INSTITUTE OF SCIENCE, TECHNOLOGY & ADVANCED STUDIES (VISTAS)
(Deemed to be University Estd. u/s 3 of the UGC Act, 1956)
PALLAVARAM - CHENNAI
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DCBGL-21

Financial Accounting - II

B.Com
ODL MODE
[Semester Pattern]

School of Management Studies and Commerce
Centre for Distance and Online Education
Vels Institute of Science, Technology and Advanced Studies (VISTAS)
Pallavaram, Chennai - 600 117

Vels Institute of Science, Technology and Advanced Studies

Centre for Distance and Online Education

B.Com- ODL Mode

(Semester Pattern)

DCBGL-21: Financial Accounting-II

(4 Credits)

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FOREWORD

Dr.Ishari K Ganesh
Chancellor

Vels Institute of Science, Technology and Advanced Studies (VISTAS), Deemed-to-be University, was established in 2008 under section 3 of the Act of 1956 of the University Grants Commission (UGC), Government of India, New Delhi.

VISTAS has blossomed into a multi-disciplinary Institute offering more than 100 UG & PG Programmes, besides Doctoral Programmes, through 18 Schools and 46 Departments. All the Programmes have the approval of the relevant Statutory Regulating Authorities such as UGC, UGC-DEB, AICTE, PCI, BCI, NCTE and DGS.

Our University aims to provide innovative syllabi and industry-oriented courses, and hence, the revision of curricula is a continuous process. The revision is initiated based on the requirement and approved by the Board of Studies of the concerned Department/School. The courses are under Choice Based Credit Systems, which enables students to have adequate freedom to choose the subjects based on their interests.

I am pleased to inform you that VISTAS has been rendering its services to society to democratize the opportunities of higher education for those who are in need through Open and Distance Learning (ODL) mode. VISTAS ODL Programmes offered have been approved by the University Grants Commission (UGC) – Distance Education Bureau (DEB), New Delhi.

The Curriculum and Syllabi have been approved by the Board of Studies, Academic Council, and the Executive Committee of the VISTAS, and they are designed to help provide employment opportunities to the students.

The ODL Programme [B.Com., BBA , B.A(Hons)-Economics and B.A(Hons)-English] Study Materials have been prepared in the Self Instructional Mode (SIM) format as per the UGC-DEB (ODL & OL) Regulations 2020. It is highly helpful to the students, faculties and other professionals. It gives me immense pleasure to bring out the ODL programme with the noble aim of enriching learners' knowledge. I extend my congratulations and appreciation to the Programme Coordinator and the entire team for bringing up the ODL Programme in an elegant manner.

At this juncture, I am glad to announce that the syllabus of this ODL Programme has been made available on our website, **www.vistascdoe.in**, for the benefit of the student community and other knowledge seekers. I hope that this Self Learning Materials (SLM) will be a supplement to the academic community and everyone.

CHANCELLOR

FOREWORD

Dr.S.Sriman Narayanan
Vice-Chancellor

My Dear Students!

Open and Distance Learning (ODL) of VISTAS gives you the flexibility to acquire a University degree without the need to visit the campus often. VISTAS-CDOE involves the creation of an educational experience of qualitative value for the learner that is best suited to the needs outside the classroom. My wholehearted congratulations and delightful greetings to all those who have availed themselves of the wonderful leveraged opportunity of pursuing higher education through this Open and Distance Learning Programme.

Across the World, pursuing higher education through Open and Distance Learning Systems is on the rise. In India, distance education constitutes a considerable portion of the total enrollment in higher education, and innovative approaches and programmes are needed to improve it further, comparable to Western countries where close to 50% of students are enrolled in higher education through ODL systems. Recent advancements in information and communications technologies, as well as digital teaching and e-learning, provide an opportunity for non-traditional learners who are at a disadvantage in the Conventional System due to age, occupation, and social background to upgrade their skills. VISTAS has a noble intent to take higher education closer to the oppressed, underprivileged women and the rural folk to whom higher education has remained a dream for a long time.

I assure you all that the Vels Institute of Science, Technology and Advanced Studies would extend all possible support to every registered student of this Deemed-to-be University to pursue her/his education without any constraints. We will facilitate an excellent ambience for your pleasant learning and satisfy your learning needs through our professionally designed curriculum, providing Open Educational Resources, continuous mentoring and assessments by faculty members through interactive counselling sessions.

VISTAS, Deemed- to- be University, brings to reality the dreams of the great poet of modern times, Mahakavi Bharathi, who envisioned that all our citizens be offered education so that the globe grows and advances forever.

I hope that you achieve all your dreams, aspirations, and goals by associating yourself with our ODL System for never-ending continuous learning.

With warm regards,

VICE-CHANCELLOR

Course Introduction

The **DCBGL-21: Financial Accounting - II** Course has been divided in to five Blocks consisting of 18 Units. Financial Accounting includes the branch accounts, departmental accounts, Hire purchase and installment system, admission, retirement and death of a partner, dissolution, insolvency and piece meal distribution.

The Block-1 **Branch Accounts** has been divided in to four Units. Unit-1 describes about the introduction to branch accounts, Unit-2 explains about Dependent Branches, Unit-3 deals with the Independent Branches and Unit-4 presents the Foreign Branch.

The Block-2 **Departmental Accounts** has been divided in to four Units. Unit-5 describes about the introduction of Departmental Accounts, Unit-6 explains about the Methods and Techniques of Departmental Accounting, Unit-7deals with Final Accounts, Including Balance Sheet and the Unit-8 presents about the Inter Departmental Transfers at Cost Price.

The Block-3 Accounts Relating to **Hire- Purchase and Installment System** has been divided in to four Units. Unit-9 describes about the Accounts Relating to Hire-Purchase, Unit-10 explains about the Installment Purchase System, Unit-11 deals with Default and Repossession and the Unit-12 describes about the Methods of Computation of Profit.

The Block-4 **Admission, Retirement and Death of a Partner** has been divided in to three Units. Unit-13 describes about the Partnership Fundamentals, Unit-14 explains about the Admission of a Partner and the Unit-15 describes about Retirement and Death of a Partner.

The Block-5 **Dissolution, Insolvency and Gradual Realisation and Piece Meal Distribution** has been divided in to three Units. Unit-16 describes about the Dissolution of a Firm, Unit-17 explains about the Insolvency of Partners and the Unit-18 deals with the Piece Meal Distribution.

DCBGL-21: Financial Accounting-II

Block-1: Introduction

Block-1: Branch Accounts has been divided in to four Units.

Unit-1: Introduction to Branch Accounts deals with Introduction, Branch Meaning, Branch Definition, Objectives of Branch Accounts, Types of Branch Accounts, Home Branches, Foreign Branches, Distinction between branch accounts and departmental accounts, Journal Entries and Format of Branch Accounts

Unit-2 : Dependent Branches explains about Introduction, Meaning, Features of Dependent Branches, Methods for charging goods to branches, Accounting for dependent branches, Methods of maintaining accounts of Dependent Branches, Debtors Method, Stock and Debtors method, Wholesale branch system and Final Accounts Method.

Unit-3 : Independent Branch deals with Introduction, Meaning, Features of Independent Branches, Accounting for Independent branches, Journal Entries, Adjustment and reconciliation of branch and head office accounts and Inter-branch transactions.

Unit- 4 : Foreign Branch describes about Introduction, Accounting for foreign branches, Integral Foreign Operation (IFO), Non- integral Foreign Operation (NFO), Techniques for foreign currency translation, Illustration

In all the units of Block -1 **Branch Accounts,** the Check your progress, Glossary, Answers to Check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

Unit-1

Introduction to Branch Accounts

STRUCTURE

Overview

In this unit we will learn the meaning, the Branch accounting is a system of accounting used by businesses that operate in more than one location, also known as branches. This system of accounting allows for the separate recording of financial transactions of each branch, which can be helpful in monitoring and managing the performance of each branch.

Objectives

After studying this unit, students should be able to:

- Describe the need for Accounting
- Understand the concept of branches and their classification from accounting point of view.
- Distinguish between the accounting treatment of dependent branches and independent branches.
- Learn various methods of charging goods to branches
- Prepare the necessary accounts under this system.

1.1. Introduction

A branch can be described as any establishment carrying on either the same or substantially the same activity as that carried on by head office of the company. It must also be noted that the concept of a branch means existence of a head office;for there can be no branch without a head office - the principal place of business. From the accounting point of view, branches may be classified as follows:

- Inland Branches which can be further classified as:
- Independent Branches which maintain independent accounting records
- Dependent Branches for which whole accounting records are kept at Head Office
- Foreign Branches

A large concern may have a main office and many local offices indifferent cities. A branch is a local office which is a part of a large business concern. Branches are opened to increases a sale in various areas which cannot be directly served from H.O. invests funds to set up and run the branches. The profit of the branch belongs to the H.O. The basic purpose of branch accounting is to ascertain the branch income, branch expenses, branch assets and branch liabilities. The branch accounts help the H.O. to decide whether a particular branch is earning profits and should be continued. An independent branch keeps all accounts on its own and can independently ascertain its income, expenses, assets and liabilities. In case of a dependent branch, its accounts are kept by the H.O. and hence its income, expenses, assets and liabilities can be ascertained only by the H.O.

1.2. Branch - Meaning

The aim of every business is to grow and increase its sales volume so as to earn more and more profits. To achieve this objective the strategy is to make market its products/services over a large territory, which is possible only if the business, decide to split its business into certain divisions or parts. These are called branches.

For example, Bank of Punjab Ltd. With its registered head office at Chandigarh has opened up its branches in different sectors of Chandigarh as well as in different cities all over India. Likewise, Bata Shoe Co., State Bank of India LIC Housing Finance, Tata Finance Ltd., etc. have many branches all over the country.

1.3. Branch Definition

According to Sec. 2 (a) of the Companies Act, 1958, a branch (office) is defined as:

a) “any establishment described as a branch by the Company, or,

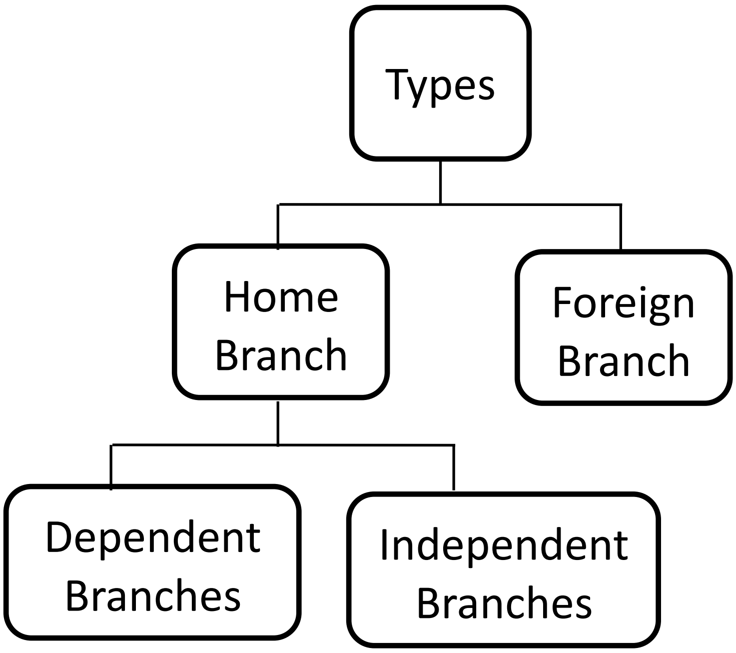
b) Any establishment carrying on either the same or substantially the same activity as that carried on by the head office of the company, or

c) Any establishment engaged in any production, processing or manufacture, but does not include any establishment specified in any order made by the Central Govt., u/s-8

1.4. Objectives of Branch Accounts

- To Ascertain Profit or Loss at Branch: Every business house wants to measure the performance of its branches separately. Hence, separate records for each branch are necessary. Efficiency or otherwise of a branch can also be measured with the help of its accounting records.
- To Ascertain True Financial Position of Business: Branch Accounting helps the business to ascertain its true financial position.
- Accounting records of the assets and liabilities will helps in preparing in the balance sheet which is a mirror of the financial position.
- Compliance with Statutory Requirement: Branch accounts are necessary to meet large requirements with the company law, Income tax laws and other such acts.
- To Increase Efficiency of the Branch: Branch accounts are the indicators of the efficiency of the branch.
- They will indicate the loopholes or drawbacks which can be rectified in time. In this way, branch accounts will be helpful in increasing the efficiency of the branch.
- To Exercise Control Over Branch: Head Office exercises control only through information supplied by branches to head office.
- The main source of information is the accounts maintained from branch transactions.

1.5. Types of Branches



1.5.1. Home Branches

When a branch is opened in the same country where the head office is registered, it is called a home branch.

Home branch are of two types-

a) **Dependent branches**

The branch that do not maintain a complete record of its transactions are called 'Dependent branches'.

b) **Independent branches**

Independent branches are those branches which maintain a complete record of its transactions.

1.5.2. Foreign Branches

These branches are located outside the country. They are operated in the foreign country which has a different currency and, as such, question of rate of exchange will arise.

These branches may be of:

(i) Dependent Branch

(ii) Independent Branch depending on the method of accounting.

1.6. Distinction between Branch Accounts and Departmental Accounts

Basis of distinction	Branch Accounts	Departmental Accounts
1. Maintenanceof accounts	Branch accounts may be maintained either atbranch or at head office.	Departmental accounts aremaintained at one place only.
2. Allocation of common expenses	No allocation problem arises since the expenses in respect of each branch can beidentified.	Common expenses are distributed among the departments concerned on some equitable basis considered suitable in thecase.
3. Reconciliation	Reconciliation of head office and branch accounts is necessary in case of Branches maintaining independent accountingrecords at the end ofthe accounting year.	No such problem arises.
4. Conversion Foreign currency	At the time of finalization of accounts, conversion of figures of Foreign branch is necessary.	No such problem arises in departmental accounts.

1.7. Journal Entries

The following are the journal entries of branch accounting.

1. Inventory

If the head office transferred inventory of $1,000 to its branch office, then below journal entries will be passed in the head office books.

Particulars	Debit	Credit
Branch Account……Dr.	$1,000	
To Inventory A/c		$1,000

2. Cash Remitted by Branch to Head Office

If the branch office remits cash of $500 to head office.

Particulars	Debit	Credit
Cash A/c…… …… Dr.	$500	
To Branch Account		$500

3. Head Office Paid Expenses of Branch

If the head office paid wages of $500, rent $400, and salary $300 on behalf of the branch.

Particulars	Debit	Credit
Branch Account …… Dr.	$1,200	
To Cash		$1,200

1.7.1 Formats Of Branch Account:

In the books of Head Office (H.O.)

………….. Branch Account

Dr. Cr.

PARTICULARS	RS.	RS.	PARTICULARS	RS.	RS.
To Balance B/D			By Balance B/D		
- Stock	***		- Creditors	***	
- Debtors	***		- O/s expenses	***	
- Petty cash	***		-		****
- Other assets (ifany)		****	By Stock Reserve A/c (load on Op. stock)		****
To Goods sent to branch A/c (Goods sent to branch)		****	By Bank A/c		
			- Cash sales	***	
			- Collection fromdebtors	***	
			(Cash remitted bybranch)		****
To Bank A/c (Cash sent to branch)		****	By Goods sent tobranch A/c (goods returned to H.O)		****
To Goods sent tobranch A/c (load on goods returnedto H.O.)		****	By Abnormal Loss A/c		****
			By Goods sent tobranch A/c (load on goods sent to branch)		****
To Abnormal Loss A/c (load on abnormal loss)	***	****	By General P/L A/c (Branch loss transfer)	*** *** ***	****
To General P/L A/c (Branch profit transfer)	***	****	By Balance C/D		
To Stock Reserve A/c (load on Cl. stock)		****	- Stock		****
To Balance C/D		****	- Debtors		
- Creditors			- Petty cash		
- o/s expenses			- Other assets(if any)		****
		******			******

Illustration 1

From the following particulars relating to Hyderabad branch for the year ended 31.12.90. PrepareBranch a/c in the head office books.

Particulars	Rs	Rs
Stock at the Branch on 1.1.90		15,000
Debtors at the Branch on 1.1.90		30,000
Petty cash at the Branch on 1.1.90		300
Goods sent to Branch during 1990		2,52,000
Cash sales 1990		60,000
Received from Debtors 1990		2,10,000
Credit Sales during 1990		2,28,000
Cheques sent to branch during 1990		
For Salaries For Rent & RatesFor Petty cash	9,000 1,500	11,600
Stock at the branch on 31.12.90	1,100	25,000
Petty cash 31.12.90 Goods returned by the branch Debtors on 31.12.90		200 2,000 48,000

Solution:

In the Books of Head Office

Hyderabad Branch a/c

Dr		Rs	Cr		Rs
Jan 1	To Balance b/d Stock Debtors Petty cash To Goods sent to brancha/c	 15,000 30,000 300 2,52,000	Dec 31	By Bank Cash Sales 60,000 Cash from drs 2,10,000	 2,70,000
Dec 31	To Bank Salaries 9,000 Rent & Rates 1,500 Petty Cash 1,100 To General P& La/c (profit)	 11,600 36,300	Dec 31	By Goods sent to branch(return to HO) By Balance c/d Stock Debtors Petty Cash	 2,000 25,000 48,000 200
		3,45,200			3,45,200

Illustration 2

The following information relates to Madurai branch.

particulars	**Rs**	**Rs**
Stock on 1.1.94		11,200
Branch debtors on 1.1.94		6,300
Goods sent to Branch		51,000
Cash sent to Branch for:		
Rent	1,500	
Salaries	3,000	
Petty Cash	500	5,000
Sales at branch		
Cash	25,000	
Credit	39,000	64,000
Cash received from Debtors		41,200
Stock on 31.12.94		13,600

Prepare Branch account for the year 1994

Solution:

In the books of head office

Madurai Branch a/c

1994		Rs			Rs
Jan 1	To balance b/d		Dec 31	By Bank	
	Stock	11,200		Cash Sales 25,000 Cash coll drs 41,200	66,200
Dec 31	Debtors	6,300		By Balance c/d	
	To Goods sent to Branch	51,000		Stock	13,600
	To Bank:			Debtors	4,100
	Rent 1,500				
	Salaries 3,000				
	Petty cash 500	5,000			
	To Genereal P&LA/C (Profit)	10,400			
		83,900			83,900

Working Notes:

Calculation of Closing Debtors:

Date	Particulars	Rs.	Date	Particulars	Rs.
1.1.94	To Balance b/d To Sales (Credit)	6,300 39,000	31.12.94	By Branch cash By Balance c/d (bal fig)	41,200 4,100
		45,300			45,300

Let Us Sum Up

In this unit you have learned about the following:

Either a branch can be described as any establishment carrying on the same or substantially the same activity as that carried on by head office of the company. It must also be noted that the concept of a branch means existence of a head office;for there can be no branch without a head office - the principal place of business.

Check Your Progress

1. What do you mean by Branch Accounts?

 ____

 ____

 ____

2. Define – Branch Account.

 ____

 ____

 ____

3. Describe the objectives of Branch Accounts.

 ____

 ____

 ____

Glossary

Dependent branches: The branch that do not maintain a complete record of its transactions are called 'Dependent branches'.

Independent branches: Independent branches are those branches which maintain a complete record of its transactions.

Foreign branches: These branches are located outside the country. They are operated in the foreign country which has a different currency and, as such, question of rate of exchange will arise.

Answers to check your progress

1. The aim of every business is to grow and increase its sales volume so as to earn more and more profits. To achieve this objective the strategy is to make market its products/services over a large territory, which is possible only if the business decide to split its business into certain divisions or parts. These are called branches.
2. According to Sec. 2 (a) of the Companies Act, 1958, a branch (office) is defined as: “any establishment described as a branch by the Company.
3. Objectives
    a. To Ascertain Profit or Loss at Branch
    b. To Ascertain True Financial Position of Business
    c. Compliance with Statutory Requirement
    d. To Exercise Control Over Branch

Suggested Readings

1. Hanif and A. Mukherjee, “Financial Accounting- II”, McGraw Hill, 2018
2. P.C. Tulsian, “Financial Accounting”, 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, “Introduction to Financial Accounting”, 2017
4. Barry Elliott and Jamie Elliott, “Financial Accounting and Reporting”, 19^{th} Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., “Financial Accounting”, New York: McGraw Hill Book Company, 1990.

Unit-2

Dependent Branches

STRUCTURE

Overview

In this unit we will learn the concept of dependent branch and its meaning. A dependent branch is a type of branch that relies heavily on its parent company for financial and operational support. It is a branch that cannot operate independently without the support of its parent company, and it may not have the authority to make decisions on its own.

Objectives

After studying this unit, students should be able to:

- Describe the features of the independent branch
- Know the profit or loss of each branch.
- Understand the different systems.
- Control the activities of the branch.
- Find out the requirement of goods or cash for each branch.

2.1. Introduction

A branch which is dependent upon Head Office mainly for “Goods and Cash”. Books of accounts relating to such branch also will be maintained by Head Office. Features of Dependent Branch: Branch receives goods from Head Office. Only those goods supplied by Head office will be dealt (sold) by branch. When the business policies and the administration of a branch are wholly controlled by the head office and its accounts also are maintained by it the branch is described as Dependent branch. Branch accounts, in such a case, are maintained at the head office out of reports and returns received from the branch. Some of the significant types of branches that are operated in this manner are described below:

- A branch set up merely for booking orders that are executed by the head office. Such a branch only transmits orders to the head office;
- A branch established at a commercial center for the sale of goods supplied by the head office, and under its direction all collections are made by the H.O.; and
- A branch for the retail sale of goods, supplied by the head office.
- Accounting in the case of first two types is simple. Only a record of expensesincurred at the branch has to be maintained.

But however, a retail branch is essentially a sale agency that principally sells goods supplied by the head office for cash and, if so authorized, also on credit to approved customers. Generally, cash collected is deposited into a local bank tothe credit of the head office and the head office issues cheques thereon for meeting the expenses of the branch. In addition, the Branch Manager is provided with a ‘float’ for petty expenses which is replenished from time to time on animprest basis. If, however, the branch also sells certain lines of goods, directly purchased by it, the branch retains a part of the sale proceeds to pay for the goods so purchased.

2.2. Meaning

A branch is said to be dependent when its accounting is done at the H.O. i:e. the branch income, branch expenses, branch assets and branch liabilities are ascertained at the H.O.

2.3. Features of Dependent Branches

- The branch receives goods from Head Office. Only those goods supplied by the Head office will be dealt (sold) by branch.

- Goods may be supplied to Head office at Cost price/Invoice price
- Cash sales and collection from debtors are periodically remitted to the Head office.
- Branch expenses like salary, rent, etc. are paid/met by the Head office.
- The head office separately sends cash to the branch for meeting expenses.

2.4. Methods for Charging Goods to Branches

Goods may be invoiced to branches

(1) at cost; or

(2) at selling price; or

(3) in caseof retail branches, at wholesale price; or

(4) arbitrage price.

Selling price method is adopted where the goods would be sold at a fixed price by the branch. It is suitable for dealers in tea, petrol, ghee, etc. In this way, greater control can be exercised over the working of a branch in as much as that the branch balance in the head office books would always be composed of the value of unsold stock at the branch and remittances or goods in transit. The arbitrary price method is usually adopted if the selling price is not known or when it is not considered desirable to disclose to the branch manager the profit made by the branch.

2.5. Accounting for Dependent Branches

Dependent branch does not maintain a complete record of its transactions. The Head office may maintain accounts of dependent branches in any of the following methods:

2.5.1. Methods of Maintaining Accounts of Dependent Branches

- If Goods are invoiced at cost or selling price: Debtors Method; Stock and Debtors Method; Trading and profit and loss account method (Final Accounts method)
- If Goods are invoiced at wholesale price: Whole Sale branch method

When goods are invoiced at cost

If goods are invoiced to the branch at cost, the trading results of branch can be ascertained by following any of the three methods:

(i) Debtors Method

(ii) Stock and Debtors method

(iii) Wholesale branch system

(iv) Final Accounts Method.

For finding out the trading results of branch, it is assumed that the branch is an entity separate from the head office.

On the basis, a Branch Account is stated in the head office books to which the price of goods or services provided or expenses paid out are debited and correspondingly, the value of benefits and cash received from the branch are credited.

2.5.1.1. Debtors Method

This method of accounting is suitable for small sized branches. Under this method, separate branch account is maintained for each branch to compute profit or loss made by each branch.

The opening balance of stock, debtors (if any), petty cash (if any), are debited to the Branch Account; the cost of goods sent to branch as well as expenses of the branch paid by the head office,e.g., salaries, rent, insurance, etc., are also debited to it.

Conversely, amounts remitted by the branch and the cost of goods returned by the branch are credited.

At the end of the year, the value of unsold stock, the total of customers' balances outstanding and that of petty cash are brought into the branch accounton the credit side and then the branch account will reveal profit or loss; Debit 'balance' will be the loss suffered by the working of the branch and vice versa.

If the branch is allowed to make small purchases of goods locally as well as to incur expenses out of its cash receipts, it will be necessary for the branch to supply tothe head office a copy of the Cash Account, showing details of cash collections and disbursements.

To illustrate the various entries which are made in the Branch Account, the proforma of a Branch Account is shown below:

Proforma Branch Account

To Balance b/d Cash Stock Debtors Petty Cash Fixed Assets Prepaid Expenses To Goods sent to Branch To Bank A/c Salaries Rent Sundry Expenses To Profit & Loss A/c—Profit (if credit side is larger)		By Bank A/c (Cash remitted) By Return to H.O. By Balance c/d Cash Stock Debtors Petty Cash Fixed Assets Prepaid Expenses By Profit and Loss A/c — Loss(if debit side is larger)

Illustration 1

Buckingham Bros, Bombay have a branch at Nagpur. They send goods at cost totheir branch at Nagpur. However, direct purchases are also made by the branch for which payments are made at head office. All the daily collections are transferred from the branch to the head office. From the following, prepare Nagpur branch account in the books of head office by Debtors method:

Particulars	Amount	Particulars	Amount
Opening balance (1-1-2011) Imprest Cash	2,000	Bad Debts	1,000
Sundry Debtors	25,000	Discount to Customers	2,000
Stock: Transferred from H.O.	24,000	Remittances to H.O.	
Direct Purchases	16,000	(recd. by H.O.)	1,65,000
Cash Sales	45,000	remittances to H.O.	
Credit Sales	1,30,000	(not recd. by H.O. so far)	5,000
Direct Purchases	45,000	Branch Exp. directly paidby H.O.	30,000
Returns from Customers	3,000	Closing Balance (31-12-2011)	
Goods sent to branch from H.O.	60,000	Stock: Direct Purchase	10,000
Transfer from H.O. for Petty	4,000	Transfer from H.O.	15,000
Cash expenses		Debtors	?
		Imprest Cash	?
		Petty Cash expenses	4,000

Solution:

In the Books of Buckingham Bros,

BombayNagpur Branch Account

Particulars	Amount	Particulars	Amount	Amount
To Opening Branch Assets Stock (24,000 + 16,000) Debtors Imprest Cash To Goodssent toBranch A/c To Creditors (Direct Purchases) To Bank (Sundry exp.) To Bank (Petty cashexp.) To Net Profit transferred to General Profit & Loss A/c	 40,000 25,000 2,000 60,000 45,000 30,000 4,000 15,000	By Bank – Remittances received from branch Cash Sales Cash from Debtors By Cash from Debtors in Transfer Stcck: Transfer from H.O. By Direct Purchase Sundry Debtors(W.N. 2) Imprest Cash(W.N. 3)	 45,000 1,20,000 5,000	 1, 70,000 15,000 10,000 24,000 2,000
	2,21,000			**2,21,000**

Working Notes:

1. Collections from debtors:

Particulars	Amount
Total remittances (` 1,65,000 + ` 5,000) Less: Cash sales	1,70,000 (45,000)
	1,25,000

2. Calculation of Sundry Debtors closing Balance:

particulars	Amount
Opening Balance Add: Credit Sales	25,000 1,30,000
 Less: Returns, Discount, Bad debts & collections (3,000 + 2,000 +1,000 + 1,25,000)	1,55,000 (1,31,000)
Closing balance	24,000

3. Calculation of closing balance of Imprest Cash

particulars	Amount
Opening Balance	2,000
Add: Transfer from H.O.	4,000
	6,000
Less: Expenses	(4,000)
Closing balance	2,000

2.5.1.2. Stock and Debtors Method

If it is desired to exercise a more detailed control over the working of a branch,the accounts of the branch are maintained under the Stock and Debtors Method.

According to this method, the following accounts are maintained by the Head Office:

Account	Purpose
1. Branch Stock Account (or BranchTrading Account)	Ascertainment of shortage or surplus
2. Branch Profit and Loss Account	Calculation of net profit or loss
3. Branch Debtors Account	Ascertainment of closing balance ofdebtors
4. Branch Expenses Account	Ascertainmentof total expenses incurred
5. Goods sent to Branch Account	Ascertainment of cost of goods sent to branch

If the branch is also allowed to purchase goods locally and to incur expenses outof its cash collections, it would be necessary to maintain

a) a Branch Cash Account, and

b) an independent record of branch assets.

The manner in which entries are recorded in the above method is shown below:

	Transaction	Account debited	Account credited
(a)	Cost of goods sent tothe Branch	Branch Stock A/c	Goods sent to BranchA/c
(b)	Remittances forexpenses	Branch Cash A/c	(H.O.) Cash A/c
(c)	Any assets (e.g. furniture) provided by H.O.	Br Asset (Furniture) A/c	(i) (H.O.) Cash A/c or (ii) Creditors A/c (iii)(H.O.)Furniture A/c
(d)	Cost of goods returnedby the branch	Goods sent to BranchA/c	Branch Stock A/c
(e)	Cash Sales at the Branch	Branch Cash A/c	Branch Stock A/c
(f)	Credit Sales at the Branch	Branch Debtors A/c	Branch Stock A/c
(g)	Return of goods by debtors to the Branch	Branch Stock A/c	Branch Debtors A/c
(h)	Cash paid by debtors	Branch Cash A/c	Branch Debtors A/c
(i)	Discount & allowanceto debtors, bad debts	Branch Expenses A/c	Branch Debtors A/c
(j)	Remittances to H.O.	(H.O.) Cash A/c	Branch Cash A/c
(k)	Expenses met by H.O.	Branch Expenses A/c	(H.O.) Cash A/c

Illustration 2

Stock and Debtors Method

2011	Particulars	Rs.	2011	Particulars	Rs.	Rs.	Rs.
Jan. 1	To Stock	7,000	Dec. 31	By Sales:			
Dec. 31	To Goods Sent to BranchA/c	26,000		Cash		17,500	
				Credit	28,400		
	To Branch P&LA/c	19,900		Less:Return	(500)	27,900	45,400
				By Goods sent to Branch A/c-Return			1,000
				By Balance c/d (Stock)			6,500
		52,900					52,900
2012 Jan. 1	To Balance b/d	6,500					

Delhi Branch Debtors Account

2011	Particulars	Rs.	2011	Particulars	Rs.
Jan. 1	To Balance b/d	12,600	Dec.31	By Cash	28,500
Dec. 31	To Sales	28,400		By Returns	500
				By Allowances	200
				By Discounts	1,400
				By Bad debts	600
				By Balance c/d	9,800
		41,000			41,000
2012					
Jan. 1	To Balance b/d	9,800			

Delhi Branch Expenses Account

2011	Particulars	Rs.	2011	Particulars	Rs.
Dec. 31	To Salaries & Wages	6,200	Dec. 31	By Branch P&L A/c	10,500
	To Rent & Rates	1,200			
	To Sundry Expenses	800			
	To Petty Cash	100			
	Expenses (200-100)				
	To Allowances to				
	customers	200			
	To Discounts				
	To Bad Debts	1,400			
		600			
		10,500			10,500

Delhi Branch Profit & Loss Account

2011	Particulars	Rs.	2011	Particulars	Rs.
Dec. 31	To Branch Exp. A/c	10,500	Dec. 31	By Gross Profit b/d	19,900
	To Net Profit to General P & LA/c	9,400			
		19,900			19,900

Branch Trading and Profit and Loss Account

Particulars	Rs.	Rs	Particulars	Rs.	Rs
To Stock		7,000	By Sales:		
To Goods sent from H.O.	26,000		Cash	17,500	
			Credit 28,400		
Less: Returns to H.O.	(1,000)	25,000	Less: Returns (500)	27,900	45,400
To Gross profit c/d		19,900	By Closing Stock		6,500
		51,900			51,900

To Salaries & Wages	6,200	By Gross Profit b/d		19,900
To Rent & Rates	1,200			
To Sundry Exp.	800			
To Petty Cash Exp.	100			
To Allowances to Customers	200			
To Discounts	1,400			
To Bad Debts	600			
To Net Profit	9,400			
	19,900			19,900

Closing Stock:

Credit the Branch Stock Account with the value of closingstock at cost. It will be carried down as opening balance (debit) for thenext accounting period. The Balance of the Branch Stock Account, (after adjustment therein the value of closing stock), if in credit, will represent the gross profit on sales and vice versa.

Other Steps

i. Transfer Balance of Branch Stock Account to the Branch Profit and LossAccount.

ii. Transfer Balance of Branch Expenses Account to the debit of Branch Profit &Loss Account.

iii. The balance in the Branch P&L A/c will be transferred to the (H.O.) Profit &Loss Account.

The credit balance in the Goods sent to Branch Account is afterwards transferredto the Head Office Purchase Account or Trading Account (in case of manufacturing concerns), it being the value of goods transferred to the Branch.

2.5.1.3. Wholesale Branch Method

Under this system, the goods are invoiced at the wholesale price to a retail branch. Opening stock and closing stock of branch will be shown at the wholesale price and unrealized profits in closing stock will be debited as stock reserve to profit and loss account of head office. For the purpose, it is assumed that the manufacturer would always be able to sell the goods on wholesale terms and thereby realizes profit equal to the difference between the wholesale price and the cost. Many concerns, therefore, invoice goods to such shops at wholesale price and determine profit or loss on sale of goods on this basis. Accordingly, Branch Stock

Account or the Trading Account is debited with:

a) the value of opening stock at the Branch; and

b) price of goods sent during the year at wholesale price. It is credited by:

c) sales effected at the shop; and

d) closing stock of goods valued at wholesale price.

The value of goods lost due to accident, theft etc. also is credited to the Branch Stock Account or Trading Account calculated at the wholesale price. At this stage, the Branch Stock or Trading Account will reveal the amount of gross profit(or loss). It is transferred to the Branch Profit and Loss Account. On further being debited with the expenses incurred at the shop and the wholesale price of goods lost, the Branch Profit and Loss Account will disclose the net profit (or loss) at the shop.

Since the closing stock at the branch has to be valued at wholesale price, it wouldbe necessary to create a stock reserve equal to the difference between its wholesale price and its cost (to the head office) by debiting the amount in theHead Office Profit and Loss Account. This Stock Reserve is carried down to the next year and then transferred to the credit of the (Head Office) Profit and Loss Account.

Illustration 3

M/s Rahul operates a number of retail outlets to which goods are invoiced at wholesale price which is cost plus 25%. These outlets sell the goods at the retailprice which is wholesale price plus 20%.

Following is the information regarding one of the outlets for the year ended 31.3.2012:

Particulars	Rs.
Stock at the outlet 1.4.2011	30,000
Goods invoiced to the outlet during the year	3,24,000
Gross profit made by the outlet	60,000
Goods lost by fire	?
Expenses of the outlet for the year	20,000
Stock at the outlet 31.3.2012	36,000

You are required to prepare the following accounts in the books of Rahul Limitedfor the year ended 31.3.2012:

(a) Outlet Stock Account.

(b) Outlet Profit & Loss Account.

(c) Stock Reserve Account.

Solution:

Outlet Stock Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	30,000	By Sales (Working Note 1)	3,60,000
To Goods sent to outlet	3,24,000	By Goods lost by fire (b.f.)	18,000
To Gross Profit c/d	60,000	By Balance c/d	36,000
	4,14,000		4,14,000

Outlet Profit & Loss Account

Particulars	Rs.	Particulars	Rs.
To Expenses	20,000	By Gross Profit b/d	60,000
To Goods lost by fire (W.N.2)	18,000		
To Profit transferred	22,000		
	60,000		60,000

Stock Reserve Account

Particulars	Rs.	Particulars	Rs.
To HO P & L A/c – Transfer	6,000	By Balance b/d	6,000
To Balance c/d (Stock Res.required)	7,200	By HO P&L A/c (W.N.3)	7,200
	13,200		13,200

Working Notes:

(1) Wholesale Price 100 + 25= 125

Retail Price 125 + 20%= 150

Gross Profit at the outlet

Wholesale Price – Retail Price (150 – 125) 25

Retail sales value = 60,000*150/25 = Rs.3,60,000

(2) Goods lost by fire

Opening Stock + Goods Sent + Gross Profit – Sales – Closing Stock

30,000 + 3,24,000 + 60,000 – 3,60,000 – 36,000 = ` 18,000

(3) Stock Reserve

Opening Stock= 30,000*25/125 = Rs. 6000

Closing stock = 36000*25/125 = Rs. 7,200

2.5.1.4. Final Accounts Method

In this method, Trading and Profit and Loss accounts are prepared consideringeach branch as a separate entity. The main advantage of this method is that, it is easy to prepare and understand. It also gives complete information of all transactions which are ignored in the other methods. It should be noted that Branch Trading and Profit and Loss account is merely a memorandum accountand therefore, the entries made there in do not have double entry effect.

Illustration 4

The Bombay Traders invoiced goods to its Delhi branch at cost. Head Office paid all the branch expenses from its bank account, except petty cash expenses which weremet by the Branch. All the cash collected by the branch was banked on the sameday to the credit of the Head Office. The following is a summary of the transactions entered into at the branch during the year ended December 31, 2011.

Particulars	Rs.	Particulars	Rs.
Balances as on 1.1.2011:			
Stock	7,000	Bad Debts	600
Debtors	12,600	Goods returned by customers	500
Petty Cash,	200	Salaries & Wages	6,200
Goods sent from H.O.	26,000	Rent & Rates	1,200
Goods returned to H.O.	1,000	Sundry Expenses	800
Cash Sales	17,500	Cash received from Sundry	
Credit Sales	28,400	Debtors	28,500
Allowances to customers	200	Balances as on 1.12.2011:	
Discount to customers	1,400	Stock	6,500
		Debtors	9,800
		Petty Cash	100

Prepare:

(a) Branch Account (Debtors Method),

(b) Branch Stock Account, Branch Profit & Loss Account, Branch Debtors and Branch Expenses Account by adopting the Stock and Debtors Method and

(c) Branch Trading and Profit & Loss Account to prove the results as disclosed by the Branch Account.

