Text Book for

INTERMEDIATE

Second Year

ACCOUNTANCY

Telugu and Sanskrit Akademi
Andhra Pradesh

SRI. Y.S. JAGAN MOHAN REDDY

CHIEF MINISTER
ANDHRA PRADESH

AMARAVATI

MESSAGE

I congratulate Akademi for starting its activities with printing of Intermediate textbooksfrom the academic year 2021 – 22.

Education is a real asset which cannot be stolen by anyone and it is the foundation onwhich children build their future. As the world has become a global village, children willhave to compete with the world as they grow up. For this there is every need for goodbooks and good education.

Our government has brought in many changes in the education system and moreare to come. The government has been taking care to provide education to the poorand needy through various measures, like developing infrastructure, upgrading theskills of teachers, providing incentives to the children and parents to pursue education. Nutritious mid-day meal and converting Anganwadis into pre-primary schools with English as medium of instruction are the steps taken to initiate children into educationfrom a young age. Besides introducing CBSE syllabus and Telugu as a compulsorysubject, the government has taken up numerous innovative programmes.

The revival of the Akademi also took place during the tenure of our government as itwas neglected after the State was bifurcated. The Akademi, which was started on August6, 1968 in the undivided state of Andhra Pradesh, was printing text books, works of popularwriters and books for competitive exams and personality development.

Our government has decided to make available all kinds of books required for studentsand employees through Akademi, with headquarters at Tirupati.

I extend my best wishes to the Akademi and hope it will regain its past glory.

Y.S. Jagan Mohan Reddy

Dr. Nandamuri Lakshmiparvathi
M.A. M.Phil., Ph.D.
Chairperson, (Cabinet Minister Rank)
Telugu and Sanskrit Akademi, A.P.

Message of Chairperson, Telugu and Sanskrit Akademi, A.P.

In accordance with the syllabus developed by the Board of Intermediate, State Council for Higher Education, SCERT etc., we design high quality Text books by recruiting efficient Professors, department heads and faculty members from various Universities and Collegesas writers and editors. We are taking steps to print the required number of these books ina timely manner and distribute through the Akademi's Regional Centers present acrossthe Andhra Pradesh.

In addition to text books, we strive to keep monographs, dictionaries, dialect texts,question banks, contact texts, popular texts, essays, linguistics texts, school leveldictionaries, glossaries, etc., updated and printed and made available to students fromtime to time.

For competitive examinations conducted by the Andhra Pradesh Public Service Commission and for Entrance examinations conducted by various Universities, thecontents of the Akademi publications are taken as standard. So, I want all the studentsand Employees to make use of Akademi books of high standards for their golden future.

Congratulations and best wishes to all of you.

Nandamuri Lakshmiparvathi
Chairperson, Telugu and Sanskrit Akademi, A.P.

J. SYAMALA RAO, I.A.S.,
Principal Secretary to Government

Higher Educational Department
Government of Andhra Pradesh

MESSAGE

I Congratulate Telugu and Sanskrit Akademi for taking up the initiative of printing and distributing textbooks in both Telugu and English media within a short span of establishing Telugu and Sanskrit Akademi.

Number of students of Andhra Pradesh are competing of National Level for admissions into Medicine and Engineering courses. In order to help these students Telugu and Sanskrit Akademi consultation with NCERT redesigned their Textbooks to suit the requirement of National Level Examinations in a lucid language.

As the content in Telugu and Sanskrit Akademi books is highly informative and authentic, printed in multi-color on high quality paper and will be made available to the students in a time bound manner. I hope all the students in Andhra Pradesh will utilize the Akademi textbooks for better understanding of the subjects to compete of state and national levels.

(J. SYAMALA RAO)

THE CONSTITUTION OF INDIA

PREAMBLE

WE, THE PEOPLE OF INDIA, having solemnly resolved to constitute India into a [SOVEREIGN SOCIALIST SECULAR DEMOCRATIC REPUBLIC] and to secure to all its citizens:

JUSTICE, social, economic and political;

LIBERTY of thought, expression, belief, faith and worship;

EQUALITY of status and of opportunity; and to promote among them all

FRATERNITY assuring the dignity of the individual and the [unity and integrity of the Nation];

IN OUR CONSTITUENT ASSEMBLY this twenty-sixth day of November, 1949 do HEREBY ADOPT, ENACT AND GIVE TO OURSELVES THIS CONSTITUTION.

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Foreword

The role played by the Akademi in stabilizing Telugu Medium at the level of Higher Education since its inception (1968) is well known. The Akademi has rendered needful services by publishing a number of Text Books, Reference Books, Translations, Popular Series, Monographs, Dictionaries, Glossaries, Readings, etc., over the years. Many among the above mentioned books were also reprinted as per the demand. Sincere effort is being made to improve the quality of these books by conducting workshops, refresher courses and also by taking suggestions given by the intellectuals in general and the students and the teachers in particular.

Akademi has been revising and updating its publications in accordance with the prescribed syllabi, as and when necessary. Akademi is publishing Text Books for Intermediate in Telugu Medium since its inception. In addition, the Akademi has entered a new phase of activity with the publication of language books from the year 1995, and preparation and publication of Intermediate Text books in English medium from the year 1998, as entrusted by the Board of Intermediate education.

For the academic year 2014-15, the Board of Intermediate Education has revised the syllabus of all Humanities Text Books for first year of Intermediate and entrusted the preparation, printing and distribution of Text Books to Akademi. Accordingly, Akademi prepared this Text Book strictly in accordance with the prescribed syllabus for the academic year 2014-15.

We are indeed very much grateful to the Government of India, State Government, State Universities, the Board of Governors of Telugu and Sanskrit Akademi. We also thank the Commissioner, Intermediate Education and Secretary, Board of Intermediate Education of Andhra Pradesh. We are also very much grateful to Text Book Development Committee of the subject concerned for their valuable cooperation.

Constructive suggestions are solicited for the improvement of this book. The suggestions received will be examined and incorporated in the subsequent editions.

Sri. V. Ramakrishna I.R.S.
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Preface

This text book is written in accountancy with the new syllabus introduced w.e.f. 2015-16 in Accountancy at Intermediate level. Service of experienced senior teachers have been utilised in preparing this book. This text book is written in accoundance with the new syllabus introduced w.e.f. 2015-16 in Accountancy at Intermediate level. Sevice of experience senior teachers have been utilised in preparing this book.

This text book is divided into five units and 10 chapters. The authors of this text book have been taking every care in simplifying and presenting the concepts in order to help even non commerce students or other interested groups to understand and acquire the accounting knowledge. This text book is divided into five units and 10 chapters. The authors of this text book have been taking every care in simplifying and presenting the concepts in order to help even non commerce students or other intrested groups to understand and accure the accounting knowledge.

The adequate number of suitable institutions are given in each chapter to make the reader to understand the subject matter. In addition to this summary to each topic is given at the end of each chapter so as to enable the students to recollect the important points covered reinforce the knowledge base. Constrictive suggestions are invited from subject experts, teachers and students for further improvement of this book. We thanks the authors and officials of the Board of Intermediate Education for there co-operation at every stage in bringing out this book successfully.

Editors

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Chapter

1

Bills of Exchange

1.1 Meaning and Definition
1.2 Features of Bills of Exchange
1.3 Parties to Bills of Exchange
1.4 Advantages of Bills of Exchange
1.5 Types of Bills of Exchange
1.6 Difference between a Bill and a Promissory Note
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1.11 Dishonour of Bills of Exchange
1.12 Renewal of a Bill
1.13 Retiring a Bill under Rebate
1.14 Insolvency of Drawee

1.1 Meaning and Definition

Goods can be sold or bought for cash or on credit. In case of cash transaction cash is paid to the seller and the goods are delivered to the buyer at the same time. In case of credit transaction the buyer promises the seller that he will pay the amount of goods purchased after a certain period. The person who purchased goods on credit becomes the debtor. The buyer has to give a promise in written to pay the amount on a certain date. The written promise may be in the form of a bill of exchange or promissory note.

The bill of exchange contains an unconditional order to pay a certain amount on an agreed date. The promissory note contains an unconditional promise to pay a certain amount on a certain date. In India these instruments are governed by the Negotiable Instruments Act 1881.

Bills of Exchange are Instruments of Credit which facilitate the credit sale of goods.

"A Bill of Exchange is an instrument in writing containing an unconditional order signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument".

Section 5 of the Negotiable Instruments Act, 1881.

1.2 Features of a Bill of Exchange

The features of a Bill of Exchange are as under.

1. A Bill of Exchange must be in writing.
2. It must contain an order and not a request to make payment.
3. The order of payment must be unconditional.
4. The amount of bill of exchange must be certain.
5. The date of bill of exchange should be clearly mentioned.
6. It must be signed by the maker or drawer of the bill.
7. It must be accepted by the drawee by signing on it.
8. The amount is payable either to a certain person or to his order or to the bearer of the bill.
9. The amount in the bill of exchange is payable either on demand or on the expiry of a fixed period.
10. It must be properly stamped as per legal requirements.

1.3 Parties to a Bill of Exchange

There are three parties to a Bill of Exchange.

1. Drawer : Drawer is the person who makes or writes the bill of exchange. In other words he is the person who has granted credit to the person on whom the bill of exchange is drawn.

2. Drawee: Drawee is the person on whom the bill of exchange is drawn for acceptance. In other words he is the person to whom credit has been granted by the drawer.

3. Payee : Payee is the person who receives the amount of the bill on its maturity from the drawee. Usually the drawer and the payee are the same person. Drawer and payee are two different persons in the following cases.

(i) When the bill is discounted by the drawer from his bank- Payee is the bank.

(ii) When the bill is endorsed by the drawer to his creditor-Payee is the endorsee.

Specimen of a bill of exchange

The usual form of a bill of exchange is given below:

U. Rama Rao sells goods to M. Thirupathi Naidu for Rs. 50,000 to be paid 3 months after date.

Rs. 50,000

Vijayanagaram

25 January 2014

Stamp

Three months after date pay to me or my order, the sum of Rupees Fifty Thousand only, for value received.

