account but it is necessary to know whether the income during the year was sufficient to meet the expenses or not. Not only that they have to provide the necessary financial information to members, donors, and contributors and also to the Registrar of Societies. For this purpose, they have to prepare their final accounts at the end of the accounting period and the general principles of accounting are fully applicable in their preparation as stated earlier, the final accounts of a 'not-for-profit organisation' consist of the following:

(i) Receipt and Payment Account
(ii) Income and Expenditure Account, and
(iii) Balance Sheet.

The Receipt and Payment Account is the summary of cash and bank transactions which helps in the preparation of Income and Expenditure Account and the Balance Sheet. Besides, it is a legal requirement as the Receipts and Payments Account has also to be submitted to the Registrar of Societies along with the Income and Expenditure Account, and the Balance Sheet. Income and Expenditure Account is akin to Profit and Loss Account. The
Not-for-Profit Organisations usually prepare the Income and Expenditure Account and a Balance Sheet with the help of Receipt and Payment Account. However, this does not imply that they do not make a trial balance. In order to check the accuracy of the ledger accounts, they also prepare a trial balance which facilitates the preparation of accurate Receipt and Payment Account as well as the Income and Expenditure Account and the Balance Sheet.
In fact, if an organisation has followed the double entry system they must prepare a trial balance for checking the accuracy of the ledger accounts and it will also facilitate the preparation of Receipt and Payment account. Income and Expenditure Account and the Balance Sheet.

▪ ***Receipt and Payment Account***

It is prepared at the end of the accounting year on the basis of cash receipts and cash payments recorded in the cash book. It is a summary of cash and bank transactions under various heads. For example, subscriptions received from the members on different dates which appear on the debit side of the cash book, shall be shown on the receipts side of the Receipt and Payment Account as one item with its total amount. Similarly, salary, rent, electricity charges paid from time to time as recorded on the credit side of the cash book but the total salary paid, total rent paid, total electricity charges paid during the year appear on the payment side of the Receipt and Payment Account. Thus, Receipt and Payment Account gives summarised picture of various receipts and payments, irrespective of whether they pertain to the current period, previous period or succeeding period or whether they are of capital or revenue nature. It may be noted that this account does not show any non cash item like depreciation. The opening balance in Receipt and Payment Account represents cash in hand/cash at bank which is shown on its receipts side and the closing balance of this account represents cash in hand and bank balance as at the end of the year, which appear on the credit side of the Receipt and Payment Account. However, if it is bank overdraft at the end it shall be shown on its debit side as the last item.

Receipts	***Payments***
1. Donations (a) General (b) Specific purpose 2. Entrance Fees 3. Legacies 4. Sale of Investments 5. Sale of Fixed Assets 6. Subscriptions from Members 7. Life Membership Fees 8. Sale of old Newspapers 9. Sale of Old Sports Material 10. Interest on Fixed Deposits 11. Interest/ Dividend on Investments 12. Proceed from Charity Shows 13. Sale of Scrap 14. Grant-in-aid 15. Interest/Dividend on Specific Fund Investments	1. Purchase of Fixed Assets 2. Purchase of Sports Material 3. Investment in Securities 4. Printing and Stationery 5. Postage and Courier Charges 6. Advertisements 7. Wages and Salary 8. Honorarium 9. Telephone Charges 10. Electricity and Water Charges 11. Repairs and Renewals 12. Upkeep of Play Ground 13. Conveyance Charges 14. Subscription for Periodicals 15. Audit Fees 16. Entertainment Expenses 17. Municipal Taxes 18. Charity

16. Miscellaneous Receipts.	19. Insurance

Receipt and Payment Account for the year ending ————

Receipts	*Amount (Rs.)*	*Payments*	*Amount (Rs.)*
Balance b/d		Balance b/d (Bank overdraft)	xxx
Cash in Hand	xxx	Wages and Salaries	xxx
Cash at Bank	xxx	Rent	xxx
Subscriptions	xxx	Rates and Taxes	xxx
General Donations	xxx	Insurance	xxx
Sale of newspaper/	xxx	Printing and Stationery	xxx
periodicals/waste paper		Postage and courier	xxx
Sale of old sports materials	xxx	Advertisement	xxx
Interest on fixed deposits		Sundry expenses	xxx
Interest/Dividend on general	xxx	Telephone charges	xxx
investments		Entertainment expenses	xxx
Locker Rent	xxx	Audit fees	xxx
Sale of scraps	xxx	Honorarium	xxx
Proceeds from charity show	xxx	Repair and Renewals	xxx
Miscellaneous receipts	xxx	Upkeep of ground	xxx
Grant-in-aid**	xxx	Conveyance	xxx
Legacies	xxx	Newspapers and Periodicals	xxx
Specific Donations	xxx	Purchases of Assets	xxx
Sale of Investments	xxx	Purchase of Investments	xxx
Sale of Fixed Assets	xxx	Balance c/d	xxx
Life membership fees	xxx	Cash in hand	xxx
Entrance fees	xxx	Cash at Bank*	xxx
Receipts on account of	xxx		
specific purpose funds			
Interest on specific funds'	xxx		
investments			
Balance b/d (Bank Overdraft)*	xxx		
	xxxxx		xxxxx