Solution:

1. Debtors Method

Delhi Branch Account

2011	Particulars	Rs.	Rs	2011	Particulars	Rs.	Rs
Jan. 1	To Balance b/d			Dec.	By Bank		
	Stock	7,000		31	Cash Sales	17,500	
	Debtors	12,600			Cash from		
	Petty cash	200	19,800		Sundry Debtors	28,500	46,000
Dec.31	**To** Goods sent to BranchA/c		26,000		By Goods sentto Branch A/c – Return to H.O.		1,000
	To Bank: Salaries & Wages	6,200			By Balance c/d	6,500	
	Rent & Rates	1,200			Stock	9,800	
	Sundry Exp.	800	8,200		Debtors	100	16,400
	To Balance being Profit carried To (H.O.) P & L A/c		9,400		Petty Cash		
			63,400				63,000
Jan. 1, 2012	To Balance b/d		16,400				

2. Stock and Debtors Method

Branch stock account

2011	Particulars	Rs.	2011	Particulars	Rs.	Rs	Rs
Jan. 1	To Stock	7,000	Dec.	By Sales:			
Dec.31	To Goods Sent to BranchA/c	26,000	31	Cash		17,500	
				Credit	28,400		
	To Branch P&LA/c	19,900		Less: Return	(500)	27,900	45,400
				By Goods sent to Branch A/c - Return			1,000
				By Balance c/d (Stock)			6,500
2012		52,900					52,900
Jan. 1	To Balance b/d	6,500					

Delhi Branch Debtors Account

2011	Particulars	Rs.	2011	Particulars	Rs.
Jan. 1	To Balance b/d	12,600	Dec. 31	By Cash	28,500
Dec. 31	To Sales	28,400		By Returns	500
				By Allowances	200
				By Discounts	1,400
				By Bad debts	600
				By Balance c/d	9,800
20X2		41,000			41,000
Jan. 1	To Balance b/d	9,800			

Delhi Branch Expenses Account

2011	Particulars	Rs.	2011	Particulars	Rs.
Dec. 31	To Salaries & Wages	6,200	Dec. 31	By Branch P & L A/c	10,500
	To Rent & Rates	1,200			
	To Sundry Expenses	800			
	To Petty Cash Expenses (200-100)	100			
	To Allowances to customers	200			
	To Discounts	1,400			
	To Bad Debts	600			
		10,500			10,500

Delhi Branch Profit & Loss Account

2011	Particulars	Rs.	2011	Particulars	Rs.
Dec. 31	To Branch Exp. A/c	10,500	Dec. 31	By Gross Profit b/d	19,900
	To Net Profit to General P & L A/c	9,400			
		19,900			19,900

3. Branch Trading and Profit and Loss Account

Particulars	Rs.	Rs	Particulars	Rs.	Rs
To Stock		7,000	By Sales:		
To Goods sent from H.O.	26,000		Cash	17,500	
Less: Returns to H.O.	(1,000)	25,000	Credit 28,400		
To Gross profit c/d		**19,900**	Less: (500) Returns	27,900	45,400
			By Closing Stock		6,500
		51,900			**51,900**
To Salaries & Wages		6,200	By Gross Profit b/d		
To Rent & Rates		1,200			
To Sundry Exp.		800			
To Petty Cash Exp.		100			
To Allowances to Customers		200			
To Discounts		1,400			
To Bad Debts		600			
To Net Profit		9,400			
		19,000			**19,000**

Let Us Sum Up

In this unit you have learned about the following:

A branch which is dependent upon Head Office mainly for “Goods and Cash”. Books of accounts relating to such branch also will be maintained by Head Office. Branch receives goods from Head Office. Only those goods supplied by Head office will be dealt by branch. Goods may be invoiced to branches (1) at cost; or (2) at selling price; or (3) in caseof retail branches, at wholesale price; or (4) arbitrage price.

Check Your Progress

1. Write the feature of dependent branches.

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____

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2. Describe debtors Method?

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3. What do you mean by Stock and debtors method?

____

4. Explain briefly the different methods of dependent branches.

Glossary

Arbitrage price: Selling price method is adopted where the goods would be sold at a fixed price by the branch. It is suitable for dealers in tea, petrol, ghee, etc. In this way, greater control can be exercised over the working of a branch in as much as that the branch balance in the head office books would always be composed of the value of unsold stock at the branch and remittances or goods in transit. The arbitrary price method is usually adopted.

Debtors Method: Under this method, separate branch account is maintained for each branch to compute profit or loss made by each branch. The opening balance of stock, debtors (if any), petty cash (if any), are debited to the Branch Account; the cost of goods sent to branch as well as expenses of the branch paid by the head office, e.g., salaries, rent, insurance, etc., are also debited to it. Conversely, amounts remitted by the branch and the cost of goods returned by the branch are credited.

Stock and Debtors Method: If it is desired to exercise a more detailed control over the working of a branch,the accounts of the branch are maintained under the Stock and Debtors Method.

Wholesale Branch Method: Under this system, the goods are invoiced at the wholesale price to a retail branch. Opening stock and closing stock of branch will be shown at the wholesale price and unrealized profits in closing stock will be debited as stock reserve to profit and loss account of head office.

Answers to Check Your Progress

1. Features:-

   a. The branch receives goods from Head Office. Only those goods supplied by the Head office will be dealt (sold) by branch.
   b. Goods may be supplied to Head office at Cost price/Invoice price
   c. Cash sales and collection from debtors are periodically remitted to the Head office.
   d. Branch expenses like salary, rent, etc. are paid/met by the Head office.
   e. The head office separately sends cash to the branch for meeting expenses.

2. Under debtors method a separate branch account is maintained for each branch to compute profit or loss made by each branch. The opening balance of stock, debtors (if any), petty cash (if any), are debited to the Branch Account; the cost of goods sent to branch as well as expenses of the branch paid by the head office,e.g., salaries, rent, insurance, etc., are also debited to it. Conversely, amounts remitted by the branch and the cost of goods returned by the branch are credited.

3. If it is desired to exercise a more detailed control over the working of a branch,the accounts of the branch are maintained under the Stock and Debtors Method.

4. Methods

   - If Goods are invoiced at cost or selling price: Debtors Method; Stock and Debtors Method; Trading and profit and loss account method (Final Accounts method)
   - If Goods are invoiced at wholesale price: Whole Sale branch method

   When goods are invoiced at cost

   If goods are invoiced to the branch at cost, the trading results of branch can be ascertained by following any of the three methods:

   a) Debtors Method

   b) Stock and Debtors method

   c) Wholesale branch system

   d) Final Accounts Method.

Suggested Readings

1. Hanif and A. Mukherjee, “Financial Accounting- II”, McGraw Hill, 2018
2. P.C. Tulsian, “Financial Accounting”, 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, “Introduction to Financial Accounting”, 2017
4. Barry Elliott and Jamie Elliott, “Financial Accounting and Reporting”, 19th Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., “Financial Accounting”, New York: McGraw Hill Book Company, 1990.

Unit-3

Independent Branch

STRUCTURE

Overview

In this unit we will learn the meaning of independent branch. An independent branch is a type of branch that operates autonomously and does not rely on its parent company for financial or operational support. It is established as a separate legal entity, with its own management team and decision-making authority.

An independent branch is usually established when a parent company wants to enter a new market or expand its business, but does not want to operate directly in that market. Instead, it establishes an independent branch to operate in the new market, with the aim of capturing market share and generating profits.

Objectives

After studying this unit, students would be able to:

- Understand the meaning of branch accounts
- Describe the features of independent branches
- Able to identify the inter-branch transactions

3.1. Introduction

A branch is said to be independent when it keeps a full system of accounting and maintains its own books of accounts. In other words, the branch carries on business as an independent unit, records all the transactions in its own books, extracts its own trial balance and prepares its own trading and profit & loss account and balance sheet.

3.2. Meaning

Independent Branches are those which make purchases from outside, get goods from Head Office, supply goods to Head Office and fix the selling price by itself.

3.3. Features of Independent Branches

- Independent Trading: Independent branches are authorized to independent trading. These branches make purchases at its own and make sales.
- Own Set of Books are Maintained: The independent branches make their own set of books. The books are kept on the double entry system. The journal, ledger, subsidiary books are maintained of each branch separately. At the end of the year, only the trial balance prepared is sent to the head office to make the consolidated accounts of whole business.
- Maintenance of Branch Account: In case of Independent Branches, the branch account is opened. This account is debited with the cash or goods sent to branch. It will get credit when cash is received by the head office from the branch. It is maintained like personal account and it indicates the amount due by the branch to the head office
- Maintenance of Head Office Account: In the books of the branch, the 'Head Office Account'. This account is debited with the amount remitted by the branch to the head office and get credited in respect of goods received by the branch from the head office, cash received and expenses paid by the head office on behalf of the branch. This account appears as the liability in the branch balance sheet.

3.4. Accounting for Independent Branches

When the size of the business is big, it is desirable that the branch maintainscomplete records of its transactions. These branches are called independent branches and each independent branch maintains comprehensive account books for recording their transactions; therefore a separate trial balance of each branchcan be prepared. The head office maintains one ledger account for each such branch, wherein all transactions between the head office and the branches are recorded.

Salient features of accounting system of an independent branch are as follows:

1. Branch maintains its entire books of account under double entry system.
2. Branch opens in its books a Head Office account to record all transactionsthat take place between Head Office and branch. The Head Office maintainsa Branch account to record these transactions.
3. Branch prepares its Trial Balance, Trading and profit and loss Account at theend of the accounting period and sends copies of these statements to Head Office for incorporation.
4. After receiving the final statements from branch, Head Office reconciles between the two – Branch account in Head Office books and Head Office account in Branch books.
5. Head office passes necessary journal entries to incorporate branch trial balance in its books.

3.5. Journal Entries

The Head Office Account in branch books and Branch Account in head office books is maintained respectively.

No	Transactions	Head office books		Branch books	
(i)	Dispatch of goods to branch by H.O.	Branch A/c To Good sent to Branch A/c	Dr.	Goods received from H.O. A/c To Head Office A/c	Dr.
(ii)	When goods are returned by theBranch to H.O.	Goods sent to Branch A/c To Branch A/c	Dr.	Head Office A/c To Goods received from H.O. A/c	Dr.
(iii)	Branch Expenses are paid by the Branch	No Entry		Expenses A/c To Bank or Cash A/	Dr.
(iv)	Branch Expenses paid by H.O.	Branch A/c To Bank or cash	Dr.	Expenses A/c To Head Office A/c	Dr.
(v)	Outside purchases made by the Branch	No Entry		Purchases A/c To Bank (or) CreditorsA/c	Dr.

(vi)	Sales effected by the Branch	No Entry		Cash or Debtors A/cTo Sales	Dr.
(vii) (viii)	Collection from Debtors of the Branch recd. By H.O. Payment by H.O. for purchase made by Branch	Cash or Bank A/c To Branch A/c Branch A/cTo Bank	Dr. Dr.	Head office A/c To Sundry DebtorsA/c Purchases (or) Sundry Creditors A/c To Head Office	Dr. Dr
(x) (x) (xi) (xii) (xiii) (xiv)	Purchase of Asset by Branch Asset purchasedby the Branch butAsset A/c retained at H.O.books Depreciation on (x) above Remittance of funds by H.O. to Branch Remittance of funds by Branch to H.O. Transfer of goodsfrom one Branch to another branch	No Entry Branch Asset A/cTo Branch A/c Branch A/c To Branch Asset Branch A/c To Bank Reverse entry of(xii)above (Recipient) Branch A/c To Supplying Branch A/c	 Dr. Dr. Dr. Dr.	Sundry Assets To Bank (or) LiabilityHead office To Bank (or) Liability Depreciation A/c To Head Office A/cBank A/c To Head Office Reverse entryof (xii)above SupplyingBranch H.O.A/c To Goods Receivedfrom H.O. A/c Recipient Branch Goods Received from H.O. A/c To Head Office A/c	Dr. Dr. Dr. Dr. Dr. Dr.

Students may find a few further practical situations and it is hoped that they can pass entries on the basis of accounting principles explained above. The final result of these adjustments will be that so far as the Head Office is concerned, the branch will be looked upon either as a debtor or creditor, as adebtor if the amount of its assets is in excess of its liabilities and as a creditor if the position is reverse.

A debit balance in the Branch Account should always be equal to the net assets at the branch. The important thing to remember, when independent sets of accountsare maintained, is that the branch and head office books are connected with each other only through the medium of the Branch and the Head Office Account which are converse of each other.; also when accounts of the branch and head office are consolidated both the Branch and Head Office Accounts will be eliminated.

3.6. Adjustment and Reconciliation of Branch and Head Office Accounts

If the branch and the head office accounts, converse of each other, do not tally,these must be reconciled before the preparation of the final accounts of the concern as a whole.

For example if Head Office has sent goods worth ` 50,000 but the branch has received till the closing date goods only ` 40,000, then the branch should treat ` 10,000 as goods in transit and should pass the following entry :

Goods in transit A/c Dr. 10,000

To Head Office A/c 10,000

However, there will be no entry in Head office books being the point where theevent has been recorded in full, hence no further entries in Head office books.

3.7. Inter-Branch Transactions

Inter-branch transactions are usually adjusted as if they were entered into onlywith the head office. It is a very convenient method of treating such transaction especially where the number of branches are large. Suppose Kolkata Branch incurred an expenditure on advertisement of 1,000 on account of Delhi Branch,the entries that would be made in such a case would be as follows:

Particulars		Dr.	Cr
In Kolkata Books:			
Head Office A/c	Dr.	1,000	
To Cash			1,000
In Delhi Books:			
Advertisement A/c	Dr.	1,000	
To H.O. A/c			1,000
In H.O. Books:			
Delhi Branch A/c	Dr.	1,000	
To Kolkata Branch A/c			1,000

Fixed Assets

Often the accounts of fixed assets of a branch are kept in the head office books; in such a case, at the end of the year, the amount of depreciation on the assets is debited to the branch concerned by recording the following entry:

Branch Account Dr.

To Branch Asset Account

The branch will pass the following entry:

Depreciation Account Dr.

To Head Office Account

Head office Expenses charged to Branch

Usually the head office devotes considerable time in attending to the affairs ofthe branch; on that account, it may decide to raise a charge against the branch in respect of the cost of such time. In such a case the amount is debited to the branch as 'Expenses' and is credited to appropriate revenue head such as Salaries Accounts, General Charges Account, Entertainment Account etc. The branch credits the H.O. Account and debits Expenses Account.

Illustration 1

Messrs Ramchand & Co., Hyderabad have a branch in Delhi. The Delhi Branch dealsnot only in the goods from Head Office but also buys some auxiliary goods anddeals in them. They, however, do not prepare any Profit & Loss Account but close all accounts to the Head Office at the end of the year and open them afresh on thebasis of advice from their Head Office. The fixed assets accounts are also maintained at the Head Office.

The goods from the Head Office are invoiced at selling prices to give a profit of 20per cent on the sale price. The goods sent from the branch to Head Office are at cost. From the following prepare Branch Trading and Profit & Loss Account andBranch Assets Account in the Head Office Books.

Trial Balance of the Delhi Branch as on 31-12-2011

Debit	Rs	Credit	Rs.
Head office opening balance on1-1-2011	15,000	Sales	1,00,000
Goods from H.O.	50,000	Goods to H.O.	3,000
Purchases	20,000	Head Office Current A/c	15,000
Opening Stock		Sundry Creditors	3,000
(H.O. supplies goods at invoice prices)	4,000		
Opening Stock of other goods	500		
Salaries	7,000		
Rent	3,000		

Office expenditure	2,000		
Cash on Hand	500		
Cash at Bank	4,000		
Sundry Debtors	15,000		
	1,21,000		1,21,000

The Branch balances as on 1st January, 2011, were as under: Furniture ` 5,000;Sundry Debtors ` 9,500; Cash ` 1,000, Creditors ` 30,000. The closing stock at branch of the head office goods at invoice price is ` 3,000 and that of purchasedgoods at cost is ` 1,000. Depreciation is to be provided at 10 per cent on branchassets.

Solution:

Delhi Branch

Trading and Profit & Loss Account for the year ended 31st Dec., 2011

Particulars	Rs.	Rs	Particulars	Rs.	Rs
To Opening Stock:			By Sales		1,00,000
Head office	3,200		By Goods from		3,000
Goods			Branch		
(4,000 x 80%)	500	3,700	By Closing Stock	2,400	
Others		40,000	:		
To Goods to			Head Office	1,000	3,400
Branch		20,000	goods		
(50,000 x 80%)		42,700	(3,000 x 80%)		
To Purchases			Others		
To Gross Profit c/d		1,06,400			1,06,400
		7,000			42,700
		3,000			
To Salaries		2,000			
To Rent		500	By Gross profit		
To Office Expenses		30,200	b/d		
To Dep. On					
furniture @ 10%					
To Net profit					
		42,700			42,700

Branch (Fixed) Assets Account (In Head Office Books)

2011	Particulars	Rs.	2011	Particulars	Rs.
Jan. 1	To Balance b/d	5,000	Dec.31	By Delhi Branch A/c (Depreciation)	500
				By Balance c/d	4,500
		5,000			5,000
2012 Jan. 1	To Balance b/d	4,500			

Working Notes:

Cash/Bank Account (Branch Books)

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,000	By Salaries	7,000
To Cash Received fromDebtors **	94,500	By Rent	3,000
		By Office Exp.	2,000
		By Creditors*	47,000
		By Head Office (Balancingfig.)	32,000
		By Cash Balance	500
		By Bank Balance	4,000
	95,500		95,500

*Opening Balance + Purchases – Closing balance = Payment

Rs.30,000 + Rs.20,000 – Rs. 3,000 = Rs.47,000.

** Opening Balance + Sales – Closing balance = Received

Rs.9,500 + Rs.1,00,000 – Rs.15,000 = Rs.94,500

Trial Balance of Delhi Branch as on 1-1-2011

Particulars	Rs.	Dr. Rs	Cr. Rs
Debtors		9,500	
Cash		1,000	
Stock H.O. Goods	4,000		
Others	500	4,500	
Creditors			30,000
Head Office Account		15,000	
		30,000	30,000

Head Office Account

Particulars	Rs.	Particulars	Rs.
To Balance (transfer)	15,000	By Goods from HeadOffice	50,000
To Cash	32,000		
To Goods sent	3,000		
	50,000		50,000

Credit balance in Head Office Account before this transfer will be 15,000 credit.

Note: Furniture A/c is maintained in Head office books; it is not a part of eitheropening or closing balance.

Illustration 2

Ring Bell Ltd. Delhi has a Branch at Bombay where a separate set of books is used.The following is the trial balance extracted on 31st December, 2011.

Head Office Trial Balance

Particulars	**Rs.**	**Rs**
Share Capital (Authorised: 10,000 Equity Shares of ` 100 each): Issued: 8,000 Equity Shares		8,00,000
Profit & Loss Account - 1-1-2011		25,310
General Reserve		1,00,000
Fixed Assets	5,30,000	
Stock	2,22,470	
Debtors and Creditors	50,500	21,900
Profit for 2011		52,200
Cash Balance	62,730	
Branch Current Account	1,33,710	
	9,99,410	9,99,410

Branch Trial Balance

Particulars	Rs.	Rs
Fixed Assets	95,000	
Profit for 2011		31,700
Stock	50,460	
Debtors and Creditors	19,100	10,400
Cash Balance	6,550	
Head Office Current Account		1,29,010
	1,71,110	1,71,110

The difference between the balances of the Current Account in the two sets of booksis accounted for as follows:

a) Cash remitted by the Branch on 31st December, 2011, but received by the Head Office on 1st January 2012 - ` 3,000.

b) Stock stolen in transit from Head Office and charged to Branch by the Head Office, but not credited to Head Office in the Branch books as the BranchManager declined to admit any liability (not covered by insurance) - ` 1,700.

Give the Branch Current Account in Head Office books after incorporating Branch TrialBalance through journal.

Solution:

The Branch Current Account in the Head Office Books and Head Office CurrentAccount in the Branch Books do not show the same balances. Therefore, in order to reconcile them, the following journal entries will be passed in the Head Officebooks:

Journal Entries

	Particulars	**Dr.**	**Cr.**
2011 Dec., 31	Cash in Transit A/c Dr. To Branch Current A/c (Cash sent by the Branch on 31st Dec., 2011but received at H.O. on 1st Jan., 2012)	3,000	 3,000
	Loss by theft A/c Dr. To Branch Current A/c (Stock lost in transit from H.O. to Branch)	1,700	 1,700

In order to incorporate, in the H.O. books, the given Branch trial balance whichhas been drawn up after preparing the Branch Profit & Loss Account, the following journal entries will be necessary:

Journal Entries

2011	Particulars	Rs.	Rs.
Dec.31	Branch Current Account Dr. To Profit & Loss Account (Branch Profit for the year)	31,700	 31,700
	Branch Fixed Dr. AssetsBranch Dr. Stock Branch Dr. Debtors Branch Dr. Cash To Branch Current Account H.O.	95,000 50,460 19,100 6,550	 1,71,110

	(Branch assets brought into books) Branch Current A/c Dr. To Branch Creditors H.O. (Branch creditors brought into books)	10,400	10,400

Branch Current Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,33,710	By Cash in transit	3,000
To Profit & Loss A/c	31,700	By Loss of theft	1,700
To Branch Creditors	10,400	By Sundry Branch Assets	1,71,110
	1,75,810		1,75,810

Profit and Loss Account for 2021

Particulars	Rs.	Particulars	Rs.
To Loss by Theft	1,700	By Balance b/d	25,310
To Balance c/d	1,07,510	By Year's Profit H.O.:	52,200
		Branch	31,700
	1,09,210		1,09,210

Let Us Sum Up

In this unit, you have learned about the followings:

Independent branches are those branches which keep full system of accounting and enjoy certain amount of autonomy in functioning. They maintain complete records on double entry system and prepare their own trial balances. The head office simply maintains a personal account for each branch which shows all transactions that take place between the branch and the head office. Similarly, each branch maintains a Head Office Account to show the corresponding entries. There are certain transactions which require special treatment both in head office and branch books.

These are: (i) goods in transit (ii) cash on transit (iii) head office expenses chargeable to branch (iv) depreciation on branch fixed assets the accounts of which are maintained at the head office level, and (v) inter-branch transactions

Check Your Progress

1. What is independent branch?
2. Describe the Salient features of accounting system.
3. Describe the accounting for independent branch.

Glossary

Independent Trading: Independent branches are authorized to independent trading. These branches make purchases at its own and make sales.

Maintenance of Branch Account: In case of Independent Branches, the branch account is opened. This account is debited with the cash or goods sent to branch. It will get credit when cash is received by the head office from the branch. It is maintained like personal account and it indicates the amount due by the branch to the head office.

Maintenance of Head Office Account: In the books of the branch, the 'Head Office Account'. This account is debited with the amount remitted by the branch to the head office and get credited in respect of goods received by the branch from the head office, cash received and expenses paid by the head office on behalf of the branch. This account appears as the liability in the branch balance sheet.

Answers to check your progress

1. Independent Branches are those which make purchases from outside, get goods from Head Office, supply goods to Head Office and fix the selling price by itself.
2. Features
    a. Branch maintains its entire books of account under double entry system.
    b. Branch opens in its books a Head Office account to record all transactionsthat take place between Head Office and branch. The Head Office maintainsa Branch account to record these transactions.
    c. Branch prepares its Trial Balance, Trading and profit and loss Account at theend of the accounting period and sends copies of

these statements to Head Office for incorporation.

d. After receiving the final statements from branch, Head Office reconciles between the two – Branch account in Head Office books and Head Office account in Branch books.

a. Head office passes necessary journal entries to incorporate branch trial balance in its books

3. Accounting for independent branch

When the size of the business is big, it is desirable that the branch maintainscomplete records of its transactions. These branches are called independent branches and each independent branch maintains comprehensive account books for recording their transactions; therefore a separate trial balance of each branchcan be prepared. The head office maintains one ledger account for each such branch, wherein all transactions between the head office and the branches are recorded.

Suggested Readings

1. Hanif and A Mukherjee, "Financial Accounting- II", McGraw Hill, 2018
2. P.C. Tulsian, "Financial Accounting", 2002.
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, "Introduction to Financial Accounting", 2017
4. Barry Elliott and Jamie Elliott, "Financial Accounting and Reporting", 19th Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., "Financial Accounting", New York: McGraw Hill Book Company, 1990.

Unit- 4
Foreign Branch

STRUCTURE

Overview

In this unit we will learn the meaning and the concept of foreign branch. A foreign branch is a type of branch that is established by a company in a foreign country. It is a separate legal entity that operates in the foreign country, and is subject to the laws and regulations of that country. The purpose of a foreign branch is to expand the business of the parent company into a new market or geographic location, and to take advantage of the opportunities available in that country.

A foreign branch is usually established when a company wants to enter a new market and does not want to set up a separate legal entity. This allows the company to benefit from the market opportunities available in the foreign country, while still maintaining a degree of control over the operations of the branch.

Objectives

After studying this unit, students would be able to

- understand the accounting for foreign branches
- understand Integral Foreign operation
- prepare necessary accounts under this system

4.1. Introduction

Foreign branches generally maintain independent and complete record of business transacted by them in currency of the country in which they operate. Thus problems of incorporating balances of foreign branches relate mainly to translation of foreign currency into Indian rupees. This is because exchange rateof Indian rupee is not stable in relation to foreign currencies due to international demand and supply effects on various currencies. The accounting principles which apply to inland branches also apply to a foreign branch after converting the trial balance of the foreign branch in the Indian currency.

4.2. Accounting for Foreign Branches

For the purpose of accounting, AS 11 (revised 2003) classifies the foreignbranches may be classified into two types:

- Integral Foreign Operation;
- Non- Integral Foreign Operation.

Let us discuss these two types of foreign branches in detail.

4.3. Integral Foreign Operation (IFO)

It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. The business of IFO is carried on as if it were an extension ofthe reporting enterprise's operations. For example, sale of goods imported fromthe reporting enterprise and remittance of proceeds to the reporting enterprise.

4.4. Non-Integral Foreign Operation (NFO)

It is a foreign operation that is not an Integral Foreign Operation. The business ofa NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. An NFO may also enter into transactions in foreign currencies, including transactions in the reporting currency. An example of NFOmay be production in a foreign currency out of the resources available in such country independent of the reporting enterprise.

The following are the indicators of Non- Integral Foreign Operation-

- Control by reporting enterprises - While the reporting enterprise may control the foreign operation, the activities of foreign operation are carried independently without much dependence on reporting enterprise.

- Transactions with the reporting enterprises are not a high proportion of the foreign operation's activities.
- Activities of foreign operation are mainly financed by its operations or from local borrowings. In other words it raises finance independently and is in no way dependent on reporting enterprises.
- Foreign operation sales are mainly in currencies other than reporting currency.
- All the expenses by foreign operations are primarily paid in local currency,not in the reporting currency.
- Day-to-day cash flow of the reporting enterprises is independent of the foreign enterprises cash flows.
- Sales prices of the foreign enterprises are not affected by the day-to-daychanges in exchange rate of the reporting currency of the foreign operation.
- There is an active sales market for the foreign operation product.

The above are only indicators and not decisive/conclusive factors to classify the foreign operations as non-integral, much will depend on factual information, situations of the particular case and, therefore, judgment is necessary to determine the appropriate classification.

Controversies may arise in deciding the foreign branches of the enterprises into integral or non-integral. However, there may not be any controversy that subsidiary associates and joint ventures are non-integral foreign operation.

In case of branches classified as independent for the purpose of accounting are generally classified as non-integral foreign operations.

Change in Classification

When there is a change in classification, accounting treatment is as under-

Integral to Non-Integral

i. Translation procedure applicable to non-integral shall be followed from the date of change.
ii. Exchange difference arising on the translation of non-monetary assets at the date of re-classification is accumulated in foreign currency translation reserve.
iii. Non-Integral to Integral

iv. Translation procedure as applicable to integral should be applied from thedate of change.

v. Translated amount of non-monetary items at the date of change is treated as historical cost.

vi. Exchange difference lying in foreign currency translation reserve is not to be recognized as income or expense till the disposal of the operation even ifthe foreign operation becomes integral.

4.5. Techniques for Foreign Currency Translation

Integral Foreign Operation (IFO)

Following are the standard recommendations for foreign currency translation:

All transactions of IFO be translated at the rate prevailing on the date oftransaction. This will require date wise details of the transaction entered by that operation together with the rates. Weekly or monthly average rate ispermitted if there are no significant variations in the rate.

- Translation at the balance sheet date-Monetary items at closing rate;
- Non-monetary items: The cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If tangible fixed asset is carried at fair value, translation should be done using the rate existed on thedate of the valuation.
- The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.
- Exchange difference arising on the translation of the financial statement of integral foreign operation should be charged to profit and loss account.

Non-Integral Foreign Operation

Accounts of non-integral foreign operation are translated using the following principles:

- Balance sheet items i.e. Assets and Liabilities both monetary and non- monetary – apply closing exchange rate.
- Items of income and expenses – At actual exchange rates on the date of transactions. However, accounting standard allows average rate subject to materiality.

- Resulting exchange rate difference should be accumulated in a "foreign currency translation reserve" until the disposal of "net investment in non- integral foreign operation".

4.6. Illustrations

Illustration 1

On 31st December, 2012 the following balances appeared in the books of ChennaiBranch of an English firm having its HO office in New York:

Particulars	Amount in`	Amount in`
Stock on 1st Jan., 2012	2,34,000	
Purchases and Sales	15,62,500	23,43,750
Debtors and Creditors	7,65,000	5,10,000
Bills Receivable and Payable	2,04,000	1,78,500
Salaries and Wages	1,00,000	-
Rent, Rates and Taxes	1,06,250	-
Furniture	91,000	-
Bank A/c	5,68,650	
New York Account	-	5,99,150
	36,31,400	**36,31,400**

Stock on 31st December, 2012 was ` 6,37,500.

Branch account in New York books showed a debit balance of $ 13,400 on 31st

December, 2012 and Furniture appeared in the Head Office books at $ 1,750.

The rate of exchange for 1 $ on 31st December, 2011 was ` 52 and on 31stDecember, 2012 was ` 51. The average rate for the year was ` 50.

Prepare in the Head Office books the Profit and Loss a/c and the Balance Sheet of theBranch assuming integral foreign operation.

Solution

In the books of English Firm (Head Office in New York)
Chennai Branch Profit and Loss Account
for the year ended 31st December, 2012

Particulars	$	Particulars	$
To Opening stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c/d	23,625	(6,37,500 / 51)	
	59,375		59,375
To Salaries	2,000	By Gross profit b/d	23,625

To Rent, rates and taxes	2,125		
To Exchange translation loss	2,000		
To Net Profit c/d	17,500		
	23,625		23,625

Balance Sheet of Chennai Branchas on 31st December, 2012

Liabilities	$	$	Assets	$
Head Office A/c	13,400		Furniture	1,750
Add : Net profit	17,500	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bills Receivable	4,000
			Cash at bank	11,150
		44,400		44,400

Working notes:

Calculation of Exchange Translation Loss
Chennai Branch Trial Balance (converted in $)
as on 31st December, 2012

Particulars	Dr. Rs	Cr. Rs.	Conversion Rate	Dr. $.	Cr. $.
Stock on 1st Jan., 2012	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	
Rent, Rates and Taxes	1,06,250		50	2,125	
Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	36,31,400	36,31,400		73,775	73,775

Illustration 2

S & M Ltd., Bombay, have a branch in Sydney, Australia. Sydney branch is anintegral foreign operation of S & M Ltd. At the end of 31st March, 2012, the following ledger balances have been extractedfrom the books of the Bombay Office and the Sydney Office:

Particulars	Bombay (` thousands)		Sydney (Australia dollarsthousands)	
	Debit	Credit	Debit	Credit
Share Capital	–	2,000	–	–
Reserves & Surplus	–	1,000	–	–

Land	500	–	–	–
Buildings (Cost)	1,000	–	–	–
Buildings Dep. Reserve	–	200	–	–
Plant & Machinery (Cost)	2,500	–	200	–
Plant & Machinery Dep. Reserve	–	600	–	130
Debtors / Creditors	280	200	60	30
Stock (1.4.2011)	100	–	20	–
Branch Stock Reserve	–	4	–	–
Cash & Bank Balances	10	–	10	–
Purchases / Sales	240	520	20	123
Goods sent to Branch	–	100	5	–
Managing Director's salary	30	–	–	–
Wages & Salaries	75	–	45	–
Rent	–	–	12	–
Office Expenses	25	–	18	–
Commission Receipts	–	256	–	100
Branch / H.O. Current A/c	120	–	–	7
	4,880	4,880	390	390

The following information is also available:

Stock as at 31.3.2012:

Bombay ` 1,50,000

Sydney A $ 3,125

You are required to convert the Sydney Branch Trial Balance into rupees;(use the following rates of exchange :

Opening rate A $. = ` 20

Closing rate A $. = ` 24

Average rate A $. = ` 22

For Fixed Assets A $. = ` 18).

Solution:

Sydney Branch Trial Balance (in Rupees)
As on 31st March, 2012

(` '000)

Conversion	Rate per A$	Dr.	Cr.
Plant & Machinery (cost)	` 18	36,00	
Plant & Machinery Dep. Reserve	` 18		23,40
Debtors / Creditors	` 24	14,40	7,20
Stock (1.4.2011)	` 20	4,00	
Cash & Bank Balances	` 24	2,40	

Purchase / Sales	` 22	4,40	27,06
Goods received from H.O.	–	1,00	
Wages & Salaries	` 22	9,90	
Rent	` 22	2,64	
Office expenses	` 22	3,96	
Commission Receipts	` 22		22,00
H.O. Current A/c			1,20
		78,70	80,86
Exchange loss (balancing figure)		2,16	
		80,86	80,86

Let Us Sum Up

In this unit you have learned about the following:

These branches are located outside the country. They are operated in the foreign country which has a different currency and, as such, question of rate of exchange will arise. These branches may be of: (i) Dependent Branch or (ii) Independent Branch depending on the method of accounting

Check Your Progress

1. What do you mean by Foreign Branch?

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2. Write short note on IFO

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3. Explain briefly Non- Integral Foreign Operation

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Glossary

Not - Integral Foreign Operation NFO: It is a foreign operation that is not an Integral Foreign Operation. The business of a NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. An NFO may also enter into transactions in foreign currencies, including transactions in the reporting currency. An example of NFOmay be production in a foreign currency out of the resources available in such country independent of the reporting enterprise.

Items of income and expenses: At actual exchange rates on the date of transactions. However, accounting standard allows average rate subject to materiality.

Answers to Check Your Progress

1. Foreign branches generally maintain independent and complete record of business transacted by them in currency of the country in which they operate. Thus problems of incorporating balances of foreign branches relate mainly to translation of foreign currency into Indian rupees. This is because exchange rateof Indian rupee is not stable in relation to foreign currencies due to international demand and supply effects on various currencies. The accounting principles which apply to inland branches also apply to a foreign branch after converting the trial balance of the foreign branch in the Indian currency.

2. It is a foreign operation, the activities of which are an integral part of those of the reporting enterprise. The business of IFO is carried on as if it were an extension ofthe reporting enterprise’s operations. For example, sale of goods imported fromthe reporting enterprise and remittance of proceeds to the reporting enterprise.

3. It is a foreign operation that is not an Integral Foreign Operation. The business ofa NFO is carried on in a substantially independent way by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowing in its local currency. An NFO may also enter into transactions in foreign currencies, including transactions in the reporting currency. An example of NFOmay be production in a foreign currency out of the resources available in such country independent of the reporting enterprise.

Suggested Readings

1. Hanif and A. Mukherjee, "Financial Accounting- II", McGraw Hill, 2018
2. P.C. Tulsian, "Financial Accounting", 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, "Introduction to Financial Accounting", 2017
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Block-2: Introduction

Block-2: Departmental Accounts has been divided in to four Units.

Unit-5 : Departmental Accounts deals with Introduction, Meaning, Objectives of departmental Accounting, Advantages of departmental Accounting, Concept of departmental accounting, Principles of departmental accounting, Formulation of policies, Assist in Expansion and Shut down decisions, Reveal the success or failures of units and Benefits to Auditors and Investors.

Unit-6: Methods and Techniques of Departmental Accounting discuss about Introduction, Methods and Techniques, Basis of Allocation of expenses, Inter departmental transfer and Journal entries and Illustration.

Unit-7: Final Accounts, Including Balance Sheet explains about Introduction, Meaning, Objectives of Preparing final accounts and Illustration.

Unit-8 : Inter Departmental Transfers at Cost Price describes about Introduction, Standard cost based transfer price, Inter departmental transfer at sale or invoice price and Illustration .

In all the units of Block -2 **Departmental Accounts,** the Check your progress, Glossary, Answers to Check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

Unit-5

Departmental Accounts

STRUCTURE

Overview

In this unit we will learn the meaning and the concept of Departmental accounting. Departmental accounting is a system of accounting used by companies that have multiple departments or divisions. It involves the separate recording and reporting of financial transactions for each department, allowing for the analysis of the financial performance of each department.

Objectives

After reading this unit, you should be able to:

- Understand departmental accounting
- Check out an interdepartmental performance.
- Evaluate the performance of the department with the previous period result.

5.1. Introduction

Departmental accounting is a system of accounting which maintains a separate book of account for every department or branch of a business enterprise. It is one where accounts are prepared and maintained for different departments of an organization on an individual basis for evaluating their results in a fair manner. These individual books of account are then consolidated together with accounts of head office for preparation of financial statements of business.

Departmental accounting aims at recording all the expenses and revenues of each department in a separate book of accounts. It enables in measuring the profitability of every branch and detect if any department is underperforming than their capability.

5.2. Meaning

Where a big business with diverse trading activities conduct under the same roof the same usually divide into several departments and each department deals with a particular kind of goods or service. For example, a textile merchant may trade in cotton, woolen and jute fabrics. The overall performance for this type of business depends, however, on departmental efficiency.

5.3. Objectives of Departmental Accounting

- To know the financial position of each and every department separately, it is helpful to make a comparison.
- To check out the interdepartmental performance. Unprofitable departments will be revealed.
- To evaluate the performance of the department with the previous period result. The gross profit of each department can be ascertained.
- To help the owner formulating the right policy for the future. The progress of each department can be monitored for appropriate actions to be taken.
- To assist the management in making the decision to drop or add a department. The result of operations can be used to determine the remuneration of managers of each department.
- To provide detail information about the entire organization. It can help the management in deciding which department should be developed more and which should be closed in order to maximize the profitability of the whole company.

- To assist management for cost control. It helps in determining the commission of the department manager when it is linked to profit achieved by their department.

5.4. Advantages of Departmental Accounting

Facilitates interdepartmental comparison : Departmental accounting is one which enables managers in doing a performance comparison of various departments of business. A separate book of accounts is prepared for every unit which records revenue and expenses of these units on an individual basis. Profit is calculated and compared with one another for determining their performance level.

5.5. Concept of Departmental Accounting

Departmentalization enables big firms to determine the areas needing special attention to the achievement of overall objectives. The units or departments needing more funds and more attention than others and the one(s) contributing more toward goal attainment could identify with good departmentalization. The purpose is basically to find out the performance and capability of the units or departments to make adjustments for the achievement of the firm's objectives.

Each unit, department or subsidiary gives the free use of some of the assets of the firm and some responsibilities which can be profit-making, revenue generation or cost control. As expenses incur by the firm on behalf of all its departments, indirect expenses are to apportion to the departments, if each department is to present a financial statement or if the statement is to prepare by the company on a departmental basis.

5.6. Principles of Departmental Accounting:

Preparation of final accounts of a departmentalized business requires the following:

- That the gross profit or loss and the net profit or loss of each department determine separately before taking. The totals to the appropriate account or the balance sheet of the business, and.
- That there should be some basis of apportioning gains and expenses to the departments or units of the business. And, that should be done as fair and equitable as possible.

5.7. Formulation of Policies

Formulation of proper plans and policies is an important role played by departmental accounting. Managers get detailed information about every unit through the individual book of accounts. They analyze these set of books for determining the efficiency level of various departments. Proper knowledge of every business unit enables them to take proper actions for increasing profitability.

5.8. Assist in Expansion and Shut down Decisions

Departmental accounting plays an inefficient role in deciding the expansion and shutting down of different departments of an organization. Managers through an individual set of books are able to detect which units have a more important role in business operations and which one plays the least role. They can easily decide on the basis of results that which units should be expanded further and which one should be closed.

5.9. Reveal the Success or Failures of Units

This accounting determines the success rate and failure of every department within the organization. Every expense and income of these departments are properly recorded for calculating its real profitability. Amount of revenue generated by these units gives a clear idea about the one that is successful in their role and one that fails to meet their goals.

5.10. Benefits to Auditors and Investors

It supplies all revenant information in a correct manner about each unit of business to auditors and investors. Auditors can easily access to the account of each individual unit for knowing all expenses and revenues and thereby enables them in verifying the correctness of financial statements. Investors can get a clear view of portability and overall value of an organization.

Determine manager's commission

Departmental accounting assists in the fair calculation of manager's commission working within different departments of the business. Commissions are paid to managers on the basis of profit earned by their respective departments. Proper accounts that are maintained separately for every unit yield right amount of their profit levels.

Promote competitive spirit

It promotes a sense of completive spirit among all staff working within an organization. All operations of each business unit is properly monitored under this system of accounting. Team members are rewarded on the basis of performance of their departments which is revealed by the departmental book of accounts. This motivates staff to work efficiently for improving the overall performance.

Enhance profitability

Departmental accounting has an efficient role in increasing the profitability of the business organization. This system of accounting closely monitors every aspect of cost and revenues of organization related to various units for avoiding any errors and frauds. It ensures that all resources are efficiently utilized with minimum wastage. These separate account books assist managers in determining performance level from time to time and taking corrective actions which leads to raising the profit level.