To

M. Tirupathi Naidu

P-15, Siri Apartments

M.V.P Colony

Vishakapatnam

A.P

Accepted

M. Tirupathi Naidu

U. Rama Rao

1.4 Advantages of a Bill of Exchange

The bills of exchange as instruments of credit are used frequently in business because of the following advantages.

1. It helps in purchases and sales of goods on credit basis.
2. It is a legally valid document in the eyes of Law. It assures a easier recovery to the drawer if drawee fails to make the payments.
3. It acts as a source of finance since it can be discounted from the bank before the due date.
4. It is written and signed acknowledgement of debt.
5. It can be easily transferred from one person to another by endorsement.
6. By drawing accommodation bills on one another, traders can raise money.

1.5 Types of Bills of Exchange

Bills of Exchange can be classified as follows:

1. Time and Demand Bills
2. Trade and Accommodation Bills
3. Inland and Foreign Bills

1.5.1 Time and Demand Bills

When payment of a bill of exchange is to be made after a particular period of time., the bill is termed as a "Time Bill". In such a case date of maturity is always calculated by adding three days of grace. Time bill must be accepted by the drawee. In case of a "Demand Bill", payment is to be made on demand. Neither the acceptance of the drawee is necessary nor any days of grace are allowed in this case.

1.5.2 Trade and Accommodation Bills

Where a bill of exchange has been drawn and accepted for a genuine trade transaction, it is termed as a "Trade Bill". For example, Rani sells goods worth Rs. 10,000 to Ravi on credit. Rani draws a bill of exchange on Ravi for the said amount and the same is accepted by Ravi. This is trade bill. This bill will become a bills receivable to Rani (sellar and Draweer of the bill) since the amount of bill is receivable in future. The same bill will become bills payable to Ravi (purchaser and acceptor of the bill) since he has to pay the amount of the bill in future.

Accommodation Bills refer to those bills which are drawn, accepted or endorsed without any consideration. These bills are drawn and accepted to meet the financial needs of drawer/drawee/ both for temporary period by getting bills discounted at bank.

1.5.3 Inland and Foreign Bills

A bill is termed as an Inland Bill if (a) it is drawn in India on a person residing in India whether payable in or outside India, or (b) it is drawn in India on a person residing outside India but payable in India.

A bill which is not an Inland Bill is a Foreign Bill. A Foreign Bill is generally drawn up in triplicate and each copy is sent by separate post, so that at least one copy reaches the concerned party at the earliest. Of course, the Drawee or Acceptor will sign on a single set. It becomes the actual bill and the payment will be made on such bill only.

1.6 Difference between a Bill and a Promissory note

Promissory Note

"A Promissory Note is an Instrument in writing (not being a Bank note or Currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument".

Section 4 of the Negotiable Instruments Act, 1881.

The differences between a Bill of Exchange and Promissory Note are as follows.

Basis of Difference	Bill of Exchange	Promissory Note
1. Drawer	It is drawn by the creditor	It is drawn by the debtor
2. Order or Promise	It contains an order to make the payment	It contains a promise to make the payment
3. No. of Parties	It has three parties namely 1. Drawer 2. Drawee 3. Payee	It has two parties namely 1. The maker (Drawer) 2. Payee
4. Acceptance	It is valid only when it is accepted by the drawee	It does not require any acceptance
5. Payee	Drawer and Payee can be the same person	Drawer cannot be the payee of it
6. Noting	In case of dishonour of bill noting becomes important	Noting is not necessary in case of dishonour of promissory note

1.7 Difference between a Bill and a Cheque

Cheque

"A Cheque is a Bill of Exchange drawn on a specified banker and payable on demand".

Section 6 of the Negotiable Instruments Act, 1881.

A cheque is similar to a bill of exchange with the following two additional qualifications:

(i) It is always drawn on a specified banker.

(ii) It is always payable on demand.

Thus, all cheques are bills of exchange but all bills of exchange are not cheques.

The differences between a Bill of Exchange and Cheque are as follows.

Basis of Differene	Bill of Exchange	Cheque
1. Acceptance	It requires an acceptance to become a valuable instrument	It does not require any acceptance
2. Stamp Duty	It requires necessary stamp as per act	It does not require any stamp
3. Crossing	It will not have any crossing on the instrument	It may have crossing
4. Due date for Payment	The bill proceeds will be payable on the due date of instrument	The cheque amount should be paid immediately as and when it is presented to the bank for payment
5. Days of Grace	Three days of grace are allowable after the due date of the bill for payment of bill amount	Days of grace are not applicable in the case of cheques
6. Withdrawal	Once accepted, the bill cannot be withdrawn by drawee	It can be withdrawn by the maker by giving stop payment order to the bank

1.8 Important Terminology

1. Acceptance of Bill

The drawee has to accept the bill prepared by the drawer. Unless the drawee gives his acceptance by writing the word "Accepted" and also putting his signature along with date, the bill does not become a legal document. Before acceptance the bill is called "Draft". After acceptance the bill will be returned to the drawer. This is called acceptance of bill of exchange.

2. Term of Bill

It is the period after the expiry of which the sum mentioned in the bill is to be paid. The period intervening between the date on which a bill is drawn and the date on which it becomes due for payment is called "Term of Bill".

3. Maturity of Bill

A bill payable on demand, at sight or presentment becomes due as soon as the bill is presented for payment. A bill payable a certain period after date or after sight becomes nominally due on the expiry of such period, but it becomes legally due 3 days after the nominally due date. These 3 additional days are known as "Days of Grace".

The date which comes after adding 3 days of grace to the nominally due date of a bill is called "Date of maturity".

4. Days of Grace

For making the payment of bill, the Drawee is allowed **Three** extra days after the normal due date. Such 3 days are known as "Days of Grace". If the due date is public holiday previous day is due date. If the due date is sudden holiday next day is due date.

5. Holder

The person who is entitled to have the possession of the bill and who has a right to demand and receive the amount due on the instrument is called the "Holder". The holder may be the drawer or the endorsee or the bank.

6. Discounting of Bill

When the bill is encashed from the bank before its due date, it is known as Discounting of Bill. Bank deducts a small sum of money as discount from the amount of bill and disburses the balance amount to the drawer of the bill.

7. Endorsement

The drawer may endorse or transfer the bill in favour of another person. Being a negotiable instrument, the bill of exchange can be endorsed by the drawer in favour of his creditor by putting his signature on the back of the bill. The person who makes the endorsement is called the "Endorser" and the person to whom the endorsement of bill is made is called the "Endorsee". The endorsee can get the payment of the bill from the drawee. If the drawee fails to pay the amount the endorsee can claim the amount from the drawer.

8. Dishonour of Bill

When the drawee (or acceptor) of the bill fails to make payment of the bill on the date of maturity, it is called "Dishonour of Bill".

9. Noting Charges

To obtain the proof of dishonour of a bill, it is re-sent to the drawee through a legally authorized person called Notary Public. Notary Public charges a small fee for providing this service known as Noting Charges.

Noting charges are paid to the Notary Public first by the holder of the bill but are ultimately recovered from the drawee, because he is the responsible person for the dishonour.

10. Bill sent for Collection

It is a process when the bill is sent to the bank with instructions to keep the bill till maturity and collect its amount from the acceptor on the date of maturity.

11. Renewal of a Bill

Some times the drawee of a bill finds himself unable to meet the bill on due date. To avoid dishonouring of bill, he may request the holder of the bill to cancel the original bill and draw a new bill in place of old one. If the holder agrees, the old bill is cancelled and a new bill with new terms is drawn on the drawee and also accepted by him. this process is called "Renewal of a bill".

12. Retirement of a Bill

When the drawee makes the payment of the bill before its due date it is called "Retirement of bill". In such a case, holder of the bill usually allows a certain amount as Rebate to the drawee.

13. Insolvency of Acceptor

When the drawee (or acceptor) of a bill is unable to meet his liabilities on due date, the drawee becomes an insolvent. In other words, an insolvent is a person whose liabilities are more than his assets.

1.9 Accounting Treatment for Bills of Exchange

For the convenience of accounting bills are classified into two. They are

(i) Bills receivable (ii) Bills payable

For the person who draws the bill of exchange and gets it back after its due acceptance, it is bills receivable. For the person who accepts the bill, it is bills payable.

The same bill is both a Bill Receivable to the drawer who receives amount on date of maturity, and Bill Payable to the drawee who has to pay the amount on date of maturity. Bills receivables are assets and bills payables are liabilities.

Where more number of bills are drawn and accepted, subsidiary books called Bills Receivable Book and Bills Payable Book are maintained to record the particulars of the bills. If number of bills transactions are less, the bill transactions will be recorded in the journal.

1.9.1 Methods of Dealing with a Bill of Exchange by Drawer

The drawer has the following alternatives with the bill of exchange held by him.

1. He may **retain or keep the bill in his own possession** till the due date and realize the amount against it on the due date, or
2. He may **discount the bill with a bank** before its maturity, when he is in need of money, or
3. He may **endorse (transfer) the bill to his creditor,** or
4. He may **send the bill to the bank for collection**.

The following journal entries are to be recorded in the books of drawer and drawee under various situations.