It may be noted that the receipts side of the Receipt and Payment Account gives a list of revenue receipts (for past, current and future periods) as well as capital receipts. Similarly, the payments side of the Receipts and Payments Account lists the Revenue Payments (for past, current and future periods) as well as Capital Payments.

▪***Salient Features***

1. It is a summary of the cash book. Its form is identical with that of simple cash book (without discount and bank columns) with debit and credit sides. Receipts are recorded on the debit side while payments are entered on the credit side.
2. It shows the total amounts of all receipts and payments irrespective of the period to which they pertain . For example, in the Receipt and Payment account for the year ending on March 31, 2012, we record the total subscriptions received during 2011–12 including the amounts related to the years 2010–2011 and 2011-2012. Similarly, taxes paid during 2011–12 even if they relate to the years 2010–11 and 2012–2013 can also be recorded in this account of 2011-12.
3. It includes all receipts and payments whether they are of capital nature or of revenue nature.

4. No distinction is made in receipts/payments made in cash or through bank. With the exception of the opening and closing balances, the total amount of each receipt and payment is shown in this account.
5. No non-cash items such as depreciation outstanding expenses accrued income, etc. are shown in this account.
6. It begins with opening balance of cash in hand and cash at bank (or bank overdraft) and closes with the year end balance of cash in hand/ cash at bank or bank overdraft. In fact, the closing balance in this account (difference between the total amount of receipts and payments) which is usually a debit balance reflects cash in hand and cash at bank unless there is a bank overdraft.

▪***Steps in the preparation of Receipt and Payment Account***
1. Take the opening balances of cash in hand and cash at bank and enter them on the debit side. In case there is bank overdraft at the begining of the year, enter the same on the credit side of this account.
2. Show the total amounts of all receipts on its debit side irrespective of their nature (whether capital or revenue) and whether they pertain to past, current and future periods.
3. Show the total amounts of all payments on its credit side irrespective of their nature (whether capital or revenue) and whether they pertain to past, current and future periods.
4. None of the receivable income and payable expense is to be entered in this account as they do not involve inflow or outflow of cash.
5. Find out the difference between the total of debit side and the total of credit side of the account and enter the same on the credit side as the closing balance of cash/bank. In case, however, the total of the credit side is more than that of the total of the debit side, show the difference on the debit as bank overdraft and close the account.

▪ **Income and Expenditure Account**
It is the summary of income and expenditure for the accounting year. It is just like a profit and loss account prepared on accrual basis in case of the business organisations. It includes only revenue items and the balance at the end represents surplus or deficit. The Income and Expenditure Account serves the same purpose as the profit and loss account of a business organization does. All the revenue items relating to the current period are shown in this account, the expenses and losses on the expenditure side and incomes and gains on the income side of the account. It shows the net operating result in the form of surplus (i.e. excess of income over expenditure) or deficit (i.e. excess of expenditure over income), which is transferred to the capital fund shown in the balance sheet. The Income and Expenditure Account is prepared on accrual basis with the help of Receipts and Payments Account along with additional information regarding outstanding and prepaid expenses and depreciation etc. Hence, many items appearing in the Receipts and Payments need to be adjusted.

▪***Steps in the Preparation of Income and Expenditure Account***
Following steps may be helpful in preparing an Income and Expenditure Account from a given Receipt and Payment Account:
1. *Persue* the Receipt and Payment Account thoroughly.
2. Exclude the opening and closing balances of cash and bank as they are not an income.
3. Exclude the capital receipts and capital payments as these are to be shown in the Balance Sheet.
4. Consider only the revenue receipts to be shown on the income side of Income and Expenditure Account. Some of these need to be adjusted by excluding the amounts relating to the preceding and the succeeding periods and including the amounts relating to the current year not yet received.