Let Us Sum Up

In this unit you have learned about the following:

Departmental accounting is a system of accounting which maintains a separate book of account for every department or branch of a business enterprise. It is one where accounts are prepared and maintained for different departments of an organization on an individual basis for evaluating their results in a fair manner. Departmentalization enables big firms to determine the areas needing special attention to the achievement of overall objectives.

Check Your Progress

1. What is departmental Accounting?

   ____
   ____
   ____

2. Describe the objective of departmental Accounting.

   ____
   ____
   ____

3. What are the advantages of departmental Accounting?

   ____
   ____
   ____

Glossary

Departmental accounting:	Departmental accounting is a system of accounting which maintains a separate book of account for every department or branch of a business enterprise.
Manager's commission :	Departmental accounting assists in the

fair calculation of manager's commission working within different departments of the business. Commissions are paid to managers on the basis of profit earned by their respective departments.

Answer to Check Your Progress

1. Where a big business with diverse trading activities conduct under the same roof the same usually divide into several departments and each department deals with a particular kind of goods or service. For example, a textile merchant may trade in cotton, woolen and jute fabrics. The overall performance for this type of business depends, however, on departmental efficiency.

2. Objectives

    a) To know the financial position of each and every department separately, it is helpful to make a comparison.

    b) To check out the interdepartmental performance. Unprofitable departments will be revealed.

    c) To evaluate the performance of the department with the previous period result. The gross profit of each department can be ascertained.

    d) To help the owner formulating the right policy for the future. The progress of each department can be monitored for appropriate actions to be taken.

    e) To assist the management in making the decision to drop or add a department. The result of operations can be used to determine the remuneration of managers of each department.

    f) To provide detail information about the entire organization. It can help the management in deciding which department should be developed more and which should be closed in order to maximize the profitability of the whole company.

    g) To assist management for cost control. It helps in determining the commission of the department manager when it is linked to profit achieved by their department.

3. Departmental accounting is one which enables managers in doing a performance comparison of various departments of business. A separate book of accounts is prepared for every unit which records revenue and expenses of these units on an individual basis. Profit is

calculated and compared with one another for determining their performance level.

Suggested Readings

1. Hanif and A Mukherjee, "Financial Accounting- II", McGraw Hill, 2018
2. P.C. Tulsian, "Financial Accounting", 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, "Introduction to Financial Accounting", 2017
4. Barry Elliott and Jamie Elliott, "Financial Accounting and Reporting", 19th Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., "Financial Accounting", New York: McGraw Hill Book Company, 1990.

Unit-6

Methods and Techniques of Departmental Accounting

STRUCTURE

Overview

In this unit we will learn the meaning and the concepts of methods and techniques of departmental accounting. There are several techniques used in departmental accounting to record and analyze financial transactions for each department. Some of the most common techniques include:

Cost center accounting: This technique involves dividing departments into cost centers, such as production, sales, or administration. Each cost center is assigned a budget and actual expenses are recorded for each cost center. This allows for the analysis of the costs associated with each department.

Revenue center accounting: This technique involves dividing departments into revenue centers, such as product lines or sales territories. Revenue generated by each revenue center is recorded and analyzed to determine the profitability of each department.

Objectives

After reading this unit, you should be able to:

- understand the different methods and techniques of departmental accounting

- understand separate set of books
- allocate the expenses between different departments

6.1. Introduction

Departmental accounts are prepared in such a manner that all desired information is available and departmental profit can correctly make. Departmental accounts refer to the maintenance of accounts of a business in a manner that makes it possible to ascertain the operational results of each activity, section or department by preparing separate trading and profit and loss account for each any of them.

- Separate Set of Books
- Accounting in Columnar Books form

Separate Set of Books

Under this method, the accounts of each department independently maintain. The departmental results of all the departments collect and take into consideration to find out the net result of the organization.

Accounting in Columnar Books Form

A Departmental Trading and Profit and Loss Account open for each department in a columnar form together with a separate column for 'Total' to ascertain the individual result of the different departments and also as a whole. But the Balance Sheet prepares in a combining form.

To incorporate the purchase and sale of goods, the subsidiary books and also the nominal accounts into the ledger must be ruled out with extra columns for each department in arriving at the desired departmental figures to prepare departmental final accounts. If there is a larger volume of cash purchase and cash sales, the Cash Book also must maintain separate columns for cash purchases and cash sales of various departments.

6.2. Methods and Techniques

- When accounts are finalized, departmental trading and profit and loss account is prepared in columnar form to find gross profit and net profit of each department.
- Maintenance of records
- Departmentalization of expenses
  - Direct expenses
  - Indirect expenses

- Expenses which cannot be apportioned
    - Expenses which can be apportioned
    - Inter-departmental transfer
        - Inter- departmental transfer at cost price
        - Inter-departmental transfer at selling price or loaded price

6.3. Basis of Allocation of Expenses

Expenses	Basis of Apportionment
Salesman's commission Discount allowed & Carriage Outwards Bad debts & Provision for discount on debtors Advertisement & Packing expenses Traveling salesman's salary and commission	Sales of Each Department
Discount received Provision for discount on creditors Freight & Duty Carriage Inwards	Purchase of Each Department
Rent, Rates and taxes Repair and maintenance of building Insurance on building Heating & Air conditioning expenses	Area of Floor Space of Each Department
Depreciation of Machinery Repairs and maintenance of plant Insurance premium	Value of Assets In Each Department
Workmen's compensation insurance Canteen expenses Labor welfare expenses Supervision Time keeping & Personnel office	Number Of Workers
Compensation to workers Holiday pay Provident fund contribution Group insurance premium	Direct Wages
Lighting expenses	Number of Light Points/ Area of Floor Space
Electric Power	Horse Power of Machine And /or Production Hours
Work manager's salary	Time Devoted by Him For Each Department

6.4. Inter-Departmental Transfer

Whenever goods or services are provided by one department to another, their cost should be separately recorded and charged to the department benefiting there by and credited to that providing the goods or services. The totals of such benefits (inter-departmental transfers) should be disclosed in the departmental Profit and Loss Account, to distinguish them from other items of expenditure.

Basis of Inter-Departmental Transfers

Goods and services may be charged by one department to another usually on either of the following three bases:

- Cost,
- Current market price,
- Cost plus agreed percentage of profit.

Elimination of Unrealized Profit

When profit is added in the inter-departmental transfers the loading included in the unsold inventory at the end of the year is to be excluded before final accounts are prepared so as to eliminate any anticipatory (internal) profit included therein.

Stock Reserve

Unrealized profit included in unsold stock at the end of accounting period is eliminated by creating an appropriate stock reserve by debiting the combined Profit and Loss Account. The amount of stock reserve will be calculated as:

$$\textbf{Stock Reserve} = \frac{\text{Transfer price of unsold stock} \times \text{Profit included in transfer price}}{\text{Transfer price}}$$

6.5. Journal Entries

At the end of the accounting year, the following journal entry will be passed forelimination of unrealised profit (creation of stock reserve):

Profit and Loss Account Dr.
To Stock Reserve

(Being a provision made for unrealised profit included in closing stock)

In the beginning of the next accounting year, the aforesaid journal entry will bereversed as under:

Stock Reserve Dr.
To Profit and Loss Account

(Being provision for unrealised profit reversed.)

Illustration 1

Goods are transferred from Department P to Department Q at a price 50% above cost.If closing stock of Department Q is `27,000, compute the amount of stock reserve.

Solution:

Particulars	Amount
Closing Stock of Department Q	27,000
Goods send by Department P to Department Q at a price 50% abovecost	
Hence profit of Department P included in the stock will be –	9,000
$\frac{27,000\square 50}{150}$	
Amount of the Stock Reserve will be `9,000.	

Working Note:

Dept P transfers goods to Dept Q at a profit of 50% of cost. Hence, if cost is ` 100/- the profit = ` 50 and Transfer Price = ` 150. Therefore, the profit of Dept P included in the stock value of Dept Q is one – third of the sale value

Illustration 2

Z Ltd. has three departments and submits the following information for the year endingon 31st March, 2011:

Particulars	A	B	C	Total (Rs)
Purchases (units)	6,000	12,000	14,400	
Purchases (Amount)				6,00,000
Sales (Units)	6,120	11,520	14,976	
Selling Price (per unit) `	40	45	50	
Closing Stock (Units)	600	960	36	

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

Solution

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

Particulars	A	B	C	Particulars	A	B	C
To OpeningStock (W.N.4)	11,520	8,640	12,240	By Sales A-6120 x 40 B-11,520 x 45 By C-14,976 x 50	2,44,800	5,18,400	7,48,800
To Purchases (W.N.2)	96,000	2,16,000	2,88,000	Closing Stock (W.N.4)	9,600	17,280	720
To Gross Profit (b.f)	1,46,880	3,11,040	4,49,280				
	2,54,400	5,35,680	7,49,520		2,54,400	5,35,680	7,49,520

Working Notes:

Profit Margin Ratio

Selling price of unit purchased:	Rs.
Department A 6,000 x 40	2,40,000
Department B 12,000 x 45	5,40,000
Department C 14,400 x 50	7,20,000
Total Selling Price	15,00,000
Less: Purchase (Cost) Value	(6,00,000)
Gross Profit	9,00,000
Profit Margin Ratio = $\frac{9,00,000}{15,00,000}$ X 100 = 60%	

Statement showing department-wise per unit Cost and Purchase Cost

	A	B	C
Selling Price (Per unit) (`)	40	45	50
Less: Profit Margin @ 60% (`) Profit Margin is uniform for all depts at 60%	(24)	(27)	(30)
Purchase price per unit (`)	16	18	20
Number of units purchased	6,000	12,000	14,400
(Purchase cost per Unit x Units purchased)	96,000	2,16,000	2,88,000

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

	A	B	C
Sales (Units)	6,120	11,520	14,976
Add: Closing Stock (Units)	600	960	36
	6,720	12,480	15,012
Less: Purchases (units)	(6,000)	(12,000)	(14,400)
Opening Stock (Units)	720	480	612

Statement showing department-wise cost of Opening Stock and ClosingStock

Particulars	A	B	C
Cost of Opening Stock (`)	720 x 16	480 x 18	612 x 20
`	11,520	8,640	12,240
Cost of Closing Stock	600 x 16	960 x 18	36 x 20
`	9,600	17,280	720

Let Us Sum Up

In this unit you have learned about the following:

Determine Departmental accounting assists in the fair calculation of manager's commission working within different departments of the business. Commissions are paid to managers on the basis of profit earned by their respective departments.

Proper accounts that are maintained separately for every unit yield right amount of their profit levels. It promotes a sense of completive spirit among all staff working within an organization. All operations of each business unit is properly monitored under this system of accounting. Team members are rewarded on the basis of performance of their departments which is revealed by the departmental book of accounts. This motivates staff to work efficiently for improving the overall performance.

Check Your Progress

1. Write short notes on separate set of books.

   ____

   ____

   ____

2. Describe Departmental accounts.

   ____

3. What do you mean by inter-departmental transfer.

Glossary

Manager's commission: Departmental accounting assists in the fair calculation of manager's commission working within different departments of the business. Separate Set of Books: the accounts of each department independently maintain.

Accounting in Columnar Books form: To incorporate the purchase and sale of goods, the subsidiary books and also the nominal accounts into the ledger must be ruled out with extra columns for each department in arriving at the desired departmental figures to prepare departmental final accounts.

Answer To Check Your Progress

1. Under this method, the accounts of each department independently maintain. The departmental results of all the departments collect and take into consideration to find out the net result of the organization.
2. Departmental accounts are prepared in such a manner that all desired information is available and departmental profit can correctly make. Departmental accounts refer to the maintenance of accounts of a business in a manner that makes it possible to ascertain the operational results of each activity, section or department by preparing separate trading and profit and loss account for each any of them.
3. Whenever goods or services are provided by one department to another, their cost should be separately recorded and charged to the department benefiting there by and credited to that providing the goods or services. The totals of such benefits (inter-departmental transfers) should be disclosed in the departmental Profit and Loss Account, to distinguish them from other items of expenditure.

Suggested Readings

1. Hanif and A. Mukherjee, “Financial Accounting- II”, McGraw Hill, 2018
2. P.C. Tulsian, “Financial Accounting”, 2002.
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, “Introduction to Financial Accounting”, 2017.
4. Barry Elliott and Jamie Elliott, “Financial Accounting and Reporting”, 19^{th} Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., “Financial Accounting”, New York: McGraw Hill Book Company, 1990.
6. Charles T. Horngren’ “Financial Accounting”, Revised Edition, 1997.
7. Asish K. Bhattacharyya, “Essentials of Financial Accounting”,2020.
8. Accounting Made Simple, Mike Piper, 2012.

Unit-7

Final Accounts, Including Balance Sheet

STRUCTURE

Overview

In this unit we will learn the meaning and the concept of final accounts including balance sheets.

The final accounts in branch accounting are prepared to determine the financial performance of the branch and the parent company.

The final accounts consist of Branch Trading and Profit and Loss Account: This account shows the revenue earned and expenses incurred by the branch during the accounting period, as well as the resulting profit or loss and Branch Balance Sheet: This balance sheet shows the assets and liabilities of the branch as at the end of the accounting period. It includes details of current assets and liabilities, fixed assets, and capital employed in the branch.

Objectives

After reading this unit, you should be able to:

- compare the performance of one department with that of another and to measure the progress of the department itself by comparing year-wise performance.
- measure the profitability of each department.

7.1. Introduction

Departmental Trading and Profit and Loss Account: When the books and accounts are maintained on a columnar basis, Trading and Profit and Loss Account can also be prepared on columnar basis.

There arises no difficulty in finding out gross profit and net profit for each department separately. From the analytical ledger accounts and subsidiary books department-wise figures are readily available. If an item of expenses definitely identified with a particular department, it can be termed as direct expenses with reference to the department.

7.2. Meaning

The trading, profit and loss accounts of each of the departments in a departmentalized organization are drawn separately but in a combined format called departmental trading, profit and loss account.

7.3. Objectives of Preparing Final Accounts

The aim of departmental, trading, profit and loss account is to compare trading result and to assist the owner of the business in formulating policies, having known the departments that perform better and those that perform worse.

7.4. Illustrations

Illustration 1

Final Profit / Loss	Dept. A Rs. 3,80,000 (Loss)	Dept. B Rs. 5,04,000 (Profit)	Dept. C Rs. 7,20,000 (Profit)	Dept. D Rs. 10,80,000 (Profit)
Inter-departmental transfers included at loaded price in the departmental stocks	-	Rs. 7,00,000 (Rs. 2,20,000 from Dept. A and Rs. 4,80,000 from Dept. C	-	Rs. 48,000 (Rs. 36,000 from Dept. C and Rs. 12,000 from Dept. A)

Solution:

Statement showing re-computation of departmental profit and loss

Particulars	Department A	Department B	Department C	Department D
Net profit/loss (as given) Add back: Commission to departmental managers [Working Note (i)]	Rs. – 3,80,000 + 60,000	Rs. – 5,04,000 + 60,000	Rs. – 7,20,000 + 80,000	Rs. – 10,80,000 + 1,20,000
Less: Unrealised profit in stock valued at loaded price [Working Note (ii)]	– 3,20,000 - 20,000 - 2,000	+ 5,64,000	– 8,00,000 - 80,000 - 6,000	+ 11,20,000
Adjusted profit/loss Less: Recomputed Commission to departmental manager [Working Notes (iii)]	– 3,42,000 - 60,000	– 5,64,000 - 60,000	– 7,14,000 - 71,400	– 12,00,000 - 1,20,000
Recomputed net profit/loss	- 4,02,000	+ 5,04,000	+ 6,42,600	+10,80,000

Working Notes:

(i) Commission to departmental managers as already recorded:

Department A = Minimum Commission. Rs. 60,000

Department B = Minimum Commission. Rs. 60,000

Department C = Commission is 10% of profit before such commission. It is, therefore, 1/9th of profit after such commission.

Hence, commission = Rs. 7,20,000 $\times \frac{1}{9}$ = Rs. 80,000

Department D = Rs. 10,80,000 $\times \frac{1}{9}$ = Rs. 1,20,000

(ii) Unrealised profit:

Department A = Transfer to Department B.

Rs. 2,20,000 $\times \frac{10}{110}$ = Rs. 20,000

Transfer to Department D.

Rs. 12,000 $\times \frac{20}{120}$ = Rs. 2,000

Department C = Transfer to Department B.

Rs. 4,80,000 $\times \frac{20}{120}$ = Rs. 80,000

Transfer to Department D.

Rs. 36,000 $\times \frac{20}{120}$ = Rs. 6,000

(iii) Recomputed commission to departmental managers:

Department A = Minimum commission, Rs. 60,000

Department B = Minimum commission, Rs. 60,000

Department C = 10% of Rs. 7,14,000 = Rs. 71,400

Department C = 10% of Rs. 12,00,000 = Rs. 1,20,000

Illustration 2

From the following figures prepare departmental Trading and Profit and Loss Accounts for the year ended 31st March. 2012:

	Cloth Department Rs.	Readymade Clothes Rs.
Opening Stock on 1st April, 2011	3,00,000	50,000
Purchases	20,00,000	15,000
Sales	22,00,000	4,50,000
Transfer to Readymade Clothes Department	3,00,000	---
Expenses – Manufacturing		60,000
Selling	20,000	6,000
Stock on 31st March, 2012	2,00,000	60,000

The stock in the readymade clothes department may be considered as consisting of 75% cloth and 25% other expenses. The Cloth Department earned gross profit at the rate of 15% in 2010-11. General Expenses of the business as a whole came to Rs1,10,000.

Dr. Solution: Departmental Trading and Profit and Loss Accounts for the year ending March 31, 2012 Cr.

Particulars	Cloth Rs.	Readymade Clothes Rs.	Total Rs.	Particulars	Cloth Rs.	Readymade Clothes Rs.	Total Rs.
To Opening Stock	3,00,000	50,000	3,50,000	By Sales	22,00,000	4,50,000	26,50,000
To Purchases	20,00,000	15,000	20,15,000	To Transfer to Readymade Clothes	3,00,000		3,00,000
To Transfer From Cloth Department		3,00,000	3,00,000	By Closing Stock	2,00,000	60,000	2,60,000
To Manufacturing Expenses		60,000	60,000				
To Gross Profit c/d	4,00,000	85,000	4,85,000				
	27,00,000	5,10,000	32,10,000		27,00,000	5,10,000	32,10,000
To Selling Expenses	20,000	6,000	26,000	By Gross Profit b/d	4,00,000	85,000	4,85,000
To Profit c/d	3,80,000	79,000	4,59,000				
	4,00,000	85,000	4,85,000		4,00,000	85,000	4,85,000
To General Expenses			1,10,000	By Profit b/d			4,59,000
To Stock Reserve (See Note)			1,575				
To Net Profit			3,47,425				
			4,59,000				4,59,000

Note: Stock Reserve has been calculated as follows:

Rate of gross profit on sales in Cloth Department = $\frac{44,000}{25,00,000} \times 100 = 16\%$

Element of cloth in closing stock of Readymade Clothes: 75% of Rs. 60,000 Rs. 45,000

Reserve required for unrealized profit @ 16% of Rs. 45,000 Rs. 7,200

Reserve already existing in Opening Stock = $\frac{15}{100} \times \frac{75}{100} \times 50,000$ Rs. 5,625

Additional Reserve required Rs. 1,575

Note:

It has been possible to know the reserve credited against unrealised profit in the opening stock. In the absence of information, the reserve should be calculated on the difference in the opening and closing stocks. In the above case, it would have been calculated on Rs 10,000/-, since the closing stock has increased, the reserve calculated on it would be debited to the Profit and Loss Account.

Illustration 3

Sunrise Ltd. has two departments X and Y.

From the following particulars, prepare departmental trading accounts and general profit and loss account for the year ending 31st March. 2012:

	Department – X Rs.	**Department – Y Rs.**
Opening stock (at cost)	40,000	24,000
Purchases	1,84,000	1,36,000
Carriage inward	4,000	4,000
Wages	24,000	16,000
Sales	2,80,000	2,24,000
Purchased goods transferred:		
By Dept. Y to Dept. X	20,000	--
By Dept. X to Dept. Y	--	16,000
Finished goods transferred:		
By Dept. Y to Dept. X	70,000	--
By Dept. X to Dept. Y	--	80,000
Return of finished goods:		
By Dept. Y to Dept. X	20,000	--
By Dept. X to Dept. Y	--	14,000
Closing Stock: Purchased goods	9,000	12,000
Finished goods	48,000	28,000

Purchased goods have been transferred mutually at their respective departmental purchase cost and finished goods at departmental market price and that 20% of the closing finished stock with each department represents finished goods received from the other department.

Solution:

Departmental Trading Account

Dr. for the year ended 31st March, 2012 Cr

	X Rs.	Y Rs.		X Rs.	Y Rs.
To Opening Stock	40,000	24,000	By Sales	2,80,000	2,24,000
To Purchases	1,84,000	1,36,000	By Transfers		
To Carriage	4,000	4,000	Purchased goods	16,000	20,000
To Wages	24,000	16,000	Finished goods	80,000	70,000
To Transfers:			By Returns:		
Purchased goods	20,000	16,000	Finished goods	14,000	20,000
Finished goods	70,000	80,000	By Closing Stock.		
To Returns:			Purchased goods	9,000	12,000
Finished goods	20,000	14,000	Finished goods	48,000	28,000
To Gross Profit c/d	85,000	84,000			
	4,47,000	**3,74,000**		**4,47,000**	**3,74,000**

Dr. Profit and Loss Account for the year ended 31st March, 2012 Cr

	Rs.		**Rs.**
To Provision for unrealized profit included in closing stock:		By Gross Profit b/d	
Dept. X	2,880	Dept. X	85,000
Dept. Y	1,400	Dept. Y	84,000
To Net Profit	1,64,720		
	1,69,000		1,69,000

Working Notes:

i) Calculation of rates of gross profit:

	Dept. X Rs.	**Dept. Y Rs.**
Sales	2,80,000	2,24,000
Add: Transfer of finished goods	80,000	70,000
	3,60,000	2,94,000
Less: Return of finished goods	20,000	14,000
	3,40,000	2,80,000
Gross profit	85,000	84,000

Rate of gross profit $\frac{85,000}{3,40,000} \times 100 = 25\%$ $\frac{84,000}{2,80,000} \text{ X } 100 = 30\%$

ii) Finished goods from other department included in closing stoct:

	Dept. X Rs.	**Dept. Y Rs.**
Stock of finished goods	48,000	28,000
Stock related to other department (20% of finished goods stock)	**9,600**	**5,600**

iii) Amount of unrealised profit included in stock:
Department X' = 30% of Rs. 9,600 = Rs. 2,880
Department Y' = 25% of Rs. 5,600 = Rs. 1,400

Illustration 4

Truck Master was the proprietor of a garage. His trial balance on March 31, 2012 was as follows:

Purchases -	Tools	17,600		
	Spares	21,200		
	Petrol and Oil	62,500	1,01,300	
Advertising			10,400	
Rent, Rates, and Lighting			68,000	
Insurance: -	Hire Cars	12,500		
	Burglary	2,000	14,500	
Wages: -	Chauffeurs	1,65,000		
	Repairs	70,000		
Department		25,000		
	Office	45,000	3,05,600	
	Garage	53,200		
Sales :-	Petrol and Oil	34,600		87,000
	Spares	4,32,600		
Receipts:-	Hiring	1,54,000		
	Repairs	95,000		6,81,800
	Garaging		14,500	
Licences for Hire Care			29,600	
Office Expenses			9,500	
Sundry Debtors				16,400
Sundry Creditors				34,000
Commission on Sold Cars			29,500	
Cash at Bank				
			11,50,000	**11,50,000**

The following additional information was extracted :-

a. The stock on hand, on March 31, 2012 was:-

	Rs.
Tools	10,600
Petrol and Oil	4,200
Spares	16,400

b. Petrol valued at Rs. 34,000 and oil at Rs. 6,200, were used by the Hire Department; petrol, valued at Rs. 2,800 and oil at Rs. 1,400 were used by the Repairs Department; private consumption was Rs. 1,600.

c. Repairs Department performed work on private cars valued at Rs. 23,400. In addition, Rs. 4,000 worth of work was performed on the proprietor's own car. Spares used by Repairs Department during the year were valued at Rs. 32,200.

d. Depreciation of Private Hire Cars and Repairs Van at 20% p.a. is to be provided .

e. Rent, Rates and Lighting are to be apportioned as follows:-

Repairs Department	¼	Garage	½
Hir Department	1/8	Office	1/8

f. The licence of Rs. 1,000 and insurance Rs. 1,000 for the proprietor's own car are included in the insurance and licences paid by the business.

g. Advertising is to be allocated Rs. 1,000 each to Petrol and Spares and the remaining charged equally over the other departments.

Prepare Departmental Trading Account and Profit and Loss Account for the year ended 31st March, 2012 and a Balance Sheet as on that date.

Solution: (Departmental Trading Account and Profit and Loss Account are on page)

Departmental Trading and Profit and Loss Account of Truck Master for the year ended March 31, 2012

2012 Particulars	Petrol and Oil Rs.	Spares Rs.	Repairs Department Rs.	Hire Department Rs.	Garage Rs.	Particulars	Petrol and Oil Rs.	Spares Rs.	Repairs Department Rs.	Hire Department Rs.	Garage Rs.
To Opening Stock	5,600	29,500	15,000			By Sales and	53,200	34,600	1,54,200	4,32,600	95,000
To Purchases	62,500	21,200	17,600			Receipts					
To Transfers from:						By Transfers to:	40,200				
Petrol and Oil			4,200	40,200		Hire Department	4,200	32,200	23,400		
Repairs				23,400		Repairs	1,600		4,000		
Spares			32,200			Department	4,200	16,400	10,600		
To wages			70,600	1,65,000	45,000	Drawings					
To Gross Profit c/d	35,000	32,500	52,600	2,04,000	50,000	By Closing Stock					
	1,03,400	83,200	1,92,200	4,32,600	95,000		1,03,400	83,200	1,92,200	4,32,600	95,000
						By Gross Profit b/d	35,300	32,500	52,600	2,04,000	50,000
To Licences											
(loss Proprietor's)				13,500							
To Licences											
(loss Proprietor's)		1,000	1,000	11,500							
To Advertising	1,200	1,000	2,800	2,800	2,800						
To Rent, Rates and											
Lighting			17,000	8,500	34,000						
To Depreciation on:											
Van			4,200								
Cars				91,200							
To Profit carried to											
Consolidated Profit											
and Loss A/c	34,300	30,500	27,600	76,500	13,200						
	35,300	**32,500**	**52,600**	**2,04,000**	**50,000**		**35,300**	**32,500**	**52,600**	**2,04,000**	**50,000**

Dr. Consolidated Profit and Loss Account for year ended March 31, 2012 Cr.

	Rs.			Rs.
To Wages (Office)	25,000	By Profit as revealed by		
To Rent, Rates and Lighting	8,500	departmental accounts:-	Rs.	
To Office Expenses	29,600	Petrol and Oil	34,300	
To Net Profit transferred to	1,53,000	Spares	30,500	
Capital A/C		Repairs	27,600	
		Hire	76,500	
		Garage	13,200	1,82,100
		By Commission on Sales of Cars		34,000
	2,16,100			**2,16,100**

Dr. Balance Sheet of Truck Master as on March 31, 2012 Cr.

			Rs.			Rs.
Sundry Creditors			16,400	Cash		29,500
Capital:		Rs.		Sundry Debtors		9,500
Balance on 1st April, 2011		3,30,000		Stocks---	Rs.	
Add: Net Profit		1,53,000		Petrol and Oil	4,200	
		4,83,000		Spares	16,400	
Less: Drawings:	Rs.			Loose Tools	**10,600**	31,200
Cash	40,000			Private Cars	4,56,000	
Petrol	1,600			Less:		3,64,800
Repairs	4,000			Depreciation	**91,20**	
Insurance and				**0**		
Licence	**2,000**	**47,600**	**4,35,400**			**16,800**
				Repairs Varis	21,000	
				Less: Depreciation	**4,200**	
			4,51,800			**4,51,800**

Let Us Sum Up

In this unit you have learned about the following:

Departmental Trading and Profit and Loss Account: When the books and accounts are maintained on a columnar basis, Trading and Profit and Loss Account can also be prepared on columnar basis.

There arises no difficulty in finding out gross profit and net profit for each department separately.

The trading, profit and loss accounts of each of the departments in a departmentalized organization are drawn separately but in a combined format called departmental trading, profit and loss account.

The aim of departmental, trading, profit and loss account is to compare trading result and to assist the owner of the business in formulating policies, having known the departments that perform better and those that perform worse.

Check Your Progress

1. What is department?

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2. What are the advantages of preparing departmental accounts?

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3. Explain the procedure for preparation of departmental accounts.

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Glossary

Departmental trading & profit and loss account: Departmental trading and profit and loss account is an account that shows the revenue earned and expenses incurred by each department of a company during a specific period. It is used to determine the profitability of each department and to identify areas where costs can be reduced or revenue can be increased.

The format of the departmental trading and profit and loss account is similar to the format of the trading and profit and loss account for a single entity, but with additional columns for each department. The account starts with the total revenue earned by the company, which is then allocated to each department based on the revenue earned by each department.

Answer to Check Your Progress

1. Department accounts are a method of accounting that involves keeping separate accounts for different departments within a business. Each department's financial transactions are recorded in its own separate account, allowing for a detailed analysis of the department's financial

performance.

2. Departmental accounts provide a clear picture of the financial performance of each department, allowing businesses to identify which departments are profitable and which ones are not. This information can be used to make decisions about resource allocation and to identify areas where costs can be reduced or revenue can be increased.

3. Set up a chart of accounts: The first step in preparing departmental accounts is to set up a chart of accounts that includes separate accounts for each department. This ensures that financial transactions for each department are recorded separately and accurately.

   Record revenue and direct expenses for each department: Revenue earned and direct expenses incurred by each department should be recorded in separate departmental trading accounts. These accounts should show the revenue earned and direct expenses incurred by each department.

   Record indirect expenses for each department: Indirect expenses such as rent, utilities, and administrative expenses should be allocated to each department based on a predetermined allocation method. These expenses should be recorded in separate departmental profit and loss accounts.

Suggested Readings

1. Hanif and A. Mukherjee, “Financial Accounting- II”, McGraw Hill, 2018
2. P.C. Tulsian, “Financial Accounting”, 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, “Introduction to Financial Accounting”, 2017
4. Barry Elliott and Jamie Elliott, “Financial Accounting and Reporting”, 19th Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., “Financial Accounting”, New York: McGraw Hill Book Company, 1990.
6. Charles T. Horngren’ “Financial Accounting”, Revised Edition, 1997.
7. Asish K. Bhattacharyya, “Essentials of Financial Accounting”,2020.
8. Accounting Made Simple, Mike Piper, 2012.

Unit-8

Inter Departmental Transfers at Cost Price

STRUCTURE

Overview

In this unit we will learn the meaning and the concept of Inter-departmental transfers. Inter-departmental transfers refer to the movement of goods or services from one department to another department within the same organization. These transfers are recorded in the accounting books of the organization and are an important part of departmental accounting

Objectives

After reading this unit, you should be able to:

- know the financial position of each and every department separately, it is helpful to make comparison.
- calculate the department wise manager's commission
- evaluate the result of each department.
- know the profitability of each department.

8.1. Introduction

The price at which one department supplies goods to another department or when some services are rendered by department to another department is known as Transfer Price. It refers to the charge made for goods and services sold internally. It may be market price if one is available. The transfer price is adjusted with the following amounts:

- **Cash discount**

Cash discounts refer to an incentive that a seller offers to a buyer in return for paying a bill before the scheduled due date. In a cash discount, the seller will usually reduce the amount that the buyer owes by either a small percentage or a set dollar amount.

- **Selling costs**

Selling costs we include the salaries of sales persons, allowances to retailers to display the products etc. besides the advertisements. Advertisement expenditure includes costs incurred for advertising in newspapers and magazines, televisions, radio, cinema slides etc. It was Chamberlin who introduced the analysis of selling costs and distinguished it from the production costs.

- **Margin of profit**

Profit margin gauges the degree to which a company or a business activity makes money, essentially by dividing income by revenues. Expressed as a percentage, profit margin indicates how many cents of profit has been generated for each dollar of sale.

- **Standard costs.**

Recording inter-departmental transfers helps the management in setting up profit centres, fixing responsibility on departmental managers and eventually, evaluates the performance and efficiency of the concerned departments.

8.2. Standard Cost Based Transfer Price

Under this method of pricing the prices may be based on the actual cost or total cost or standard cost or marginal cost. Standard cost is preferred to actual cost as the efficiency of one department is not allowed to pass to another department. When goods are transferred at cost, the fixed cost of supplying department becomes the variable cost of the receiving department.

8.3. Inter Departmental Transfer at Sales or Invoice Price

The goods may also be transferred from one department to another at sale or invoice price. The department which transfers the goods is known as Transferor department and the department to which goods are transferred is known as Transferee department. In this case, the transferor department retains the normal profit and does not allow the transferee department to increase its profit at the cost of the transferor.

When the goods received are sold out, the load or profit retained by the transferor department becomes the actual profit realized.

Transfer Price

A transfer price is the price at which divisions of a company transact with each other. Transactions may include the trade of supplies or labor between departments. Transfer prices are used when individual entities of a larger multi-entity firm are treated and measured as separately run entities.

8.4. Illustrations

Illustration 1

Inter-Departmental stock transfers are made as follows:

X Department to Y Department at 33 1/3% over department cost.

X Department to Selling Department at 50% over department cost.

Y Department to Selling Department at 25% over department cost.

The following information is given for the year ended 31st March, 2012:

	Department X		**Department Y**		**Selling Department**	
	M.T.	**Rs.**	**M.T.**	**Rs.**	**M.T.**	**Rs.**
Opening Stock	60	60,000	20	40,000	50	1,45,000
Raw Material Consumption	90	1,00,000	20	20,000		
Labour Charge		50,000		80,000		
Sales						5,00,000
Closing Stock	30		50		60	

Out of the total production in X. Department, 30 M.T. were for transfer to the Selling Department, Apart from these stocks which were transferred during the year, the balance output and the entire opening and closing stocks of X Department were for transfer to Y Department. The per tonne material and labour consumption in X Department on production to be transferred directly to the Selling Department is 300 per cent of the labour and material consumption on production meant for Y Department. The Administrative and Office Expenses totalled Rs. 1,65,000/-.

Prepare Departmental Profit and Loss accounts and the General Profit and Loss Account.

Dr. Departmental Profit and Loss Account for the year ending 31st March, 2012 Cr.

2012 Particulars	X Department		Y Department		Selling Department		Particulars	X Department		Y Department		Selling Department	
	Qty. M.T.	Rs.	Qty. M.T.	Rs.	Qty. M.T.	Rs.		Qty. M.T.	Rs.	Qty. M.T.	Rs.	Qty. M.T.	Rs.
To Opening Stock	60	60,000	20	40,000	50	1,45,000	By Stock transfers	120	2,55,000	80	2,00,000		
To Raw materials							By Sales					100	5,00,000
Consumed	90	1,00,000	20	20,000			By Closing Stock	30	30,000	50	1,00,000	60	1,80,000
To Labour Charges		50,000		80,000									
To Stock transferred													
from X Dept.			90	1,20,000	30	1,35,000							
To Stock transferred													
from Y Dept.					80	2,00,000							
To Profit to General													
Profit & Loss A/c.		75,000		40,000		2,00,000							
	150	2,85,000	130	3,00,000	160	6,80,000		150	2,85,000	130	3,00,000	160	6,80,000

Working Notes:

(i)	Department X:	M.T.	Rs.	
	Quantity and value of production	150	2,10,000	
	Transfer to Selling Department			
	(30. M.T., equal to 90 M.T.)	90*	90,000*	
	Meant for transfer to Y Department	120	1,20,000	
	Closing Stock (out of production meant for Y Department)	30	30,000	
	Actual transfer to Y Department	90	90,000	
	Add: Mark up at 33 1/3%	Rs.	30,000	1,20,000
	"Cost" of transfer to selling Department	90,000		
	Add: Mark up at 50%	45,000	1,35,000	
(ii)	Department Y:			
	Quantity and value of production	130	2,60,000	
	Closing Stock (average basis)	50	1,00,000	
	Cost of transfer to Selling Department	80	1,60,000	
	Add: Mark up at 25%		40,000	2,00,000
(iii)	Stock Reserve Required:			
	a) Y Department-Transfer from X Department			1,20,000
	"Own" Cost			1,00,000
	Total			2,20,000
	Increase in Closing Stock (Rs. 1,00,000–Rs. 40,000)		60,000	
	Proportion of element of transfer from x Department $\text{Rs. } 60{,}000 \times \frac{1{,}20{,}000}{2{,}20{,}000}$			32,727
	Unrealised Profit at 25% of transfer price (or 33 1/3% on cost)			8,182

b) Selling Department (Assuming the closing stock is a mixture of transfer from both the manufacturing departments)

1.	Increase in stock, (Rs. 1,80,000 – Rs. 1,45,000	35,000
2.	Total transfer from the two departments	3,35,000
3.	Total profit included in the transfer	85,000
4.	Unrealised profit in increase in Stock, $\text{Rs. } 35{,}000 \times \frac{85{,}000}{3{,}35{,}000}$	8,881
5.	Element of transfer from X Dept. in Rs. 35,000 $\text{Rs. } 35{,}000 \times \frac{1{,}35{,}000}{2{,}00{,}000}$	23,625
6.	Element of transfer from X Dept. included in 5 above. $\text{Rs. } 23{,}625 \times \frac{1{,}20{,}000}{2{,}20{,}000}$	12,886
7.	Profit included in 6 above while transferred from X Dept. 25%	3,222
8.	Total Unrealised Profit (4 + 7)	12,103

Illustration 2

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

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

Particulars	Rs.
Department X	36,000
Department Y	27,000
Department Z	18,000

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

Particulars	Department X Rs	Department Y Rs.	Department Z Rs.
Transfer from Department X	---	15,000	11,000
Transfer from Department Y	14,000	---	12,000
Transfer from Department Z	6,000	5,000	---

Find out the correct departmental profit after charging manager's commission.

Solution:

Statement showing Correct Departmental Profits

particulars	Department X (`)	Department Y (`)	Department Z (`)
Profits after charging managers' commission (but before adjusting unrealized profits)	36,000	27,000	18,000
Add back: Managers' commission (10/90)	4,000	3,000	2,000
	40,000	30,000	20,000
Less: Unrealized profit on stock (see Note)	4,000	4,500	2,000
Profits before charging managers' commission	36,000	25,500	18,000
Less: Manager's Commission @ 10%	3,600	2,550	1,800
Correct departmental profits	32,400	22,950	16,200

Working Note:

Unrealized profit on stock: Rs

Profit of department X:	
On stock held by department Y : - 25/125 × ` 15,000	3,000
On stock held by department Z : - 10/110 × ` 11,000	1,000
	4,000
Profit of department Y:	
On stock held by department X : - 15/100 × ` 14,000	2,100
On stock held by department Z : - 20/100 × ` 12,000	2,400
	4,500
Profit of department Z:	
On stock held by department X : - 20/120 × ` 6,000	1,000
On stock held by department Y : - 25/125 × ` 5,000	1,000
	2,000

Let Us Sum Up

In this unit, you have learned about the followings:

Transfer of goods or services by one department to another department are called inter departmental transfers.

When one department transfers goods to another department, the transaction should be considered as a salefor the supplying department and a purchase for the receiving department.

As such, the supplying departmentshould be credited and the receiving department should be debited with the value of goods supplied.

Goods may be transferred either at cost price or at selling price. If goods are transferred at selling price by thetransferor department and such goods are unsold at the end of the accounting year by the transferee department, then profit charged on such unsold goods by the transferor department is treated as unrealized profit and it should be debited to the general profit and loss account as stock reserve. In the balance sheet stock reserve should be deducted from closing stock.

Check Your Progress

1.What is selling price?

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2.What is margin of safety?

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3.Write short notes on standard cost.

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Glossary

Inter departmental transfers: Transfer of goods or services by one department to another department are called inter departmental transfers.

Cash discount: Cash discounts refer to an incentive that a seller offers to a buyer in return for paying a bill before the scheduled due date.