Specimen Journal Entries

Transaction	In the books of Drawer	In the books of Drawee (Acceptor)
Ia. When Goods are sold/ purchased on credit	Debtor (drawee) A/c Dr To Sales A/c (Being goods sold on credit)	Purchases A/c Dr To Creditor (drawer) A/c (Being goods purchased on credit)
Ib. When the bill is drawn / accepted	Bills Receivable A/c Dr To Debtor (drawee) A/c (Being the bill drawn)	Creditor (drawer) A/c Dr To bills Payable A/c (Being the bill accepted)
II. When Bill is retained by the drawer a) Bill is honoured	Cash / Bank A/c Dr To Bills Receivable A/c (Being bill amount received from drawee on date of maturity)	Bills Payable A/c Dr To Cash / bank A/c (Being bill amount paid on maturity)
b) Bill is dishonoured	Drawee A/c Dr To bills Receivable A/c (Being the bill dishonoured on the date of maturity)	Bills Payable A/c Dr To Drawer A/c (Being the bill dishonoured on the due date)
c) Noting charges are paid by the drawer	Drawee A/c Dr To Cash/ Bank A/c (Being the noting charges paid by the drawer)	Noting Charges A/c Dr To Drawer A/c (Being the Noting Charges incurredby the drawer)
III) When Bill is discounted with a bank	Bank A/c Dr Discount A/c Dr To Bills Receivable A/c (Being the bill discounted with a bank)	No Entry
a) Bill is honoured	No Entry	Bills Payable A/c Dr To Cash / bank A/c (Being bill amount paid to bank on date of maturity)
b) Bill is dishonoured	Drawee A/c Dr To Bank A/c (Being the discounted bill dishonoured)	Bills Payable A/c Dr To Drawer A/c (Being the discounted bill dishonoured)
c) Noting charges are paid by the Bank	Drawee A/c Dr To Bank A/c (Being the noting charges paid by the Bank)	Noting Charges A/c Dr To Drawer A/c (Being the Noting Charges incurred by the drawer)
IV) When Bill is Endorsed to a creditor	Endorsee A/c Dr To Bills Receivable A/c (Being the bill endorsed to a creditor)	No Entry

Transaction	In the books of Drawer	In the books of Drawee (Acceptor)
a) Bill is honoured	No Entry	Bills Payable A/c Dr To Cash / bank A/c (Being bill amount paid on maturity)
b) Bill is dishonoured	Drawee A/c Dr To Endorsee A/c (Being the endorsed bill dishonoured)	Bills Payable A/c Dr To Drawer A/c (Being the endorsed bill dishonoured)
c) Noting charges are paid by Endorsee	Drawee A/c Dr To Endorsee A/c (Being the noting charges paid by the Endorsee on dishonour of bill)	Noting Charges A/c Dr To Drawer A/c (Being the Noting Charges incurred by the drawer)
V) When Bill is sent to the bank for collection	Bills Sent for Collection A/c Dr To Bills Receivable A/c (Being the bill sent to bank for collection)	No Entry
a) Bill is honoured	Bank A/c Dr To Bills Sent for Collection A/c (Being the bill amount collected by the bank on maturity)	Bills Payable A/c Dr To Cash / bank A/c (Being bill amount paid on maturity)
b) Bill is dishonoured	Drawee A/c Dr To Bills Sent for Collection A/c (Being the bill sent to bank for collection dishonoured)	Bills Payable A/c Dr To Drawer A/c (Being the bill dishonoured on the due date)
c) Noting charges are paid by the Bank	Drawee A/c Dr To Bank A/c (Being the noting charges paid by the Bank)	Noting Charges A/c Dr To Drawer A/c (Being the Noting Charges incurred by the drawer)
VI) Retiring a Bill Under Rebate	Cash / Bank A/c Dr Rebate on Bill A/c Dr To Bills Receivable A/c (Being the bill amount received before maturity and rebate allowed)	Bills Payable A/c Dr To Cash / Bank A/c To Rebate on Bill A/c (Being the bill amount paid before maturity and rebate received)
VII) Renewal of a Bill a) For cancellation of Old Bill	Drawee A/c Dr To Bills Receivable A/c (Being the old bill cancelled)	Bills Payable A/c Dr To Drawer A/c (Being the old bill cancelled)
b) For charging interest for extended period	Drawee A/c Dr To Interest A/c (Being the interest charged for extended period)	Interest A/c Dr To Drawer A/c (Being the interest payable for extended period)
c) For interest received/paid in cash	Cash A/c Dr To Interest A/c (Being the interest received in cash for extended period)	Interest A/c Dr To Cash A/c (Being the interest paid in cash for extended period)

Transaction	In the books of Drawer	In the books of Drawee (Acceptor)
d) For Part Payment Received / Made	Cash / Bank A/c Dr To Drawee A/c (Being the part payment received)	Drawer A/c Dr To Cash / Bank A/c (Being the part payment made)
e) Drawn / Accepted	For New Bill Bills Receivable A/c Dr To Drawee A/c (Being a new bill drawn)	Drawer A/c Dr To Bills Payable A/c (Being a new bill accepted)
VIII) Insolvency of Drawee a) When Drwee is insolvent	Drawee A/c Dr To Bills Receivable A/c (Being the bill dishonoured due to insolvency of the drawee)	Bills Payable A/c Dr To Drawer A/c (Being the bill dishonoured due to insolvency)
b) When Nothing could be recovered	Bad Debts A/c Dr To Drawee A/c (Being amount of bill written-off as bad debts)	Drawer A/c Dr To Deficiency A/c (Being the amount of bill written -off)
c) When amount is received partially	Cash / Bank A/c Dr Bad Debts A/c Dr To Drawee A/c (Being partial amount received and remaining written-off due to insolvency of drawee)	Drawer A/c Dr To Cash / Bank A/c To Deficiency A/c (Being partial amount paid in settlement of debt, due to insolvency)

1.10 Honour of Bills of Exchange

When the drawee (acceptor) of the bill makes payment of the bill on the date of maturity, it is called "honour of a bill".

Illustrations on Bills of Exchange Honoured

I. When the bill is retained in the hands of Drawer till Due date

Illustration – 1

On 1st March 2014 Ravi sold goods for Rs. 10,000 to Vikas on credit and drew a bill for 3 months for the same amount. Vikas accepted the bill and returned it to Ravi. This bill is honoured on the date of maturity.

Pass the necessary journal entries in the books of Ravi and Vikas.

Solution

Journal Entries in the Books of Ravi (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 March 01	Vikas Account Dr To Sales Account (Being the goods sold on credit)		10,000	10,000
2014 March 01	Bills Receivable Account Dr To Vikas Account (Being the bill drawn for 3 months on vikas)		10,000	10,000
2014 June 04	Cash Account Dr To Bills receivable Account (Being the bill amount received on date of maturity)		10,000	10,000

Journal Entries in the Books of Vikas (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 March 01	Purchases Account Dr To Ravi Account (Being the goods purchased on credit)		10,000	10,000
2014 March 01	Ravi Account Dr To Bills Payable Account (Being the bill accepted for 3 months)		10,000	10,000
2014 June 04	Bills Payable Account Dr To Cash Account (Being the bill amount paid on date of maturity)		10,000	10,000

II. When the Bill is discounted with the Bank

If the drawer of the bill is in need of money, he may choose the option of discounting the bill with his bank before maturity of the bill. The bank will deduct a small sum of money as discount and pay the remaining amount to the drawer of the bill.

The discount will be calculated at a certain rate of percent per annum on the amount of bill for its unexpired period from the date of discounting upto the date of maturity.

For example, if a Bill for Rs. 5,000 drawn on 1st March 2014 payable after 3 months is discounted at 12% per annum on 1st March 2014, the discount will be calculated as under.

Discount = Amount of bill discounted $\times \frac{Rate}{100} \times$ unexpired period

Discount = $5000 \times \frac{12}{100} \times \frac{3}{12} = 150$

Discount = Rs. 150

The remaining amount to be paid to the drawer is Rs. 4,850

If the above bill is discounted after one month i.e on 1st April 2014, then the discount will be calculated as under

Discount = $5000 \times \frac{12}{100} \times \frac{2}{12} = 100$

Discount = Rs. 100

In this case, the remaining amount to be paid to the drawer is Rs. 4,900

Illustration – 2

On 1st January 2013, Sankar sold goods worth Rs. 20,000 to Bhaskar on credit and drew a bill for 3 months for the same amount. Bhaskar accepted the bill and returned it to Sankar. On the same day Sankar discounted the bill with his bank at 10% per annum. On the due date, the bill is honoured.

Pass the necessary journal entries in the books of Sankar and Bhaskar.

Solution

Journal Entries in the Books of Sankar (Drawer)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2013	Bhaskar Account	Dr		20,000	
January 01	To Sales Account				20,000
	(Being the goods sold on credit)				
2013	Bills Receivable Account	Dr		20,000	
January 01	To Bhaskar Account				20,000
	(Being the bill drawn for 3 months on bhaskar)				
2013	Bank Account	Dr		19,500	
January 01	Discount Account	Dr		500	
	To Bills Receivable Account				20,000
	(Being the bill discounted with the bank Discount = 20,000 X 10/100 X 3 /12 = 500)				

Journal Entries in the Books of Bhaskar (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2013 January 01	Purchases Account Dr To Sankar Account (Being the goods purchased on credit)		20,000	20,000
2013 January 01	Sankar Account Dr To Bills Payable Account (Being the bill accepted for 3 months)		20,000	20,000
2013 April 04	Bills Payable Account Dr To Bank Account (Being the bill amount paid to the bank on the due date)		20,000	20,000

Illustration 3

On 1st March 2014 Sumathi purchased goods for Rs. 8,000 from Lakshmi and accepted a bill for the same amount drawn by Lakshmi payable after 3 months. Lakshmi discounted the bill with her bank on 1st April 2014 at 12% per annum. Sumathi met her acceptance on the due date.

Pass the necessary journal entries in the books of Lakshmi and Sumathi.

Solution

Journal Entries in the Books of Lakshmi (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 March 01	Sumathi Account Dr To Sales Account (Being the goods sold on credit)		8,000	8,000
2014 March 01	Bills Receivable Account Dr To Sumathi Account (Being the bill drawn for 3 months on Sumathi)		8,000	8,000
2014 April 01	Bank Account Dr Discount Account Dr To Bills Receivable Account (Being the bill discounted with the bank Discount = 8,000 X 12/100 X 2 /12 = 160)		7,840 160	8,000

Journal Entries in the Books of Sumathi (Drawee)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2014	Purchases Account	Dr		8,000	
March 01	To Lakshmi Account				8,000
	(Being the goods purchased on credit)				
2014	Lakshmi Account	Dr		8,000	
March 01	To Bills Payable Account				8,000
	(Being the bill accepted for 3 months)				
2014	Bills Payable Account	Dr		8,000	
June 04	To Bank Account				8,000
	(Being the bill amount paid to the bank on the due date)				

III. When the Bill is endorsed in favour of a creditor

The drawer may endorse or transfer the bill in favour of another person. Being a negotiable instrument, the bill of exchange can be endorsed by the drawer in favour of his creditor by putting his signature on the back of the bill. The person who makes the endorsement is called the "Endorser" and the person to whom the endorsement of bill is made is called the "Endorsee". The endorsee can get the payment of the bill from the drawee. If the drawee fails to pay the amount the endorsee can claim the amount from the drawer.