5. Take the revenue expenses to the expenditure side of the Income and Expenditure Account with due adjustments as per the additional information provided relating to the amounts received in advance and those not yet received.
6. Consider the following items not appearing in the Receipt and Payment Account that need to be taken into account for determining the surplus/ deficit for the current year :
(a) Depreciation of fixed assets.
(b) Provision for doubtful debts, if required.
(c) Profit or loss on sale of fixed assets.

▪ **Balance Sheet**

'Not-for-Profit' Organisations prepare Balance Sheet for ascertaining the financial position of the organisation. The preparation of their Balance Sheet is on the same pattern as that of the business entities. It shows assets and liabilities as at the end of the year. Assets are shown on the right hand side and the liabilities on the left hand side. However, there will be a Capital Fund or General Fund in place of the Capital and the surplus on deficit as per Income and Expenditure Account shall be added to/deducted to this fund. It is also a common practice to add some of the capitalised items like legacies, entrance fees and life membership fees directly in the capital fund.
Besides the Capital or General Fund, there may be other funds created for specific purposes or to meet the requirements of the contributors/donors such as building fund, sports fund, etc. Such funds are shown separately in the liabilities side of the balance sheet. Some times it becomes necessary to prepare Balance Sheet as at the beginning of the year in order to find out the opening balance of the capital/general fund.

▪***Preparation of Balance Sheet***

The following procedure is adopted to prepare the *Balance Sheet*:
1. Take the Capital/General Fund as per the opening balance sheet and add surplus from the Income and Expenditure Account. Further, add entrance fees, legacies, life membership fees, etc. received during the year.
2. Take all the fixed assets (not sold/discarded/or destroyed during the year) with additions (from the Receipts and Payments account) after charging depreciation (as per Income and Expenditure account) and show them on the assets side.
3. Compare items on the receipts side of the Receipts and Payments Account with income side of the Income and Expenditure Account. This is to ascertain the amounts of: (a) subscriptions due but not yet received: (b) incomes received in advance; (c) sale of fixed assets made during the year; (d) items to be capitalised (i.e. taken directly to the Balance Sheet) e.g. legacies, interest on specific fund investment and so on.
4. Similarly compare, items on the payments side of the Receipt and Payment Account with expenditure side of the Income and Expenditure Account. This is to ascertain the amounts if: (a) outstanding expenses; (b) prepaid expenses; (c) purchase of a fixed asset during the year; (d) depreciation on fixed assets; (e) stock of consumable items like stationery in hand; (f) Closing balance of cash in hand and cash at bank as, and so on.

Proforma Balance Sheet

Liabilities	*Amount (Rs.)*	*Assets*	*Amount (Rs.)*
Capital fund: Opening Balance *Add: Surplus* OR *Less: Deficit*	 …… 	 *Cash in hand and /or Cash at Bank* *Outstanding Incomes* *Prepaid Expenses*	 …… …… ……

Add: Capitalised Income of the	……	*Stock of Consumable Items:*	
Current Year on account of:		Previous Balance	
Legacies	……	*Add: Purchases in the current*	
Entrance Fees	……	period	
Life Membership Fees	……	*Less: Value consumed during*	……
Closing Balance	……	the period	
Special Fund/Donations:		Previous Balance	……
Previous Balance (If any)		*Add: Purchases in the current*	
Add: Receipts for the item		period	
during the period		*Less: Book Value of the Asset*	
Add: Income earned on		sold/disposed off	
fund/Donations'		*Closing Balance*	……
Investments			
Less: Expenses paid out of			
fund/Donations			
Net Balance	……		
Creditors for Purchases			
and/or supplies	……		
Bank Overdraft	……		
Outstanding Expenses:			
Income received in Advance	……		
	……		……

▪***<u>Some Peculiar Items</u>***

Final accounts of the Not-for-Profit organisations are prepared on the similar pattern as that of a business orgnisation. However, a few items of income and expenses of such orgnisations are somewhat different in nature and need special attention in their treatment in final accounts. They are peculiar to these orgnisations. Some of the common peculiar items are explained as under:

<u>Subscriptions:</u> Subscription is a membership fee paid by the member on annual basis. This is the main source of income of such orgnisations. Subscription paid by the members is shown as receipt in the Receipt and Payment Account and as income in the Income and Expenditure Account. It may be noted that Receipt and Payment Account shows the total amount of subscription actually received during the year while the amount shown in Income and Expenditure Account is confined to the figure related to the current period only irrespective of the fact whether it has been received or not. For example, a club received Rs. 20,000 as subscriptions during the year 2010-11 of which Rs.3,000 relate to year 2009-10 and Rs.2,000 to 2011-12, and at the end of the year 2010-11 Rs.6,000 are still receivable. In this case, the Receipt and Payment Account will show Rs.20,000 as receipt from subscriptions. But the Income and Expenditure Account will show Rs. 21,000 as income from subscriptions for the year 2010-11, the calculation of which is given as below:

	Rs.
Subscriptions received in 2010-11	20,000
Less: Subscriptions for the year 2009-10	3,000
	17,000
Less: Subscription for the year 2011-12	2,000
	15,000
Add: Subscriptions outstanding for the year 2010-11	6,000
Income from subscriptions for the year 2010-11	**21,000**

The above amount of subscriptions to be shown as income can also be ascertained by preparing the subscription account as follows:

Subscription Account

Date	*Particulars*	*J.F.*	*Amount (Rs.)*	*Date*	*Particulars*	*J.F.*	*Amount (Rs.)*
	Balance b/d (outstanding at the beginning)		3,000		Balance b/d (received in advance during previous year)		Nil
	Income and Expenditure Account (balancing figure)		21,000		Cash (subscription received)		20,000
	Balance c/d (received in advance)		2,000		Balance c/d (outstanding at the end)		6,000
			26,000				**26,000**

Donation: It is art of gift in cash or property received from some person or organisation. It appears on the receipts side of the Receipts and Payments Account. Donation can be for specific purposes or for general purposes.

(i) *Specific Donations:* If donation received is to be utilised to achieve specified purpose, it is called Specific Donation. The specific purpose can be an extension of the existing building, construction of new computer laboratory, creation of a book bank, etc. Such donation is to be capitalized and shown on the liabilities side of the Balance Sheet irrespective of the fact whether the amount is big or small. The intention is to utilise the amount for the specified purpose only.

(ii) *General Donations:* Such donations are to be utilised to promote the general purpose of the organisation. These are treated as revenue receipts as it is a regular source of income hence, it is taken to the income side of the Income and Expenditure Account of the current year.

Legacies: It is the amount received as per the *will* of a deceased person. It appears on the receipts side of the Receipt and Payment Account and is directly added to capital fund/general fund in the balance sheet, because it is not of recurring nature. However, legacies of a small amount may be treated as income and shown on the income side of the Income and Expenditure Account.

Life Membership Fees: Some members prefer to pay lump sum amount as life membership fee instead of paying periodic subscription. Such amount is treated as capital receipt and credited directly to the capital/general fund.

Entrance Fees: Entrance fee also known as admission fee is paid only once by the member at the time of becoming a member. In case of organisations like clubs and some charitable institutions, is limited and the amount of entrance fees is quite high. Hence, it is treated as non-recurring item and credited directly to capital/general fund. However, for some organisations like educational institutions, the entrance fees is a regular income and the amount involved may also be small. In their case, it is customary to treat this item as a revenue receipt. However, if there is specific instruction, it is advisable to treat the entire amount as capital receipt and the relevant amount should be directly added to capital/general fund.

Sale of old asset: Receipts from the sale of an old asset appear in the Receipts and Payments Account of the year in which it is sold. But any gain or loss on the sale of asset is taken to the Income and Expenditure Account of the year. For example, if an item furniture with a book value of Rs. 800 is sold for Rs. 700, this amount of Rs. 700 will be shown as receipt in Receipts and Payments Account and Rs. 100 on the expenditure side of the Income and

Expenditure Account as a loss on sale of old asset and while showing furniture in the balance sheet Rs. 800 will be deducted from its total book value.

Sale of Periodicals: It is an item of recurring nature and shown as the income side of the Income and Expenditure Account.

Sale of Sports Materials: Sale of sports materials (*used* materials like old balls, bats, nets, etc) is the regular feature with any Sports Club. It is usually shown as an income in the Income and Expenditure Account.

Payments of Honorarium: It is the amount paid to the person who is not the regular employee of the institution. Payment to an artist for giving performance at the club is an example of honorarium. This payment of honorarium is shown on the expenditure side of the Income and Expenditure Account.

Endowment Fund: It is a fund arising from a bequest or gift, the income of which is devoted for a specific purpose. Hence, it is a capital receipt and shown on the Liabilities side of the Balance Sheet as an item of a specific purpose fund.

Government Grant: Schools, colleges, public hospitals, etc. depend upon government grant for their activities. The recurring grants in the form of maintenance grant is treated as revenue receipt (i.e. income of the current year) and credited to Income and Expenditure account. However, grants such as building grant are treated as capital receipt and transferred to the building fund account. It may be noted that some Not-for-Profit organisations receive cash subsidy from the government or government agencies. This subsidy is also treated as revenue income for the year in which it is received.