Transfer Price: A transfer price is the price at which divisions of a company transact with each other. Transactions may include the trade of supplies or labour between departments. Transfer prices are used when individual entities of a larger multi-entity firm are treated and measured as separately run entities

Answer to Check Your Progress

1. Selling costs we include the salaries of sales persons, allowances to retailers to display the products etc. besides the advertisements. Advertisement expenditure includes costs incurred for advertising in newspapers and magazines, televisions, radio, cinema slides etc. It was Chamberlin who introduced the analysis of selling costs and distinguished it from the production costs.

2. Profit margin gauges the degree to which a company or a business activity makes money, essentially by dividing income by revenues. Expressed as a percentage, profit margin indicates how many cents of profit has been generated for each dollar of sale.

3. Recording inter-departmental transfers helps the management in setting up profit centres, fixing responsibility on departmental

managers and eventually, evaluates the performance and efficiency of the concerned departments.

Suggested Readings

1. Hanif and A. Mukherjee, "Financial Accounting- II", McGraw Hill, 2018
2. P.C. Tulsian, "Financial Accounting", 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, "Introduction to Financial Accounting", 2017
4. Barry Elliott and Jamie Elliott, "Financial Accounting and Reporting", 19^{th} Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., "Financial Accounting", New York: McGraw Hill Book Company, 1990.
6. Charles T. Horngren' "Financial Accounting", Revised Edition, 1997.
7. Asish K. Bhattacharyya, "Essentials of Financial Accounting",2020.
8. Accounting Made Simple, Mike Piper, 2012.

Block-3: Introduction

Block-3: Accounts Relating to Hire- Purchase and Instalment System has been divided in to four Units.

Unit-9 : Introduction to Hire-Purchase deals with Introduction, Meaning, Definition, Features of hire purchase system, Hire purchase agreements, Advantages of hire purchase system, Disadvantages of hire purchase system, Rights and duties of hire vendor, Rights and duties of hire purchaser, Terms used in hire purchase system, Difference between hire purchase agreement and Instalment payment agreement.

Unit-10: Instalment System explain about Introduction, Meaning, Concept of Instalment Purchase System, Features of Instalment system, Methods of Computing Installment under Hire Purchase and Illustrations.

Unit-11: Default and Repossession discuss with Introduction, Types of Repossession, Complete repossession, Partial repossession and Illustrations.

Unit-12: Methods of Computation of Profit describes about Introduction, Hire purchase Trading, Debtors Method, Stock and Debtors Method

In all the units of Block -3, **Accounts Relating to Hire- Purchase and Instalment System,** the Check your progress, Glossary, Answers to Check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

Unit-9

Introduction to Hire-Purchase

STRUCTURE

Overview

In this unit we will learn the concept of hire purchase and its meaning. Hire purchase system is a type of installment purchase agreement where the seller allows the buyer to take possession of goods and pay for them in installments over a specified period of time. The buyer does not become the owner of the goods until the final installment has been paid.

Objectives

After studying this unit, students would be able to:

- understand the meaning of Hire-Purchase System
- explain the Salient Features of Hire-Purchase System
- learn the Accounting Treatment – Methods of Recording Transactions in the Books of Hire Purchase and Hire Vendor

9.1. Introduction

One's needs are many and varied, but resources to achieve such wants are scanty and scarce. In an era of electronic world, markets are flooded with so many articles with utility values. They induce the customers to purchase for their daily use in life. But resources to acquire them are not within the reach of common man. Understanding this psychological concept of humanity, trading institutions exploit the situation by adopting a technique or device to sell the goods under easy terms and conditions for those buyers who have no or minimum amount of money. Such a system is known as Hire-Purchase System and Instalment System. Under such scheme, one may come across with so many attractive captions – interest free loan; no hidden cost; no margin money; low EMI rates and so on.

Legal Position of Hire Purchase:

The Hire Purchase Act, 1972 defines a hire purchase agreement as an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of the agreement and includes an agreement under which:

1. Possession of goods is delivered by the owner there off to a person on a condition that such person pays the agreed amount in periodic payments, and
2. The property in the goods is to pass to such person on the payment of the last of such installments, and
3. Such person has a right to terminate the agreement at any time before the property so passes." Section 3 of the Act provides that every hire purchase agreement must be in writing and signed by all parties thereto.

9.2. Meaning of Hire Purchase

Hire purchase means a transaction where goods are purchased and sold on the terms that:

1. Payment will be made in installments,
2. The possession of the goods is given to the buyer immediately,
3. The property (ownership) in the goods remains with the vendor till the last installment is paid,
4. The seller can repossess the goods in case of default in payment of any installment, and

5. Each installment is treated as hire charges till the last installment is paid.

9.3. Definition

"A system whereby the owner of the goods lets them on hire for periodic payments by the hirer upon an agreement that when a certain number of payments have been completed, the absolute property in the goods will pass to the hirer, but so that the hirer may return the goods at any time without any obligation to pay any balance of rent accruing after return; until the conditions have been fulfilled the property remains in the owner".

9.4. Features of Hire Purchase System

The main features of a hire purchase agreement are as below:

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

9.5. Hire Purchase Agreements

1. In a hire-purchase agreement, the owner hires goods to the hirer with an option to purchase the goods when he has made the payment of a certain sum.
2. By this system, the purchaser who is unable to pay the full price of the asset at one lump sum, gets facilities to acquire an asset and after making the payment of an initial amount called premium, the purchaser pays the balance consideration money in instalments.

3. After the payment of all the instalments, the property in the goods passes to the hirer.
4. The hirer has an option to return the goods during the period of hire. In a hire-purchase agreement, the hirer has the right to terminate the agreement for hire at his pleasure and is not bound to pay the value of the goods.
5. A hire-purchase agreement is a form of bailment; the hirer is given the right to purchase the goods on certain conditions. That, however, is an option not an obligation to purchase.
6. The hirer may elect to purchase the goods and when he does so, after he fulfills all the conditions prescribed in the agreement, the title to the goods will pass to him. But he may elect not to do so, and in that event he is entitled to return the goods and terminate the agreement in the manner provided therein.

9.6. Advantages of Hire Purchase System

Spreading the cost

A car is an expensive purchase, and in many cases having a readily available lump sum of cash to buy one isn't possible. Hire purchase means the payments can be spread out over time, making buying a car more affordable.

Fixed monthly repayments

When you take out a hire purchase agreement, the interest rate is fixed from the time you start the contract. That means you'll pay the same amount every single month, making it far easier to fit in with your monthly budget.

Reduce repayments to fit your budget

There are a couple of ways to reduce your monthly repayments. Paying a bigger deposit will reduce the overall amount and interest you need to pay back. Having flexible repayment terms – from one to five years – means you can also lessen the monthly amount by choosing a longer term.

Fewer restrictions

While some leasing and financing options come with mileage or conditional restrictions.

It can be paid off early in most cases

Most Hire Purchase agreements will allow you to pay your finance off earlier. So if you want to settle your agreement, either partially or fully before the end of the term, you could make early repayments. Some, however, will only allow you to do so after a certain amount of repayments.

Get accepted with less than perfect credit

Hire purchase is the easiest type of car finance to get accepted for. So if you're worried about your credit rating affecting your chances of approval, hire purchase may be the best option for you.

9.7. Disadvantages of Hire Purchase System

Higher cost than purchasing outright

Interest will be added to your monthly payments, making hire purchase more expensive than if you paid for the car in full upfront.

Interest rates are based on credit rating

Generally, to get the best interest rates on a hire purchase agreement, ideally, you need to have a good credit rating. Those with poor credit ratings can often find that they're offered a higher interest rate and over the duration of the term, that can all add up.

Missing or making late payments could affect your credit score

A hire purchase agreement is a type of credit, so it's usually reported to the major credit reporting agencies. This means if you fail to make a payment or make it late, it could be reported and therefore have an impact on your credit score. Missing and late payments stay on your file for up to six years and are visible to lenders searching your report, so can have an effect on your borrowing in the future. If you have any concerns about how hire purchase can affect your credit score, our team will be more than happy to answer any questions.

9.8. Rights and Duties of Hire Vendor

In a hire-purchase agreement, the hirer has the right to terminate the agreement for hire at his pleasure and is not bound to pay the value of the goods. A hire-purchase agreement is a form of bailment; the hirer is given the right to purchase the goods on certain conditions.

9.9. Rights and Duties of Hire Purchaser

Right of hirer to purchase at any time with rebate. Right to hirer to terminate agreement at any time. Right to hirer to appropriate payments in respect of two or more agreements.

Assignment and transmission of hirer's right or interest under hire-purchase agreement.

9.10. Terms Used in Hire Purchase System

1. **Hire Vendor:** Hire vendor is a person who delivers the goods along with its possession to the hire purchaser under a hire purchase agreement.
2. **Hire Purchaser:** Hire purchaser is a person who obtains the goods and rights to use the same from hire vendor under a hire purchase agreement.
3. **Cash Price**: Cash price is the amount to be paid by the buyer on outright purchase in cash.
4. **Down Payment:** Down payment is the initial payment made to the hire vendor by the hire purchaser at the time of entering into a hire purchase agreement.
5. **Hire Purchase Instalment:** Hire purchase instalment is the amount which the hire purchaser has to pay after a regular interval upto certain period as specified in the agreement to obtain the ownership of the asset purchased (on payment of the last installment) under a hire purchase agreement. It comprises of principal amount and the interest on the unpaid amount.
6. **Hire purchase price:** It means the total sum payable by the hire purchaser to obtain the ownership of the asset purchased under hire purchase agreement. It comprises of cash price and interest on outstanding balances.

9.11. Difference between Hire Purchase Agreement and Instalment Payment Agreement.

S.N	Basis of Distinction	Hire Purchase	Instalment System
1.	Governing Act	It is governed by Hire Purchase Act, 1972.	It is governed by the Saleof Goods Act, 1930.
2.	Nature of Contract	It is an agreement of hiring.	It is an agreement of sale.
3.	Passing of Title (ownership)	The title to goods passeson last payment.	The title to goods passes immediately as in the caseof usual sale.
4.	Right to Return goods	The hirer may return goods without further payment except for accrued instalments.	Unless seller defaults, goods are not returnable.

5.	Seller's right to repossess	The seller may take possession of the goods ifhirer is in default.	The seller can sue for price if the buyer is in default. He cannot take possession of the goods.
6.	Right of Disposal	Hirer cannot hire out sell, pledge or assign entitling transferee to retain possession as against the hire vendor.	The buyer may dispose off the goods and give good title to the bona fide purchaser.
7.	Responsibility for Risk of Loss.	The hirer is not responsible for risk of loss of goods if he has taken reasonable precaution because the ownership has not yet transferred.	The buyer is responsible for risk of loss of goods because of the ownership has transferred.
8.	Name of Parties involved	The parties involved are called Hirer and Hire vendor.	The parties involved are called buyer and seller.
9.	Component other than cash price.	Component other than Cash Price included in installment is called Hire charges.	Component other than Cash Price included in Installment is called Interest.

Let Us Sum Up

In this unit you have learned about the following:

Hire purchase means a transaction where goods are purchased and sold on the terms. In an era of electronic world, markets are flooded with so many articles with utility values.

They induce the customers to purchase for their daily use in life. But resources to acquire them are not within the reach of common man.

Understanding this psychological concept of humanity, trading institutions exploit the situation by adopting a technique or device to sell the goods under easy terms and conditions for those buyers who have no or minimum amount of money.

Check Your Progress

1. Define 'hire purchase'.

2. Who is hire vendor?

3. Briefly explain the hire purchase system?

4. Distinguish between cash price and hire purchase price.

5. What are the features of hire purchase system?

Glossary

Hire Vendor:	Hire vendor is a person who delivers the goods along with its possession to the hire purchaser under a hire purchase agreement.
Hire purchase price:	It means the total sum payable by the hire purchaser to obtain the ownership of the asset purchased under hire purchase agreement. It comprises of cash price and interest on outstanding balances.
Down Payment:	Down payment is the initial payment made to the hire vendor by the hire purchaser at the time of entering into a hire purchase agreement.

Answer to Check Your Progress

1. "A system whereby the owner of the goods lets them on hire for periodic payments by the hirer upon an agreement that when a certain number of payments have been completed, the absolute property in the goods will pass to the hirer, but so that the hirer may return the goods at any time without any obligation to pay any balance of rent accruing after return; until the conditions have been fulfilled the property remains in the owner".

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

3. Hire purchase system is a type of installment purchase agreement where the seller allows the buyer to take possession of goods and pay for them in installments over a specified period of time. The buyer does not become the owner of the goods until the final installment has been paid.

4. Cash Price: The cash price is the full price of the product that the customer would have to pay if they were to purchase the product outright in cash. The cash price does not include any interest or finance charges.

   Hire Purchase Price: The hire purchase price is the total amount that the customer would pay for the product if they choose to purchase it on hire purchase. The hire purchase price includes the cash price of the product plus any interest and finance charges that are applicable to the hire purchase agreement.

5. The main features of a hire purchase agreement are as below:

   Possession: The hire vendor transfers only possession of the goods to thehire purchaser immediately after the contract for hire purchase is made.

   Installments: The goods are delivered by the hire vendor on the conditionthat a hire purchaser should pay the amount in periodical instalments.

   Down Payment: The hire purchaser generally makes a down payment, i.e., an amount on signing the agreement.

   Constituents of Hire purchase instalments: Each instalment consists of two elements- finance charge (interest on unpaid amount) and capital payment.

   Ownership: The property in goods is to pass to the hire purchaser on the payment of the last instalment and exercising the option conferred upon him under the agreement.

Repossession: In case of default in respect of payment of even the last instalment, the hire vendor has the right to take the goods back without making any compensation.

Suggested Readings

1. Hanif and A. Mukherjee, "Financial Accounting- II", McGraw Hill, 2018
2. P.C. Tulsian, "Financial Accounting", 2002
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Unit-10

Instalment System

STRUCTURE

Overview

In this unit we will learn the concept of Instalment System and its meaning. In the Installment System also, the purchaser pays the cost of purchased asset in number of installments. However, under installment system, ownership of the goods is transferred by owner on the date of delivery of thegoods. In instalment payment system, the ownership of the goods is passed immediatelyto the buyer on the signing the agreement. The accounting entries under instalment payment system are similar to those passed under the hire-purchase system.

Objectives

After studying this unit, Students should be able to:

- Understand the instalment payment system
- Explain the concept Of Installment Purchase System
- Learn different Methods of Computing Instalment under Hire Purchase

10.1. Introduction

Under Installment System also, the purchaser pays the cost of purchased asset in number of installments. However, under installment system, ownership of the goods is transferred by owner on the date of delivery of thegoods. In instalment payment system, the ownership of the goods is passed immediatelyto the buyer on the signing the agreement. The accounting entries under instalment payment system are similar to those passed under the hire-purchase system. The scheme of entries is as under:

Books of buyer: Buyer debits asset account with full cash price, credits vendor's account with full instalment price and debits interest suspense account with the difference between full cash price and full instalment price. Interest is debited to interest suspense account because it includes interest in respect of a number of years.

Every year interest account is debited and interest suspense account is credited with the interest of current year. Interest account, atthe end of the year, is closed by transferring to profit and loss account.

The balance of vendor account should be shown in the balance sheet after deducting amount in interest suspense account. Vendor is paid the instalment due to himand entry for the depreciation is passed in the usual way.

Books of Seller: The seller debits the purchaser with the full amount payable by him and credits sales account by the full cash price and credits interest suspense account by the difference between the total instalment price and total cash price.

Seller, like the buyer, also transfers the amount of interestdue from the interest suspense account interest account every year. Interest account is closed by transferring to profit and loss account and the purchaser account should be shown in the balance sheet after deducting amount in interest suspense account. On receiving the instalment the vendor debits cash/bank account and credits purchaser's account.

10.2. Meaning

The Installment system is almost similar to the hire purchase system. The main difference between the two is that in installment system, the buyer gets the ownership rights as soon as the contract is signed with the seller. If he makes any default in payment of any installment, the seller can repossess the article only with the help of the Court.

Hire purchase and installment systems facilitate brisk sale of consumer durable. Commodities like two wheeler, television sets, radios, refrigerators, cycle, furniture etc., are sold in large volumes under hire purchase and installment system.

The products to be sold under these systems should be

1. Durable,
2. High in quality,
3. Fashionable
4. Standardized; and
5. High priced.

10.3. Concept of Installment Purchase System

An installment system is just like a credit purchase and hire purchase system of selling and buying goods. Like hire purchase, in installment system an agreement is made between buyer and seller to purchase and sell of goods. The buyer makes certain down payment at the time of signing agreement and the balance is paying in installment over a period of time.

An installment system is a credit sale in which payments are made in installments over a period of time. In this system, the buyer gets the possession as well as ownership of the goods right at the time of signing the agreement. During the course of paying the installment, if the buyer makes default in paying the installment, the vendor cannot responses the goods. In that case, the vendor can sue the buyer for recovery of dues. Like in hire purchase even the paid installments also cannot be forfeited in case of default in paying installment.

Thus, it can be said that installment system is a kind of credit sale where installments are entertained over the period and default in such payment cannot responses the goods and in that case, the vendor can only sue the buyer for the recovery of amount due.

10.4. Features of Instalment Purchase System

Under the installment purchase system, there is an outright sale of goods with the buyer having the facility to pay the purchase price in a certain number of agreed installments. In this system, a certain amount is paid as a down payment amount at the time of signing the agreement. The buyer makes certain down payment at the time of signing an agreement and the balance is paying in installment over a period of time.

10.5. Method of Computing Installment under Hire Purchase

Under Hire Purchase, interest is usually charged on a flat rate for the period of hire. We can calculate the amount of installment by adding the amount of principal (cost of the asset) and the total interest for the period, and further by dividing the total amount of payment to be made by the number of installments.

Say, an equipment costing Rs. 1,00,000/- is sold on hire purchase on the terms that interest will be charged at 15% p.a. on flat rate basis and the payment is to be made in 5 equal year-end installments.

In the above example,

the total Interest burden shall be Rs. 75,000 i.e. 1,00,000 × 15/100 × 5 and the yearly installment shall be 1,00,000 + 75,000/5 = Rs. 35,000 Method of Splitting H.P. Installment into Interest and Principal Repayments:

(a) First of all interest included in each installment is calculated on the basis that interest in each installment shall be in ratio of amounts outstanding. In case the installments are of equal amounts, we can apply the sum of digit method.

(b) We can determine the amount of principal repayment in the installment by deducting from it the amount of interest calculated in (a) above.

The interest can be allocated as below:

Leasing Versus Hire Purchase:

Both Leasing and hire purchase provide a source of financing fixed assets. However the two are not similar on many accounts.

Selecting between Leasing and Hire Purchase:

(a) If a firm has the choice of selecting between leasing and hire purchase, it should evaluate the financial viability of both the proposals by adopting the normal methods of capital budgeting. We would prefer the technique of comparison of the present values of net outflows after-tax from the two options. The option with lower present value of cash outflows implies lesser cost and hence should be selected.

10.6. Illustrations

Illustration:1

X Transport Ltd. purchased from Delhi Motors 3 Tempos costing ` 50,000 each onthe hire purchase system on 1-1-2011. Payment was to be made ` 30,000 down and the remainder in 3 equal annual instalments payable on 31-12-2011, 31-12-2012 and 31-12-2013 together with interest @ 9%. X Transport Ltd. write off depreciation at the rate of 20% on the diminishing balance. It paid the instalment due at the end of the first year i.e. 31-12-2011 but could not pay the next on 31-12-2012. Delhi

Motors agreed to leave one Tempo with the purchaser on 1-1-2013 adjusting the value of the other 2 Tempos against the amount due on 31-12-2012. The Tempos were valued on the basis of 30% depreciation annually. Show the necessary accounts in the books of X Transport Ltd. for the years 2011,2012 and 2013.

Solution

X Transport Ltd.

Tempo Account

2011	Particulars	Amount	2011	Particulars	Amount
Jan. 1	To Delhi Motors	1,50,000	Dec. 31	By Depreciation A/c :20% on 1,50,000	30,000
				By Balance c/d	1,20,000
		1,50,000			1,50,000
2012			2012		
Jan. 1	To Balance b/d	1,20,000	Dec. 31	By Depreciation A/c	24,000
				By Delhi Motors A/c (Value of 2 tempos taken away)	49,000
				By Profit and Loss A/c [(96,000 x 2/3)–49,000]	15,000
				By Balance c/d (Value of one tempo left) (W.N.1)	32,000
		1,20,000			1,20,000
2013			2013		
Jan. 1	To Balance b/d	32,000	Dec. 31	By Depreciation A/c	6,400
				By Balance b/d	25,600
		32,000			32,000

Delhi Motors Account

2011	Particulars	Amount	2011	Particulars	Amount
Jan.1	To Bank (DownPayment)	30,000	Jan. 1	By Tempos A/c	1,50,000
Dec. 31	To Bank	50,800	Dec. 31	By Interest (9% on 1,20,000)	10,800
	To Balance c/d	80,000			
		1,60,800			1,60,800
2012			2012		
Jan. 1	To Tempo	49,000	Jan. 1	By Balance b/d	80,000
Dec. 31	To Balance b/d	38,200	Dec. 31	By Interest (9% on 80,000)	7,200
		87,200			87,200
2013			2013		
Dec. 31	To Bank	41,638	Jan. 1	By Balance b/d	38,200
				By Interest (9% on 38,200)	3,438
		41,638			41,638

Working Notes:

(1) Value of a Tempo left with the buyer.

Particulars	Amount
Cost	50,000
Depreciation @ 20% p.a. under WDV method for 2 years [i.e. 10,000 + 8,000]	(18,000)
Value of the Tempo left with the buyer at the end of 2nd year	32,000

(2) Value of a Tempo left with the buyer.

No. of tempos Two

Particulars	Amount
Cost ` 50,000 × 2 =	1,00,000
Depreciation @ 30% Under WDV method for 2 years [i.e. ` 30,000 + ` 21,000]	(51,000)
Value of tempos taken away at the end of 2nd year	49,000

Let Us Sum Up

In this unit, you have learned about the following:

Under Installment System also, the purchaser pays the cost of purchased asset in number of installments. However, under installment system, ownership of the goods is transferred by owner on the date of delivery of thegoods.

In instalment payment system, the ownership of the goods is passed immediatelyto the buyer on the signing the agreement. Books of buyer: Buyer debits asset account with full cash price, credits vendor's account with full instalment price and debits interest suspense account with the difference between full cash price and full instalment price. Books of Seller: The seller debits the purchaser with the full amount payable by him and credits sales account by the full cash price and credits interest suspense account by the difference between the total instalment price and total cash price.

Check Your Progress

1. What do you mean by Instalment system?

____
____
____

2. Write short notes on Books of buyer.

____
____
____

3. Briefly explain the Method of Computing Installment under Hire Purchase

____
____
____

Glossary

Hire Purchase System: Hire purchaser will pay cost of purchased asset in installments. The ownership of the goods will be transferred by theHire Vendor only after payment of outstanding balance.

Installment system: Ownership of the goods is transferred by owner on the date of delivery of goods.

Books of buyer: Buyer debits asset account with full cash price, credits vendor's account with full instalment price and debits interest suspense account with the difference between full cash price and full instalment price. Interest is debited to interest suspense account because it includes interest in respect of a number of years. Every year interest account is debited and interest suspense account is credited with the interest of current year. Interest account, atthe end of the year, is closed by transferring to profit and loss account. The balance of vendor account should be shown in the balance sheet after deducting amount in interest suspense account. Vendor is paid the instalment due to himand entry for the depreciation is passed in the usual way.

Answer to Check Your Progress

1. The Installment system is almost similar to the hire purchase system. The main difference between the two is that in installment system, the buyer gets the ownership rights as soon as the contract is signed with the seller. If he makes any default in payment of any installment, the seller can repossess the article only with the help of the Court. Hire purchase and installment systems facilitate brisk sale of consumer durable.
2. Buyer debits asset account with full cash price, credits vendor's account with full instalment price and debits interest suspense account with the difference between full cash price and full instalment price. Interest is debited to interest suspense account because it includes interest in respect of a number of years. Every year interest account is debited and interest suspense account is credited with the interest of current year. Interest account, atthe end of the year, is closed by transferring to profit and loss account. The balance of vendor account should be shown in the balance sheet after deducting amount in interest suspense account.
3. Method of Splitting H.P. Installment into Interest and Principal Repayments:
   (a) First of all interest included in each installment is calculated on the basis that interest in each installment shall be in ratio of amounts outstanding. In case the installments are of equal amounts, we can apply the sum of digit method.
   (b) We can determine the amount of principal repayment in the installment by deducting from it the amount of interest calculated in (a) above.

Suggested Readings

1. Hanif and A. Mukherjee, "Financial Accounting- II", McGraw Hill, 2018
2. P.C. Tulsian, "Financial Accounting", 2002
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8. Accounting Made Simple, Mike Piper, 2012.

Unit-11

Default and Repossession

STRUCTURE

Overview

In this unit we will learn the meaning and the concept of default and repossession. The amounts received from the hire purchaser through down payment and instalments are treated as the hire charges by the hire vendor. This act of recovery of possession of the assetis termed as repossession.

Objectives

After studying this unit, students should be able to:

- explain default in relation to a hire purchase contract
- understand repossession in relation to a hire purchase contract
- pass journal entries for complete and partial repossession

11.1. Introduction

In a hire purchase agreement, the hire purchaser has to pay up to the last instalment to obtain the ownership of goods. If the hire purchaser fails to pay anyof the instalments, the hire vendor takes the asset back in its actual form without any refund of the earlier payments to the hire purchaser.

The amounts received from the hire purchaser through down payment and instalments are treated as the hire charges by the hire vendor. This act of recovery of possession of the assetis termed as repossession.

Repossessed assets are resold to any other customer after repairing or reconditioning (if necessary). Accounting figures relating to repossessed assets are segregated from the normal hire purchase entries. Repossessions are then accounted for in a separate "Goods Repossessed Account". The hire vendor can take back the whole of the asset or a part thereof depending on the agreement betweenthe parties. The former is called "Complete Repossession" and the latter is called "Partial Repossession".

11.2. Types of Repossession

The hire vendor can take back the whole of the asset or a part thereof depending on the agreement betweenthe parties. The former is called "Complete Repossession" and the latter is called "Partial Repossession".

11.2.1. Complete Repossession

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

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

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

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

11.2.2. Partial Repossession

In case of a partial repossession, only a part of the asset is taken back by the hire vendor and other part is left with the hire purchaser. The Journal Entries are asusual up to the date of default in the books of both the parties. As a portion of the asset is still left with the hire purchaser, neither party closes the account of the other in their respective books.

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

11.3. Illustrations

Illustration 1

X Ltd. purchased 3 milk vans from Super Motors costing ` 75,000 each on hire purchase system. Payment was to be made: ` 45,000 down and the remainder in 3 equal instalments together with interest @ 9%. X Ltd. writes off depreciation @ 20%on the diminishing balance. It paid the instalment at the end of the 1st year but could not pay the next. Super Motor agreed to leave one milk van with the purchaser, adjusting the value of the other two milk vans against the amount due.The milk vans were valued on the basis of 30% depreciation annually on written down value basis. X Ltd. settled the seller's dues after three months. You are required to give necessary journal entries and the relevant accounts in the books of X Ltd.

Solution

In the Books of X Ltd.

Journal Entries

Particulars		Dr. (`)	Cr. (`)
I Year Milk Vans purchased: Milk Vans A/c Dr. To Vendor A/c		2,25,000	2,25,000
On down payment:			
Vendor A/c	Dr.	45,000	
To Bank			45,000

I Year end			
Interest A/c (` 1,80,000 @ 9%)	Dr.	16,200	
To Vendor A/c			16,200
Vendor A/c	Dr.	76,200	
To Bank A/c (60,000 + 16,200)			76,200
Depreciation @ 20%			
Depreciation A/c	Dr.	45,000	
To Milk Vans A/c			45,000
Profit & Loss A/c	Dr.	61,200	
To Depreciation			45,000
To interest A/c			16,200
II Year end			
Depreciation @ 20%			
Depreciation A/c	Dr.	36,000	
To Milk Vans A/c			36,000
Interest A/c	Dr.	10,800	
(1,20,000 @ 9%)			
To Vendor A/c			10,800
For Loss in Repossession:			
Super Motors A/c (1,50,000 – 45,000 –31,500)	Dr.	73,500	
Profit/Loss A/c (b.f.)	Dr.	22,500	
To Milk Vans A/c [(2,25,000 – 45,000 – 36,000) x 2/3]			96,000
IIIrd Year Depreciation			
Depreciation A/c (48,000 x 20%)	Dr.	9,600	
To Milk Vans A/c			9,600
Settlement of A/cs			
Vendor A/c	Dr.	57,300	
To Bank			57,300

Milk Vans Account

Year	Particulars	Rs	Year	Particulars	Rs
1	To Super Motors A/c	2,25,000	1 end	By Depreciation A/c	45,000
			”	By Balance c/d	1,80,000
		2,25,000			2,25,000
2	To Balance b/d	1,80,000	2 end	By Depreciation	36,000
				By Super Motors(value of 2 vans after depreciation for 2 years @ 30%)	73,500
				By P & L A/c (balancing figure)	22,500
				By Balance c/d (one van less depre- ciation for 2 years) @ 20%	48,000
		1,80,000			1,80,000

Super Motors Account

Year	Particulars	Rs	Year	Particulars	Rs
1	To Bank A/c	45,000	1	By Milk Vans A/c	2,25,000
	To Bank A/c	76,200		By Interest @ 9% on `1,80,000	16,200
	To Balance c/d	1,20,000			
		2,41,200			2,41,200
2	To Milk Van A/c	73,500	2	By Balance b/d	1,20,000
	To Balance c/d	57,300		By Interest A/c	10,800
		1,30,800			1,30,800
3	To Bank A/c	57,300	3	By Balance b/d	57,300

Illustration 2

A firm acquired two tractors under hire purchase agreements, details of which wereas follows:

Date of Purchase	Tractor A1st April, 2021-Rs	Tractor B1st Oct., 2021- Rs
Cash price	14,000	19,000

Both agreements provided for payment to be made in twenty-four monthly instalments (of ` 600 each for Tractor A and ` 800 each for Tractor B), commencingon the last day of the month following purchase, all instalments being paid on due dates.

On 30th June, 20X2, Tractor B was completely destroyed by fire. In full settlement,on 10th July, 20X2 an insurance company paid ` 15,000 under a comprehensive policy. Any balance on the hire purchase company's account in respect of these transactions was to be written off.

The firm prepared accounts annually to 31st December and provided depreciation on tractors on a straight-line basis at a rate of 20 per cent per annum rounded offto nearest ten rupees, apportioned as from the date of purchase and up to the dateof disposal.

You are required to record these transactions in the following accounts, carrying down the balances on 31st December, 20X1 and 31st December, 20X2:

(a) Tractors on hire purchase.
(b) Provision for depreciation of tractors.
(c) Disposal of tractors.

Solution

Hire Purchase accounts in the buyer's books

Tractors on Hire Purchase Account

2021	Particulars	Rs	Rs	2021	Particulars	Rs.	Rs
April 1	To HP Co. – Cash price Tractor A		14,000	Dec. 31	By Balance c/d Tractor A	14,000	33,000
Oct.1	To HP Co. – Cash price Tractor B		19,000		Tractor B	19,000	
			33,000				33,000
2022 Jan.1	To Balance b/d Tractor A Tractor B	 14,000 19,000	 33,000	2012 June30 Dec.31	By Disposal of Tractor A/c Transfer By Balance c/d		19,000 14,000
			33,000				33,000
2013 Jan.1	To Balance b/d		14,000				

Provision for Depreciation of Tractors Account

2021	Particulars	Rs	2021	Particulars	Rs	Rs
Dec. 31	To Balance c/d	3,050	Dec.31	By P & L A/c: Tractor A Tractor B	2,100* 950**	3,050
		3,050				3,050

* 14,000 x 20% x 9/12 = 2,100

** 19,000 x 20% x 3/12 = 950

2022	Particulars	Rs	2022	Particulars	Rs
June 30	To Disposal of Tractor account t— Transfer (950 + 1,900)	2,850	Jan. 1	By Balance b/d	3,050
			Jun. 30	By P & L A/c (Depn. for Tractor B) (19,000 x 20% x 6/12)	
Dec. 31	To Balance c/d	4,900		By P & L A/c (Depn. for Tractor A) (14,000 x 20%)	1,900
			Dec.31.		2,800
				1 By Balance b/d	
		7,750			`7,750
			20X3 Jan.		4,900

Disposal of Tractor Account

2022	Particulars	Rs	2022	Particulars	Rs
June 30	To Tractors on hire purchase Tractor B	19,000	June 30	By Provision for Dept. of Tractors A/c	2,850
			July 10	By Cash : Insurance	15,000
			Dec. 31	By P & L A/c : Loss (b.f.)	1,150

Let Us Sum Up

In this unit, you have learned about the following:

Default' is the failure to act, appear or pay i.e., failure to meet the obligation.

Under a hire purchase agreement, the hirer has an obligation to pay up to the last instalment so that the ownership of goods smoothly passes to him. Possession of goods means the physical holding of goods.

You know that under hire purchase agreement the vendor transfers the possession of goods.

He does not transfer the ownership, and if the hirer fails to pay even the last instalment he has the legal right to recover the possession of the goods.

Check Your Progress

1. What is ‘default’ in hire purchase system?

2. What do you mean by Repossession?

____
____
____

3. Explain the different types of Repossession.

____
____
____

Glossary

Default: Default is the failure to act, appear or pay i.e., failure to meet the obligation.

Possession: Possession of goods means the physical holding of goods.

Rights of hire vendor to terminate the hire purchase agreement: Where the hirer makes more than one default in payment of instalment as provided in the agreement, the hire vendor shall be entitled to terminate the agreement by giving the notice of termination in writing.

Rights of the hire vendor on termination: Where a hire purchase agreement is terminated, the hire vendor shall be entitled

Answer to Check Your Progress

1. Default is the failure to act, appear or pay i.e., failure to meet the obligation.
2. If the hire purchaser fails to pay anyof the instalments, the hire vendor takes the asset back in its actual form without any refund of the earlier payments to the hire purchaser. The amounts received from the hire purchaser through down payment and instalments are treated as the hire charges by the hire vendor.
3. Complete Repossession

   Partial Repossession.

Suggested Readings

1. Hanif and A. Mukherjee, "Financial Accounting- II", McGraw Hill, 2018
2. P.C. Tulsian, "Financial Accounting", 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, "Introduction to Financial Accounting", 2017
4. Barry Elliott and Jamie Elliott, "Financial Accounting and Reporting", 19th Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., "Financial Accounting", New York: McGraw Hill Book Company, 1990.
6. Charles T. Horngren' "Financial Accounting", Revised Edition, 1997.
7. Asish K. Bhattacharyya, "Essentials of Financial Accounting",2020.
8. Accounting Made Simple, Mike Piper, 2012.

Unit-12

Methods of Computation of Profit

STRUCTURE

Overview

In this unit we shall discuss the accounting treatment of hire purchase transactions for goods of small value and study the methods of ascertaining the profit or loss on such transactions during an accounting period.

1.0 Objectives

After studying this unit, students should be able to

- To explain the basic record maintained for hire purchase transactions of goods of small value.
- To prepare hire purchase trading account.
- To ascertain the profit or loss on hire purchase business.

12.1. Introduction

When the hire vendor sells goods of lesser value under the hire purchase system, it is not easy to maintain accounts for all hire purchasers. In such cases, the hire vendor will open hire purchase trading account and enter all hire purchase transactions. Another method, followed in this case is stock and debtors system.

This system of maintaining accounting records relates to hire purchase transactions for goods of substantial sales value. In practice, however, the goods bearing small value like fridge, T.V.,'scooter, etc, are also sold on hire purchase basis. The retailers often keep separate records for these transactions and compute the profit on hire purchase business separately. This involves a peculiar method of accounting and profit ascertainment. In this unit we shall discuss the accounting treatment of hire purchase transactions for goods of small value and study the methods of ascertaining the profit or loss on such transactions during an accounting period.

12.2. Relevant Terms

In connection with the accounting for goods of small value sold on hire purchase basis, we have to define certain terms before we study different methods of ascertaining the profit or loss on such transactions. These relevant terms are:

1. Cost price of goods sold on hire purchase
2. Value of goods sold on hire purchase
3. Cash received
4. Hire Purchase Debtors
5. Hire Purchase Stock
6. Stock at shop

- **Cost price of goods sold on hire purchase :** They purchases goods from various manufacturers and sells them to the consumers under hire purchase system. Naturally, he sells the goods at a price higher than the price at which he has bought. His mark-up on hire purchase sales is bound to be more than even the cash price because he has also to cover the loss of interest on such transactions. Normally, interest is accounted for separately as you studied in the case of sale of goods of a substantial value.
- **Goods sold op hire purchase :** For the purpose of finding out the profit or loss on the hire purchase business during an accounting period, we need the figure of the value of goods sold on hire purchase. This reflects the hire purchase price of all the goods sold on hire purchase basis during the accounting period. If, however, the value of goods sold on hire purchase is not given, it ' can be worked out by applying the loading rate to the cost of goods sold on hire purchase. Alternatively, it can be worked out with the help of the first part of the Hire Purchase Trading Account.
- **Cash received :** This refers to the total amount received during the accounting period in respect of hire purchase sales wbether they relate to previous years or the current year. This includes the

amount of down payment and the amount of instalments paid during the year.

- **Hire Purchase Debtors :** It is also known as 'Installments due but not yet paid'. The total of 'cash received' and 'hire purchase debtors' ii taken as the 'realised sales' during an accounting period, and not the goods sold on hire purchase.
- **Hire Purchase Stock :** You know when goods are sold on hire purchase basis, the customer makes some down payment and agrees to pay the balance in instalments. The instalments which have not become due during the current year, are called 'instalments not yet due' or 'hire purchase stock'. It should be noted that hire purchase stock does not mean stock of goods in the shop.

12.3. Debtors Method

When the hire vendor sells goods of lesser value under the hire purchase system, it is not easy to maintain accounts for all hire purchasers. In such cases, the hire vendor will open hire purchase trading account and enter all hire purchase transactions. Another method, followed in this case is stock and debtors system.

Accounting treatment: The accounting treatment consist of how to record the transactions in the books of hire purchaser and hire vendor and how to compute the interest and cash price out of the instalment price.

In the books of the Hire purchaser:

Transactions	First method	Second method
Assets purchased under HP system	Asset A/c. (cash price) To Hire vendor A/c.	No entry
When down payment is made	Hire Vendor A/c.	Asset A/c.
	To Cash/bank A/c.	To Cash/Bank A/c.
When interest due	Interest A/c. To Hire vendor A/c.	No entry
When installment due	No entry	Asset A/c. Interest A/c. To Hire vendor A/c.
When installment paid	Hire vendor A/c. To Cash/bank A/c.	Hire vendor A/c. To Cash/bank A/c.
Depreciation on Assets	Depreciation A/c. To Assets A/c.	Depreciation A/c. To Assets A/c.
Transferring interest and depreciation	Profit and loss A/c. To Interest A/c. To Depreciation A/c.	Profit and loss A/c. To Interest A/c. To Depreciation A/c.

In the books of the Hire Vendor:

Transactions	First method	Interest suspense method
Goods sold under HP system	Hirer A/c. (cash price) To H P sales A/c.	Hirer A/c.(HP Price) To HP Sales A/c.(cashprice) To Interest Suspense A/c.
When down payment isreceived	Cash / bank A/c.. To Hirer A/c.	Cash / bank A/c.. To Hirer A/c.
When interest due	Hirer A/c. To Interest A/c.	Interest suspense A/c. To Interest A/c.
When installment is received	Cash / bank A/c.. To Hirer A/c.	Cash / bank A/c.. To Hirer A/c.
Transferring interest	Interest A/c. To Profit and Loss A/c.	Interest A/c. To Profit and Loss A/c.

Illustration 1

The hire purchase price of an asset is Rs.120000 and the cash price is Rs.100000/- which is payable in eight equal installments. The purchaser after the completion of 3^{rd} installments wants to close the HP sales by making one time payment.What is the amount of rebate available?