The endorsee may retain the bill till the due date, discount the bill with the bank if he is in need of money before due date or endorse the bill to his creditor.

The following Journal Entries are to be passed in the Books of Endorsee

Transaction	In the books of Endorsee	
1. When bill is Endorsed	Bills Receivable Account	Dr
	To Endorser Account	
	(Being bill received from debtor through endorsement)	
2. When bill is honoured on date of maturity	Cash / Bank Account	Dr
	To Bills receivable Account	
	(Being the amount received on edorsed bill)	

Illustration 4

On 1st January 2014 Venkatesh sold goods worth Rs. 5,000 to Nagarjuna and drew a bill on Nagarjuna for 3 months for the same amount. Nagarjuna accepted the bill and returned it to Venkatesh. On 1st February 2014, Venkatesh endorsed the bill in favour of his creditor Prabhakar in settlement of his debt. The bill was honoured on due date.

Pass the necessary journal entries in the books of Venkatesh, Nagarjuna and Prabhakar.

Solution

Journal Entries in the Books of Venkatesh (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 January 01	Nagarjuna Account Dr To Sales Account (Being the goods sold on credit)		5,000	5,000
2014 January 01	Bills Receivable Account Dr To Nagarjuna Account (Being the bill drawn for 3 months on Nagarjuna)		5,000	5,000
2014 February 01	Prabhakar Account Dr To Bills receivable Account (Being the bill endorsed to the creditor prabhakar)		5,000	5,000

Journal Entries in the Books of Nagarjuna (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 January 01	Purchases Account Dr To Venkatesh Account (Being the goods purchased on credit)		5,000	5,000
2014 January 01	Venkatesh Account Dr To Bills Payable Account (Being the bill accepted for 3 months)		5,000	5,000
2014 April 04	Bills Payable Account Dr To Cash Account (Being the bill amount paid on date of maturity)		5,000	5,000

Journal Entries in the Books of Prabhakar (Endorsee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 February 01	Bills receivable Account Dr To Venkatesh Account (Being the bill received on endorsement from venkatesh)		5,000	5,000
2014 April 04	Cash Account Dr To Bills Receivable Account (Being the amount received on endorsed bill)		5,000	5,000

IV. When the bill is sent to the Bank for collection

When a bill is sent to the bank with instructions to keep the bill till maturity and collect its amount from the acceptor on the date of maturity, it is known as "Bill sent for Collection". The Bank after charging this service, credits the net proceeds to the customer account. A large number of bills are usually received by big business houses in the ordinary course of business. They may forget to present the bills on the due date for payment. To avoid the risk they usually utilize the services of a bank by sending all bills received to bank for collection purpose.

Illustration 5

On 1st July 2014 Parasuram sold goods to Rama krishna for Rs. 7,000 and drew a bill on him for the same amount for two months. Rama krishna accepted the bill and returned the same to Parasuram. Immediately after its acceptance, Parasuram sent the bill to his bank for collection. On the due date bill is honoured.

Pass necessary journal entries in books of Parasuram and Rama krishna.

Solution

Journal Entries in the Books of Parasuram (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 July 01	Rama krishna Account Dr To Sales Account (Being the goods sold on credit)		7,000	7,000
2014 July 01	Bills Receivable Account Dr To Rama krishna Account (Being the bill drawn for 2 months on Rama krishna)		7,000	7,000

2014 July 01	Bills sent for collection Account Dr To Bills receivable Account (Being the bill sent to bank for collection)		7,000	7,000
2014 Sep 04	Bank Account Dr To Bills sent for collection Account (Being the bill amount collected by bank)		7,000	7,000

Journal Entries in the Books of Ramakrishna (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 July 01	Purchases Account Dr To Parasuram Account (Being the goods purchased on credit)		7,000	7,000
2014 July 01	Parasuram Account Dr To Bills Payable Account (Being the bill accepted for 2 months)		7,000	7,000
2014 Sep 04	Bills Payable Account Dr To Bank Account (Being the bill amount paid on due date)		7,000	7,000

Illustration 6

Ashok sold goods to Rajesh on 1st April 2014 for Rs. 10,000 on credit and drew upon him a bill for the same amount payable after 3 months. Rajesh accepted the bill and returned it to Ashok. On the date of maturity bill was presented to Rajesh for the payment and he honoured it.

Pass the journal entries in the books of Ashok and Rajesh when

Case I: Bill is retained by the Ashok till the date of maturity.

Case II: Bill is discounted by Ashok with his bank on the same date @12% p.a.

Case III: Bill is endorsed in favour of Santosh on 4th May 2014.

Case IV: Bill is sent to bank for collection on 1st June 2014.

Also record the journal entries in the books of Santosh.

Solution

Journal Entries in the Books of Ashok (Drawer)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
	First two Entries will be the same in all cases				
2014	Rajesh Account	Dr		10,000	
April 01	To Sales Account				10,000
	(Being the goods sold on credit)				
2014	Bills Receivable Account	Dr		10,000	
April 01	To Rajesh Account				10,000
	(Being the bill drawn for 3 months on Rajesh)				
Case – I	**When bill is retained by Ashok till the date of maturity**				
2014	Cash Account	Dr		10,000	
July 04	To Bills receivable Account				10,000
	(Being the bill amount received on due date)				
Case – II	**When bill is discounted by Ashok with his bank**				
2014	Bank Account	Dr		9,700	
April 01	Discount Account	Dr		300	
	To Bills receivable account				10,000
	(Being the bill discounted with bank)				
Case –III	**When bill is endorsed in favour of Santosh**				
2014	Santosh Account	Dr		10,000	
May 04	To Bills receivable Account				10,000
	(Being the bill endorsed in favour of santosh)				
Case – IV	**When bill is sent to bank for collection**				
2014	Bills sent for collection Account	Dr		10,000	
June 01	To Bills receivable account				10,000
	(Being the bill sent for collection to bank)				
2014	Bank Account	Dr		10,000	
July 04	To bills sent for collection Account				10,000
	(Being the bill amount collected by bank)				

Journal Entries in the Books of Rajesh (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
	These 3 entries will be the same in all four cases			
2014 April 01	Purchases Account Dr To Ashok Account (Being the goods purchased on credit)		10,000	10,000
2014 April 01	Ashok Account Dr To Bills Payable Account (Being the bill accepted for 3 months)		10,000	10,000
2014 July 04	Bills Payable Account Dr To Bank/Cash Account (Being the bill amount paid on due date)		10,000	10,000

Journal Entries in the Books of Santosh (Endorsee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 May 04	Bills receivable Account Dr To Ashok Account (Being the bill received on endorsement from Ashok)		10,000	10,000
2014 July 04	Cash Account Dr To bills receivable Account (Being payment received on endorsed bill)		10,000	10,000

1.11 Dishonour of Bills of Exchange

A bill of exchange should be presented for payment on the date of its maturity. In case, the drawee of the bill refuses or fails to make payment of the bill on the date of maturity, the bill of exchange is said to be dishonoured. When a bill is dishonoured it is legally necessary to prove the fact of dishonour. To obtain the proof of dishonour of a bill, it is re-sent to the drawee through a legally authorized person called “Notary Public”.

Notary Public presents the bill to drawee for payment and if money is received ,he will hand over the money to the concerned party. But if the bill is dishonoured, he will note the fact of dishonour and returns the bill to his client along with a certificate to this effect. For rendering all these services, Notary Public will charge some amount which is called as “Noting charges”. Noting charges are

paid to the Notary Public first by the holder of the bill but are ultimately recovered from the drawee, because he is the responsible person for the dishonour.

Illustrations on Bills of Exchange Dishonoured

The following illustrations will enable to understand the accounting treatment of bills of exchange dishonoured under various situations.

I. When the bill in the possession of the drawer is dishonoured

Illustration 7

On 15th March 2014 Suresh sold goods for Rs. 3,000 to Naresh on credit. Naresh accepted the bill of exchange drawn upon him by Suresh payable after 2 months. On the due date the bill was dishonoured and Suresh paid Rs. 40 as noting charges.

Pass the journal entries in the books of Suresh and Naresh.

Solution

Journal Entries in the Books of Suresh (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014	Naresh Account Dr		3,000	
March 15	To Sales Account			3,000
	(Being the goods sold on credit)			
2014	Bills Receivable Account Dr		3,000	
March 15	To Naresh Account			3,000
	(Being the bill drawn for 2 months on Naresh)			
2014	Naresh Account Dr		3,040	
May 18	To Bills receivable Account			3,000
	To Cash Account			40
	(Being the bill dishonoured at maturity, noting charges paid)			

Journal Entries in the Books of Naresh (Drawee)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2014 March 15	Purchases Account	Dr		3,000	
	To Suresh Account				3,000
	(Being the goods purchased on credit)				
2014 March 15	Suresh Account	Dr		3,000	
	To Bills Payable Account				3,000
	(Being the bill accepted for 2 months)				
2014 May 18	Bills Payable Account	Dr		3,000	
	Noting charges	Dr		40	
	To Suresh Account				3,040
	(Being the amount of the dishonoured bill and noting charges credited to Suresh A/c)				

II. When the bill Discounted with the Bank is Dishonoured

Illustration 8

Narayana purchased goods for Rs. 15,000 from Ravindra on 1st March 2013. Ravindra drew upon Narayana a bill of exchange for the same amount payable after two months. The bill was immediately discounted by Ravindra with his bank @ 6% p.a. On the due date the bill was dishonoured and Bank paid Rs. 100 as noting charges.

Pass the necessary journal entries in the books of Ravindra and Narayana.