Special Funds

The Not-for-Profit Organisations office create special funds for certain purposes/ activities such as 'prize funds', 'match fund' and 'sports fund', etc. Such funds are invested in securities and the income earned on such investments is added to the respective fund, not credited to Income and Expenditure Account. Similarly, the expenses incurred on such specific purposes are also deducted from the special fund. For example, a club may maintain a special fund for sports activities. In such a situation, the interest income on sports fund investments is added to the sports fund and all expenses on sports deducted therefrom. The special funds are shown in balance sheet. However, if, after adjustment of income and expenses the balance in specific or Special fund is negative, it is transferred to the debit side of the Income and Expenditure Account or adjusted as per prescribed directions.

"Don't wait for PERFECT MOMENT,
take the MOMENT and make it PERFECT"

ISSUE OF BONUS SHARES

(*1*) A company may issue fully paid-up bonus shares to its members, in any manner out of –
(i) its free reserves;
(ii) the securities premium account; or
(iii) the capital redemption reserve account.
However, no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

(*2*) No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares under (*1*) above, unless –
a) it is authorised by its articles;
b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
f) The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same. [Rule 14 of Companies (Share Capital and Debentures) Rules, 2014]

(*3*) The bonus shares shall not be issued in lieu of dividend.

<u>Accounting Treatment :</u>

On capitalization of reserve for issue of shares	Capital Redemption Reserve Account Dr. Securities Premium Account Dr. Capital Reserve Account Dr. General Reserve Account Dr. Profit & Loss Account Dr. To Bonus to Shareholders Account.	(realised in cash only)
On issue of Bonus share	Bonus to Shareholders Account Dr. To Share Capital Account.	If some shares are party paid-up, first the shares are to me made fully paid up
converting partly paid shares into fully paid shares	Profit & Loss Account Dr. General Reserve Account Dr. Capital Reserve Account Dr. To Bonus to Shareholders Account	(realised in cash only)
On making the final call due	Share Final Call Account Dr. To Share Capital Account	
On adjustment of final call	Bonus to Shareholders Account Dr. To Share Final Call Account	

CA BORN TO FIGHT

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TELEGRAM GROUPS / CHANNELS

1) CA BORN TO FIGHT (Channel)

2) CA IPCC / INTER.

3) CA FINALS

4) NOTES OF ALDINE. (CHANNEL).

5) NOTES OF ALDINE. (GROUP).

6) ICAI STUDENTS UNION.

7) CA STUDENT FUN CLUB.

CA BORN TO FIGHT

Subject wise Telegram *Groups for CA IPCC/INTERMEDIATE & FINAL*

(NEW & OLD)

8) IPCC P1
9) IPCC P2
10) IPCC P3 & P8
11) IPCC P4
12) IPCC P5
13) IPCC P6
14) IPCC P7

15) FINAL P1
16) FINAL P2
17) FINAL P3
18)FINAL P4
19) FINAL P5
20) FINAL P6
21) FINAL P7

22) FINAL P8

WHATSAPP GROUPS

1) CA BORN TO FIGHT
2) NOTES OF ALDINE
3) CA FRIENDS CLUB
4) CA INSPIRATIONAL HUB
5) CA MOTIVATIONAL VIDEO
6) CA ARTICLESHIP
7) CA UPDATES

8) CA FINAL (OLD)
9) CA FINAL (NEW)
10) CA FINAL GROUP 1 (DISCUSSION) (OLD & NEW)
11) CA FINAL GROUP 2 (DISCUSSION) (OLD & NEW)
12) NOTES OF INTER GROUP 1
13) NOTES OF INTER GROUP 2
14) NOTES OF IPCC GROUP 1

15) NOTES OF IPCC GROUP 2

Subject wise WhatsApp *Groups for CA IPCC/INTERMEDIATE & FINA*

(NEW & OLD)

16) IPCC P1
17) IPCC P2
18) IPCC P3
19) IPCC/INTER P4
20) IPCC P5

23) INTER P1
24) INTER P2
25) INTER P3
26) INTER P5
27) INTER P6

30) FINAL P1
31) FINAL P2
32) FINAL P3
33) FINAL P4
34) FINAL P5

37) FINAL P8

CA BORN TO FIGHT

21) IPCC P6 | 28) INTER P7 | 35) FINAL P6

22) IPCC P7 | 29) INTER P8 | 36) FINAL P7

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