2/3 x (HP charges x no of installment due/total installment)

Rebate = 2/3 x (20000 x 5/8) Rs.8333/-

Under hire purchase system, the important aspect is the calculation of interest

Illustration 2

The madras company purchased a machine from Bombay Machine company on hire purchase agreement on 01^{st} Jan.2006 paying cash Rs.1,00,000/- and agreeing to pay further installments of Rs.1,00,000/- each on 31^{st} December of every year. The cash price of the machine is Rs.372500/- and the interest charged at the rate of 5% p.a. The madras company writes off 10% every year of the value of machine on the reducing instalment system.

Open necessary accounts in the books of both the companies.

First aspect is the calculation of interest amount in the installment.

Particulars	Cash price	Interest	Installment		
			Cash price	Interest	Total
Cash price	372500	5%			
Less: Down payment	100000		100000		100000
	272500				

Less: first installment	86375		86375	13625	100000
	186125				
Less: Second installment	90694		90694	9306	100000
	95431				
Less; third installment	95431		95431	4569	100000
	0		372500	27500	400000

In the Books of Madras Company

Machine A/c.	372500	
To Bombay Machine Limited A/c.		372500
(being asset purchased on hire purchase from Bombay machine limited)		

Bombay Machine Limited A/c.	100000	
To cash A/c.		100000
(being down payment of Rs.100000 paid)		

interest A/c.	13625	
To Bombay Machine Limited A/c.		13625
(being interest due for the first installment)		

Bombay Machine Limited A/c.	100000	
To cash A/c.		100000
(being first installment paid)		
Depreciation A/c.	37250	
To Machinery A/c.		37250
(being depreciation charged at the rate of 10% on cash price)		
Profit and loss A/c.	50875	
To Depreciation A/c.		37250
To Interest A/c		13625
(being the depreciation and interest is transferred to profit and loss account)		
interest A/c.	9306	
To Bombay Machine Limited A/c.		9306
(being interest due for the second installment)		
Bombay Machine Limited A/c.	100000	
To cash A/c.		100000

(being second installment amount paid)		
Depreciation A/c.	33525	
To Machinery A/c.		33525
(being depreciation charged at the rate of 10% on cash price)		
Profit and loss A/c.	42831	
To Depreciation A/c.		33525
To Interest A/c		9306
(being the depreciation and interest is transferred to profit and loss account)		

Interest A/c.	4569	
To Bombay Machine Limited A/c.		4569
(being interest due for the third installment)		

Bombay Machine Limited A/c.	100000	
To cash A/c.		100000
(being third and final installment amount paid)		
Depreciation A/c.	30173	
To Machinery A/c.		30173
(being depreciation charged at the rate of 10% on cash price)		
Profit and loss A/c.	34742	
To Depreciation A/c.		30173
To Interest A/c		4569
(being the depreciation and interest is transferred to profit and loss account)		

MACHINE ACCOUNT

To Bombay Machine Ltd. A/c.	372500	By Depreciation A/c.	37250
		By Balance C/d.	335250
	372500		372500
To Balance B/d	335250	By Depreciation A/c.	33525
		By Balance C/d.	301725
	335250		335250
To Balance B/d.	301725	By Depreciation A/c.	30173

		By Balance C/d.	271552
	301725		301725

BOMBAY MACHINE LIMITED ACCOUNT

To cash A/c.	100000	By machine A/c.	372500
To cash A/c.	100000	By Interest	13625
To Balance C/d. 186125			
	386125		386125
To cash A/c.	100000	By Balance B/d.	186125
To Balance C/d.	95431	By interest A/c.	9306
	195431		195431
To Cash A/c.	100000	By Balance B/d.	95431
		By interest A/c.	4569
	100000		100000

In the Books of Bombay Machines Limited

Madras Company A/c.	372500	
To Hire purchase sales A/c.		372500
(being good sold under hire purchase system)		

cash A/c.	100000	
To Madras Company A/c.		100000
(being down payment of Rs.100000 received)		

*

Madras Company A/c.	13625	
To Interest A/c.		13625
(being interest due for the first installment)		

*

cash A/c.	100000	
To Madras Company A/c.		100000

*

Madras Company A/c.	9306	
To Interest A/c.		9306
(being interest due for the second installment)		

*

cash A/c.	100000	
To Madras Company A/c.		100000
(being second installment received)		

Madras Company A/c.	4569	
To Interest A/c.		4569
(being interest due for the third installment)		
cash A/c.	100000	
To Madras Company A/c.		100000
(being third installment received)		

12.4. Stock and Debtors Method

An alternative method is to maintain Hire Purchase Stock Account, Hire Purchase Debtors Account and Hire Purchase Adjustment Account. When goods are sold on hire purchase, Hire Purchase Stock Account is debited and Goods Sold on Hire Purchase Account is credited with full hire purchase price. Installments which become due for payment are debited to Hire Purchase Debtors Account and credited to Hire Purchase Stock Account. Cash received is credited to Hire Purchase Debtors Account.

Illustration 1:

Varun sells goods on hire purchase basis also. He fixes hire purchase price by adding 50% to the cost of the goods to him. The following are the figures relating to his hire purchase business for the year 2011-2012:

	Rs.
Balance of Hire Purchase Stock Account as on 1st April, 2011	84,000
Balance of Hire Purchase Debtors Account As on 1st April, 2011	2,100
Selling price of goods sold on hire purchase basis during the year	6,34,200
Cash received from customers during the year	6,46,800
Total amount of instalments that fell due during the year	6,48,900

One customer to whom goods had been sold for Rs. 8,400 paid only 5 instalments of Rs. 700 each. On his failure to pay the monthly instalment of Rs. 700 due on 4th March, 2012 the goods were repossessed on 27th March, 2012 after due legal notice.

Prepare ledger accounts on Stock Debtors System for the year ended 31st March 2012

[Adapted B.Com. (Hons.) Delhi]

Solution:

In the books of Varun

Dr. Hire Purchase Stock Account Cr.

	Rs.		Rs.
To Balance b/fd	84,000	By Hire Purchase Debtors Accounts	
To Goods Sold on		--Installments failing due	6,48,900
Hire Purchase Account	6,34,200	By Goods Repossessed Account	
		--Six instalments on goods	
		Repossessed	4,200
		By Balance c/d	65,100
	7,18,200		**7,18,200**
To Balance b/d	65,100		

Dr. Hire Purchase Debtors Account Cr.

	Rs.		Rs.
To Balance b/fd	2,100	By Bank	
To Hire Purchase Stock Account		Installments received	6,46,800
-- Installments falling due	6,48,900	By Goods Repossessed Account	
		-- One installments due but not	
		received in respect of	
		goods repossessed	700
		By Balance c/d	3,500
	6,51,000		**6,51,000**
To Balance b/d	3,500		

Dr. Goods Sold on Hire Purchase Account Cr.

	Rs.		Rs.
To Hire Purchase Adjustment		By Hire Purchase Stock Account	6,34,200
Account			
-- Loading	2,11,400		
To Trading Account			
-- Transfer	4,22,800		
	6,34,200		**6,34,200**

Dr. Hire Purchase Adjustment Account Cr.

	Rs.		Rs.
To Hire Purchase Stock		By Hire Purchase Stock	
Reserve Account		Reserve Account	
-- Closing balance	21,700	-- Opening balance	28,000
To Profit and Loss Account		By Goods Sold on Hire Purchase	
-- Transfer of profit	2,17,700	Account	2,11,400
	2,39,400		**2,39,400**

Dr.	Hire Purchase Stock Reserve		Cr.
	Rs.		**Rs.**
To Hire Purchase Adjustment Account -- Transfer	28,000	By Balance b/fd	28,000
		By Hire Purchase Adjustment Account	21,700
By Balance c/d	**21,700**	By Balance b/d	**2,39,400**

Working Notes:

(i) Opening balance of Hire Purchase Stock Reserve

$$= \frac{50}{150} \times \text{Rs. } 84{,}000 = \text{Rs. } 28{,}000$$

(ii) Loading on goods sold on Hire Purchase

$$= \frac{50}{150} \times \text{Rs. } 6{,}34{,}200 = \text{Rs. } 2{,}11{,}400$$

(iii) Closing balance of Hire Purchase Stock Reserve

$$= \frac{50}{150} \times \text{Rs. } 65{,}100 = \text{Rs. } 21{,}700$$

Illustration 2

A joint stock company sells its product on hire purchase terms. It charges gross profit at 25% of selling price. The following particulars pertain to its hire purchase business during the year ended 31st March, 2012:

Balances of 1st April, 2011:	Rs. ('000)
Stock at shop	4,50
Stock out on hire, at hire purchase price	12,00
Instalments due, customers still paying	90
Cash received from customers during the year	48,00
Balances on 31st March, 2012:	
Stock out on hire, at hire purchase price	18,60
Instalments due, customers still paying	1,30
Stock at shop	5,16

You are required to prepare:

(i) Hire Purchase Debtors Account

(ii) Hire Purchase Stock Account

(iii) Goods sold on Hire Purchase Account

(iv) Stock at Shop Account, and

(v) Hire Purchase Adjustment Account, Showing Profit earned.

Solution:

Dr. Hire Purchase Debtors Cr.

	Rs. ('000)		Rs. ('000)
To Balance b/fd	90	By Bank -- Cash received	48,00
To Hire Purchase Stock Account -- Installment falling due, Balancing figure	48,40	By Balance c/d	1,30
	49,30		**49,30**
To Balance b/d	1,30		

Dr. Hire Purchase Stock Account Cr.

	Rs. ('000)		Rs. ('000)
To Balance b/fd	12,00	By Hire Purchase Debtors Accounts --- Installments failing due	48,40
To Goods Sold on Hire Purchase Account -- Hire Purchase price of goods, sold, balancing figure	55,00	By Balance c/d	18,60
	67,00		**67,00**
To Balance b/d	18,60		

Dr. Goods Solds on Hire Purchase Account Cr.

	Rs. ('000)		Rs. ('000)
To Hire Purchase Adjustment Account -- Loading	11,00	By Hire Purchase Stock Account	55,00
To Stocks at Shop – Transfer of cost	44,00		
	55,00		**55,00**
To Balance b/d	18,60		

Dr. Stock at Shop Account Cr.

	Rs. ('000)		Rs. ('000)
To Balance b/fd	450	By Goods Sold on Hire Purchase Account – cost of goods sold	44,00
To Purchases -- Balancing figure	44,66	By Balance c/d	5,16
	49,16		**49,16**
To Balance b/d	5,16		

Dr. Hire Purchase Adjustment Account Cr.

	Rs. ('000)		Rs. ('000)
To Hire Purchase Stock Reserve		By Hire Purchase Stock Reserve	
-- Closing	3,72	-- Opening	2,40
To Profit and Loss Account		By Goods Sold on Hire Purchase	
-- Transfer of profit	9,68	Account – Loading	11,00
	13,40		**13,40**

Working Notes:

(i) Opening balance of Hire Purchase Stock Reserve Account

$$= \frac{25}{125} \times \text{Rs. } 12{,}00 \text{ thousand} = \text{Rs. } 2{,}40 \text{ thousand}$$

(ii) Loading in respect of goods sold on Hire Purchase

$$= \frac{25}{125} \times \text{Rs. } 55{,}00 \text{ thousand} = \text{Rs. } 11{,}00 \text{ thousand}$$

(iii) Closing balance of Hire Purchase Stock Reserve Account

$$= \frac{25}{125} \times \text{Rs. } 18{,}60 \text{ thousand} = \text{Rs. } 3{,}72 \text{ thousand}$$

Illustration 3:

X Ltd. sell products on hire purchase terms, the price being cost plus 33⅓%. From the following particulars for the ended 31st March, 2012, prepare the necessary accounts on Stock-Debtors System to reveal the profit earned.

		Rs.
2011		
April 1	Stock out on hire at hire purchase price … …	4,00,000
	Stock in hand, at shop … …	50,000
	Installments due (customers still paying) … …	30,000
2012		
March 31	Stock out on hire at hire purchase price … …	4,60,000
	Stock in hand, at the shop … …	70,000
	Installments due (customers still paying) … …	50,000
	Cash received during the year … …	8,00,000

Solutions:

Figures in brackets indicate the steps that reveal results; first of all various accounts are prepared and missing figures inserted.

This first figure to be ascertained is the total of instalments which become payable during the year).

Dr. **Hire Purchase Debtors Account** Cr.

2011		Rs.	Apr.1,		Rs.
Apr. 1	To Balance b/fd	30,000	2011 to		
Apr. 1			Mar. 31,		
2011 to			2012	By Cash	8,00,000
Mar. 31,			2012		
2012	To Hire Purchase Stock A/c – total of instalments which become due balancing figure (1)	8,20,000	Mar. 31	By Balance c/d	50,000
		8,50,000			8,50,000
2012					
Apr. 1	To Balance b/d	50,000			

Hire Purchase Stock Account

2011		Rs.	Apr.1,		Rs.
Apr. 1	To Balance b/fd	4,00,000	2011 to		
Apr. 1			Mar. 31,		
2011 to			2012	By Hire Purchase Debtors A/c (1)	8,20,000
Mar. 31,					
2012	To Goods Sold on Hire Purchase A/c --- balancing figure (2)	8,80,000	2012 Mar. 31	By Balance c/d	4,60,000
		12,80,000			12,80,000
2012					
Apr. 1	To Balance b/d	4,60,000			

Goods Sold on Hire Purchase Account

2011		Rs.	Apr.1,		Rs.
Mar. 31	To Hire Purchase Adjustment, A/c (loading)	2,20,000	2011 to Mar. 31, 2012	By Hire Purchase Stock A/c (2)	8,80,000
Mar. 31	To Trading A/c --cost of goods sold	6,60,000			
		8,80,000			8,80,000

Dr. **Hire Purchase Stock Reserve Account** Cr.

2011		Rs.	2011		Rs.
Apr. 1	To Hire Purchase Adjustment A/c –transfer	1,00,000	Apr.1,	By Balance b/fd -- 25% of Rs. 4,00,000	1,00,000
			2012	By H.P. Adjustment A/c	
2012			Mar. 31,	-- 25% of Rs. 4,60,000	1,15,000
Mar. 31	To Balance c/d	1,15,000			
			2012		
			Apr. 1	By Balance c/d	1,15,000

Dr. **Hire Purchase Adjustment Account** Cr.

2012		Rs.	2011		Rs.
Mar. 31	To Hire Purchase Stock Reserve A/c (closing)	1,15,000	Apr.1,	By Hire Purchase Stock Reserve A/c (opening)	1,00,000
			2010		
Mar. 31	To Profit & Loss A/c Transfer of profit	2,05,000	Mar. 31	By Goods Sold on H.P. Adjustment A/c	1,15,000
			2012	-- 25% of Rs. 4,60,000	
			Apr. 1		1,15,000
				By Balance c/d	
		3,20,000			

Trading Account

Dr. Hire Purchase Adjustment Account Cr.

	Rs.		Rs.
To Opening Stock	50,000	By Goods Sold on Hire Purchase A/c	6,60,000
To Purchases Account (balancing figure)	6,80,000	By Closing Stock	70,000
	7,30,000		7,30,000

Illustration 4:

Home Comforts Ltd. commenced business on April 1, 2011. The business is to sell and refrigerators geysers both for cash and on hire-purchase basis.

	Geysers	**Refrigerators**
	Rs.	**Rs.**
Cash Price	5,000	15,000
Cost	4,000	12,000
Cash Down for hire –purchase	1,000	3,000
Monthly Installment	500	1,500
Number of installments	10	12

The company purchased goods costing & to lakh in all and made cash sales totaling Rs. 43 lakh. Stock in hand on 31st March, 2012 was valued at Rs. 6 lakh. Hire Purchase transactions were as follows:

	Number sold	**Installments Collected**	**Instalments due (customers paying)**
Geysers	40	260	15
Refrigerators	20	110	10

3 geysers and 2 refrigerators on which only four instalments per piece had been collected were repossessed and were valued at a total sum of Rs. 16,000. This is not included in the figure of stock mentioned above. Prepare accounts showing the profit earned by the company.

Solution:

Dr. Hire Purchase Trading Account Cr.

		Rs.			**Rs.**
Apr.1, 2011 to Mar. 31, 2012	To Goods Sold on Hire Purchase Account	6,60,000	Apr. 1, 2011 to Mar. 31, 2012	By Cash By Goods Repossessed A/c (estimated value)	3,95,000 16,000
2012 Mar.31	To Hire Purchase Stock Reserve Account -- closing	84,690	2012 Mar.31	By Goods Sold on Hire Purchase A/c (loading)	2,60,000
2012 Mar.31	To Profit & Less A/c--- transfer of profit	1,58,310	Mar.31	By. H.P. Stock Account	2,09,500
			Mar.31	By Instalments Due A/c.	22,500
		9,03,000			**9,03,000**

Dr. Goods Sold on Hire Purchase Account Cr.

2012		**Rs.**	Apr. 1,		**Rs.**
Mar. 31	To Hire Purchase A/c (loading)	2,60,000	2011 to Mar. 31, 2012	By Hire Purchase Trading Account	6,60,000
Mar.31	To Trading Account transfer of cost	4,00,000			
		6,60,000			**6,60,000**

Dr. Goods Repossessed Account Cr.

		Rs.			
	To Hire Purchase Trading A/c				
		16,000			

Dr. Hire Purchase Stock Reserve Account Cr.

2012		**Rs.**	2012		**Rs.**
Mar. 31	To Balance c/d	84,690	Mar. 31,	By H.P. Trading Account	84,690
				By Balance b/d	84,690

Trading Account

Dr. for the year ended 31st March, 2012 Cr.

		Rs.			**Rs.**
	To Purchases Account	50,00,000		By Sales Account	43,00,000
	To Gross Profit transferred to Profit & Loss Account	3,00,000		By Goods Sold on Hire Purchase Account	4,00,000
				By Closing Stock	6,00,000
		53,000,00			**53,00,000**

Profit & Loss Account

Dr. for the year ended 31st March, 2012 Cr.

		Rs.			**Rs.**
	To Net Profit	4,58,310		By Cross Profit transferred From Trading Account	3,00,000
				By Hire Purchase Trading Account (profit on hire-purchase business)	1,58,310
		4,58,310			**4,58,310**

Note. (1) Hire-purchase price (total) is Rs. 6,000 per geyser and Rs. 21,000 per refrigerator. Total sales (and cost) on this basis are:

	Hire purchase Price	Cost
	Rs.	Rs.
Geysers 40 @ Rs. 6,000	2,40,000	1,60,000
Refrigerators 20 @ Rs. 21,000	4,20,000	2,40,000
Total	**6,60,000**	**4,00,000**

(2) Cash collected :

	Refrigerators	geysers
Cash down	60,000	40,000

Refrigerators 20 @ Rs. 21,000	1,65,000	1,30,000
	2,25,000	**1,70,000**

(3) Instalments not yet due

Refrigerators:

Total instalments on 18 refrigerators	216
Less: instalments collected and due	
(120) minus 8 instalments on repossessed unit)	112
Net yet due	104
Amount @ Rs. 1,500, 104 x Rs. 1,500	Rs.1,56,000

Geysers:

Total instalments on 37 sets	370
Less: instalments collected and due (275 less 12)	263
Net yet due	107
Amount @ Rs. 500, 107 X Rs. 500	Rs. 53,500
Total for both Items, Rs. 1,56,000 + 53,500	Rs.2,09,000

(4) Hire Purchase Stock Reserve:

	Geysers	Refrigerators
	Rs.	Rs.
Total amount due	6,000	21,000
Cost	4,000	12,000
Difference	2,000	9,000

Reserve required: Rs. $\frac{2,000}{6,000}$ X 53,500 17,833

Rs. $\frac{9,000}{21,000}$ X 53,500 66,857

Total : Rs. 17,833 + Rs. 66,857 = Rs. 84,690

Note: A more sophisticated calculation would be as follows:

Geysers: Total amount due after deducting cash down payment	5,000
Cost after deducting cash down payment	3,000
Profit (and interest) included in Rs. 5,000	2,000
Reserve required Rs. 53,500 X$\frac{2,000}{5,000}$	21,400

Refrigerators: Total amount due after deducting cash down payment	18,000
Cost after deducting cash down payment	9,000
Profit (and interest) included in Rs. 18,000	9,000
Reserve required Rs. 1,56,500 X$\frac{9,000}{18,000}$	78,000

Total Rs. 21,400 X Rs. 78,000

Alternative Solution: If stock-debtors system is followed, the ledger accounts will appear as follows:

Dr. Hire Purchase Stock Account Cr.

		Rs.			Rs.
Apr.1, 2011 to Mar. 31, 2012	To Goods Sold on Hire Purchase Account	6,60,000	Apr. 1, 2011 to Mar. 31, 2012	By Hire Purchase Debtors A/c (balancing figure) (estimated value)	4, 50,500
			2012 Mar.31	By Balance c/d	2,09,500
		6,60,000			**6,60,000**
2012 Apr. 1	To Balance b/d	**2,09,500**			

Dr. Hire Purchase Debtors Account Cr.

		Rs.			Rs.
Apr.1, 2011 to Mar. 31, 2012	To Hire Purchase Account	4,50,500	Apr. 1, 2011 to Mar. 31, 2012	By Cash / Bank	
				By Goods Repossessed A/c (estimated value)	16,000
				By Hire Purchase Adjustment Debtors A/c (loss on repossession)	17,000
			2012 Mar.31	By Balance c/d	4,17,000
		4,50,500			**4,50,500**
2012 Apr. 1	To Balance b/d	**4,17,000**			

*Loss on repossession:

Hire purchase price of 3 geysers		Rs. 6,000 x 3 = 18,000
Hire purchase price of 2 refrigerators		Rs. 21,000 x 2 = 42,000
	Total	60,000
Less: Cash received	Rs.	
In respect of 3 geysers, 3 (1,000 + 4 x 500) =	9,000	
In respect of 2 refrigerator, 2 (3,000 + 4 x 1,500) =	18,000	
Estimated value of repossessed goods	16,000	
		43,000
Loss on repossession		17,000

Dr. Goods Sold on Hire Purchase Account Cr.

		Rs.			Rs.
2012 Mar.31	To Hire Purchase Adjustment Account (loading)	2,60,000	Apr. 1, 2011 to Mar. 31, 2012	By Hire Purchase Stock Account	6, 60,000
Mar. 31	To Trading Account -- transfer of cost	4,00,000			
		6,60,000			**6,60,000**

Dr. Hire Purchase Stock Reserve Account Cr.

2012		Rs.	2012		Rs.
Mar.31	To Balance c/d	84,690	Mar. 31	By Hire Purchase Adjustment Account	84,690
				By Balance b/d	**84,690**

Dr. Hire Purchase Adjustment Account Cr.

Apr. 1, 2011 to Mar. 31, 2012	To Hire Purchase Debtors A/c (loss on repossession)	Rs. 17,000	2012 Mar. 31	By Goods Sold on Hire Purchase Account	Rs. 2,60,000
2012 Mar. 31	To Hire Purchase Stock Reserve A/c (closing)	84,690	2012 Apr. 1		
Mar. 31	To Profit & Loss A/c (transfer of profit on Hire purchase business)	1,58,310			
		2,60,000			**2,60,000**

Dr. Goods Repossessed Account Cr.

		Rs.			Rs.
Apr. 1, 2011 to Mar. 31, 2012	To Hire Purchase Debtors A/c	16,000	2012 Mar. 31	By Balance c/d	16,000
2012 Apr. 1	To Balance b/d	**16,000**			

Trading Account

Dr. for the year ended 31st March, 2012 Cr.

		Rs.			Rs.
	To Purchase A/c	50,00,000		By Sales	43,00,000
	To Profit & Loss A/c --transfer of gross profit	3,00,000		By Goods Sold on Hire Purchase A/c	4,00,000
				By closing Stock	6,00,000
	To Balance b/d	**53,00,000**			**53,00,000**

Profit & Loss Account

Dr. for the year ended 31st March, 2012 Cr.

		Rs.			Rs.
	To Net profit	4,58,310		By Trading A/c – gross profit	3,00,000
				By Hire Purchase Adjustment A/c (profit on (hire-purchase business)	1,58,310
		4,58,310			**4,58,310**

Let Us Sum Up

In this unit, you have learned about the following:

This system of maintaining accounting records relates to hire purchase transactions for goods of substantial sales value. In connection with the accounting for goods of small value sold on hire purchase basis, we have to define certain terms before we study different methods of ascertaining the profit or loss on such transactions. Cost price of goods sold on hire purchase: they sells the goods at a price higher than the price at which he has bought.

Check Your Progress

1. Write short note on hire purchase Debtors.

   ____

   ____

   ____

2. Write short notes on goods sold on hire purchase.

   ____

   ____

   ____

3. Describe hire purchase stock.

   ____

   ____

   ____

Glossary

Cost price of goods sold on hire purchase: They sells the goods at a price higher than the price at which he has bought.

Hire Purchase Stock: The instalments which have not become due during the current year, are called 'instalments not yet due' or 'hire purchase stock'.

Answer to Check Your Progress

1. It is also known as 'Instalments due but not yet paid'. The total of 'cash received' and 'hire purchase debtors' ii taken as the 'realised sales' during an accounting period, and not the goods sold on hire purchase.
2. Finding out the profit or loss on the hire purchase business during an accounting period, we need the figure of the value of goods sold on hire purchase. This reflects the hire purchase price of all the goods sold on hire purchase basis during the accounting period. If, however, the value of goods sold on hire purchase is not given, it ' can be worked out by applying the loading rate to the cost of goods sold on hire purchase. Alternatively, it can be worked out with the help of the first part of the Hire Purchase Trading Account.
3. The customer makes some down payment and agrees to pay the balance in instalments. The instalments which have not become due during the current year, are called 'instalments not yet due' or 'hire purchase stock'. It should be noted that hire purchase stock does not mean stock of goods in the shop.

Suggested Readings

1. Hanif and A. Mukherjee, “Financial Accounting- II”, McGraw Hill, 2018
2. P.C. Tulsian, “Financial Accounting”, 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, “Introduction to Financial Accounting”, 2017
4. Barry Elliott and Jamie Elliott, “Financial Accounting and Reporting”, 19^{th} Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., “Financial Accounting”, New York: McGraw Hill Book Company, 1990.
6. Charles T. Horngren’ “Financial Accounting”, Revised Edition, 1997.
7. Asish K. Bhattacharyya, “Essentials of Financial Accounting”,2020.
8. Accounting Made Simple, Mike Piper, 2012.

Block-4: Introduction

Block-4: Admission, Retirement and Death of a Partner has been divided in to three Units.

Unit-13 : Partnership Fundamentals deals with Introduction, Meaning, Definition, Essential elements of partnership business, Features of partnership Accounts, Advantages of partnership accounts, Disadvantages of partnership accounts, Classification of Partners, Partnership deed, Rules applicable in the absence of partnership deed, Accounts of partnership firm, Interest on capital, Interest on drawings, Partner's salary or commission and Interest on partner's loan.

Unit-14 : Admission of A Partner explains about Introduction, Rights of incoming partners, Accounting Adjustment, Sacrificing Ratio, Revaluation Account, Journal entries and Illustrations.

Unit-15 : Retirement and Death of a Partner describes about Introduction, Steps for adjustments, Revaluation of Assets and liabilities, Undistributed profit or loss, Adjustment regarding goodwill, Settlement of Dues to the Retiring Partner, Illustrations and Death of a partner.

In all the units of Block -4, **Admission, Retirement and Death of a Partner** the Check your progress, Glossary, Answers to Check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

Unit-13

Partnership Fundamentals

STRUCTURE

Overview

In this unit we will learn the meaning and the concepts of partnership fundamentals.

A partnership is a business structure in which two or more individuals or entities come together to operate a business and share in the profits and losses.

Partnerships are a common form of business organization and are often used in professional services such as law firms, accounting firms, and medical practices.

Objectives

After studying this unit, students should be able to

- Understand the concept of partnership firms
- Understand the journal entries for the formation of partnership
- Describe the accounting for the various partnership-related transactions.

13.1. Introduction

The proprietorship form of ownership suffers from certain limitations such as limited resources, limited skill and unlimited liability. Expansion in business requires more capital and managerial skills and also involves more risk. A proprietor finds him unable to fulfil these requirements. This call for more persons come together, with different edges and start business. For example, a person who lacks managerial skills but may have capital.

Another person who is a good manager but may not have capital. When these persons come together, pool their capital and skills and organise a business, it is called partnership. Partnership grows essentially because of the limitations or disadvantages of proprietorship.

13.2. Meaning

Partnership is a form of business in which two or more but not more than twenty people owns a business. It is based on written contract or on an oral agreement. Partnership is the relation between persons who have agreed to share the profit of a business carried on by all or any of them acting for all, persons who have entered into partnership with one another are called individually 'Partner' and collectively 'firm'.

13.3. Definition

"A partnership is an association of people who carry on business together for the purpose of making profit".

- S. E. Thomas

"Partnership is a contract of two or more competent persons to place their money, efforts, labor and skill, or some or all of them in lawful commerce or business and to divide the profit and bear the loss in certain proportions".

- Professor Kant

13.4. Essential Elements of Partnership Business

- Plurality of members: More than one person involve with the formation of partnership business.
- Contractual relation: The relationship of partners depends on contract among them.
- Legal business: The business must be legal in the eye of law. Two or more than two persons involve with the illegal business is not a partnership.
- Lawful business: The partnership business which must be legal in the eye of law.
- Earning and sharing profit: The profit which is earned from the partnership business must be shared among the partners according to the predetermine ratio.
- Mutual organization: This is the mutual organization where each and every member freely involves with the business.
- Mutual confidence and trust: Partnership business formed depends on mutual trust and confidence.

13.5. Features of Partnership Accounts

1. **More Persons:** As against proprietorship, there should be at least two persons subject to a maximum of ten persons for banking business and twenty for non-banking business to form a partnership firm.
2. **Profit and Loss Sharing:** There is an agreement among the partners to share the profits earned and losses incurred in partnership business.
3. **Contractual Relationship:** Partnership is formed by an agreement-oral or written-among the partners.
4. **Existence of Lawful Business:** Partnership is formed to carry on some lawful business and share its profits or losses. If the purpose is to carry some charitable works, for example, it is not regarded as partnership.
5. **Utmost Good Faith and Honesty:** A partnership business solely rests on utmost good faith and trust among the partners.
6. **Unlimited Liability:** Like proprietorship, each partner has unlimited liability in the firm. This means that if the assets of the partnership firm fall short to meet the firm’s obligations, the partners’ private assets will also be used for the purpose.

7. **Restrictions on Transfer of Share:** No partner can transfer his share to any outside person without seeking the consent of all other partners.
8. **Principal-Agent Relationship:** The partnership firm may be carried on by all partners or any of them acting for all. While dealing with firm's transactions, each partner is entitled to represent the firm and other partners. In this way, a partner is an agent of the firm and of the other partners.

13.6. Advantages of Partnership Accounts

1. **Easy Formation:** Partnership is a contractual agreement between the partners to run an enterprise. Hence, it is relatively ease to form. Legal formalities associated with formation are minimal. Though, the registration of a partnership is desirable, but not obligatory.
2. **More Capital Available:** We have just seen that sole proprietorship suffers from the limitation of limited funds. Partnership overcomes this problem, to a great extent, because now there are more than one person who provide funds to the enterprise. It also increases the borrowing capacity of the firm. Moreover, the lending institutions also perceive less risk in granting credit to a partnership than to a proprietorship because the risk of loss is spread over a number of partners rather than only one. .
3. **Combined Talent, Judgement and Skill:** As there are more than one owners in partnership, all the partners are involved in decision making. Usually, partners are pooled from different specialised areas to complement each other.
4. **Diffusion of Risk:** You have just seen that the entire losses are borne by the sole proprietor only but in case of partnership, the losses of the firm are shared by all the partners as per their agreed profit-sharing ratios. Thus, the share of loss in case of each partner will be less than that in case of proprietorship.
5. **Flexibility:** Like proprietorship, the partnership business is also flexible. The partners can easily appreciate and quickly react to the changing conditions. No giant business organisation can stifle so quick and creative responses to new opportunities.

6. **Tax Advantage:** Taxation rates applicable to partnership are lower than proprietorship and company forms of business ownership.

13.7. Dis Advantages of Partnership Accounts

1. Unlimited Liability:

In partnership firm, the liability of partners is unlimited. Just as in proprietorship, the partners' personal assets may be at risk if the business cannot pay its debts.

2. Divided Authority:

Sometimes the earlier stated maxim of two heads better than one may turn into "too many cooks spoil the broth." Each partner can discharge his responsibilities in his concerned individual area. But, in case of areas like policy formulation for the whole enterprise, there are chances for conflicts between the partners. Disagreements between the partners over enterprise matters have destroyed many a partnership.

3. Lack of Continuity:

Death or withdrawal of one partner causes the partnership to come to an end. So, there remains uncertainty in continuity of partnership.

4. Risk of Implied Authority:

Each partner is an agent for the partnership business. Hence, the decisions made by him bind all the partners.

At times, an incompetent partner may lend the firm into difficulties by taking wrong decisions. Risk involved in decisions taken by one partner is to be borne by other partners also.

Choosing a business partner is, therefore, much like choosing a marriage mate life partner.

13.8. Classification of Partners

By viewing of nature, work, right, duties and responsibilities, the partners may classify into the following ways:

- **Active partner**

  The active partner those partners who actively take part in the management and administrative activities of the business.

- **Dormant or Sleeping Partner**

  The sleeping partners who are not actively take part in the management and administrative activities of the business.

- **Nominal partner**

  A nominal partner is a person who has permitted others to believe that he is a partner. He does not invest capital but he gives a chance of using “Goodwill” of him.

- **Limited partner**

  A limited partner is a partner whose liability is limited to the amount that he paid to the business.

- **Quasi partner**

  A quasi partner is a partner who has withdrawal his capital but keep it as a loan to the business. He will get interest on his loan.

  Who can be or cannot be a partner?

  Who can be?

  Any person who is qualified to make a contract can be a partner of a partnership business.

  Who can not be a partner?

  - A minor
  - A man of unsound mind Mentally sick person
  - Insolvent person

- **Minor as a partner**

  Generally, minor cannot be a partner. But it a partner is dead, his/her sons or daughters can be partners of the business.

  They can enjoy the facilities and profits. But as they are minors they do not need to bear the responsibilities of the business.

- **Rights of partner**

  a) Interest on loan
  b) Right to work as an agent
  c) Right to introduce
  d) Right to retirement
  e) Right of not being expelled
  f) Right in respect of winding up of a firm
  g) Participation in the conducting of business.
  h) Right of expressing opinion

i) Right to observe, inspect and taking copy of the documents

j) Claiming remuneration

k) Right of obtaining profit

l) Profit on capital

- Duties of partner
  - Fulfillment of duties with diligence
  - No claim of remuneration
  - Proportionate bearing of loss
  - Compensation of loss occurred by willful neglect
  - Surrender of profit earned from the competitive business
  - Performing the functions within the authority
  - Bearing unlimited liability

13.9. Partnership Deed

The partnership deed or agreement refers to a document where all necessary terms and conditions are written. It is a written declaration of agreement among the partners. Oxford dictionary of business, "Deed of partnership is a partnership agreement drawn up in the form of a deed"

Professor J.L. Hanson, "Deed of partnership is a document drawn up to clarify the respective positions of the partners in a business".

Contents of a partnership Deed/ Agreement

Deed/agreement is the guideline for conducting partnership business. All types of terms and conditions must be included in the partnership deed. Sound and smooth business operations demand that partnership agreement should be written and signed. This is not a legal binding but a moral requirement. Such a contractual written agreement is termed as 'Articles of partnership'. Written agreement reduces the misunderstanding.

Written articles of agreement include the followings:

- Name of the partnership business.
- Types of business to be done.
- Location of the business.
- Expected life of the partnership.
- Names of the partners

- Amount of investment by each partner.
- Provision for taking loan for the different sources.
- Rate interest on debt and loan.
- Amount of salary to be provided to the active partner.
- The address of the bank, where the bank account will be open.
- Procedures of distributingprofits and covering the losses.
- Amounts those partners will withdraw for services.
- Procedures for withdrawal of funds.
- Provision for evaluating goodwill of the business.
- Duties of each partner.
- Procedures to hire in case of death or absent.
- Procedures of running the business.
- Provision for changing the partnership deed.
- Procedures for dissolving the partnerships.
- Provision for evaluating asset and liabilities through dissolution of partnership business.

13.9.1. Rules Applicable in the Absence of Partnership Deed

In case partners do not adopt a partnership deed, the following rules will apply:

a. The partners will share profits and losses equally.
b. Partners will not get a salary.
c. Interest on capital will not be payable.
d. Drawings will not be chargeable with interest.
e. Partners will get 6% p.a. interest on loans to the firm if they mutually agree.

13.10. Accounts of Partnership Firm

13.10.1. Interest on capital

Interest on Capital is usually allowed by an agreement between the partners. The Partnership Act is silent on this point that is, no interest on capital is allowed. Interest on capital is generally allowed on capitals so that the partner who contributes more than the proportionate capitals is properly compensated.

If partners contribute equal amounts of capital and share profits equally, no need arises for any interest to be allowed on capital. Where capital contributions are equal but the profit sharing ratios are unequal, a partner, with a lower share of profit, stands to lose. Besides, where capitals are unequal but profit sharing ratios are equal, a partner with large capital contribution is affected financially.

Interest on capital tends to balance capital account equitably, without allowing any partner to enjoy an unfair advantage over the others. Interest on capital is a loss or expense to the firm and thus debited to Interest on capital account and finally transferred to Profit and Loss Appropriation Account. And it is an income or gain to the partners and their Capital Account or Current Account is credited with the amount of interest.

13.10.2. Interest on drawings

If interest on Drawings is to be charged then it is always with reference to time. As said earlier, it is essential to know the amount of drawings, the period and the rate of interest for the calculation of interest. When drawings are made frequently then interest on Drawings can be easily calculated with the help of product method.

$$\text{Interest on Drawings} = \frac{\text{Total of Products x Rate of Interest}}{100} \times \frac{1}{12}$$

Illustration 1:

A and B are partners sharing profits in the ratio of 1:1. A draws Rs. 300 regularly at the beginning of every month during the year 2005. B draws Rs. 1,000 on 1.4.2005, Rs.600 on 1.7.2005, Rs. 800 on 1.10.2005 and Rs. 400 on 1.12.2005. Calculate interest on their drawings at 6% p.a.

Solution:

Following the Product method, interest on Drawings of A:

Date of drawings	Amount withdrawn Rs.	Period for which interest is due	Product Rs.
1.1.2005	300	12 Months	3,600
1.2.2005	300	11 Months	3,300
1.3.2005	300	10 Months	3,000
1.4.2005	300	9 Months	2,700
1.5.2005	300	8 Months	2,400
1.6.2005	300	7 Months	2,100
1.7.2005	300	6 Months	1,800
1.8.2005	300	5 Months	1,500

1.9.2005 1.10.2005 1.11.2005 1.12.2005	300 300 300 300	4 Months 3 Months 2 Months 12 Months	1,200 900 600 300
		The Sum of Products	23,400

Interest for One Month @ 6% p.a.

$$\frac{23{,}400 \times 6 \times 1}{100 \times 12} = \text{Rs. } 117$$

Note:

When the amount withdrawn is same every time and is drawn at regular intervals, a still easier method is:

Take the period at the average of the periods applicable to the first and the last installments. In this illustration, the period of first installment is 12 months and that of the last installments is one month.

Average is = 12+½ = 6 ½ months

Then calculate interest at given rate for 6½ months on the total amount withdrawn during the year. In this case A withdraws Rs. 3,600 during the year.

Interest on his Drawings, as per this formula:

$$\text{Rs. } 3{,}600 \times \frac{6}{100} \times \frac{6\tfrac{1}{2}}{12} = \text{Rs. } 117$$

Under Average Due Date Method:

$$\text{Interest for } \frac{23{,}400}{3{,}600} \text{ Months @ 6\% p.a. on Rs. } 3{,}600$$

$$\text{That is } \frac{23{,}400}{3{,}600} \times \frac{6}{100} \times \frac{3{,}600}{12} = \text{Rs.}117$$

Note:

If drawings are made in the beginning of each month, interest can be calculated on the whole of the amount for 6 1/2 months.

If drawings are made at the end of each month, the period is 5 1/2 months for the total amount.