Solution

Journal Entries in the Books of Ravindra (Drawer)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2013 March 01	Narayana Account	Dr		15,000	
	To Sales Account				15,000
	(Being the goods sold on credit)				
2013 March 01	Bills Receivable Account	Dr		15,000	
	To Narayana Account				15,000
	(Being the bill drawn for 2 months on Narayana)				
2013 March 01	Bank Account	Dr		14,850	
	Discount Account	Dr		150	
	To Bills Receivable Account				15,000
	(Being the bill discounted with the bank Discount = 15,000 X 6/100 X 2 /12 = 150)				

2013 May 04	Narayana Account Dr To Bank Account (Being the amount of dishonoured bill and noting charges debited to Narayana A/c)		15,100	 15,100

Journal Entries in the Books of Narayana (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2013 March 01	Purchases Account Dr To Ravindra Account (Being the goods purchased on credit)		15,000	 15,000
2013 March 01	Ravindra Account Dr To Bills Payable Account (Being the bill accepted for 2 months)		15,000	 15,000
2013 May 04	Bills Payable Account Dr Noting charges Account Dr To Ravindra Account (Being the amount of dishonoured bill and noting charges credited to Ravindra A/c)		15,000 100	 15,100

III. When the bill endorsed in favour of creditor is dishonoured

When the bill is endorsed, the creditor becomes the endorsee and the drawer becomes endorser. The endorsee will be the holder of the bill on the due date. He will present the bill to the drawee for payment on the due date. If the drawee fails to pay the amount of the bill, he can claim the amount of bill along with noting charges, if any, incurred by him from the drawer.

The following Journal Entries are to be passed in the Books of Endorsee

Transaction	In the books of Endorsee
1. When bill is dishonoured on the date of maturity.	Endorser Account Dr To Bills receivable Account (Being the endorsed bill dishonoured)
2. When noting charges are paid by endorsee.	Endorser Account Dr To cash Account (Being noting charges paid on dishonour of endorsed bill)

Illustration 9

On 1st January 2013 Leela purchased goods for Rs. 15,000 from Neela. She immediately made a payment of Rs. 5,000 by cash and for the balance accepted the bill of exchange for 3 months drawn upon her by Neela. On 25th January 2013 Neela purchased goods worth Rs. 10,000 from Bala and endorsed the above bill to Bala. On the due date the bill was dishonoured and Bala paid Rs. 50 as noting charges.

Pass the necessary journal entries in the books of Neela, Leela and Bala.

Solution

Journal Entries in the Books of Neela (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2013 January 01	Leela Account Dr To Sales Account (Being the goods sold on credit)		15,000	15,000
2013 January 01	Cash Account Dr To Leela Account (Being the amount received from Leela)		5,000	5,000
2013 January 01	Bills Receivable Account Dr To Leela Account (Being the bill drawn for 3 months on Leela)		10,000	10,000
2013 January 25	Purchases Account Dr To Bala Account (Being goods purchased on credit)		10,000	10,000
2013 January 25	Bala Account Dr To Bills receivable Account (Being the bill endorsed to the creditor Bala)		10,000	10,000
2013 April 04	Leela Account Dr To Bala Account (Being the endorsed bill dishonoured by the drawee noting charges paid by Bala)		10,050	10,050

Journal Entries in the Books of Leela (Drawee)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2013 January 01	Purchases Account	Dr		15,000	
	To Neela Account				15,000
	(Being the goods purchased on credit)				
2013 January 01	Neela Account	Dr		5,000	
	To Cash Account				5,000
	(Being the amount paid)				
2013 January 01	Neela Account	Dr		10,000	
	To Bills Payable Account				10,000
	(Being the bill accepted for 3 months)				
2013 April 04	Bills Payable Account	Dr		10,000	
	Noting Charges Account	Dr		50	
	To Neela Account				10,050
	(Being the amount of dishonoured bill and noting charges credited to Neela account)				

Journal Entries in the Books of Bala (Endorsee)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2013 January 25	Neela Account	Dr		10,000	
	To Sales Account				10,000
	(Being the goods sold on credit)				
2013 January 25	Bills receivable Account	Dr		10,000	
	To Neela Account				10,000
	(Being the bill received on endorsement from Neela)				
2013 April 04	Neela Account	Dr		10,050	
	To Bills Receivable Account				10,000
	To Cash Account				50
	(Being the amount of dishonoured bill and noting charges debited to Neela account)				

IV. When the bill sent to bank for collection is dishonoured

Illustration 10

On 1st June 2014 Jaya sold goods to Surya for Rs. 8,000 on credit and drew a bill on Surya for the above amount payable after 3 months. Immediately after its acceptance Jaya sent the bill to

her bank for collection. On the due date the bill was dishonoured and the noting charges amounted to Rs. 70.

Pass the necessary journal entries in the books of Jaya and Surya.

Solution

Journal Entries in the Books of Jaya (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 June 01	Surya Account Dr To Sales Account (Being the goods sold on credit)		8,000	 8,000
2014 June 01	Bills Receivable Account Dr To Surya Account (Being the bill drawn for 3 months on Surya)		8,000	 8,000
2014 June 01	Bills sent for collection Account Dr To Bills receivable Account (Being the bill sent to bank for collection)		8,000	 8,000
2014 Sep 04	Surya Account Dr To Bills sent for collection Account To Bank Account (Being the amount of dishonoured bill and noting charges debited to Surya account)		8,070	 8,000 70

Journal Entries in the Books of Surya (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 June 01	Purchases Account Dr To Jaya Account (Being the goods purchased on credit)		8,000	 8,000
2014 June 01	Jaya Account Dr To Bills Payable Account (Being the bill accepted for 3 months)		8,000	 8,000
2014 Sep 04	Bills Payable Account Dr Noting Charges Account Dr To Jaya Account (Being the amount of dishonoured bill and noting charges credited to Jaya account)		8,000 70	 8,070

Illustration 11

Siva sold goods to Pradeep on 1st May 2014 for Rs. 6,000 on credit and drew upon him a bill for the same amount payable after 2 months. Pradeep accepted the bill and returned it to Siva. On the date of maturity, Pradeep failed to make payment of bill.

Pass the necessary journal entries in the books of Siva and Pradeep in the following cases:

Case I : When Siva retained the bill till the due date and paid noting charges of Rs. 100

Case II: When Siva discounted the bill with his bank on 4th June 2014 @12% p.a. and bank paid noting charges of Rs. 100.

Case III: When Siva endorsed the bill in favour of his creditor Rahul on 1st June 2014 and Rahul paid noting charges of Rs. 100.

Case IV: When Siva sent the bill to his bank for collection on 1st June 2014 and bank paid noting charges of Rs. 100.

Solution

Journal Entries in the Books of Siva (Drawer)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
	First two Entries will be the same in all cases				
2014 May 01	Pradeep Account	Dr		6,000	
	To Sales Account				6,000
	(Being the goods sold on credit)				
2014 May 01	Bills Receivable Account	Dr		6,000	
	To Pradeep Account				6,000
	(Being the bill drawn for 2 months on Pradeep)				

Case – I **When bill is retained by Siva till date of maturity**

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2014 July 04	Pradeep Account	Dr		6,100	
	To Bills receivable Account				6,000
	To Cash Account				100
	(Being the amount of dishonoured bill and noting charges debited to Pradeep)				

Case –II **When bill is discounted by Siva with his bank**

Date	Particulars		L.F.	Debit	Credit
2014 June 04	Bank Account	Dr		5,940	
	Discount Account	Dr		60	
	To Bills receivable account				6,000
	(Being the bill discounted with the bank)				
2014 July 04	Pradeep Account	Dr		6,100	
	To Bank Account				6,100
	(Being the amount of dishonoured bill and noting charges debited to Pradeep)				

Case – III **When bill is endorsed in favour of Rahul**

Date	Particulars		L.F.	Debit	Credit
2014 June 01	Rahul Account	Dr		6,000	
	To Bills receivable Account				6,000
	(Being the bill endorsed in favour of Rahul)				
2014 July 04	Pradeep Account	Dr		6,100	
	To Rahul Account				6,100
	(Being the amount of dishonoured bill and noting charges debited to Pradeep)				

Case – IV **When bill is sent to bank for collection**

Date	Particulars		L.F.	Debit	Credit
2014 June 01	Bills sent for collection Account	Dr		6,000	
	To Bills receivable account				6,000
	(Being the bill sent to bank for collection)				
2014 July 04	Pradeep Account	Dr		6,100	
	To Bills sent for collection Account				6,000
	To Bank Account				100
	(Being the amount of dishonoured bill and noting charges debited to Pradeep)				

Journal Entries in the Books of Pradeep (Drawee)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
	These 3 entries will be the same in all four cases				
2014	Purchases Account	Dr		6,000	
May 01	To Siva Account				6,000
	(Being the goods purchased on credit)				
2014	Siva Account	Dr		6,000	
May 01	To Bills Payable Account				6,000
	(Being the bill accepted for 2 months)				
2014	Bills Payable Account	Dr		6,000	
July 04	Noting charges Account	Dr		100	
	To Siva Account				6,100
	(Being the amount of dishonoured bill and noting charges credited to Siva account)				

1.12 Renewal of a Bill

When the acceptor (drawee) of a bill fails or is unable to honour the bill on the due date he may request the drawer to cancel the old bill and draw a new bill on him for another period. In such a case the drawer may charge some interest for the delayed payment at a mutually agreed rate of interest. Interest can be either paid in cash or may be included in the new bill. The process of cancellation of the old bill and drawing a fresh bill for the extended period is known as renewal of a bill.

A bill can be renewed in any one of the following ways

1. When the acceptor of a bill wants to make a partial payment at the time of renewal.
2. When the acceptor of the bill wants to pay only the interest component for the extended period at the time of renewal.
3. The old bill is cancelled and a new bill is drawn in its place for the amount of the old bill including interest thereon for the extended period of the new bill.

Case I : Partial payment is made by drawee at the time of renewal

Illustration 12

On 1st September 2014 Hari purchased goods for Rs. 12,000 from Sekhar and accepted a bill for the same amount drawn by Sekhar payable after 3 months. On the date of maturity Hari offered to pay Rs. 6,000 and requested Sekhar to draw new bill for 3 months for the balance amount including interest at 12% p.a. Sekhar agreed to this proposal.