If drawings are made at the middle of each month, the period is 6 months for the total amount.

Interest on Drawings of B is:

Date of Drawings	Amount Drawn Rs.	Period for which interest is due	Product
1.4.2005	1,000	9 Months	9,000
1.7.2005	600	6 Months	3,600
1.10.2005	800	3 Months	2,400
1.12.2005	400	1 Month	400
Total of Products			15,400

Interest for one month @ 6% p.a. = 15,400 x 1/12 = Rs. 77

13.10.3. Partner's Salary or Commission

Sometimes, a partner may fully devote his time to the working of the business. It is similar to allowing interest on capital to a partner, who contributes larger amount towards capital. When the partners decide to honour the service of a partner, an additional benefit in the name of salary is allowed. The Salary Account is debited and the capital or Current Account is credited with the amount of salary.

Under the partnership law all partners are supposed to devote their time to the affairs of the firm but in practice many partners may not devote any time and some of the partners may have to carry on the entire work of the firm. Thus, a percentage of profit is paid to a partner for the special work or service done. This commission may be payable before charging such commission or after charging such commission.

13.10.4. Interest on Partner's Loan

Profit and Loss Appropriation Account:

The Profit and Losses of the partnership are divisible equally or in any other manner agreed upon by the partners. In case of partnership accounting, it is usual that adjustments relating to Interest on Capital Interest on Drawings, Salary, Commission, Share of profits etc. to be made through the Profit and Loss Appropriation Account.

The Profit disclosed by Profit and Loss Account, is transferred to Profit and Loss Appropriation Account and the adjustment entries relating to partners are made through this account. Then, the remaining profit is transferred to Capital Account or Current Account on the basis of Profit sharing ratio.

Adjusting Journal Entries

(1) For Interest on Capital	Interest on Capital Account Dr. To Partners Capital /Current Account
(2) For Interest on Drawings	Partners Capital/Current Account Dr.

	To Interest on Drawings Account
(3) For Partners Salary / Commission etc.	Partners Salary/Commission Account Dr. To Partners Capital / Current Account
(4) For Interest on Partners Loan Account	Interest on Loan Account Dr. To Partners Loan Account
(5) For Adjusting Net Profit	Profit & Loss Appropriation Account Dr. To Partners' Capital / Current A/c
(6) For Adjusting Net Loss	Partners Capital / Current Account Dr. To Profit & Loss Appropriation A/c

Illustration 2:

A and B started a business on 1st January 2005, contributing Rs. 50,000 by A and Rs. 40,000 by B. On 30th June, 2005 B made a further contribution of Rs. 10,000 towards his capital. Drawings during the year come to Rs. 4.000 by A and Rs. 5,000 by B. 6% interest is to be charged on capitals and no interest is to be charged on drawings. B is to be allowed a salary of Rs. 500 p.m. The profit for the year comes to Rs. 32,000 before charging salary and interest on capitals.

Show the Profit and Loss Appropriation Account and the partner's counts under fixed capital method and Fluctuating Capital Method.

Solution

Profit and Loss Appropriation Account
for the year ended 31st December 2005

		Rs.		Rs.
To Interest on Capital:			By Net Profit	32,000
A: 6% on Rs. 50,000 for one year	3,000			
B: 6% on Rs. 40,000 For one year	2,400			
6% on Rs. 10,000 For 6 months	300	5,700		
To Salary A/c		6,000		
To Net Profit:				
A:	10,150			
B:	10,150	20,300		
		32,000		**32,000**

When the Capitals are fixed:

Dr. **Capital Accounts** **Cr.**

		A	B			A	B
2005		Rs.	Rs.	2005		Rs.	Rs.
Dec.31	To balance c/d	50,000	50,000	Jan.	By cash	50,000	40,000
				June 30	By cash		10,000
		50,000	**50,000**			**50,000**	**50,000**
				2006 Jan. 1	By Balance b/d	50,000	50,000

Dr. **Current Accounts** **Cr.**

		A	B			A	B
2005		Rs.	Rs.	2005		Rs.	Rs.
Dec.31	To Drawings	4,000	5,000	Jan.	By Interest	3,000	2,700
	To balance c/d	9,150	13,850	June 30	By Salary	-	6,000
					By Net Profit	10,150	10,150
		13,150	**18,850**			**13,150**	**18,850**
				2006			
				Jan. 1	By Balance b/d	9,150	13,850

When the Capital are Fluctuating

Dr. **Capital Accounts** **Cr.**

		A	B			A	B
2005		Rs.	Rs.	2005		Rs.	Rs.
Dec.31	To Drawings	4,000	5,000	Jan.1	By Cash	50,000	40,000
	To balance c/d	59,150	63,850	June 30	By Cash	-	10,000
				Dec. 31	By Interest	3,000	2,700
				Dec. 31	By Salary	-	6,000
					By Net Profit	10.150	10,150
		63,150	**68,850**			**63,150**	**68,850**
				2006			
				Jan. 1	By Balance b/d	59,150	63,850

Illustration 3:

A and B started a business in a partnership from 1st January, 2005, without any Partnership Agreement, with a Capital of Rs. 20,000, to which A contributes Rs. 15,000 and B contributes Rs.5,000.

In the Middle of the year A further introduces Rs.3, 000 to the partnership, as a loan without any agreement as to inters.

The profit for the year ended December 2005 comes to Rs. 12,000.

During the whole year B was fully engaged in the business.

There arises a dispute between A and B. Both of them put forward their claims as follows: A demands:

(i) Interest @ 10% on his capital and loan.

(ii) Division of profits on the basis of contribution of Capital.

B demands:

(i) Since he is fully engaged in the firm, he needs a salary of Rs. 500 p.m.

(ii) Divisible profits should be divided equally

(iii) Interest should be allowed on capital and loan at 5% p.a.

Solution:

Dr. Profit and Loss Appropriation Account Cr.

	Rs.		Rs.
To Interest on A's Loan of Rs. 3,000 for half year at 6% p.a.	90	By Net Profit	**12,000**
To Net Profit transferred to Capital Accounts A – 5,955 B – 5,955	11,910		
	12,000		**12,000**

Note: In the absence of agreement between the partners, the Partnership Act 1932 will apply accordingly,

1. No interest is provided on partners Capital in the absence of Partnership Deed.
2. Partners are entitled to interest @ 6% p.a. on loans advanced to the firm apart from the capital contribution.
3. A partner is not allowed to receive any remuneration/salary.
4. Partners are entitled to share equally in the profits of the business, and must contribute equally to losses sustained by the firm.

Illustration 4:

A and B are partners in a firm sharing profits and losses in the ratio of 4: 1.

On 1st April 2004, the Capital of the partners: A – Rs 50,000 and B – Rs 40,000.

The Profit and Loss Account of the firm for the year ended 31st March 2005 showed a net profit of Rs 1, 75,000.

You are required to give the Profit and Loss Appropriation Account of the firm after taking into consideration the following:

(i) Interest on Capital at 5% p.a.

(ii) Interest on B's Loan Account of Rs 50,000 for the whole year.

(iii) Interest on drawings of partners at 6% p.a. Drawings of A – Rs 15,000; B – Rs 10,000.

(iv) Transfer 10% of the distributable profit, before distribution, to the Reserve Fund of the firm.

Solution

Dr. **Profit and Loss Appropriation Account** **Cr.**

For the year ended 31st March 2005

		Rs.			**Rs.**
To Interest on Capital			By Profit & Loss Account		1,75,000
A –	2,500		By Interest on Drawings:		
B –	5,955	4,500	A--	450	
To Interest on B's Loan		3,000	B--	300	750
To Reserve Fund 10%		16,826			
To Share of Profit:					
A --	1,21,140	1,51,425			
B --					
	30,285				
		1,75,750			**1,75,750**

Let Us Sum Up

In this unit you have learned about the following:

Partnership is a form of business in which two or more but not more than twenty people owns a business. It is based on written contract or on an oral agreement.

A limited partner is a partner whose liability is limited to the amount that he paid to the business.

A nominal partner is a person who has permitted others to believe that he is a partner. He does not invest capital but he gives a chance of using "Goodwill" of him.

The partnership deed or agreement refers to a document where all necessary terms and conditions are written. It is a written declaration of agreement among the partners.

Check Your Progress

1. Define partnership.

2. Who is nominal partner?

3. What is partnership deed?

4. Who is Dormant or Sleeping Partner

____

____

____

Glossary

Partnership: Partnership is a form of business in which two or more but not more than twenty people owns a business. It is based on written contract or on an oral agreement.

Active partner The active partner those partners who actively take part in the management and administrative activities of the business.

Minor as a partner Generally, minor cannot be a partner. But it a partner is dead, his/her sons or daughters can be partners of the business.

Answer to Check Your Progress

1. "Partnership is a contract of two or more competent persons to place their money, efforts, labor and skill, or some or all of them in lawful commerce or business and to divide the profit and bear the loss in certain proportions". - Professor Kant.
2. A nominal partner is a person who has permitted others to believe that he is a partner. He does not invest capital but he gives a chance of using "Goodwill" of him.
3. The partnership deed or agreement refers to a document where all necessary terms and conditions are written. It is a written declaration of agreement among the partners. Oxford dictionary of business, "Deed of partnership is a partnership agreement drawn up in the form of a deed"
4. The sleeping partners who are not actively take part in the management and administrative activities of the business.

Suggested Readings

1).Hanif and A. Mukherjee, "Financial Accounting- II", McGraw Hill, 2018

2).P.C. Tulsian, "Financial Accounting", 2002

3).T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, "Introduction to Financial Accounting", 2017

Unit-14

Admission of a Partner

STRUCTURE

Overview

The admission of a new partner to a partnership is a process by which a new individual or entity joins an existing partnership. This can happen for a variety of reasons, such as the desire to expand the partnership, the retirement or departure of an existing partner, or the need for additional capital or expertise.

In this unit the concept of admission of a partner has been explained.

Objectives

After studying this unit, students should be able to:

- calculate new profit sharing ratio.
- understand the rights of
- incoming partner
- prepare the revaluation account

14.1. Introduction

According to the Partnership Act 1932, a new partner can be admitted into the firm only with the consent of all the existing partners unless otherwise agreed upon. With the admission of a new partner, the partnership firm is reconstituted and a new agreement is entered into to carry on the business of the firm. Inclusion of a new person as a partner to an existing firm is called admission of a partner. The new partner who joins the business is called the incoming partner or new partner.

14.2. Rights of Incoming Partners

- For acquisition of the right to share the asset, the new partner has to bring an agreed amount of the capital.
- For the right to share profit of the partnership firm, the new partner is required to bring some amount which is known as premium or his share of goodwill.

14.3. Accounting Adjustment

Admission of a partner necessitates the following accounting adjustment in the books of the firm

- Ascertainment of new profit sharing ratio
- Calculation of sacrificing ratio
- Revaluation of asset and reassessment of liability
- Distribution of reserve and accumulated profit or loss
- Treatment of goodwill
- Adjustment of capital

New profit sharing ratio

New profit sharing ratio is the ratio in which all partners share the future profit and losses.

a. The mutual profit sharing ratio among the existing partners may remain unaltered after giving away the new partner's share.

Example 1:

X and Y were partners sharing profit/losses as 3 : 2. They admit as a new partner giving him 1/5th share of future profits. What should be the new profit sharing ratio?

Solution :

Z's share = 1/5   Balance = 1 – 1/5 = 4/5

X's share = 4/5 x 3/5 = 12/25;

Y's share = 4/5x2/5 = 8/25;

Z's share = 1/5 = 5/25.

The new profit sharing ratio = 12 : 8 : 5.

b. The mutual profit sharing ratio among existing partners may be changed by agreement.

Example 2 :

P and Q were partners sharing profits/losses as 4 : 3. R is admitted as a new partner for 1/5 th share. P and Q decide to share the balance of profits equally.

Solution:

R's share = 1/5   Balance = 1 – 1/5 = 4/5.

P's share = 4/5 × 1/2 = 4/10;

Q's share = 4/5 × 1/2 = 4/10;

R's share = 1/5 = 2/10.

New Ratio = 4 : 4 : 2 or 2 : 2 : 1.

c. If the sacrifice made individually by the existing partners is given then New Ratio should be calculated by deducting the sacrifice from the old ratio.

Example 3:

A, B & C were partners sharing profits/loses as 3 : 2: 1. They admitted D as a new partner giving him 1/6th share of future profits. D acquired 3/24 th share from A and 1/24 share from B. Calculate the new Profit Sharing Ratio.

Solution :

New Ratio = Old Ratio – Sacrifice Ratio

A = 3/6 – 3/24 = 12/24 – 3/24 = 9/24;

B = 2/6-1/24 = 8/24 – 1/24 = 7/24;

C = 1/6 – Nil = 4/24 – Nil = 4/24;

D=3/24 + 1/24=4/24

The new ratio = 9 : 7 : 4 : 4.

14.4. Sacrificing Ratio

The ratio in which the old partners sacrifices or surrender their share of profit in favour of incoming partner is called sacrificing ratio.

Sacrificing Ratio = Old Ratio - New Ratio

Admission

Case 1: When old partner's ratio and new partner's share of profit is given

Eg: A:B = 3:2 (old ratio)

A new partner C is admitted into the firm for 1/4th share in profit.

New ratio:

Let total share 1

C - 1/4th

Remaining share 1-¼-- ¾

New share

A - ¾* = 9/20 ⅗

B - ¾* = 6/20⅖

C - ¼ *5/5= 5/20

A:B:C - 9:6:5. NEW RATIO

Sacrificing ratio = old ratio - new ratio

(SON)

A= -9/20 = 3/20⅗

B = -6/20 = 2/20 ⅖

A:B = 3:2

Case 2: A:B = 3:2 Old ratio

C is admitted for ¼th share

A:B decided to share equally in future

Let total share 1

Remaining share = 1-¼ = ¾

New ratio

A = ¾*½ = 3/8

B = ¾*½ = ⅜

C = ¼*2/2 = 2/8

A:B:C = 3:3:2 New ratio

Sacrificing ratio = old ratio - new ratio

A = $-\frac{3}{8}$ = 9/40

14.5. Revaluation Account

A revaluation account is a nominal account prepared to bring the asset and liabilities of the firm to their true values and to find out the profit or loss arising there from. The revaluation account records the positive or negative holding gains accruing during the accounting period to the owners of financial and non-financial assets and liabilities.

14.6. Journal Entries

Journal Entries

- For increase in the value of assets

Asset a/c	Dr	xxx	
To Revaluation	a/c		xxx

- For decrease in the value of assets

Revaluation a/c	Dr	xxx	
To Asset	a/c		xxx

- For increase in the value of liability

Revaluation a/c	Dr	xxx	
To Liability	a/c		xxx

- For decrease in the value of liability

Liability a/c	Dr	xxx	
Revaluation a/c		xxx	

- For recording unrecorded assets

Asset a/c	Dr	xxx	
To Revaluation	a/c		xxx

- For recording unrecorded liability

Revaluation a/c	Dr	xxx	
To Liability a/c			xxx

- For transferring profit on revaluation

Revaluation a/c	Dr	xxx	
To Old partners capital	a/c		xxx

- For transferring loss on revaluation

Old partners capital a/c	Dr	xxx	
To Revaluation a/c			xxx

Proforma of Revaluation Account

Date	Particulars	Amt	Date	Particulars	Amt
	Decrease in value of Assets Increase on reassessment of liabilities Capital account (Gain on revaluation)	xxx xxx xxx		Increase in the value of assets Decrease on reassessment of liabilities Capital account (Loss on	xxx xxx xxx

				revaluation)	
		xxx			xxx

Adjustment for reserve and other accumulated profit or loss The incoming partner is not entitled to any share in the accumulated profit or loss of the business appearing in the balance sheet as on the date of admission. The balance appearing in the form of reserves or profit or loss account balance should be transferred to the capital account of old partners in their old profit sharing ratio.

Methods of treatment of Goodwill

- Premium method
- Revaluation method
- Memorandum Revaluation Method

Premium method

Under this method the new partner brings in his share of goodwill in cash. The amount of premium brought in by the new partner is shared amongst the old partner in their sacrificing ratio.

Journal entry

❖ For bringing the premium (share of goodwill)

Cash/ Bank a/c Dr

Goodwill a/c

❖ For transferring goodwill to the capital account of old partners in sacrificing ratio

Goodwill a/c Dr

Old partner's capital a/c

By combining the above two entries, one entry may be passed as follows

Cash/Bank a/c Dr

Old partner's capital a/c

Goodwill brought in cash is withdrawn by old partners

If the partnership agreement so permits, the old partners can withdrawn either fully or partially, the amount brought in by the new partners for goodwill. In such case two entries are given in firm books

- For the amount brought in for goodwill

Cash a/c Dr

Old partners capital account a/c

- On withdrawing the amount by old partners

  Old partners capital a/c Dr

  Cash a/c

When only a portion of goodwill brought in cash by new partner

In such a situation, the actual amount of goodwill brought in cash is credited to premium account. The unpaid amount of goodwill is debited to new partners capital account.

Journal entry

- Goodwill premium brought by new partner transferred to the capital account of old partners

Cash a/c Dr

Old partner's capital A/C

- Unpaid amount of goodwill premium credited to the capital account of old partners in sacrificing ratio

  New Partners Capital a/c Dr

  Old Partners Capital a/c

Revaluation Method of Treatment of Good will

Under this method, the new partner does not bring in his share of goodwill in cash instead, a goodwill account is raised in the firms book. Goodwill account is created in its full value by crediting the amount in the old partners capital account in their old ratio. The goodwill account should be shown on the asset side of the balance sheet.

The journal entry for raising the goodwill is

Goodwill a/c Dr

Old partners capital a/c

Memorandum Revaluation Method

Under this method .goodwill is raised in the books at its full value and written off immediately after admission. On raising the goodwill, the value is credited to the old partner's capital account in their old ratio. And on writing it off all partners (including new partners) capital account are debited with the value of goodwill in their new profit sharing ratio.

Journal entries

- Goodwill a/c Dr

Old partners capital Account

(Full value of goodwill shared in old ratio)

- All partners capital a/c Dr

  Goodwill a/c

(The full value of goodwill written off by debiting all partners including the new partners in their new profit sharing ratio)

Share of Goodwill brought in Kind

The incoming partners may contribute his share of goodwill in the form of assets instead of bringing cash. The asset brought in by the new partners will be debited and goodwill account will be credited. Later the share of goodwill will be transferred to the capital account will be credited. Later the share of goodwill will be transferred to the capital account of old partners in their sacrificing ratio.

Journal entry for recording the transactions

- For asset brought by the new partner

  Asset a/c Dr

  New Partners Capital a/c

  Premium(Goodwill) a/c

- For transferring the amount to the capital accounts of the sacrificing partners in their sacrificing ratio

  Premium (Goodwill) a/c Dr

  Sacrificing Partners Capital a/c

Adjustment of Capital

At the time of admission, the partner may agree that their capital account should be adjusted as to make it in proportion to the new profit sharing ratio. This can be done either

- On the basis of new partner capital a/c
- On the basis of old partners capital

Adjustment of capital on the basis of new partner's capital

Under this method, the total capital of the firm is calculated on the basis of the share of new partner and the amount of capital brought by him. Capital required for each partner is ascertained on the basis of the total capital of the firm and new profit sharing ratio. The required amount of capital will now be compared with actual amount of capital of each partner after all adjustment are made. If the balance is more than the required amount, the excess will be withdrawn by partner from the firm or will transferred to their current account.

Similarly if the balance is less than the required amount of capital, the deficiency will brought by the partners in cash or will be transferred to their current account.

New partners bring his capital on the basis of old partner's capital

Under this method, the amount of capital to be contributed by the new partner is ascertained on the basis of the combined capital of old partners. In such a case, first of all, balance of old partners capital account after making all adjustments should be calculated. The combined capital of old partners is found out and on the basis the old capital of the new firm is ascertained. From the total capital, the share of new partner's capital is calculated by applying the new profit sharing ratio.

14.7. Illustrations

Illustration 1.

X, Y and Z were in partnership sharing profits and losses in the ratio 3 : 2 : 1. Their Balance Sheet stood as under:

Balance Sheet as at 1.4.2012

Liabilities		Amount	Assets	Amount
Capital			Fixed Assets	80,000
X	40,000		Machinery Replacement	15,000
Y	30,000			
Z	20,000	90,000	Investment:	
General Reserve		12,000	Investment (MV ` 7,000)	10,000
Machinery Replacement Fund		16,000	Current Asset	33,000
Investment Fluctuation Fund		15,000		
Current Liabilities		5,000		
		1,38,000		**1,38,000**

Show the entries for accumulated profits/reserves assuming that Mr. T is admitted as partner for 1/5th share.

Solution:

In the books of……… Journal

Date	Particulars		L.F.	Debit Rs	Credit Rs.
	General Reserve A/c	Dr.		12,000	
	Investment Fluctuation Fund A/c	Dr.		12,000	
	(` 15,000 – ` 3,000)				
	To X - Capital A/c To Y				12,000
	Capital A/c To Z –				8,000
	Capital A/c				4,000
	(Accumulated profits are distributed in 3 : 2 : 1)				

Illustration 2

A and B are partner in a firm sharing profit and losses in the ratio of 4:1. Their Balance Sheet as on 31st March 2013 stood as follows :

Liabilities		Amount	Assets	Amount
Capital A/c			Furniture	20,000
A	25,000		Stock	40,000
B	65,000	90,000	Bills Receivable	10,000
Reserve		20,000	Debtors	30,000
Creditors		25,000	Cash at Bank	40,000
Bills Payable		5,000		
		1,40,000		1,40,000

They agreed to take C as a partner with effect from 1st April 2013 on the following terms:

a) A, B and C will share profit and losses in the ratio of 5 : 3 : 2.

b) C will bring ` 20,000 as premium for goodwill and ` 30,000 as capital.

c) Half of the Reserve is to be withdrawn by the partners.

d) The asset will be revalued as follows : Furniture ` 30,000; Stock ` 39,500; Debtors ` 28,500.

e) A creditor of ` 12,000 has agreed to forgo his claim by ` 2,000.

f) After making the above adjustments, the capital accounts of A and B should be adjusted on the basis of C's capital, by bringing cash or withdrawing cash as the case may be.

Show Revaluation Account, Partners' Capital Account and the Balance Sheet of the new firm :

Solution:

In the books of A, B and C

Dr. Revaluation Account Cr.

Particulars	Amount	Particulars	Amount
To Stock A/c	500	By Furniture A/c	10,000
To Prov. for Bad Debts A/c	1,500	By Creditors	2,000
To Profit on Revaluation:			
A 8,000			
B 2,000	10,000		
	12,000		**12,000**

Capital Account

Particulars	A	B	C	Particulars	A	B	C
To A's Capital A/c	---	10,000	---	By Balance b/d	25,000	65,000	---
To Bank A/c	8,000	2,000	---	By Bank	---	---	30,000
To Bank A/c	---	14,000	---	By Revaluation			
(bal. fig.)				— Profit	8,000	2,000	---
To Balance c/d	75,000	45,000	30,000	By Reserve	16,000	4,000	---
				By Goodwill	20,000	---	---
				By Capital A/c	10,000	---	---
				By Bank (bal. fig.)	4,000	---	---
	83,000	**71,000**	**30,000**		**83,000**	**71,000**	**30,000**

Balance sheet as at 1st April, 2013

Particulars	A	B	Particulars	A	B
Capital A/c			Furniture		30,000
A	75,000		Stock		39,500
B	45,000		Debtors	30,000	
C	30,000	1,50,000	Less : R/B/Debts	1,500	28,500
Creditors (25,000-2,000)		23,000	Bills		10,000
Bills Payable	75,000	5,000	Receivable		70,000
			Cash at Bank		
			(`40,000+`50,000- `10,000		
			+ `4,000 – `14,000)		
		1,78,000			**1,78,000**

Workings:

1. Sharing of Goodwill

Sacrificing Ratio:

A = 4/5 - 5/10 = (8 - 5)/10 = 3/10 (Sacrifice)

B = 1/5 - 3/10 = (2 - 3)/10 = 1/10 (Gains)

C = 2/10 (Gains)

Entire goodwill to be credited to A's Capital Account. B will have to pay A for goodwill

= ` 20,000 × 10/2 x 1/10

= ` 10,000.

2. Adjustment of Capital

C brings for 2/10	` 30,000	
A will have to bring for 5/10	= ` 30,000 x 5/10 x 10/2	= ` 75,000
And B should bring for 3/10	= ` 30,000 x 3/10 x 10/2	= ` 45,000

Let Us Sum Up

In this unit you have learned about the following:

Inclusion of a new person as a partner to an existing firm is called admission of a partner.

The new partner who joins the business is called the incoming partner or new partner. New profit sharing ratio is the ratio in which all partners (including new partner) share the future profit and losses. A revaluation account is a nominal account prepared to bring the asset and liabilities of the firm to their true values and to find out the profit or loss arising there from.

Check Your Progress

1. What is sacrificing ratio?

2. What is revaluation account?

3. The journal entry for raising the goodwill is

____

____

____

Glossary

Sacrificing Ratio: The ratio in which the old partners sacrifices or surrender their share of profit in favour of incoming partner is called sacrificing ratio.

Adjustment of Capital: At the time of admission, the partner may agree that their capital account should be adjusted as to make it in proportion to the new profit sharing ratio.

Premium method: Under this method the new partner brings in his share of goodwill in cash. The amount of premium brought in by the new partner is shared amongst the old partner in their sacrificing ratio.

Answer to Check Your Progress

1. The ratio in which the old partners sacrifices or surrender their share of profit in favour of incoming partner is called sacrificing ratio.

   Sacrificing Ratio = Old Ratio - New Ratio

2. A revaluation account is a nominal account prepared to bring the asset and liabilities of the firm to their true values and to find out the profit or loss arising there from. The revaluation account records the positive or negative holding gains accruing during the accounting period to the owners of financial and non-financial assets and liabilities.

3. The journal entry for raising the goodwill is

   Goodwill a/c Dr

   Old partners capital a/c

Suggested Readings

1. Hanif and A. Mukherjee, “Financial Accounting- II”, McGraw Hill, 2018
2. P.C. Tulsian, “Financial Accounting”, 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, “Introduction to Financial Accounting”, 2017
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Unit-15

Retirement and Death of a Partner

STRUCTURE

Overview

In this unit we will learn the meaning and the retirement and death of a partner. The retirement of a partner can have significant implications for the partnership and the remaining partners. The retirement of a partner can be a complex process, but with proper planning and communication, it can be managed effectively to ensure the continued success of the partnership.

Objectives

After studying this unit, students should be able to

- Prepare the journal entries
- Calculate goodwill and
- Prepare revaluation account

15.1. Introduction

A Partner may leave the firm by taking retirement. Normally the retirement takes place by consent of allthe partners and / or by other mode of communication by the intended partner to all other partners. In case of retirement, for paying off the retiring partner(s) some adjustment are required to be done inthe books of accounts.

15.2. Steps for Adjustments

Following steps to be taken and books of accounts to be prepared to calculate the due of retiring partner.

15.2.1. Revaluation of Assets and liabilities.

This is required for giving the share of net assets of the firm. Treatments are:

Profit or loss on revaluation to be transferred to all the partners in old Profit Sharing ratio.

If the remaining partners decide not to alter the book value of assets or liabilities then the profit or loss on revaluation as distributed earlier should be reversed through remaining partner's capital account in new profit sharing ratio. We shall have to prepare Memorandum Revaluation Account.

15.2.2. Undistributed Profit Or Loss

Any undistributed profit or loss including reserve is to be transferred in old profit sharing ratio.

Journal entries :

In case of undistributed profit or reserves:

Profit & Loss A/c Dr.
Reserve A/c Dr.

To Old Partners Capital A/c (In old P.S.R)

In case of undistributed Loss
Old Partners Capital A/c Dr.

To Profit & Loss A/c

15.2.3. Adjustment Regarding Goodwill

At the time of retirement the retiring partner is also eligible for share of goodwill of the firm. This can be made in the following ways :

Raising of goodwill : (If goodwill is already existing in the Balance sheet the difference shall be raised)

Goodwill A/c Dr.

(Value of goodwill – existing goodwill in the balance sheet)

To All Partners Capital A/c (Old P.S.R)

(a) Goodwill raised and written off :

(i) Raise goodwill as discussed above.

(ii) Write off goodwill

Existing partners Capital A/c Dr.

To Goodwill A/c

15.3. Settlement of Dues to the Retiring Partner

The retiring partner becomes entitled to get back his dues from the firm which consists of the following

a) Balance of his capital and current account at the time of retirement.

b) Share of goodwill, undistributed profit or loss, reserves and profit or loss on revaluation of assets and liabilities.

c) Salary, commission, interest on capital, if any and all other dues till the date of retirement.

d) Any adjustment in drawings and interest thereon.

Payment of dues.

(i) Payment at a time. Subject to availability of the fund, the payment may be made at a time. Journal entry :

Retiring Partner's Capital A/c Dr.

To Bank A/c

(ii) If part payment be made by giving assets :

Retiring Partner's Capital A/c Dr.

To Assets A/c

(iii) If the dues are transferred to Loan account.

Retiring Partner's Capital A/c Dr.

To Retiring partners' Loan A/c

(iv) If the existing partners bring in cash for making payment :

Bank/Cash A/c Dr.

To Existing Partners' Capital A/c

(v) For interest due on Retiring Partners Loan A/c

Interest on Retiring Partner's Loan A/c Dr.

To Retiring Partner's Loan account.

15.4. Illustrations

Illustration-1

The Balance Sheet of Baichung, Tausif and Vijayan who shared profits and losses in the ratio3:3:2 respectively was as follows on 31st December, 2013 :

Capitals :			Machinery	31,600
Baichung	24,000		Furniture	6,400
Tausif	10,000		Stock	8,500
Vijayan	8,000	42,000	Debtors	4,300
Reserve		4,800	Cash at Bank	4,700
Creditors		8,700		
		55,500		55,500

Baichung retired from the business on 1st January, 2013. Revaluation of assets were made as : Machinery` 34,000, Furniture ` 5,000, Stock ` 9,600, Debtors ` 4,000 and Goodwill 10,000. Baichung was paid ` 4,225 immediately and the balance was transferred to a Loan Account for payment in 4 equal half-yearly installments together with interest @ 6% p.a.

Show the necessary accounts, the Balance Sheet of the firm immediately after Baichung's retirement and his Loan Account till finally paid off.

Solution:

Books of Baichung, Tausif and Vijayan

Revaluation Account

Date	Particulars	Amount	Amount	Date	Particulars	Amount	Amount
1.1.13	To Furniture A/c		1,400	1.1.13	By Machinery A/c		2,400
	To Provision On Debtors A/c		300		By Stock A/c		1,100
	To Capital A/c: (Profit on Revaluation)						
	Baichung [3/8]	675					
	Tausif [3/8]	675					
	Vijayan [2/8]	450	1,800				
			3,500				3,500

Capital Account

Date	Particulars	Baichung	Tausif	Vijayan	Date	Particulars	Baichung	Tausif	Vijayan
1.1.13	To Bank A/c	4,225			1.1.13	By Balance b/d	24,000	10,000	8,000
	To 6% Loan A/c	26,000				By Reserve	1,800	1,800	1,200
	(Balance	–				[3:3:2]	675	675	450
	transferred)					By Revaluation	3,750	3,750	2,500
	To Balance c/d		16,225	12,150		A/c " Goodwill			
		30,225	16,225	12,150			30,225	16,225	12,150

Tausif and vijayan

Balance sheet as at 1.01.2013

Liabilities	Amount	Amount	Assets	Amount	Amoun
Capitals :			Goodwill Machinery		10,000
Tausif	16,225		Furniture Stock		34,000
Vijayan	12,150	28,375	Debtors		5,000
Baichung's 6% Loan		26,000	Less: Provision Cash at		9,600
Sundry Creditors		8,700	Bank	4,300	
			[4,700–4,225]	300	4,000
					475
		63,075			63,075

Tausif's loan 6% Account

Date	Particulars	Amount	Date	Particulars	Amount
1.1.13	To Bank A/c [1/4 of 26,000+780]	7,280	1.1.13	By Baichung's Capital A/c	26,000
			30.6.13	By Interest [6% of 26,000 for 6 months]	780
31.12.13	To Bank A/c [1/4 of 26,000+585]	7,085		By Interest A/c of [6% of (26,000 – 6,500) for 6 months]	585
	To Balance c/d	13,000			
		27,365			27,365
			1.1.14	By Balance b/d	13,000
30.6.14	To Bank A/c [6,500+390]	6,890	31.06.14	By Interest A/c [6% of 13,000 for 6 months]	390
31.12.14	To Bank A/c [6,500+195]	6,695	31.12.14	By Interest A/c [6% of 6,500 for 6 months]	195
		13,585			13,585

Illustration 2.

On 31st March, 2013 the Balance Sheet of M/s. Ram, Hari and Mohan sharing profits & losses as 2:3:2,stood as follows :

Liabilities		Amount	Assets	Amount
Capital Accounts :			Land & Building	10,00,000
Ram	10,00,000		Machinery	17,00,000
Hari	15,00,000		Closing Stock	5,00,000
Mohan	10,00,000	35,00,000	Sundry Debtors	6,00,000
Sundry Creditors		5,00,000	Cash & Bank Balance	2,00,000
		40,00,000		40,00,000

On 31st March, 2013 Hari decided to retire from the firm and the remaining partners decided to carry on. It was agreed to revalue the Assets and Liabilities on that date on the following basis : (1) Land & Buildings be appreciated by 30%; (2) Machinery be depreciated by 20%; (3) Closing Stock to be revalued at ` 4,50,000; (4) Provision for bad debts be made at 5%; (5) Old credit balances of Sundry Creditors ` 50,000 be written back; (6) Joint Life Policy of the partners surrendered and cash obtained ` 3,50,000; Goodwill of the old firm be valued at ` 6,30,000 and Hari's Share of the Goodwill adjusted in the accounts of Ram and Mohan who share the profits and losses as 3 : 2. No goodwill being raised; (8) The total capital of the firm is to be the same as before retirement, Individual capitals be in their profit sharing ratio; (9) Amount due to Hari is to be settled on the following basis : 50% on retirement and the balance 50% within one year.

Prepare Revaluation Account, Capital Accounts of Partners, Cash Account and Balance Sheet as on 1.4.2013 of M/s Ram & Mohan.

Solution:

In the books of M/S Ram, Hari & Mohan

Revaluation a/c

Particulars	Amount	Amount	Particulars	Amount	Amount
To Machinery A/c		3,40,000	By Land & Buildings A/c		3,00,000
To Stock A/c		50,000	By Sundry Creditors		50,000
To Provision for Bad Debts		30,000	By Partners Capital A/cs:		
			Ram [2/7]	20,000	
			Hari [3/7]	30,000	
			Mohan [2/7]	20,000	70,000
		4,20,000			4,20,000

[Treatment of Joint Life Policy - Surrender value]

For proceeds from Joint Life Policy

Bank A/c	Dr.	3,50,000	
To Joint Life Policy A/c		3,50,000	

For sharing the proceeds of Joint Life Policy

Joint Life Policy A/c	Dr.	3,50,000	
To Ram's Capital A/c	(2/7)	1,00,000	
To Hari's Capital A/c	(3/7)	1,50,000	
To Mohan's Capital A/c	(2/7)	1,00,000	

Adjustment of Hari's share of goodwill

Hari's share of goodwill = 3/7 × 6,30,000 = 2,70,000

Goodwill A/c	Dr.	6,30,000	
To Ram Capital A/c			1,80,000
To Hari Capital A/c			2,70,000
To Mohan Capital A/c (Being the goodwill is raised)			1,80,000
Ram Capial A/c	Dr.	33,78,000	
Mohan Capital A/c	Dr.	2,52,000	
To Goodwill A/c (Being the goodwill is written off)			6,30,000
(or)			
Ram Capial A/c	Dr.	1,98,000	(In gaining ratio)
Mohan Capital A/c		72,000	
To Hari A/c	Dr.		2,70,000

(Being the Hari's share of goodwill is adjusted)

Date 2013	Particulars	Ram	Hari	Mohan	Date 2013	Particulars	Ram	Hari	Mohan
31.3	To Hari's Capital A/c To Revaluation A/c To Cash /Bank A/c [50%] To Loan A/c To Balance c/d (Note)	1,98,000 20,000 — — 21,00,000	— 30,000 9,45,000 9,45,000 —	72,000 20,000 — — 14,00,000	31.3	By Balance b/d By Bank A/c (Joint Life Policy as 2:3:2) By Ram's & Mohan's Capital (G/will shared) By Cash/Bank A/c(Bal. figure)	10,00,000 1,00,000 — 12,18,000	15,00,000 1,50,000 2,70,000 —	10,00,000 1,00,000 — 3,92,000
		23,18,000	19,20,000	14,92,000			23,18,000	19,20,000	14,92,000

Partner's Capital Account

Total Capital of the new firm= Total capital of the old firm (given)

= ` 35,00,000

Therefore Ram's Capital = 3/5 × 35,00,000 = ` 21,00,000

Mohan's Capital = 2/5 × 35,00,000 = ` 14,00,000

Cash/ Bank

Date	Particulars	Amount	Date	Particulars	Amount
31.3.13	To Balance b/d	2,00,000	31.3.13	By Hari's Capital A/c	9,45,000
	To (Joint Life Policy A/c	3,50,000		By Balance c/d	12,15,000
	To Ram's Capital A/c	12,18,000			
	To Mohan Capital A/c	3,92,000			
		21,60,000			21,60,000

Balance Sheet as on 1.4.2013

Liabilities	Amount	Amount	Assets	Amount	Amount
Capital Accounts :			Land & Building		13,00,000
Ram		21,00,000	Machinery		13,60,000
Mohan		14,00,000	Stock		4,50,000
Sundry Creditors		4,50,000	Sundry Debtors	6,00,000	
Hari's Loan		9,45,000	Less : Provision for Bad Debts	30,000	5,70,000
			Cash and Bank		12,15,000
		48,95,000			48,95,000

Working Notes :

1. Calculation of Gaining Ratio [New Ratio – Old Ratio]

Ram = 3/5 – 2/7 = 11/35;

Mohan = 2/5 – 2/7 = 4/35

So, Gaining Ratio = 11:4

15.5. Death of a Partner

If a partner dies, the partnership is usually dissolved. But if the surviving partners desire so, they may purchase the share of the deceased partner and carry on the business. In that case they have to decide (1) the total amount payable to the legal representative or executor of the deceased partner and (2) the mode of such payment.

Total Amount Payable includes:

a) The deceased partner's Capital and / Current Accounts last Balance.

b) His share of undistributed profit/loss.

c) His share of revaluation profit/loss

d) His share of goodwill.

e) His share of Joint Life Policy, if any and

f) His share of profit/loss made by the firm between the last year ending and the date of his death.

The accounting procedure involved is similar to that followed in case of retirement of a partner. The mode of payment depends on the agreement between the partners. It may be:

(i) **Lump Sum Payment**: If the firm has sufficient funds, the total amount payable on account of the deceased partner is transferred to his Representative's Account (or Executor). Such Representative's Account is debited and Bank Account is credited on payment of the dues.

(ii) **Instalment Payment/Loan Payment**: The firm may not have enough funds to make prompt payment. In such a case, the total amount payable is transferred to a loan account in the name of the legal representative or executor. The loan is paid off gradually by installments after considering interest on unpaid balance. The word "Loan" may or may not be appended with the Account. But its gradual payment will definitely resemble the payment of loan.

Joint Life Policy and its Treatment

The partners of a firm may have a Joint Life Policy covering the lives of all the partners. It helps to realize money from the Insurance company in case of death of a partner. The dues of the deceased partner can be paid off without affecting the working capital of the firm.

The policy matures when a partner dies. The money realized from the Insurance Company is distributed among all the partners, including the deceased partner. The accounting entries made are stated below:

1. If Premium paid is treated as a revenue expense of the firm : The Premium is charged to Profit & loss Account which reduces the divisible profits. The amount paid by the Insurance Company in case of death of a partner or on surrender of the Policy is shared by all the partners (including the deceased partner) in their profit sharing ratio.

1. If premium paid is treated as an expense Journal Entries :

(a) Premium Paid

Joint Life Insurance Premium A/c Dr.