Pass the necessary journal entries in the books of Sekhar and Hari.

Solution

Journal Entries in the Books of Sekhar (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 Sep 01	Hari Account Dr To Sales Account (Being the goods sold on credit)		12,000	 12,000
2014 Sep 01	Bills receivable Account Dr To Hari Account (Being the bill drawn for 3 months on Hari)		12,000	 12,000
2014 Dec 04	Hari Account Dr To Bills receivable Account (Being the original bill cancelled for renewal)		12,000	 12,000
2014 Dec 04	Cash Account Dr To Hari Account (Beiong the partial amount received from the Hari)		6,000	 6,000
2014 Dec 04	Hari Account Dr To interest Account (Beiong the interest due @12% p.a. on Rs. 6,000 for 3 months)		180	 180
2014 Dec 04	Bills receivable Account Dr To Hari Account (Being the new bill drawn for the balance amount including interest for renewal)		6,180	 6,180

Journal Entries in the Books of Hari (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014	Purchases Account Dr		12,000	
Sep 01	To Sekhar Account			12.000
	(Being the goods purchased on credit)			
2014	Sekhar Account Dr		12,000	
Sep 01	To Bills payable Account			12,000
	(Being the bill accepted for 3 months)			
2014	Bills payable Account Dr		12,000	
Dec 04	To Sekhar Account			12,000
	(Being the original bill cancelled for the renewal)			
2014	Sekhar Account Dr		6,000	
Dec 04	To Cash Account			6,000
	(Being the partial amount paid to Sekhar)			
2014	Interest Account Dr		180	
Dec 04	To Sekhar Account			180
	(Being interest due @12% p.a. on Rs. 6,000 for 3 months)			
2014	Sekhar Account Dr		6,180	
Dec 04	To Bills payable Account			6,180
	(Being the new bill accepted for 3 months)			

Case II : Only interest is paid in cash by drawee at the time of renewal

Illustration 13

Viswanadh sold goods to Srinivas on 1st April 2014 for Rs. 4,000 and drew a bill for 3 months on srinivas for the same amount. Srinivas accepted the bill and returned it to Viswanadh. On the due date Srinivas requested Viswanadh to draw a new bill for the period of 3 months. Srinivas agreed to pay interest in cash @ 9%p.a. immediately. Viswanadh agreed to this proposal. The new bill was honoured on due date.

Pass the necessary journal entries in the books of Viswanadh and Srinivas.

Solution

Journal Entries in the Books of Viswanadh (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 April 01	Srinivas Account Dr To Sales Account (Being the goods sold on credit)		4,000	4,000
2014 April 01	Bills Receivable Account Dr To Srinivas Account (Being the bill drawn for 3 months on Srinivas)		4,000	4,000
2014 July 04	Srinivas Account Dr To Bills receivable Account (Being the original bill cancelled for renewal)		4,000	4,000
2014 July 04	Cash Account Dr To interest Account (Being interest received in cash)		90	90
2014 July 04	Bill Receivable Account Dr To Srinivas Account (Being the new bill drawn for 3 months on Srinivas)		4,000	4,000
2014 Oct 07	Cash Account Dr To Bills receivable Account (Being the new bill amount received on due date)		4,000	4,000

Journal Entries in the Books of Srinivas (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 April 01	Purchases Account Dr To Viswanadh Account (Being the goods purchased on credit)		4,000	4,000
2014 April 01	Viswanadh Account Dr To Bills payable Account (Being the bill accepted for 3 months)		4,000	4,000
2014 July 04	Bills payable Account Dr To Viswanadh Account (Being the original bill cancelled for renewal)		4,000	4,000

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2014	Interest Account	Dr		90	
July 04	To Cash Account				90
	(Being interest paid @9% p.a. on Rs. 4,000 for 3 months)				
2014	Viswanadh Account	Dr		4,000	
July 04	To Bills payable Account				4,000
	(Being the new bill accepted for 3 months)				
2014	Bills payable Account	Dr		4,000	
Oct 07	To Cash Account				4,000
	(Being the new bill amount paid on the due date)				

Case III : A new bill is drawn for the amount of old bill including interest

Illustration 14

On 1st March 2013 Jagannadham sold goods to Chidambaram for Rs. 24,000 and drew upon him a bill for the same amount payable after 3 months. On the due date Chidambaram requested Jagannadham to renew the bill for a further period of 3 months at 9% interest per annum. Jagannadham agreed to this proposal. Chidambaram accepted a new bill drawn by Jagannadham for the amount of old bill including interest payable after 3 months. On the due date new bill was dishonoured.

Pass necessary journal entries in the books of Jagannadham & Chidambaram.

Solution

Journal Entries in the Books of Jagannadham (Drawer)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2013	Chidambaram Account	Dr		24,000	
March 01	To Sales Account				24.000
	(Being the goods sold on credit)				
2013	Bills Receivable Account	Dr		24,000	
March 01	To Chidambaram Account				24,000
	(Being the bill drawn on Chidambram for 3 months)				
2013	Chidambaram Account	Dr		24,000	
June 04	To Bills receivable Account				24,000
	(Being the original bill cancelled for renewal)				

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2013	Chidambram Account	Dr		540	
June 04	To interest Account				540
	(Being interest charged @9% for renewal)				
2013	Bills Receivable Account	Dr		24,540	
June 04	To Chidambaram Account				24,540
	(Being the new bill drawn on Chidambram for 3 months)				
2013	Chidambaram Account	Dr		24,540	
Sep 07	To Bills Receivable Account				24,540
	(Being the new bill dishonoured on the due date)				

Journal Entries in the Books of Chidambaram (Drawee)

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2013	Purchases Account	Dr		24,000	
March 01	To Jagannadham Account				24,000
	(Being the goods purchased on credit)				
2013	Jagannadham Account	Dr		24,000	
March 01	To Bills payable Account				24,000
	(Being the bill accepted for 3 months)				
2013	Bills payable Account	Dr		24,000	
June 04	To Jagannadham Account				24,000
	(Being the original bill cancelled for renewal)				
2013	Interest Account	Dr		540	
June 04	To Jagannadham Account				540
	(Being interest payable for the additional period for renewal of a bill)				
2013	Jagannadham Account	Dr		24,540	
June 04	To Bills payable Account				24,540
	(Being the new bill accepted for 3 months)				
2013	Bills payable Account	Dr		24,540	
Sep 07	To Jagannadham Account				24,540
	(Being the new bill dishonoured on the due date)				

1.13 Retiring a Bill under Rebate

If the Acceptor (Drawee) of the bill gets sufficient funds to make the payment of a bill before the date of maturity he may offer to honour the bill before its due date provided he is allowed some rebate for the earlier payment. This concession on bill is called "Rebate". The bill is said to have been retired under rebate. The rebate is loss to the holder (drawer) and a gain to the drawee.

Illustration 15

On 1st March 2013 Prudhvi sold goods to Akbar for Rs. 6,000 and drew upon him a bill for the same amount payable after 3 months. Akbar accepted the bill and returned it to prudhvi. On 4th April 2013 Akbar retired the bill under rebate of 12% p.a.

Pass the necessary journal entries in the books of Prudhvi and Akbar.

Solution

Journal Entries in the Books of Prudhvi (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2013 March 01	Akbar Account Dr To Sales Account (Being the goods sold on credit)		6,000	 6,000
2013 March 01	Bills Receivable Account Dr To Akbar Account (Being the bill drawn for 3 months on Akbar)		6,000	 6,000
2013 April 04	Cash Account Dr Rebate on bill Account Dr To Bills receivable Account (Being the amount received on bill before due date and rebate allowed)		5,880 120	 6,000

Journal Entries in the Books of Akbar (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2013 March 01	Purchases Account Dr To Prudhvi Account (Being the goods purchased on credit)		6,000	 6,000
2013 March 01	Prudhvi Account Dr To Bills Payable Account (Being the bill accepted for 3 months)		6,000	 6,000

2013 April 04	Bills Payable Account Dr To Cash Account To Rebate on bill account (Being the amount paid on bill before due date and rebate earned)		6,000	 5,880 120

Illustration 16

On 1st January 2014 Revathi drew a bill for Rs. 4,000 on Savithri payable after 3 months. Savithri accepted the bill and returned it to Revathi. On 4th February 2014 Savithri retired the bill under rebate of 9% p.a.

Pass the necessary journal entries in the books of Revathi and Savithri.

Solution

Journal Entries in the Books of Revathi (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 January 01	Bills Receivable Account Dr To Savithri Account (Being the bill drawn for 3 months on Savithri)		4,000	 4,000
2014 Feb 04	Cash Account Dr Rebate on bill Account Dr To Bills receivable Account (Being the amount received on bill before due date and rebate allowed)		3,940 60	 4,000

Journal Entries in the Books of Savithri (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 January 01	Revathi Account Dr To Bills Payable Account (Being the bill accepted for 3 months)		4,000	 4,000
2014 Feb 04	Bills Payable Account Dr To Cash Account To Rebate on bill account (Being the amount paid on bill before due date and rebate earned)		4,000	 3,940 60

1.14 Insolvency of Drawee

When the drawee (or acceptor) of a bill is unable to meet his liabilities on due date, the drawee becomes an insolvent. In other words, an insolvent is a person whose liabilities are more than his assets. When the bill is dishonoured due to insolvency of the drawee (or acceptor) of the bill either nothing is recovered or a portion of the amount (called dividend) in full settlement of the claim is recovered. The balance of the amount due from the insolvent which is not recovered should be written-off as bad debts and debited in the books of the drawer. In the books of the drawee the amount that cannot be paid to the drawer should be credited to deficiency account.

Case I : When nothing is recovered from the estate of drawee

Illustration 17

Damayanthi sold goods worth Rs. 9,000 to Jayanthi on 1st June 2014 and drew a bill for 2 months for the same amount. Jayanthi accepted the bill and returned it to Damayanthi. Before the due date of the bill, Jayanthi became an insolvent and nothing could be recovered from her estate.

Pass the necessary journal entries in the books of Damayanthi and Jayanthi.

Solution

Journal Entries in the Books of Damayanthi (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 June 01	Jayanthi Account Dr To Sales Account (Being the goods sold on credit)		9,000	 9,000
2014 June 01	Bills Receivable Account Dr To Jayanthi Account (Being the bill drawn for 2 months on Jayanthi)		9,000	 9,000
2014 Aug 04	Jayanthi Account Dr To bills receivable Account (Being the bill dishonoured due to insolvency of the drawee)		9,000	 9,000
2014 Aug 04	Bad debts Account Dr To Jayanthi Account (Being nothing recovered and transferred to bad debts)		9,000	 9,000

Journal Entries in the Books of Jayanthi (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014	Purchases Account Dr		9,000	
June 01	To Damayanthi Account			9,000
	(Being the goods purchased on credit)			
2014	Damayanthi Account Dr		9,000	
June 01	To Bills Payable Account			9,000
	(Being the bill accepted for 2 months)			
2014	Bills payable Account Dr		9,000	
Aug 04	To Damayanthi Account			9,000
	(Being the bill dishonoured on the due date due to insolvency)			
2014	Damayanthi Account Dr		9,000	
Aug 04	To deficiency Account			9,000
	(Being nothing paid and transferred to deficiency Account)			

Case II : When a portion of the amount of bill is recovered from the estate of drawee

Illustration 18

Kumar sold goods worth Rs. 7,000 to Murali on 1st January 2014 and drew upon him a bill for 3 months for the same amount. Murali accepted the bill and returned it to Kumar. On the due date murali requested kumar to draw a new bill for the amount due. Kumar agreed to draw a new bill for 2 months but he charged interest @12%p.a. Murali accepted the new bill which was drawn by kumar. Before the due date of the bill, Murali became an insolvent and only 50 paise in a rupee could be recovered from his estate.

Pass the necessary journal entries in the books of Kumar and Murali.

Solution

Journal Entries in the Books of Kumar (Drawer)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014 January 01	Murali Account Dr		7,000	
	To Sales Account			7,000
	(Being the goods sold on credit)			
2014 January 01	Bills Receivable Account Dr		7,000	
	To Murali Account			7,000
	(Being the bill drawn for 3 months on Murali)			
2014 Apr 04	Murali Account Dr		7,000	
	To Bills receivable Account			7,000
	(Being the original bill cancelled for renewal)			
2014 Apr 04	Murali Account Dr		140	
	To interest Account			140
	(Being the interest charged for renewal of the bill)			
2014 Apr 04	Bills Receivable Account Dr		7,140	
	To Murali Account			7,140
	(Being the new bill drawn for 2 months)			
2014 June 07	Murali Account Dr		7,140	
	To bills receivable Account			7,140
	(Being the bill dishonoured due to insolvency of the drawee)			
2014 June 07	Cash Account Dr		3,570	
	Bad debts Account Dr		3,570	
	To Murali Account			7,140
	(Being 50 paise per Rupee received from Murali in full settlement of his debt and the balance transferred to bad debts account)			

Journal Entries in the Books of Murali (Drawee)

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2014	Purchases Account Dr		7,000	
January 01	To kumar Account			7,000
	(Being the goods purchased on credit)			
2014	Kumar Account Dr		7,000	
January 01	To Bills Payable Account			7,000
	(Being the bill accepted for 3 months)			
2014	Bills payable Account Dr		7,000	
Apr 04	To Kumar Account			7,000
	(Being the original bill cancelled for renewal)			
2014	Interest Account Dr		140	
Apr 04	To Kumar Account			140
	(Being interest due @12%p.a. on Rs. 7,000 for 2 months)			
2014	Kumar Account Dr		7,140	
Apr 04	To Bills Payable Account			7,140
	(Being the new bill accepted for 2 months)			
2014	Bills payable Account Dr		7,140	
June 07	To Kumar Account			7,140
	(being the bill dishonoured on due date due to insolvency)			
2014	Kumar Account Dr		7,140	
June 07	To Cash Account			3,570
	To deficiency Account			3,570
	(Being 50 paise per rupee paid in full settlement of the debt and the balance transferred to deficiency Account)			

Summary

Now a days a large number of business transactions take place on credit. In case of credit transactions the buyer promises the seller that he will pay the amount of goods purchased after a certain period. The buyer has to give a promise in written to pay the amount on a certain date. The written promise may be in the form of a bill of exchange or promissory note. Bills of exchange and promissory notes are the instruments of credit which facilitate the credit transactions.

The bills are of two types viz., Trade Bills and Accommodation Bills. Trade

bills will be drawn and accepted for genuine trade transactions. Accommodation bills will be drawn and accepted to meet the financial needs of drawer / drawee / both for temporary period. The bills of exchange maybe used for various business transactions as means of exchange.

Bills of exchange are governed by the Negotiable instruments Act 1881 in our country.

MODEL QUESTIONS

I. Short Answer type questions:

1. What is a bill of exchange?
2. State the three parties involved in a bill of exchange.
3. What is a Promissory Note?
4. What is due date of a bill?
5. What are days of Grace?
6. What do you mean by Noting Charges?
7. What is meant by acceptance of a bill of exchange?
8. What is meant by discounting of a bill?
9. What is retirement of a bill of exchange?
10. What do you mean by renewal of bill of exchange?
11. What is meant by 'Dishonour of a Bill'?

II. Essay type questions

1. Define a bill of exchange. Explain the main features of a bill of exchange?
2. What are the advantages of a bill of exchange?
3. What are the different types of bills of exchange?
4. Explain the differences between a bill of exchange and a promissory note.
5. Explain the differences between a bill of exchange and a cheque.

Exercises

A) Bills of Exchange Honoured

1. On 1st July 2014 Madhu sold goods to Pavan for Rs. 5,000 on credit and drew a bill of exchange for 3 months for the same amount. Pavan accepted the bill and returned it to Madhu. Pavan met his acceptance on maturity.

Pass the necessary Journal entries in the books of Madhu and Pavan.

2. On 1st March 2013 Radhika sold goods to Harika worth Rs. 9,000 and drew a bill for 2 months for the same amount. Harika accepted the bill and returned it to Radhika. The bill is honoured on the date of maturity.

   Pass the necessary Journal entries in the books of Radhika and Harika.

3. On 25th March 2014 Vinod drew a bill for 3 months on Prakash for Rs.3,000. Prakash accepted the bill and handed over the bill to Vinod. The bill is honoured on the date of maturity.

   Show the journal entries in the books of Vinod and Prakash.

4. On 1st January 2014 Rajendra sold goods to Narendra worth Rs. 4,000 and drew a bill on Narendra payable after three months. After securing Narendra's acceptance, Rajendra discounted the bill with his bank at 12% p.a. on 1st February 2014. On the due date the bill is honoured.

   Pass necessary journal entries in the books Rajendra and Narendra.

   [Discount Rs. 80]

5. Amar sold goods for Rs. 10,000 to Sunder on credit on 1st July 2014. Amar drew a bill of exchange on Sundar for the same amount for three months. Sundar accepted the bill and returned it to Amar. Amar discounted the bill with his bank at 10% per annum on the same day. Sundar met his acceptance on maturity.

   Pass necessary journal entries in the books of Amar and Sundar.

   [Discount Rs. 250]

6. Sandhya sold goods for Rs 14,000 to Rajeswari on 1st march 2014 and drew upon her a bill of exchange payable after 2 months. Rajeswari accepted the bill and handed over the same to Sandhya. Sandhya immediately discounted the bill with her bank @12%p.a. On the due date Rajeswari met her acceptance .

   Pass the necessary journal entries in the books of Sandhya and Rajeswari.

   [Discount Rs. 280]

7. Satyam sold goods to Sivam worth Rs. 9000 on 1st June 2013 and drew a bill for 2months for the same amount. Sivam accepted the bill and returned it to Satyam. Satyam

endorsed the bill to his creditor sundaram on 1st July 2013. The bill was honoured on the due date.

Pass necessary Journal entries in the books of Satyam, Sivam and Sundaram.

8. On 1st July 2014 Ajay purchased goods worth Rs. 8,000 from Kiran and accepted the bill which was drawn by kiran payable after three months for the same amount. Kiran sent the bill to his bank for collection. The bill was honoured on the date of maturity.

   Pass necessary journal entries in the books of Kiran and Ajay.

9. Jayaram sold goods for Rs. 20,000 to Sivaram on 15th march 2014 and drew upon him a bill of exchange payable after two months. Sivaram accepted the bill and returned the same to Jayaram. On the due date the bill was honoured.

   Pass the necessary journal entries in the books of Jayaram and Sivaram in the following circumstances.

   I. When the bill was retained by Jayaram till the date of its maturity.

   II. When Jayaram immediately discounted the bill @6% p.a. with his bank.

   III. When the bill was endorsed immediately by Jayaram in favour of his creditor Seetharam.

   IV. When the bill was sent by Jayaram to his bank for collection on 25th April 2014.

[Discount Rs. 200]

B) Dishonour of bills of exchange

10. Kotireddy purchased goods worth Rs. 12,000 from Rajareddy on 25th March 2014 and accepted a bill of exchange drawn upon him by Rajareddy payable after two months. On the date of maturity Kotireddy dishonoured the bill. Rajareddy paid Rs. 80 as noting charges.

    Pass the necessary journal entries in the books of Rajareddy and Kotireddy.

11. Parvathi sold goods worth Rs. 14,000 to Suneetha on 1st January 2014. Suneetha paid Rs. 4000 immediately and for the balance she accepted a bill of exchange drawn upon her by Parvathi payable after 3 months. Parvathi discounted the bill immediately with her bank @10% p.a. On the due date Suneetha dishonoured the bill and the bank paid Rs. 30 as noting charges.

Pass the necessary Journal entries in the books of Parvathi and Suneetha.

[*Discount* **Rs. 250]**

12. On 1st January 2014 Hari accepted 3 months bill for Rs 12,000 drawn on him by Raju. Raju discounted the bill with his bank @9%p.a. on the Same day. On the due date Hari dishonoured his acceptance.