To Bank A/c (amount of the Premium)

(b) For charging premium as expense

P & L A/c Dr.

To J.L.P. Premium A/c

(c) Amount Realised from Insurance Company

Bank A/c Dr.

To Joint life Policies A/c (in profit sharing ratio)

(d) For sharing the surplus of Joint Life Policy

Joint Life Policy A/c Dr.

To All partners Capital A/c

2. If premium is treated as a capital expenditure (Joint Life Policy Method):

Here the premium is debited to Life Policy Account. At the end of the accounting period, the book value of the Life Policy [Opening Balance of Joint Life Policy + Current year's premium] is adjusted to its surrender value [amount receivable in case the Policy is surrendered before maturity]. Under this method the Policy appears on the Asset side at its surrender value.

Journal Entries :

(a) Premium Paid

Joint Life Policy A/c Dr.

To Bank A/c (amount of Premium)

(b) At the end of the year :

Profit & Loss A/c Dr.

To Joint Life Policy

(Difference between Book value and surrender value).

(c) Policy Money Realised

Bank A/c Dr.

To Joint Life Policy A/c (amount received)

(d) Transfer of Credit Balance of Joint Life Policy A/c Joint Life Policy A/c Dr.

To All Partners Capital A/c's (in their profit sharing ratio)

3. Joint Life Policy Reserve Method Journal Entries :

(a) Premium Paid

Joint Life Policy A/c Dr.

To Bank Ac/ (amount of premium)

(b) At the end of the year :

Joint life Policy Reserve A/c Dr.

To Joint Life Policy A/c

(Excess of surrender value over book value)

(c) Transferring from J.L.P. Reserve to P&L A/c

Profit & Loss A/c Dr.

To Joint Life Policy Reserve A/c

Adjusting the difference between premium paid and the increase in surrender value

(d) Recording the receipt of Policy money

Bank A/c Dr.

To Joint Life Policy A/c

(e) Transferring the balance of the Reserve A/c

Joint Life Policy Reserve A/c Dr.

To Joint Life Policy A/c

(f) Distributing the Life Policy among partners

Joint Life Policy A/c Dr.

To All Partners Capital A/cs (Old ratio)

Illustration 1.

X, Y and Z are partners sharing profits and losses in the ratio of 2 : 1 : 1. They took out a joint life policy of ` 1,20,000 on 1.1.2009, for the purpose of providing fund for repayment of their share of capital and goodwill in the event of death. The annual premium of ` 5,000 was payable on 1st February every year and last premium was paid on 1st February, 2012. Y died on 10th March, 2012 and policy money was received on 30th April 2012. The surrender value of the policy as on 31st December each year were : 2009 - Nil; 2010- ` 1,000; 2011- ` 1,600.

Show the necessary accounts and Balance Sheet assuming :

1. that the insurance premium is charged every year to the Profit and Loss Account of the firm as business expenses;
2. that the insurance premium is debited to Joint Life Policy Account but an adjustment is made through the Profit and Loss Account each year to bring the policy to its surrender value; and that a sum equal to the annual insurance premium is charged to Profit and Loss Appropriation Account each year and credited to Joint Life Policy Reserve Account through which the adjustment is made to bring the policy to its surrender value.

Solution

Under Method (i) When premium paid is treated as an expense

In the book of X, Y and Z Joint Life Policy Account

Date	Particulars	Amount	Date	Particulars	Amount
2009 Feb, 1	To, Bank A/c (premium paid)	5,000	2009 Mar, 31	By, Profit and Loss A/c	5,000
		5,000			5,000
2010 Feb, 1	To, Bank A/c (premium paid)	5,000	2010 Mar, 31	By, Profit and Loss A/c	5,000
		5,000			5,000
2011 Feb, 1	To, Bank A/c (premium paid)	5,000	2011 Mar, 31	By, Profit and Loss A/c	5,000
		5,000			5,000
2012 Feb,1	To, Bank A/c (premium paid)	5,000	2012 Mar,31	By, Profit and Loss A/c	5,000
		5,000			5,000
2012 Apr,30	To, Partners' Capital - X 60,000 - Y 30,000 - Z 30,000	1,20,000	2012 Apr,30	By, Bank A/c (Insurance money recd)	1,20,000
		1,20,000			1,20,000

Under Method (ii) When premium paid is treated as an assets

Joint Life Policy Account

Date	Particulars	Amount	Date	Particulars	Amount
2009 Feb.1	To Bank A/c -- Premium paid	5,000	2009 Dec.31	By Profit and Loss A/c By Balance c/d	5,000 Nil
		5,000			5,000
2010 Feb.1	To Balance b/d To Bank A/c --- Premium paid	Nil 5,000	2010 Dec.31	By Profit & Loss A/c By Balance c/d	4,000 1,000
		5,000			5,000
2011 Jan.1 Feb. 1	To Balance b/d To Bank A/c -- Premium paid	1,000 5,000	2011 Dec. 31	By Profit and Loss A/c By Balance c/d	4,400 1,600
		6,000			6,000
2012 Jan. 1 Feb.1 April 30	To Balance b/d To Bank A/c -- Premium Paid By Capital A/c -- Transferred X(2/4) 56,700 Y (1/4) 28,350 Z (1/4) 28,350	1,600 5,000 1,13,400	2011 April 30	By Balance c/d -- Policy money received	1,20,000
		1,20,000			1,20,000

(iii) J.L.P. Reserve account is maintained

Joint Life Policy

Date	Particulars	Amount (`)	Date	Particulars	Amount (`)
2009 Feb. 1	To Bank A/c — Premium paid	5,000	2009 Dec,31	By, Joint Life policy Reserve A/c	5,000
		5,000			5,000
2010 Feb, 1	To Bank A/c — Premium paid	5,000	2010 Dec,31 ,,	By, Joint Life policy Reserve A/c By, Balanced c/d (SV)	4,000 1,000
		5,000			5,000

2011 Jan, 1 Feb, 1	To, Balance b/d To, Bank A/c — Premium paid	1,000 5,000	2011 Dec.31 Dec.31	By, Joint Life policy Reserve A/c By, Balanced c/d (SV)	4,400 1,600
		6,000			6,000
2012 Jan, 1 Feb, 1 Apr,30	To, Balance b/d To, Bank A/c — Premium paid to, Joint Life Policy Reserve	1,600 5,000 1,13,400	2012 Dec,31	By, Bank A/c (Insurance money recd)	1,20,000
		1,20,000			1,20,000

Joint Life Policy Reserve Account

Date	Particulars	Amount	Date	Particulars	Amount
2009 Dec,31 Dec,31	To Joint Life Policy A/c To, Balance c/d	5,000 Nil	2009 Dec,31	By, Profit and Loss A/c	5,000
		5,000			5,000
2010 Dec,31 Dec,31	To Joint Life Policy A/c To, Balanced c/d (SV)	4,000 1,000	2010 Jan,1 Dec,31	To, Balance b/d By, Profit and Loss A/c	Nil 5,000
		5,000			5,000
2011 Dec,31 Dec,31	To Joint Life Policy A/c To, Balanced c/d (SV)	4,400 1,600	2011 Jan,1 Dec,31	To, Balance b/d By, Profit and Loss A/c	1,000 5,000
		6,000			6,000
2012 Apr,30	To, Partners' Capital -- X 57,500 -- Y 28,750 -- Z 28,750	1,15,000	2012 Jan,1 Dec,31	To, Balance b/d By, Joint Life policy A/c	1,600 1,13,400
		1,15000			1,15,000

Let Us Sum Up

In this unit you have learned about the following:

A Partner may leave the firm by taking retirement. Normally the retirement takes place by consent of allthe partners and or by other mode of communication by the intended partner to all other partners. At the time of retirement the retiring partner is also eligible for share of goodwill of the firm.

Check Your Progress

1. What is goodwill?

   ____

   ____

   ____

2. Write the journal entries, In case of undistributed profit or reserves:

   ____

   ____

   ____

3. Write the journal entries, In case of undistributed loss:

   ____

   ____

   ____

Glossary

Goodwill: Goodwill is an intangible asset that is associated with the purchase of one company by another. Specifically, goodwill is the portion of the purchase price that is higher than the sum of the net fair value of all of the assets purchased in the acquisition and the liabilities assumed in the process.

Retirement of Partner: A partner who cut his connection with the firm is called a retiring partner or outgoing partner.

Answer to Check Your Progress

1. Goodwill is an intangible asset that represents the value of a business or professional practice above and beyond its tangible assets (such as buildings, equipment, and inventory). It is created through factors such as a strong reputation, loyal customer base, skilled workforce, favorable location, and other intangible factors that contribute to the company's ability to generate profits.

2. Journal entries :

   In case of undistributed profit or reserves:

   Profit & Loss A/c Dr.

   Reserve A/c Dr.

   To Old Partners Capital A/c (In old P.S.R)

3. In case of undistributed Loss

   Old Partners Capital A/cDr.

   To Profit & Loss A/c

Suggested Readings

1. Hanif and A. Mukherjee, “Financial Accounting- II”, McGraw Hill, 2018
2. P.C. Tulsian, “Financial Accounting”, 2002
3. T. Horngren Charles, L. Sundern Gary, A. Elliott John, R. Philbrick Danna, “Introduction to Financial Accounting”, 2017
4. Barry Elliott and Jamie Elliott, “Financial Accounting and Reporting”, 19th Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., “Financial Accounting”, New York: McGraw Hill Book Company, 1990.
6. Charles T. Horngren’ “Financial Accounting”, Revised Edition, 1997.
7. Asish K. Bhattacharyya, “Essentials of Financial Accounting”,2020.
8. Accounting Made Simple, Mike Piper, 2012.

Block-5: Introduction

Block-5: Dissolution, Insolvency and Gradual Realisation and Piece Meal Distribution has been divided in to three Units.

Unit-16: Dissolution of a Firm deals with Introduction, Settlement of Accounts on Dissolution, Accounting Entries Regarding Dissolution and Illustrations.

Unit-17: Insolvency of Partners explains about Introduction, Meaning, Decision in Garner vs Murray Case, Criticism of the decision of Garner vs. Murray, Applicability in India, Illustrations, if all the parties are Insolvent and the Return of Premium to a partner on dissolution before expiry of term.

Unit-18: Piece Meal Distribution explains about the Introduction, Meaning, Importance, Surplus Capital Method and Illustrations.

In all the units of Block -5 **Dissolution, Insolvency and Gradual Realisation and Piece Meal Distribution**, the Check your progress, Glossary, Answers to check your progress and Suggested Reading has been provided and the Learners are expected to attempt all the Check your progress as part of study.

Unit-16

Dissolution of a Firm

STRUCTURE

Overview

In this unit we will learn the meaning and the concept of dissolution of a firm. The dissolution of a firm refers to the process of ending a business entity or a partnership.

It typically involves the liquidation of the company's assets, paying off debts and obligations, and distributing any remaining funds or assets among the shareholders or partners.

The process of dissolution may occur voluntarily or involuntarily. Voluntary dissolution may happen when the owners or partners of a firm decide to close the business for various reasons such as retirement, lack of profits, or disputes among partners.

On the other hand, involuntary dissolution may occur when a firm is forced to close due to bankruptcy or legal action.

Objectives

After studying this unit, students should be able to

- Identify the retirement of partners
- Prepare the journal entries
- Prepare revaluation account

16.1. Introduction

Whenever a reconstitution takes place within a Partnership in the form of admission, retirement or death of a Partner, the existing partnership is dissolved. The Partnership firm, may however, continue, if the remaining partners desire so. But if the partnership firm is discontinued for any reason, that is called Dissolution of the firm. Dissolution of Firm – when does it take place [in accordance with the Indian Partnership Act of 1932]

1. By Mutual consent of all the partners or in accordance with a contract made by them [Section 40]
2. By Notice – given in writing, by any partner to all other partners if the Partnership is at will [Section 43].
3. On the happening of any one of the following events: [Section 42] : (i) expiry of the term, where the Partnership was constituted for a fixed term; (ii) completion of the adventure for which the firm was constituted; (iii) Death of a partner, (iv) Adjudication of a Partner as insolvent.
4. Compulsory Dissolution [Section 41]
   (i) Where all the partners or all but one are adjudged insolvent.
   (ii) If any event occurs making it unlawful for the business of the firm to be carried on.
5. Dissolution by Court: According to Section 44 of the Indian Partnership Act the court, at the suit of a partner, may dissolve a firm on any one of the grounds namely –
   (i) insanity of a partner;
   (ii) permanent incapability of a partner to do his duties;
   (iii) if a partner is guilty of misconduct that might affect prejudicially the carrying on of the business;
   (iv) If a partner willfully or persistently commits breach of agreement;
   (v) If a partner transfers all his shares to a third party or has allowed his share to be charged under the Provisions of Rule 49 of order XXI of the First Schedule to the Code of Civil Procedure, 1908;
   (vi) If the court considers that the business cannot be carried on except at loss;
   (vii) On any other ground on which the court considers the

dissolution as just and equitable.

16.2. Settlement of Accounts on Dissolution

According to Section 48 of the Indian Partnership Act the following rules should be observed for settlement of Accounts after dissolution, subject to agreement by partners:

a) Regarding Losses : "Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly if necessary, by the partners individually in the proportions in which they are entitled to share profits". [Section 48(1)]

b) Regarding Assets : "The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order :

   (i) in paying the debts of the firm to third parties;

   (ii) In paying each partner ratably what is due to him from the firm for advances as distinguished from capital;

   (iii) In paying to each partner ratably what is due to him as capital; and

   (iv) The residue, if any, shall be divided among the partners in the proportions in which they are entitled to share profits." [Section 48(2)]

16.3. Accounting Entries Regarding Dissolution

The two separate aspects of Dissolution for which accounting entries have to be made are:

[A] Realization of Assets and Payment of liabilities and

[B] Settlement of the dues of the Partners,

[A] Realization of Assets and Payment of liabilities

(i).Prepare Realisation Account

(ii).Transfer all assets (except cash, bank & fictitious assets) and liabilities at book values to Realisation Account.

Journal entries

Item/Purpose	Entry	Special Points to be noted
1. Transfer of book values of assets as recorded in the Balance Sheet	Realization A/c Dr. To Sundry Assets [Book value] (including goodwill if any, shown in the Balance Sheet) Realization A/c Dr. To Debtors A/c Provision for Bad Debts A/c Dr. To Realization A/c.	a) Cash or Bank A/c are not to be credited unless the firm, as a whole, is sold out as a going concern. b) Debit balance of any Cap. A/c etc. or Debit balance of P/L A/c not to be transferred to Realization A/c. c) If there is any Provision for bad Debts, debit Realization A/c and credit Debtors A/c with gross figure. Then debit Provision A/c and credit Realization A/c. Same treatment for Provision for Depreciation.
2. Realization/ Sale of above assets	Cash/Bank A/c (amt. realized) .. Dr. OR Partners Cap. A/c Dr. (agreed value at which a partner takes over an asset/assets) To Realization A/c.	
3. Shares etc. received as purchase consid- eration	in exchange of the firm's assets. Shares A/c Dr. To Realization A/c. (agreed value)	
4. Closing the External liabilities	External Liabilities A/c Dr. (such as creditors, outstanding expenses, Bank Loan etc.) To Realization A/c. (book value)	a) Alternatively – this entry may be passed (combining 4,5 & 6) Liability A/c ……. Dr. To Bank A/c (actual amt. paid) OR, To Partners Cap. A/c (agreed value) To Realization A/c (Discount, if any received on payment/ discharge) b) Where assets and liabilities are taken over by another business on making some lump sum payment, separate entries for realization of assets and / payment of liabilities need not be made.
5. External liabilities paid off	Realization A/c. Dr. To Cash/Bank A/c (actual amt. paid)	
6. External liabilities taken over by any partner	Realization A/c. Dr. To Particular Partner's Cap. A/c (agreed value)	
7. Unrecorded asset sold or taken over by any partner	Cash / Bank A/c Dr. Partners Capital A/c Dr. To Realisation A/c	
8. If any unrecorded liability is paid.	Realization A/c Dr. To Cash/Bank A/c (actual amt.)	

9. If shares etc. received and shown in (3) above are sold out or transferred to partners.	Cash/Bank A/c Dr. OR, Partners Cap. A/c Dr. [excluding insolvent partner] To shares A/c	For sale, there may be profit or loss on sale which is transferred to Realization A/c.
10. Payment of Expenses of Realization.	Realization A/c Dr. To Cash/Bank A/c (if paid by the firm) OR To Partners Cap. A/c (if paid by any partner)	If a partner bears such expenses personally in pursuance of a separate agreement – NO ENTRY is required.
11. Balance of 12. Realization Account 13. representing Profit or Loss on Realization.	Realization A/c. Dr. To Partners Cap. A/c (Profit shared in Profit Sharing Ratio) OR, Partner's Cap. A/c Dr. To Realization A/c. (Loss shared in Profit Sharing Ratio)	

a. Settlement of Partners Dues – through Capital Accounts

Item/Purpose	Entry	Special Points to be noted
1. Prepare Capital Accounts with balance as per Balance Sheet before the dissolution.	By Balance b/d (Cr. balance) To Balance b/d (Dr. balance)	
2. Transfer of Current A/c, if any.	Partner's Current A/c Dr. To Partner's Cap. A/c. (Credit Balance) OR Partner's Capital A/c. Dr. To Partner's Current A/c (Debit balance)	
3. Undistributed Profit, Reserve, Joint Life Policy Reserve, Investment Fluctuation Fund, Contingency Reserve etc. transfer.	Profit & Loss (Cr.) A/c Dr. OR, Any Reserve A/c Dr. To Partner's Capital A/cs [Profit sharing ratio]	
4. Undistributed Loss, Fictitious/Unrealizable Assets etc. transfer.	Partners Capital A/c Dr. To Profit & Loss (Dr.) A/c OR, To Fictitious Assets A/c (Profit Sharing Ratio)	Example of unrealizable Asset-Advertisement Suspense A/c
5. Any loan taken from any partner	Partner's Loan A/c …. Dr. To Cash/Bank A/c	U/s 48 Repayment of loan should enjoy priority over repayment of capital.

6. Any loan given to any partner	Cash/Bank A/c Dr. To Partner's Loan A/c OR Partner's Capital A/c Dr. To Partner's Loan A/c	If such amount is realized. Adjustment of loan against Capital
7. If any Partner's Capital A/c shows a debit balance (after balancing)	Cash/Bank A/c Dr. To Particulars Partner's Capital A/c [Cash brought in to make up the shortfall]	If the deficient partner is insolvent, treatment will be different- Vide – Insolvency of Partner.
8. Payment of credit balance (after final balancing)	Particulars Partner's Cap. A/c Dr. To Cash/Bank A/c	Same as above

16.4. Illustration

Illustration 1

Cloud, Storm and Rain were partners in a firm sharing profits and losses in the ratio of 5:3:2. Due to difference in opinion, they decided to dissolve the partnership with effect from 1st April, 2013 on which date the firm's position was as under:

Liabilities	Amount	Assets	Amount
Capital Accounts:		Plant and Machinery	80,000
Cloud	60,000	Furniture & Fixtures	45,000
Storm	40,000	Motor car	25,000
Rain	30,000	Stock in Trade	30,000
Current Accounts:		Sundry Debtors	71,000
Cloud	8,000	Cash at bank	14,000
Storm	10,000	Current Account:	
Sundry Creditors	1,20,000	Rain	3,000
	2,68,000		2,68,000

The following information is given:

(i) Plant costing ` 40,000 was taken over by Cloud at an agreed valuation of ` 45,000 and the remaining machineries realised ` 50,000.

(ii) Furniture & fixture realised ` 40,000.

(iii) Motor car was taken over by storm for ` 30,000.

(iv) Sundry Debtors included a Bad Debt for ` 1,200 and the rest portion was realised subject to a cash discount of 10%.

(v) Stock worth ` 5,000 was taken over by rain for ` 5,200 and the rest realised at 20% above their book value.

(vi) A creditor for ` 2,000 was untraceable and other creditors accepted payment allowing 15% discount. Realisation expenses amounted to ` 5,000.

You are required to show the Realisation Accounts and the Capital Accounts of the partners on dissolution showing final payment to them.

Solution

In the Books of Cloud, Storm & rain

Realisation Account

Particulars	Amount	Amount	Particulars	Amount	Amount
To Plant & Machinery		80,000	By Sundry Creditors		1,20,000
" Furniture & Fixtures		45,000	" Cloud's A/c		45,000
" Motor car		25,000	— plants taken over		
" Stock in trade		30,000	" Storm's A/c		30,000
" Sundry debtors:		71,000	— Motor car taken over		
Bank Payments:			" Rain's A/c		5,200
Sundry Creditors 85%	1,00,300		— Stock taken over		
of (1,20,000 – 2,000)			" Bank (assets realised);		
To Realisation	5,000	1,05,300	Machinery	50,000	
Expenses			Furniture & Fixtures	40,000	
" Profit on Realisation:			Debtors – 90% of	62,820	
Cloud (5/10)	13,360		(71,000 – 1,200)		
Storm (3/10)	8016		Stock 120% of	30,000	1,82,820
Rain (2/10)	5,344	26,720	(30,000 – 5,000)		
		3,83,020			3,83,020

Capital Account

Particulars	Cloud	Storm	Rain	Particulars	Cloud	Storm	Rain
To Current A/c	-	-	3,000	By Balance b/d	60,000	40,000	30,000
To Realisation A/c	45,000	-	-	" Current A/c	8,000	10,000	-
– Plant taken over				" Realisation A/c – Profit	13,360	8,016	5,344
To Realisation A/c							
– Motor car taken over	-	30,000	-				
To Realisation A/c	-	-	5,200				
– Stock taken over							
To Bank							
– Final Payment	36,360	28,016	27,144				
	81,360	58,016	35,344		81,360	58,016	35,344

Illustration 2

The following is the Balance Sheet of S and R as on 31.12.2013

Liabilities	Amount	Assets	Amount
Sundry Creditors	76,000	Cash at bank	23,000
Loan from Lalita (Wife of S)	20,000	Stock –in trade	12,000
Loan from R	30,000	Sundry Debtors 40,000	38,000
Reserve Fund	10,000	Less: Provisions2,000	8,000
Capital:		Furniture	56,000
S	20,000	Plant	20,000
R	16,000	Investments	15,000
	1,72,000	Profit and Loss A/c	1,72,000

The firm was dissolve on 31.12.2013 and the following was the result:

(i) S took over investment at an agreed value of ` 16,000 and agreed to pay off the loan to Lalita (wife of S).

(ii) The assets realised as under: Stock ` 10,000; debtors ` 37,000; Furniture ` 9,000 and plant ` 50,000.

The expenses of realization was ` 2,200.

(iii) The Sundry Creditors were paid off less 2½% discount. S and R shared profits and losses in the ratio of 3:2. Show Realisation Account, Bank Account and the Capital Accounts of the partners.

Solution:

In the books of S and R

Realisation Account

Particulars	Amount	Particulars	Amount
To Sundry Assets:		By Provision for bad debts	2,000
Stock 12,000		,, Sundry Creditors (Discount)	1,900
Debtors 40,000		,, Bank:	
Furniture 8,000		Stock 10,000	
Plant 56,000		Debtors 37,000	
Investments 20,000	1,36,000	Furniture 9,000	
,, Bank – Expenses	2,200	Plant 50,000	1,06,000
		,, Capital Account:	16,000
		S (Investments taken)	
		,, Loss on Realisation:	
		S (3/5) 7,380	
		R (2/5) 4,920	12,300
	1,38,200		1,38,200

Capital Account

Particulars	S`	R`	Particulars	S`	R`
To Profit and Loss A/c	9,000	6,000	By Balance b/d	20,000	16,000
Loss (3:2)			,, Reserve Fund (3:2)	6,000	4,000
,, Realisation A/c	16,000	-	,, Loan from Lalita	20,000	-
Investment taken over			,, Loan from R	-	30,000
,, Realisation A/c	7,380	4920			
Loss	13,620	39,080			
,, Bank A/c (Final payment)	46,000	50,000		46,000	50,000

Bank Account

Particulars	Amount`	Particulars	Amount`
To Balance b/d	23,000	By Sundry Creditors A/c	74,100
,, Realisation A/c		,, Realisation – Expenses	2,200
Assets realised	1,06,000	,, Capital Accounts:	
		S 13,620	
		R 39,080	52,700
	1,29,000		1,29,000

Sundry Creditors Account

Particulars	Amount	Particulars	Amount
To Bank A/c	74,100	By Balance b/d	76,000
,, Realisation (Discount) A/c	1,900		
	76,000		76,000

Illustration 3

A, B and C sharing profits in 3 : 1 : 1 agree upon dissolution. They each decide to take over certain assets and liabilities and continue business separately.

Balance Sheet as on date of dissolution

Liabilities	Amount	Assets	Amount
Creditors	6,000	Cash at Bank	3,200
Loan	1,500	Sundry Assets	17,000
Capitals:		Debtors	
A 27,500		24,200	23,000
B 10,000		Less: Bad Debts Provision 1,200	7800
C 7,000	44,500	Stock	1,000
		Furnitures	
	52,000		52,000

It is agreed as follows:

(1) Goodwill is to be ignored.

(2) A is to take over all the Fixtures at ` 800; Debtors amounting to ` 20,000 at ` 17, 200. The creditors of ` 6,000 to be assumed by A at the figure.

(3) B is to take over all the stocks at ` 7,000 and certain of the sundry assets at ` 7,200 (being book value less 10%)

(4) C is take over the remaining sundry assets at 90% of book values less ` 100 allowances and assume responsibility for the discharge of the loan, together with accruing interest of ` 30 which has not been recorded in the books of the firm.

(5) The expenses of dissolution were ` 270. The remaining debtors were sold to a debt collecting agency for 50% of book values.

Prepare Realisation Account, partners' Capital Accounts and Bank Account.

Solution

In the books of A.B and C

Realization Account

Particulars		**Amount`**	**Particulars**		**Amount`**
To Sundry Assets:			By Provision for bad debts		1,200
Sundry Assets	17,000		Capital Account A :		
Debtors	24,200		Fixtures	800	
Stock	7,800		Debtors	17,200	18,000
Fixtures	1,000	50,000	B: Stock	7,000	
,, Bank – Expenses		270	Sundry Assets	7,200	14,200
,, Capital Account			C: Sundry Assets		8,000
C- Interest on loan		30	By Bank: Collection from Debtors		2,100
			By Loss on realization:		
			A (3/5)	4,080	
			B (1/5)	1,360	6,800
			C (1/5)	1,360	
		50,300			50,300

Capital Account

Particulars	A`	B`	C`	Particulars	A`	B`	C`
To Dissolution Assets taken	18,000	14,200	8,000	By Balance b/d	27,500	10,000	7,000
,, Dissolution A/c Loss	4,080	1,360	1,360	,, Creditors	6,000	-	-
,, Bank — Final payment	11,420	-	-	,, Loan(with interest)	-	-	1,530
				,, Bank Final receipts	-	5,560	830
	33,500	15,560	9,360		33,500	15,560	9,360

Bank Account

Particulars	Amount`	Particulars	Amount`
To Balance b/d	3,200	By Dissolution Account Expenses	270
,, Dissolution A/c Collection from Debtors	2,100	,, Capital Account: A	11,420
,, Capital Accounts: B 5,560 C 830	6,390		
	11,690		11,690

Working Notes: `

1. **Realization of Sundry Assets:**

Sundry Assets (Book Value)	17,000
Less: Taken by B [7,200 x (100/90)]	8,000
Remaining at book value	9,000

Taken by C: 90% of Book value

i.e. (9,000 x (90/100) = 8,100 – 100 for allowance = 8,000

2. **Collection from Debtors:**

Debtors (Book Value)	24,200
Less: Taken by (Book value)	20,000
	4,200

Remaining at 50% i.e., ` 2100

Let Us Sum Up

In this unit you have learned about the following:

Whenever a reconstitution takes place within a Partnership in the form of admission, retirement or death of a Partner, the existing partnership is dissolved. The Partnership firm, may however, continue, if the remaining partners desire so. “Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly if necessary, by the partners individually in the proportions in which they are entitled to share profits”. The two separate aspects of Dissolution for which accounting entries have to be made are: Realization of Assets and Payment of liabilities and Settlement of the dues of the Partners.

Check Your Progress

1. Write short notes on dissolution of a partnership firm

   ____
   ____
   ____

2. Define the term

   a. Regarding losses

   b. Regarding Assets

   ____
   ____
   ____

Glossary

Partnership dissolution: Partnership dissolution refers to the termination of a partnership as well as the cessation of its various business activities.

Voluntary dissolution : Voluntary dissolution may happen when the owners or partners of a firm decide to close the business for various reasons such as retirement, lack of profits, or disputes among partners.

Involuntary dissolution : Involuntary dissolution may occur when a firm is forced to close due to bankruptcy or legal action.

Answer to Check Your Progress

1. The dissolution of a firm refers to the process of ending a business entity or a partnership. It typically involves the liquidation of the company's assets, paying off debts and obligations, and distributing any remaining funds or assets among the shareholders or partners

2. a) Regarding losses

   Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly if necessary, by the partners individually in the proportions in which they are entitled to share profits

   b) Regarding Assets

   The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:

   1. in paying the debts of the firm to third parties;
   2. In paying each partner ratably what is due to him from the firm for advances as distinguished from capital;
   3. In paying to each partner ratably what is due to him as capital; and
   4. The residue, if any, shall be divided among the partners in the proportions in which they are entitled to share profits

Suggested Readings

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2. P.C. Tulsian, "Financial Accounting", 2002
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4. Barry Elliott and Jamie Elliott, "Financial Accounting and Reporting", 19th Edition, Kindle Edition, 2019.
5. Matulich, S. & Heitger, L.E., "Financial Accounting", New York: McGraw Hill Book Company, 1990.
6. Charles T. Horngren' "Financial Accounting", Revised Edition, 1997.
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8. Accounting Made Simple, Mike Piper, 2012.

Unit-17

Insolvency of Partners

STRUCTURE

Overview

Insolvency of partners refers to a situation where one or more partners of a business entity are unable to pay their debts when they become due, and their liabilities exceed their assets. In other words, they are unable to meet their financial obligations and are considered financially distressed.

In this unit, the concept of insolvency of partners has been clearly explained.

Objectives

After studying this unit, students should be able to

- understand the concept of insolvency of partners
- prepare the journal entries and
- prepare capital account, Bank account, etc.

17.1. Introduction

Section 34 in The Indian Partnership Act, 1932, Where a partner in a firm is adjudicated an insolvent he ceases to be a partner on the date on which the order of adjudication is made, whether or not the firm is hereby dissolved. If a partner becomes insolvent and fails to pay his debit balance of Capital A/c either wholly or in part, the unrecoverable portion is a loss to be borne by the solvent partners. The question now arises is that, in what ratio they will share this loss. Prior to the decision in the leading case of Garner vs. Murray this loss was borne by the solvent partners in the profit sharing ratio just like ordinary losses.

17.2. Meaning

Where under a contract between the partners the firm is not dissolved by the adjudication of a partner as an insolvent, the estate of a partner so adjudicated is not liable for any act of the firm and the firm is not liable for any act of the insolvent, done after the date on which the order of adjudication is made.

17.3. Decision in Garner vs. Murray Case

Justice Joyee held in the case of Garner vs. Murray that the loss arising due to the insolvency of a partner must be distinguished from an ordinary loss (including realization loss). Unless otherwise agreed, the decision in Garner vs. Murray requires –

i. That the solvent partners should bring in cash equal to their respective shares of the loss on realization;

ii. That the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.

In case of fixed capital system, capitals as per last Balance Sheet represent last agreed capitals. In case of fluctuating capital system, however, all necessary adjustments in respect of reserved, un-appropriated profits or losses (but not realization profit or loss), Drawings A/c., undisclosed liabilities and assets etc. must be made to get last agreed capitals. A partner who has nil or negative balance in his capital account before dissolution does not contribute anything to the loss arising as a result of insolvency of a partner.

17.4. Criticism of the Decision of Garner vs. Murray

The following criticism may be advocated against the decisions laid down in Garner vs. Murray principle:

(i) If any solvent partner has a debit balance in capital account, he must not bear the deficiency of the insolvent partner;

(ii) This principle does not apply if there are only two partners;

(iii) In spite of having a credit balance in capital account the solvent partner must bring cash equal to the amount of loss on realization which is immaterial and useless; and

If any solvent partner who possess more private asset but contributes less capital, he will naturally, as per Garner vs. Murray decision, bear less amount of deficiency of the insolvent partner than the other solvent partner who possess less private assets but contributes more capital to the firm. This is not justified.

17.5. Applicability in India

According to sub section (ii) of Sec 48(b) of the Indian Partnership Act, if a partner becomes insolvent or otherwise incapable of paying his share of the contribution, the solvent partners must share ratably the available assets. That is to say, the available assets will be distributed in proportion to their capitals.

Thus, under the Indian Partnership Act also the solvent partners are required to make good their share of the realization loss (i.e., capital deficiency). The total cash available after making good the solvent partners' share of capital deficiency shall be shared by the solvent partners in proportion to their capitals. As a result of this the ultimate debit balance of the insolvent partner's Capital A/c. is borne by the solvent partners in capital ratio.

The provision of the Indian Partnership Act in this respect are, thus, similar to the rules laid down by the decision in Garner vs. Murray.

When there is a specific provision in the Partnership Deed as to how the deficiency of an insolvent partner is to be borne by the solvent partners, such provision must be followed, because the provision of the Act will apply only when there is no specific agreement.

17.6. Illustrations

Illustration 1

A, B and C are in partnership sharing profit and losses equally and agreed to dissolve the firm on 30.06.2012.

On that date their Balance Sheet stood as follows:

Balance Sheet as on 30th June 2013

Liabilities		Amount	Asset	Amount
Capital A/c			Sundry Asset Profit & Loss	50,000
A	34,000		A/c Capital A/c	12,000
B	24,000	58,000	C	8,000
Creditors		12,000		
		70,000		70,000

The assets are realised at 50% of the book value. Realization expenses amounted to ` 5,000. C became insolvent and received ` 2,000 from his estates.

Close the book of the firm under (i) Fixed Capital Method and (ii) Fluctuating Capital Method applying Garner Vs. Murray principles.

Solution:

In the books of A,B& C

Realisation A/c

Particulars	Amount	Particulars	Amount
To Sundry Asset A/c	50,000	By Bank A/c	
`` Bank A/c Expense	5,000	Amount Realised	25,000
		`` Capital A/c	
		Loss on Realization	
		A 10,000	
		B 10,000	
		C 10,000	30,000
	55,000		55,000

Working:

(a) Under Fixed Capital Method

Deficiency of the insolvent partner Mr. C must be borne by the solvent partner A and B as per their last agreed capital given in the Balance Sheet i.e., 17:12.

(b) Under Fluctuating Capital Method

Deficiency of the insolvent partner Mr. C must be borne by the solvent partners A & B as the following adjusted capital which will be considered as the last agreed capital i.e., after adjusting the debit balance of Profit and Loss Account.

Particulars	A	B
Capital as per Balance Sheet	34,000	24,000
Less: Debit balance of P&L A/c (equally)	(-) 4,000	(-) 4,000
	30,000	20,000

Ratio = 3:2

Capital Account under Fixed Capital Method

Capital Account

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	---	---	8,000	By Balance b/d	34,000	24,000	---
`` Realisation A/c Loss				`` Bank A/c	---	---	2,000
`` Profit & Loss A/c	10,000	10,000	10,000	`` Bank A/c	10,000	10,000	---
Loss				`` A's Capital	---	---	11,724
`` C's Capital A/c	4,000	4,000	4,000	`` B's Capital	---	---	8,276
`` Bank A/c (bal. fig.)	11,724	8,276	---				
	18,276	11,724	---				
	44,000	34,000	22,000		44,000	34,000	22,000

Bank Account

Particulars	Amount	Particulars	Amount
To Balance b/d	25,000	By Realisation A/c Expenses	5,000
`` Capital A/c		`` Creditors	12,000
A 10,000		`` Capital A/c	
B 10,000		A	18,276
C 2,000	22,000	B	11,724
	47,000		47,000

Under Fluctuating Capital Method

Capital Account

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	---	---	8,000	By Balance b/d	34,000	24,000	---
`` Realisation A/c Loss	10,000	10,000	10,000	`` Bank A/c	10,000	10,000	---
`` Profit & Loss A/c Loss	4,000	4,000	4,000	`` Bank A/c	---	---	2,000
`` C's Capital A/c	12,000	8,000	---	`` A's Capital	---	---	12,000
`` Bank A/c (bal. fig.)	18,000	12,000	---	`` B's Capital	---	---	8,000
	44,000	34,000	22,000		44,000	34,000	22,000

Bank Account

Particulars	**Amount**	**Particulars**	**Amount**
To Realisation A/c	25,000	By Realisation A/c Expenses	
Assets realized		`` Creditors	5,000
`` Capital A/c		`` Capital A/c	12,000
A	10,000	A	18,000
B	10,000	B	12,000
C	2,000		
	47,000		47,000

Liabilities	**Amount**	**Amount**	**Assets**	**Amount**	**Amount**
Sundry Creditors		30,000	Cash at Bank		14,000
Capital A/c			Sundry Debtors	35,000	
Kay	70,000		Less: Provision for Bad Debts	5,000	30,000
Enn	30,000	1,00,000			
			Other Assets		51,000
			Capital A/c		
			Ell	20,000	
			Emm	15,000	35,000
		1,30,000			1,30,000

Illustration

Kay, Ell, Emm and Enn are partners in a firm sharing profits and losses in the ratio 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31st March 2013.

On 31st March, 2013, the firm was dissolved. The partnership agreement provides that the deficiency on an insolvent partner will be borne by the solvent partners in the ratio of capitals as they stand just before dissolution.

The following arrangements are agreed upon:

(a) Kay is to take over 60% of book debts at 70% and Enn is to take over the balance at 75%. Further, they are to be allowed ` 2,100 and ` 1,100, respectively, to cover future losses.

(b) Enn is to realized other assets and to pay-off the creditors. He is to receive 5% gross commission on the amounts finally payable to other partners but to bear expenses of realization. He reports the result of realization as follows:

Other assets realize a loss of 2% on net collection and pays off the creditors at a discount of 30%. Realization expenses amount to ` 3,000. Enn is declared insolvent and a dividend of 20% in a rupee is realized from his estate. Prepare Bank Account, Realisation Account, Capital Account and Deficiency Account.

Solution :

Balance Sheet In the books of Kay, Ell, Emm & Enn

Realization Account

Particulars		Amount	Particulars		Amount
	`		`		
To Sundry Asset :	35,000		By Provision for Bad Debts		5,000
Other Assets	51,000	86,000	`` Creditors		9,000
			`` Bank – Other assets realized		50,000
`` Capital A/c			`` Capital Accounts:		
			Kay	14,700	
Kay	2,100		Enn	10,500	25,200
Enn	1,100	3,200			
		89,200			89,200

Capital a/c

Particulars	KAY`	ELL`	EMM`	ENN`	Particulars	KAY`	ELL`	EMM`	ENN`
To Balance b/d	---	20,000	15,000	---	By Balance b/d				
`` Realisation Debtors taken	14,700	---	---	10,500	``Realisation Future loss	70,000	---	---	30,000
					`` Bank	2,100	---	---	1,100
``Deficiency A/c	11,200	---	---	4,800	`` Deficiency	---	4,000	---	---
					`` Capital	---	16,000	---	---
`` Capital A/c Enn	2,200	---	---	---	A/c (Kay)	---	---	---	2,200
					`` Bank	---	---	15,000	---
`` Bank A/c -- Final payment	44,000	---	---	18,000					
	72,100	20,000	15,000	33,300		72,100	20,000	15,000	33,300

Bank A/c

Particulars	Amount	Particulars	Amount
`		`	
To Balance b/d	14,000	By Creditors	21,000
`` Realisation – Assets realized	50,000	`` Capital Accounts:	
`` Capital A/c		Kay 44,000	
Ell 4,000		Enn 18,000	62,000
Emm 15,000	19,000		
	83,000		83,000

Deficiency a/c

Particulars	Amount	Particulars	Amount
To Capital A/c Ell	16,000	By Capital Accounts:	11,200
		Kay (7/10) Enn (3/10)	4,800
	16,000		16,000

Creditors a/c

Particulars	Amount`	Particulars	Amount`
To Bank - Payment	21,000	By Balance b/d	30,000
`` Realisation (Discount @ 30%)	9,000		
	30,000		30,000

Working Notes:

(i) There will be no entry for the realization expense.

(ii) Sundry Debtors taken over:

Kay-60% of ` 35,000 i.e., 21,000 at 70% which is ` 14,700

Enn-40% of ` 35,000 i.e., 14,000 at 75% which is ` 10,500.

(iii) Net Collection of Sundry Assets:

Sundry Assets	51,000
Less: Loss (51,000 x 2/102)	1,000
	50,000

(iv) Commission payable of Enn:

Gross amount payable to Key ` 46,200. So, Commission ` 46,200 x 5/105 = ` 2,200

(v) Since Emm has got a debt balance in capital account, he will not take part in deficiency account although he is solvent.

17.7. If all the Parties are Insolvent

Since all partners are insolvent, creditors cannot expect to be paid in full. In such a case Sundry Creditors should not be transferred to Realization Account. Cash in hand together with the amount realized on sale of assets and surplus from private estate of partners, if any, less expenses will be applied in making payment to the creditors. The balance of Creditors Account represents the deficiency to be borne by them which to be transferred to a Deficiency Account. The balance of Capital Accounts should also to be transferred to the Deficiency Account to close the books. Alternatively, the deficiency to be borne by the Creditors may be directly adjusted in between Creditors Account and Capital Accounts.

The following entries required to be passed :

(i) To pay-off the creditors

Creditors A/c	Dr.	(Total Creditors)
To Bank A/c		(Amount paid)
To Deficiency A/c		(Amount unpaid)

(ii) When deficiency is transferred

Deficiency A/c Dr.

To Partners' Capital A/c

Illustration 1.

Balance Sheet as at 30.10.2013

Liabilities	Amount	Asset	Amount
Capitals		Fixed Assets	1,00,000
P	5,000		
Q	3,000		
R	2,000	Cash	10,000
Bank Loan	60,000		
Sundry Creditors	40,000		
	1,10,000		**1,10,000**

All the partners were declared insolvent. Profit sharing ratio : 5 : 3 : 2. Assets realized `60,000. Prepare necessary ledger accounts to close the books of the firm.

Solution:

Realization A/c

Particulars	Amount `	Particulars	Amount `
To Fixed Assets	1,00,000	By Cash A/c (realisation)	60,000
		By Partners Capital A/cs (loss on realisation)	
		P: 20,000	
		Q: 12,000	
		R: 8,000	40,000
	1,00,000		**1,00,000**

Partner's capital Account

Particulars	P	Q	R	Particulars	P	Q	R
				By Balance b/d	5,000	3,000	2,000
To Realization A/c	20,000	12,000	8,000	By Deficiency A/c	15,000	9,000	6,000
	20,000	12,000	8,000		20,000	12,000	8,000

Deficiency Account

Particulars	Amount`	Particulars	Amount`
To Partners Capital A/cs:			
P	15,000	By Bank Loan A/c	18,000
Q	9,000	By Creditors	12,000
R	6,000		
	30,000		30,000

Ban Loan Account

Particulars	Amount	Particulars	Amount
To Deficiency A/c	18,000	By Balance b/d	60,000
To Cash A/c	42,000		
	60,000		60,000

Creditors A/C

Particulars	Amount	Particulars	Amount
To Deficiency A/c	12,000	By Balance b/d	40,000
To Cash A/c	28,000		
	40,000		40,000

Cash A/C

Particulars	Amount	Particulars	Amount
To Balance b/d	10,000	By Bank Loan A/c	42,000
To Realisation A/c	60,000	By Creditors A/c	28,000
	70,000		70,000

Note :

The total deficiency of the partners i.e. the firm is `30,000. This is shared between the external liabilities in the ratio of their amount outstanding `60,000 : `40,000 = 3 : 2

Bank Loan A/c	Dr.	18,000
Creditors A/c	Dr.	12,000
To Deficiency A/c		30,000

17.8. Return of Premium to a Partner on Dissolution before Expiry of Term

Conditions:

i. A partner was admitted in the partnership firm for a fixed term period,

ii. Such partner had paid a premium for goodwill at the time of admission.

iii. The partnership firm has dissolved.

Exceptions: The partner will not be entitled to any claim under any of the following conditions :

i. the firm is dissolved due to death of a partner

ii. the dissolution is due to the misconduct of the partner claiming refund

iii. dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

Amount of Refund: the amount to be repaid will be determined having regard to the terms upon which the admission was made and to the length of the period agreed upon and the period that has expired.

Liability of other partners: the amount of refund payable shall be borne by the other partners in their profit sharing ratio.

Illustration 1.

X was admitted into partnership for 5 years, for which he paid a premium of `1,20,000. After 39 months, the partnership firm was dissolved due to misconduct of Mr.Z , another partner of the firm. Y, being the third partner. Profit Sharing Ratio : Y : Z : X = 5 : 3 : 2.

Solution:

X is entitled to claim the refund of premium paid at the time of admission, since the admission was for a fixed term period and the firm is getting dissolved due to a misconduct of Mr.Z, another partner of the firm.

The amount of refund is

= (Total Premium Paid × Unexpired term of the partnership)/Total term of the partnership

= 1,20,000 × 21/60 = `42,000

This shall be shared by the other partners Y and Z in their profit sharing ratio 3 : 2.

Y's Capital A/c	Dr.	25,200
Z's Capital A/c	Dr.	16,800
To X's Capital A/c		42,000

(Being premium paid during admission now refunded to X after adjusting capitals of other partners)

Let Us Sum Up

In this unit you have learned about the following:

Where under a contract between the partners the firm is not dissolved by the adjudication of a partner as an insolvent, the estate of a partner so adjudicated is not liable for any act of the firm and the firm is not liable for any act of the insolvent, done after the date on which the order of adjudication is made.

When there is a specific provision in the Partnership Deed as to how the deficiency of an insolvent partner is to be borne by the solvent partners, such provision must be followed, because the provision of the Act will apply only when there is no specific agreement.

Check Your Process

1. Define solvent partners.

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____

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2. Explain Decision in Garner vs. Murray Case

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Glossary

Fluctuating Capital: Fluctuating capital refers to changes in the capital balance of a business entity over time. It can occur due to various factors such as profits, losses, investments, and withdrawals. In a sole proprietorship, the owner's capital balance may fluctuate due to changes in profits or losses, investments made in the business, or withdrawals

	taken from the business. In a partnership, the capital balances of each partner may also fluctuate due to changes in profits or losses, investments, or withdrawals.
Amount of Refund:	The amount to be repaid will be determined having regard to the terms upon which the admission was made and to the length of the period agreed upon and the period that has expired.
Liability of other Partners:	The amount of refund payable shall be borne by the other partners in their profit sharing ratio.

Answer To Check Your Process

1. Solvent partners refer to partners of a business entity who have sufficient assets or resources to meet their financial obligations and pay their debts when they become due. In other words, they are financially stable and have a positive net worth.

2. Decision in Garner vs. Murray Case

   Justice Joyee held in the case of Garner vs. Murray that the loss arising due to the insolvency of a partner must be distinguished from an ordinary loss (including realization loss). Unless otherwise agreed, the decision in Garner vs. Murray requires:-

1. That the solvent partners should bring in cash equal to their respective shares of the loss on

   a. realization;

2. That the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.

   In case of fixed capital system, capitals as per last Balance Sheet represent last agreed capitals. In case of fluctuating capital system, however, all necessary adjustments in respect of reserved, un-appropriated profits or losses, Drawings A/c., undisclosed liabilities and assets etc. must be made to get last agreed capitals.

   A partner who has nil or negative balance in his capital account before dissolution does not contribute anything to the loss arising as a result of insolvency of a partner.

Suggested Readings

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Unit-18

Piece Meal Distribution

STRUCTURE

Overview

A piecemeal distribution is a term used to describe the gradual distribution of assets from a company or other business entity to its owners or shareholders. It is called "piecemeal" because the distribution is made in small increments rather than all at once.

In this unit, the concept of piece meal distribution has been clearly explained.

Objectives

After studying this unit, students should be able to

- Explain piecemeal distribution
- Understand preferential creditors and
- Able to prepare profit sharing ratio

18.1. Introduction

Till now the discussion was based on the implicit assumption that all assets were realized and settlement was done on the same date. In fact, on the dissolution of a partnership, assets are sometimes realized gradually over a period of time. In such a case it may be agreed that different parties are to be paid in order of preference as and when assets are realized without unnecessarily waiting for the final realization of all the assets.

The order of the payment will be as follows :

i. Realisation expenses

ii. For provision for expenses that are to be made

iii. Preferential creditors (say, Income Tax or any payment made to the Government)

iv. Secured creditors – upto the amount realized from the disposal of assets by which they are secured and for the balance, if any, to be paid to unsecured creditors

v. Unsecured creditors – in proportion to the amount of debts, if more than one creditor

vi. Partners' loan – if there is more than one partner – in that case, in proportion to the amount of loan

vii. Partners' capital – the order of payment may be made by any one of the following two methods:

   (a) Surplus Capital Method/ Proportionate Capital Method/ Highest Relative Capital Method

   (b) Maximum Possible Loss Method

18.2. Meaning

Piecemeal distribution of cash is concerned with systematically distribution of cash at the time of dissolution of Partnership. Dissolution of Partnership in it was assumed that the entire dissolution process is completed in a day but it is not the truth, the dissolution of a firm is a lengthy process.

18.3. Importance

(a) Assets will be realised gradually and hence whenever cash is received, cash will be debited and Realisation Account credited.

(b) The statement of piecemeal distribution will show how cash is be utilised.

18.4. Surplus Capital Method or Proportionate Capital Method or Highest Relative Capital Method

Under this method, actual capital of the partners on the date of dissolution is compared with their proportionate capital (determined on the basis of minimum capital per unit of profit) to determine surplus capital of the partners. Surplus capital is paid first and any balance left thereafter is distributed in the profit sharing ratio. This ensures that final balances of partners show their share of realisation profit/ loss and thus, no settlement need to be dome at that point of time.

18.5. Illustrations

Illustration 1.

Capitals (as on the date of dissolution):

P = ` 55,000; Q = ` 37,500; R = ` 31,500; Profit-Sharing Ratio = 5 : 3 : 2.

Statement showing the Highest Relative Capital or Absolute Surplus :

Particulars	P	Q	R
1. Actual Capital	55,000	37,500	31,500
2. Profit Sharing Ratio (PSR)	5	3	2
3. Actual Capital ÷ PSR = Proportionate Capital	11,000	12,500	15,750
4. Consider the smallest of proportionate capital as per (3) as base capital ×PSR [i.e. 11,000 × PSR]	55,000	33,000	22,000
5. Surplus Capital [(1) — (4)]	—	4,500	9,500
6. PSR	—	3	2
7. Surplus Capital (as per 5) ÷ PSR	—	1,500	4,750
8. Consider the smallest of Proportionate capital as per (7)	—	4,500	3,000
9. Absolute surplus [5 - 8]	—	—	6,500

This means that R will be paid ` 6,500 to clear off his Absolute Surplus Capital.

Illustration 2.

Capitals : X = ` 15,000 ; Y = ` 18,000 ; Z = ` 9,000

Profit Sharing Ratio = 2 : 2 : 1

Statement showing the Highest Relative Capital

Particulars	X	Y	Z
1. Actual Capital	15,000	18,000	9,000
2. PSR	2	2	1
3. Actual Capital ÷ PSR = Prop. Capital Consider the smallest of Proportionate	7,500	9,000	9,000
4. Capital as Base × PSR [i.e. 7,500×PSR]	15,000	15,000	7,500
5. Surplus Capital [1—4]	NIL	3,000	1,500

Since the Surplus Capitals for Y & Z are in their profit-sharing ratio, no further steps are required.

Illustration 3.

Partners M, N and P have called upon you to assist them in winding up the affairs of their partnership on 30th June, 2013. Their Balance Sheet as on that date is given below:

Liabilities	Amount	Assets	Amount
Sundry Creditors	17,000	Cash at Bank	6,500
Capital Accounts :		Sundry Debtors	22,000
M	67,000	Stock in trade	13,500
N	45,000	Plant and Equipment	99,000
P	31,500	Loan : M	12,000
		Loan : N	7,500
	1,60,500		1,60,500

(a) The partners share profits and losses in the ratio of 5 : 3 : 2.

(b) Cash is distributed to the partners at the end of each month.

(c) A summary of liquidation transaction are as follows :

July:

` 16,000 — collected from Debtors; balance is irrecoverable.

` 10,000 — received from sale of entire stock.

` 1,000 — liquidation expenses paid.

` 8,000 — cash retained in the business at the end of the month.

August:

`1,500 — liquidation expenses paid; as part of the payment of his capital, P accepted an equipment for `10,000 (book value `4,000).

` 2,500 — cash retained in the business at the end of the month.

September:

`75,000 — received on sale of remaining plant and equipment.

`1,000 — liquidation expenses paid. No cash is retained in the business.

Particulars	Creditors	Capital		
		M	N	P
A. Balance Due	17,000	55,000	37,500	31,500
B. Amount distributed as on 31st July	17,000	—	—	6,500
C. Balance Due (A – B)	—	55,000	37,500	25,000
D. Cash paid to 'N' and Equipment given to P on 31st August.		—	4,000	10,000
E. Balance due (C – D)		55,000	33,500	15,000
F. Amount paid to partners on 30th September		41,500	25,400	9,600
G. Loss on Realisation (Unpaid Balance) [E – F]		13,500	8,100	5,400

Required : Prepare a Schedule of cash payments as on 30th September, showing how the cash was distributed.

Solution :

Statement showing the Distribution of Cash (According to Proportionate Capital Method)

Working Notes:

a. Statement showing the Calculation of Highest Relative Capital

Particulars	M	N	P
A Balance of Capital Accounts B Less : Loan	67,000	45,000	31,500
C Actual Capital (A – B) D Profit sharing ratio	12,000	7,500	—
E Actual Capital ÷ Profit sharing ratio	55,000	37,500	31,500
F Proportionate Capitals taking M's Capital as Base Capital G Excess of Actual Capitals over	5	3	2
Proportionate Capitals (C - F)	11,000	12,500	15,750
H Profit Sharing Ratio	55,000	33,000	22,000
I Surplus Capital ÷ Profit Sharing Ratio	—	4,500	9,500
J Revised Proportionate Capitaltaking N's Capital as	—	3	2
Base Capital	—	1,500	4,750
K Excess of Surplus Capital over Revised	—	4,500	3,000
Proportionate Capitals (G - J)		—	6,500

Scheme of distribution of available cash : First instalment up to ` 6,500 will be paid to P. Next instalment up to ` 7,500 will be distribution between N and P in the ratio of 3 : 2. Balance realisation will be distributed among M, N and P in the ratio of 5 : 3 : 2.

b. Statement showing the Calculation of Cash Available for Distribution

Particulars	July	August	September
A Opening Balance	6,500	8,000	2,500
B Add : Net amount realised	25,000	(1,500)	74,000
(Gross amount — Expenses)			
C Less : Closing Balance	8,000	2,500	—
D Amount available for distribution (A + B – C)	23,500	4,000	76,500

c. Statement showing the Manner of Distribution of amount available in August and September

Particulars	July	August	September
First ` 7,500	—	4,500	3,000
Balance ` 83,000	41,500	24,900	16,600
(Cash and Equipment)	41,500	29,400	19,600
Less : Actual Distribution in August	--	4,000	10,000
Manner of Distribution in September	41,500	25,400	9,600

Illustration 4.

The firm of Blue Collars presented you with the following Balance Sheet drawn as on 31st March 2013:

Liabilities		Amount	Assets	Amount
Sundry Creditors		37,000	Cash in hand	3,000
Capital Accounts :			Sundry Debtors	34,000
L	40,000		Stock in trade	39,000
K	30,000		Plant and Machinery	51,000
J	27,000	97,000	Current Accounts :	
			K 4,000	
			J 3,000	7,000
		1,34,000		1,34,000

Partners shared profits and losses in the ratio of 4 : 3 : 3. Due to difference among the partners, it was decided to wind up the firm, realise the assets and distribute cash among the partners at the end of each month.

The following realisations were made :

(i) May — ` 15,000 from debtors and ` 20,000 by sale of stock. Expenses on realisation were ` 500.

(ii) June — Balance of debtors realised ` 10,000. Balance of stock fetched ` 24,000.

(iii) August — Part of machinery was sold for ` 18,000. Expenses incidental to sale were ` 600.

(iv) September — Part of machinery valued in the books at ` 5,000 was taken by K, in part discharge at an agreed value of ` 10,000. Balance of machinery was sold for ` 30,000 (net).

(v) Partners decided to keep a minimum cash balance of ` 2,000 in the first 3 months and ` 1,000 thereafter.

Required: Show how the amounts due to partners will be settled.

Solution:

(i) Statement showing the Distribution of Cash

(According to Proportionate Capital Method)

Particulars	Creditors	Capital		
		L	K	J
A Amount due	37,000	40,000	26,000	24,000
B Amount distribution as on 31st May C	35,500	—	—	—
Balance Due (A - B)	1,500	40,000	26,000	24,000
D Amount Distributed as on 30th June				
First ` 1,500	1,500			
Next ` 5,333	—	5,333	—	—
Next ` 4,667	—	2,667	2,000	—
Balance ` 22,500	—	9,000	6,750	6,750
E Balance due (C - D)		23,000	17,250	17,250
F Amount Distributed as on 31st August G		7,360	5,520	5,520
Balance Due (E - F)		15,640	11,730	11,730
H Add : Profit on realisation		760	570	570
(` 41,000 – ` 39,100)				
I Amount Distributed (including Machinery taken by K) as on 30th September.		16,400	12,300*	12,300
* Includes value of Machinery				
` 10,000 and Cash ` 2,300				

Working Notes:

(i) Assumption: As the firm is dissolved due to difference among the partners, all partners are presumed to be solvent and the problem has been worked out on the basis of the highest relative capital.

ii. Statement showing the Calculation of Highest Relative Capitals

Particulars	L	K	J
A Actual Capitals	40,000	26,000	24,000
B Profit sharing ratio	4	3	3
C Actual Capitals ÷ Profit ratio	10,000	8,667	8,000
D Proportionate Capitals taking J's Capital as Base Capital	32,000	24,000	24,000
E Surplus Capital of L and K (A - D)	8,000	2,000	—
F Profit sharing ratio	4	3	_
G Surplus Capital ÷ Profit sharing ratio	2,000	667	_
H Revised Proportionate Capital of L and J I Revised	2,667	2,000	—
Surplus Capital of L (E - H)	5,333	—	—

While distributing surplus among partners, 1st instalment up to ` 5,333 will be paid to L, next instalment up to ` 4,667 will be distributed between L and K in the ratio of 4 : 3 and the Balance among L, K and J in the ratio of 4 : 3 : 3.

iii. Statement showing the Calculation of Cash available each month

Particulars	May	June	August	September
A Opening Balance	3,000	2,000	2,000	1,000
B Add : Amount realised Less Expenses	34,500	34,000	17,400	30,000
C Less : Closing blance	2,000	2,000	1,000	—
D Total Cash available for Distribution (A+B–C)	35,500	34,000	18,400	31,000

iv. Realisation Account

Particulars	Amount	Particulars	Amount
To Sundry Debtors	34,000	By Sundry Creditors	37,000
To Stock in trade	39,000	By Cash/Bank	1,17,000
To Plant and Machinery	51,000	By L (Assets taken over)	10,000
To Cash/Bank :			
Creditors	37,000		
Expenses	1,100		
To Profit transferred to Capital A/c	1,900		
	1,64,000		1,64,000

Illustration 5.

A partnership firm was dissolved on 30th June, 2013. Its Balance Sheet on the date of dissolution was as follows:

Liabilities	Amount	Assets	Amount
Capitals :		Cash	5,400
Atrik	38,000	Sundry Assets	94,600
Mohit	24,000		
Rupa	18,000		
Loan A/c — Mohit	5,000		
Sundry Creditors	15,000		
	1,00,000		1,00,000

The assets were realised in instalments and the payments were made on the proportionate capital basis.

Creditors were paid ` 14,500 in full settlement of their account. Expenses of realisation were estimated to be ` 2,700 but actual amount spent on this account was ` 2,000.

This amount was paid on 15th September. Draw up a Memorandum of distribution of Cash, which was realised as follows :

On 5th July ` 12,600

On 30th August ` 30,000

On 15th September ` 40,000

The partners shared profits and losses in the ratio of 2 : 2 : 1. Give working notes.

Solution :

Statement Showing the Distribution of Cash (According to Proportionate Capital Method)

	Particulars	Creditors	Mohit's Loan	Atrik	Mohit	Rupa
A	Balance Due	15,000	5,000	38,000	24,000	18,000
B	Cash paid (` 5,400 – ` 2,700)	2,700	—	—	—	—
C	Balance unpaid (A - B)	12,300	5,000	38,000	24,000	18,000
D	1st installment of ` 12,600	11,800	8 0 0	—	—	—
E	Balance unpaid (C - D)	5 0 0	4,200	38,000	24,000	18,000
F	Less : Written-off	5 0 0				
G	2nd installment of ` 30,000		4,200	16,320	2,320	7,160
H	Balance unpaid (E-F-G)			21,680	21,680	10,840

I	3rd installment (` 40,000 + ` 700)			16,280	16,280	8,140
J	Unpaid Balance					
	(H-I) = Loss on Realisation			5,400	5,400	2,700

Working Notes:

(i) Statement showing the Calculation of Highest Relative Capitals

	Particulars	Atrik	Mohit	Rupa
A	Actual Capitals	38,000	24,000	18,000
B	Profit-sharing ratio	2	2	1
C	Actual Capitals ÷ Profit Sharing Ratio	19,000	12,000	18,000
D	Proportionate Capitals taking Mohit's Capital as Base	24,000	24,000	12,000
E	Capital Surplus Capital [A-D]	14,000	Nil	6,000
F	Surplus Capital ÷ Profit Sharing Ratio	7,000	—	6,000
G	Revised Proportionate capitals taking Rupa's Capital as the basis	12,000	—	6,000
H	Revised Surplus Capital (E - G)	2,000	—	—

ii) Distribution of Second Instalment of ` 30,000

Particulars		Mohit's Loan	Atrik	Mohit	Rupa
First	` 4,200	4,200	— 2,000	—	—
Next	` 2,000 (Absolute Surplus)		12,000	—	—
Next	` 18,000 (Balance of Surplus)		2,320	—	6,000
Balance	` 5,800 (2 : 2 : 1)		16,320	2,320	1,160
Total	30,000			2,320	7,160
		4,200			

Illustration 6.

East, South and North are in partnership sharing profits and losses in the ratio 3 : 2 : 1 respectively.

They decide to dissolve the business on 31st July, 2013 on which date their Balance Sheet was as follows:

Liabilities	Amount	Assets	Amount
Capital Accounts :		Land and Buildings	30,810
East	38,700	Motor car	5,160

South	10,680	Investment	1,080
North	11,100	Stock	19,530
Loan account : North	3,000	Debtors	11,280
Creditors	10,320	Cash	5,940
	73,800		73,800

The assets were realised piecemeal as follows and it was agreed that cash should be distributed as and when realised :

14th	August	10,380
20th	September	27,900
16th	October	3,600
North took over investment as follows at a value of:-		
15th	November	1,260
18th	November	19,200

Dissolution expenses were originally provided for an estimated amount of ` 2,700, but actual amount spent on 25th October was ` 1,920.

The creditors were settled for ` 10,080.

Required : Prepare a statement showing distribution of cash amongst the partners, according to Proportionate Capital Method.

Solution :

Statement Showing the Distribution of Cash (According to Proportionate Capital Method)

	Particualr	Creditors	Loan	East	South	North
A	Balance Due	10,320	3,000	38,700	10,680	11,100
B	Paid to Creditors	3,240	—	—	—	—
	[` 5,940 – ` 2,700]	7,080	3,000	38,700	10,680	11,100
C	Balance Due (A - B)	6,840	3,000	540		
D	Amount paid on 14th August	240	—	38,160	10,680	11,100
E	Less : Written off	(240)	—	—	—	—
F	Balances Due (D - E)			38,160	10,680	11,100
G	Amount paid on 20th					
	September			4,860	—	—
	(i) First 4,860 (i.e.` 5,400 –			33,300	10,680	11,100
	`540)					
	(ii) Balance ` 23,040			17,280	—	5,760
H	Balance Due (F - G)			16,020	10,680	5,340
I	Amount paid on 16th October J			1,800	1,200	600
	Balance Due (H-I)			14,220	9,480	4,740
K	Amount paid on 25th October			390	260	130
	(being excess over estimated					
	expenses ` 780)					
L	Balance due (J - K)			13,830	9,220	4,610
M	Cash brought in by North N			630	420	210
	Balance Due (L-M)					
O	Amount paid on 18th			13,200	8,800	4,400
	November			9,600	6,400	3,200
P	Balance unpaid (N-O)			3,600	2,400	1,200

Working Note :

Statement Showing the Calculation of Highest Relative Capitals

	Particulars	East	South	North
A	Actual Capitals	38,700	10,680	11,100
B	Profit Sharing Ratio	3	2	1
C	Actual Capital ÷ Profit Sharing Ratio	12,900	5,340	11,100

D	Proportionate capitals taking South's Capital as Base Capital (being the smallest) × PSR	16,020	10,680	5,340
E	Surplus capital (i.e. Excess of Actual Capitals over proportionate capital) [A-D]	22,680	—	5,760
F	Profit Sharing Ratio	3	—	1
G	Surplus Capital ÷ Profit Sharing Ratio	7,560	—	5,760
H	Revised Proportionate Capitals taking North's Capital as Base Capital	17,280	—	5,760
I	Revised Surplus Capital [E-H]	5,400	—	—
J	Distribution Sequence			
	First ` 5,400 [To East]	5,400	—	—
	Next ` 23,040 [To East & North in the ratio of 3 : 1]	17,280	—	5,760
	Balance ` 19,200 [To East, South & North in the ratio of 3 : 2 : 1]	9,600	6,400	3,200

Let Us Sum Up

In this unit you have learned about the following:

Piecemeal distribution of cash is concerned with systematically distribution of cash at the time of dissolution of Partnership. Dissolution of Partnership in it was assumed that the entire dissolution process is completed in a day but it is not the truth, the dissolution of a firm is a lengthy process.

Check Your Progress

True/False

1. Piecemeal distribution of cash is concerned with systematically distribution of cash at the time of dissolution of Partnership.
2. Assets will be realised gradually and hence whenever cash is received, cash will be debited and Realisation Account credited.
3. A piecemeal distribution is a term used to describe the gradual distribution of assets from a company or other business entity to its owners or shareholders.

Glossary

Piecemeal Distribution: In fact, on the dissolution of a partnership, assets are sometimes realized gradually over a period of time. In such a case it may be agreed that different parties are to be paid in order of preference as and when assets are realized without unnecessarily waiting for the final realization of all the assets.

Surplus Capital Method : Under this method, actual capital of the partners on the date of dissolution is compared with their proportionate capital to determine surplus capital of the partners.

Answers to check your progress

1.True

2.True

3.True

Suggested Readings

1. Hanif and A Mukherjee, "Financial Accounting- II", McGraw Hill, 2018
2. P.C. Tulsian, "Financial Accounting", 2002
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1. Anne Beatty, Scott Liao, Financial accounting in the banking industry: A review of the empirical literature, Journal of Accounting and Economics, 2014
2. Philippe J.C. Lassou, Trevor Hopper, Collins Ntim, Accounting and development in Africa, https://doi.org/10.1016/j.cpa.2020.102280, 2021.
3. Charl de Villiers, Pei-Chi Kelly Hsiao, A review of accounting research in Australasia, 2018.

Web links:

1. https://youtu.be/vZyxxj0QizM
2. https://youtu.be/F-p8g1TsSGw
3. https://youtu.be/aPzAtdcSwx8
4. https://youtu.be/mUHy33I9s8c

Model End Semester Examination Question Paper

Bachelor of Commerce (B.Com)

Course Code: **DCBGL-21** / Course Title: **Financial Accounting-II**

Max. Marks: 70 **Time: 3 hours**

PART – A (5x2 =10 Marks)

Answer any FIVE questions out of EIGHT questions

[All questions carry equal marks]

(1).What do you mean by branch accounts

(2).Describe the salient features of accounting system

(3).Describe the objective of departmental Accounting

(4).Write short notes on standard cost

(5).Who is hire vendor?

(6).What do you mean by Instalment system?

(7).What do you mean by Repossession

(8).What is partnership deed?

PART – B (4X5=20 Marks)

Answer any FOUR questions out of SEVEN questions

[All questions carry equal marks]

(9).The following information relates to Madurai branch.

particulars	Rs	Rs
Stock on 1.1.94		11,200
Branch debtors on 1.1.94		6,300
Goods sent to Branch		51,000
Cash sent to Branch for:		
Rent	1,500	
Salaries	3,000	
Petty Cash	500	5,000
Sales at branch		
Cash	25,000	
Credit	39,000	64,000
Cash received from Debtors		41,200
Stock on 31.12.94		13,600

Prepare Branch account for the year 1994

(10).Buckingham Bros, Bombay have a branch at Nagpur. They send goods at cost totheir branch at Nagpur. However, direct purchases are also made by the branch for which payments are made at head office. All the daily collections are transferred from the branch to the head office.

From the following, prepare Nagpur branch account in the books of head office by Debtors method:

Particulars	Amount	Particulars	Amount
Opening balance (1-1-2011) Imprest Cash	2,000	Bad Debts	1,000
Sundry Debtors	25,000	Discount to Customers	2,000
Stock: Transferred from H.O.	24,000	Remittances to H.O.	
Direct Purchases	16,000	(recd. by H.O.)	1,65,000
Cash Sales	45,000	remittances to H.O.	
Credit Sales	1,30,000	(not recd. by H.O. so far)	5,000
Direct Purchases	45,000	Branch Exp. directly paidby H.O.	30,000
Returns from Customers	3,000	Closing Balance (31-12-2011)	
Goods sent to branch from H.O.	60,000	Stock: Direct Purchase	10,000
Transfer from H.O. for Petty	4,000	Transfer from H.O.	15,000
Cash expenses		Debtors	?
		Imprest Cash	?
		Petty Cash expenses	4,000

(11).Ring Bell Ltd. Delhi has a Branch at Bombay where a separate set of books is used.The following is the trial balance extracted on 31st December, 2011.

Head Office Trial Balance

Particulars	Rs.	Rs
Share Capital (Authorised: 10,000 Equity Shares 100 each):		
Issued: 8,000 Equity Shares		8,00,000
Profit & Loss Account - 1-1-2011		25,310
General Reserve		1,00,000
Fixed Assets	5,30,000	
Stock	2,22,470	
Debtors and Creditors	50,500	21,900
Profit for 2011		52,200
Cash Balance	62,730	
Branch Current Account	1,33,710	
	9,99,410	9,99,410

Branch Trial Balance

Particulars	Rs.	Rs
Fixed Assets	95,000	
Profit for 2011		31,700
Stock	50,460	
Debtors and Creditors	19,100	10,400
Cash Balance	6,550	
Head Office Current Account		1,29,010
	1,71,110	1,71,110

The difference between the balances of the Current Account in the two sets of booksis accounted for as follows:

(a).Cash remitted by the Branch on 31st December, 2011, but received by the Head Office on 1st January 2012 - ` 3,000.

(b).Stock stolen in transit from Head Office and charged to Branch by the Head Office, but not credited to Head Office in the Branch books as the Branch Manager declined to admit any liability (not covered by insurance) - ` 1,700.

Give the Branch Current Account in Head Office books after incorporating Branch TrialBalance through journal

(12).Explain briefly Non- Integral Foreign Operation

(13).Z Ltd. has three departments and submits the following information for the year endingon 31st March, 2011:

Particulars	A	B	C	Total (Rs)
Purchases (units)	6,000	12,000	14,400	
Purchases (Amount)				6,00,000
Sales (Units)	6,120	11,520	14,976	
Selling Price (per unit) `	40	45	50	
Closing Stock (Units)	600	960	36	

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

(14). X Transport Ltd. purchased from Delhi Motors 3 Tempos costing 50,000 each onthe hire purchase system on 1-1-2011. Payment was to be made 30,000 down and the remainder in 3 equal annual instalments payable on 31-12-2011, 31-12-2012 and 31-12-2013 together with interest @ 9%. X Transport Ltd. write off depreciation at the rate of 20% on the diminishing balance. It paid the instalment due at the end of the first year i.e. 31-12-2011 but could not pay the next on 31-12-2012. Delhi Motors agreed to leave one Tempo with the purchaser on 1-1-2013 adjusting the value of the other 2 Tempos against the amount due on 31-12-2012. The Tempos were valued on the basis of 30% depreciation annually. Show the necessary accounts in the books of X Transport Ltd. for the years 2011,2012 and 2013.

(15).Varun sells goods on hire purchase basis also. He fixes hire purchase price by adding 50% to the cost of the goods to him. The following are the figures relating to his hire purchase business for the year 2011-2012:

	Rs.
Balance of Hire Purchase Stock Account as on 1st April, 2011	84,000
Balance of Hire Purchase Debtors Account As on 1st April, 2011	2,100
Selling price of goods sold on hire purchase basis during the year	6,34,200
Cash received from customers during the year	6,46,800
Total amount of instalments that fell due during the year	6,48,900

One customer to whom goods had been sold for Rs. 8,400 paid only 5 instalments of Rs. 700 each. On his failure to pay the monthly instalment of Rs. 700 due on 4th March, 2012 the goods were repossessed on 27th March, 2012 after due legal notice.

Prepare ledger accounts on Stock Debtors System for the year ended 31st March 2012

PART - C (10 Marks) 4X10= 40 Marks

Answer any FOUR questions out of SEVEN questions

[All questions carry equal marks]

(16).A and B started a business on 1st January 2005, contributing Rs. 50,000 by A and Rs. 40,000 by B. On 30th June, 2005 B made a further contribution of Rs. 10,000 towards his capital. Drawings during the year come to Rs. 4.000 by A and Rs. 5,000 by B. 6% interest is to be charged on capitals and no interest is to be charged on drawings. B is to be allowed a salary of Rs. 500 p.m. The profit for the year comes to Rs. 32,000 before charging salary and interest on capitals. Show the Profit and Loss Appropriation Account and the partner's counts under fixed capital method and Fluctuating Capital Method.

(17).X, Y and Z were in partnership sharing profits and losses in the ratio 3 : 2 : 1. Their Balance Sheet stood as under:

Balance Sheet as at 1.4.2012

Liabilities	Amount	Assets	Amount
Capital		Fixed Assets	80,000
X 40,000		Machinery	15,000
Y 30,000		Replacement	
Z 20,000	90,000		
General Reserve	12,000	Investment:	10,000
Machinery	16,000	Investment (MV `	33,000
Replacement Fund	15,000	7,000)	
Investment	5,000	Current Asset	
Fluctuation Fund			
Current Liabilities			
	1,38,000		**1,38,000**

Show the entries for accumulated profits/reserves assuming that Mr. T is admitted as partner for $1/5^{th}$ share.

(18). X, Y and Z are partners sharing profits and losses in the ratio of 2 : 1 : 1. They took out a joint life policy of ` 1,20,000 on 1.1.2009, for the purpose of providing fund for repayment of their share of capital and goodwill in the event of death. The annual premium of ` 5,000 was payable on 1st February every year and last premium was paid on 1st February, 2012. Y died on 10th March, 2012 and policy money was received on 30th April 2012. The surrender value of the policy as on 31st December each year were: 2009 - Nil; 2010- ` 1,000; 2011- ` 1,600.

Show the necessary accounts and Balance Sheet assuming :

(a).that the insurance premium is charged every year to the Profit and Loss Account of the firm as business expenses;

(b).that the insurance premium is debited to Joint Life Policy Account but an adjustment is made through the Profit and Loss Account each year to bring the policy to its surrender value; and that a sum equal to the annual insurance premium is charged to Profit and Loss Appropriation Account each year and credited to Joint Life Policy Reserve Account through which the adjustment is made to bring the policy to its surrender value.

(19).Cloud, Storm and Rain were partners in a firm sharing profits and losses in the ratio of 5:3:2. Due to difference in opinion, they decided to dissolve the partnership with effect from 1st April, 2013 on which date the firm's position was as under:

Liabilities	Amount	Assets	Amount
Capital Accounts:		Plant and Machinery	80,000
Cloud	60,000	Furniture & Fixtures	45,000
Storm	40,000	Motor car	25,000
Rain	30,000	Stock in Trade	30,000
Current Accounts:		Sundry Debtors	71,000
Cloud	8,000	Cash at bank	14,000
Storm	10,000	Current Account:	
Sundry Creditors	1,20,000	Rain	3,000
	2,68,000		2,68,000

The following information is given:

(i).Plant costing ` 40,000 was taken over by Cloud at an agreed valuation of ` 45,000 and the remaining machineries realised ` 50,000.

(ii).Furniture & fixture realised ` 40,000.

(iii).Motor car was taken over by storm for ` 30,000.

(iv).Sundry Debtors included a Bad Debt for ` 1,200 and the rest portion was realised subject to a cash discount of 10%.

(v).Stock worth ` 5,000 was taken over by rain for ` 5,200 and the rest realised at 20% above their book value.

(vi).A creditor for ` 2,000 was untraceable and other creditors accepted payment allowing 15% discount. Realisation expenses amounted to ` 5,000.

You are required to show the Realisation Accounts and the Capital Accounts of the partners on dissolution showing final payment to them.

(20).From the following figures prepare departmental Trading and Profit and Loss Accounts for the year ended 31st March. 2012:

	Cloth Department Rs.	Readymade Clothes Rs.
Opening Stock on 1st April, 2011	3,00,000	50,000
Purchases	20,00,000	15,000
Sales	22,00,000	4,50,000
Transfer to Readymade Clothes	3,00,000	---
Department Expenses – Manufacturing		60,000
Selling	20,000	6,000
Stock on 31st March, 2012	2,00,000	60,000

The stock in the readymade clothes department may be considered as consisting of 75% cloth and 25% other expenses. The Cloth Department earned gross profit at the rate of 15% in 2010-11. General Expenses of the business as a whole came to Rs 1,10,000.

(21).A firm acquired two tractors under hire purchase agreements, details of which wereas follows:

Date of Purchase	**Tractor A1st April, 2021-Rs**	**Tractor B1st Oct., 2021- Rs**
Cash price	14,000	19,000

Both agreements provided for payment to be made in twenty-four monthly instalments (of ` 600 each for Tractor A and ` 800 each for Tractor B), commencingon the last day of the month following purchase, all instalments being paid on due dates.

On 30th June, 20X2, Tractor B was completely destroyed by fire. In full settlement,on 10th July, 20X2 an insurance company paid ` 15,000 under a comprehensive policy. Any balance on the hire purchase company's account in respect of these transactions was to be written off.

The firm prepared accounts annually to 31st December and provided depreciation on tractors on a straight-line basis at a rate of 20 per cent per annum rounded offto nearest ten rupees, apportioned as from the date of purchase and up to the dateof disposal.

You are required to record these transactions in the following accounts, carrying down the balances on 31st December, 20X1 and 31st December, 20X2:

(a).Tractors on hire purchase.
(b).Provision for depreciation of tractors.
(c).Disposal of tractors.

(22).Home Comforts Ltd. commenced business on April 1, 2011. The business is to sell and refrigerators geysers both for cash and on hire-purchase basis.

	Geysers	**Refrigerators**
	Rs.	**Rs.**
Cash Price	5,000	15,000
Cost	4,000	12,000
Cash Down for hire –purchase	1,000	3,000
Monthly Installment	500	1,500
Number of installments	10	12

The company purchased goods costing & to lakh in all and made cash sales totaling Rs. 43 lakh. Stock in hand on 31st March, 2012 was valued at Rs. 6 lakh. Hire Purchase transactions were as follows:

	Number sold	**Installments Collected**	**Instalments due (customers paying)**
Geysers	40	260	15
Refrigerators	20	110	10

3 geysers and 2 refrigerators on which only four instalments per piece had been collected were repossessed and were valued at a total sum of Rs. 16,000. This is not included in the figure of stock mentioned above. Prepare accounts showing the profit earned by the company.

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