    Pass the necessary journal entries in the books of Raju and Hari.

    [Discount Rs. 270]

13. On 25th April 2013 Bhagavan sold goods for Rs. 13,000 to Lakshman and drew upon him a bill of exchange for 3 months for the same amount. Lakshman accepted the bill and sent the same to Bhagavan. Bhagavan endorsed the bill in favour of his creditor Raman. On the due date the bill was dishonoured and Raman paid Rs. 90 as Noting charges.

    Pass the necessary journal entries in the books of Bhagavan and Lakshman.

14. Manga purchased goods for Rs. 20,000 from Ganga on 1st February 2013 and accepted a bill of exchange drawn by Ganga for the same amount payable after 2 months. On 20th February 2013 Ganga sent the bill to her bank for collection. On the due date Manga dishonoured the bill and the bank paid Rs. 100 as noting charges.

    Pass the necessary journal entries in the books of Ganga and Manga.

15. Mohan sold goods for Rs. 15,000 to Vinod on 1st January 2014 and drew upon him a bill of exchange for the same amount payable after two months. Vinod accepted the bill and handed over the bill to Mohan. On the due date the bill was dishonoured.

    Pass the necessary journal entries in the books of Mohan and Vinod in the following cases.

    I. When Mohan retained the bill till the due date and paid Rs. 150 as noting charges

    II. When Mohan discounted the bill @12%p.a. on 4th February 2014 and the bank paid Rs. 150 as noting charges.

    III. When Mohan endorsed the bill immediately in favour of his creditor Amar and Amar paid Rs. 150 as noting charges.

    IV. When Mohan sent the bill to his bank for collection on 25th January 2014 and bank paid Rs. 150 as noting charges. ***[Discount Rs. 150]***

C) Renewal of a bill

16. On 1st July 2013 kalyan sold goods to Kapil for Rs. 24,000 and drew upon him a bill for the same amount payable after 3 months. Kapil accepted the bill and returned it to Kalyan. On due date kapil expressed his inability to honour the bill and offered to pay Rs. 12,000 in cash and to accept a new bill for the balance amount including interest at 10% p.a. for 2 months. Kalyan agreed to this proposal. On the due date the new bill was honoured.

    Pass the necessary journal entries in the books of Kalyan and kapil.

    [Interest Rs. 200]

17. Anasuya sold goods worth Rs 6000 to Padma on 1st March 2013 and drew upon her a bill for the same amount payable after three months. Padma accepted the bill and sent it back to Anasuya. On the due date, padma expressed her inability to honour the bill and requested Anasuya to cancel the original bill and to draw a new bill for three months. Anasuya agreed the proposal provided interest at 12% was paid immediately in cash.Padma paid such interest in cash and accepted a new bill. The new bill was dishonoured on the due date.

    Pass necessary journal entries in the books of Anasuya and Padma.

    [Interest Rs.180]

18. On 1st May 2014 Akhil sold goods to Nikhil for Rs. 6,000 on credit and drew a bill on him for three months for the same amount. Nikhil accepted the bill and returned it to Akhil. On 4th August 2014 Nikhil requested Akhil to draw a new bill for the amount due. Akhil agreed to draw a new bill for 2 months but he charged interest @12% p.a. This bill was honoured on its maturity.

    Pass necessary journal entries in the books of Akhil and Nikhil. ***[Interest Rs. 120]***

D) Retiring of a bill under rebate

19. On 1st January 2013 Nagababu sold goods for Rs. 10,000 to Damodhar and drew upon him a bill of exchange payable after two months. Damodhar accepted the bill and handed over the same to Nagababu. One month before the maturity of the bill Damodhar approached Nagababu to accept the payment against the bill under rebate of 9%p.a. Nagababu agreed to the request of Damodhar. Damodhar retired the bill under the agreed rate of rebate.

    Pass the necessary Journal entires in the books of Nagababu and Damodhar.

    [Rebate Rs. 75]

20. On 1st June 2014 Meghana sold goods for Rs. 13,000 to Kaveri and drew upon her a bill of exchange payable after 3 months. Kaveri accepted the bill and returned it to Meghana. One month before the maturity of the bill Kaveri approached Meghana to accept the payment against the bill under rebate of 12% p.a. Meghana agreed to the request of Kaveri and kaveri retired the bill under the agreed rate of rebate.

    Pass the necessary journal entries in the books of Meghana and Kaveri.

    [Rebate Rs. 130]

E) Insolvency of Drawee

21. Jayababu purchased goods for Rs. 25,000 from Tatababu on 1st February 2014 and accepted a bill of exchange drawn by Tatababu for the same amount. The bill was payable after 2 months. Before the due date of the bill, Jayababu became an insolvent and nothing could be recovered from his estate.

    Write necessary journal entries in the books of Tatababu and Jayababu.

22. Anil sold goods worth Rs. 17,000 to Sunil on 1st March 2014 and drew upon him a bill for three months for the same amount. Sunil accepted the bill and handed over it to Anil. On the same day Anil discounted the bill @12%p.a. with his bank. Before the due date of the bill, Sunil became an insolvent and only 50 paise in a rupee could be recovered from his estate.

    Pass necessary journal entries in the books of Anil and Sunil. ***[Discount 510]***

Chapter

2

Depreciation

2.1 Meaning and Definition
2.2 Need for Depreciation
2.3 Causes of Deprecition
2.4 Accounting Treatment
2.5 Methods of Depreciation
2.6 Straight Line Method
2.7 Reducing Balance Method

2.1 Meaning and Definition

Business enterprises maintain two types of assets. They are Fixed Assets and Current Assets. Fixed Assets are those assets which are used in business for more than one accounting year. Fixed assets tend to reduce their value once they are put to use.

Depreciation is the gradual reduction or loss in the value of fixed assets like building, plant and machinery, furniture etc… If a company purchases a machine for Rs 80,000 with 10 years estimated life, machine will lose value of Rs 8,000 per year. This reduction or loss in the value of the machine every year is called as depreciation.

The word "Depreciation" is derived from a Latin word "Depretium". 'De' means decline and pretium means price. It means decline in price or value of asset. "Depreciation" means decline in the value of a fixed asset due to use, passage of time, obsolescence or any other cause.

In order to have a clear understanding of the concept of depreciation it will be useful to go through the definitions given by various experts in accounting.

"Depreciation is the measure of exhaustion of the effective life of an asset from any cause during a given period" ***Spicer and Pegler***

"Depreciation is the permanent and continuing diminution in the quality, quantity or the value of an asset" ***Pickles***

"Depreciation is the diminution in intrinsic value of the asset due to use and / or the lapse of time" ***Institute of Cost and Management Accounting (ICMA, London)***

From the above definitions, it can be said that depreciation is a permanent, continuous and gradual decrease in the book value of an asset due to various causes.

2.2 Need for Depreciation:

The need for providing depreciation arises due to the following objectives.

a) **To ascertain true profit or loss:** The true profit or loss can be ascertained only when the depreciation is debited to the Profit and Loss Account along with other revenue expenses like salaries, postage and stationary etc. which are incurred for the purpose of earning revenue.

b) **To present true and fair financial position:** If reasonable depreciation is not deducted from the value of assets, the Balance Sheet will not reflect the true and fair financial position of the business enterprise. Hence depreciation should be provided every year to present true and fair financial position.

c) **To have funds for replacement of assets:** A portion of profits is set aside in the form of depreciation every year. This amount accumulates and will be available for replacement of the asset at the end of its life or when it is discarded.

d) **To ascertain the true cost of production:** For ascertaining the cost of production, it is necessary to charge depreciation as an item of cost of production. If the depreciation is not charged, the cost records would not present the true cost of production.

e) **To fulfill the legal requirements:** In case of joint stock companies, it is compulsory to provide depreciation on Fixed assets. Without providing depreciation dividends cannot be declared.

2.3 Causes of Depreciation

The main causes of depreciation include the following.

a) **Wear and Tear:** When the Fixed assets are put to use in the business operations for earning revenue, the value of such assets may decrease. Such decrease in the value of assets is said to be due to wear and tear.

b) **Physical Forces:** When the assets are exposed to the forces of nature like weather, winds, rains etc. the value of such assets may decrease even if they are not being put to any use.

c) **Expiration of Legal Rights:** When the use of assets like Patents, Copyrights, Leases etc. is governed by a time bound agreement, the value of such assets may decrease with the passage of time.

d) **Obsolescence:** Obsolescence implies an existing asset becoming out of date on account of the availability of better type of asset due to technological changes or improvements in production methods.

e) **Accidents:** Decline in the usefulness of the asset may be caused by accidents due to fire, earthquake, floods etc.. Accidental loss is permanent.

f) **Depletion:** Assets of wasting character such as mines, quarries, oil wells etc. get depleted with the extraction of raw-materials out of them.

2.4 Accounting Treatment

2.4.1 Purchase of Asset

If an Asset is purchased in the beginning of the year, depreciation is to be calculated for the full year. If an Asset is purchased in the middle of the year, depreciation is to be calculated from the date of purchase of such Asset.

For example, if the Asset is purchased on 1st July and the books are closed on 31st December, depreciation is to be calculated for six months only in that year.

2.4.2 Use of Asset

The business enterprise may use the Asset from the date of its purchase or later. If the Asset is used in the business, not from the date of purchase but later, depreciation is to be calculated from the date of use only. For example, if the Asset is purchased on 01-01-2014 but started using from 01-04-2014, and the books are closed on 31st December, Depreciation is to be calculated for 9 months only from 01-04-2014.

2.4.3 Sale of Asset

When an Asset is sold in the middle of the year due to some reasons, depreciation is to be calculated up to the date of sale of an Asset. For example, if the Asset is sold on 01-07-2014 and the books are closed on 31st December, depreciation is to be calculated for 6 months only up to 01-07-2014. The profit or loss on sale of an Asset is to be transferred to profit and loss Account.

The following journal entries are required in this connection

a) For purchase of an Asset

Asset account	Dr
To Bank/Creditor Account	

b) For provision of depreciation

Depreciation Account	Dr
To Asset Account	

c) For transfer of Depreciation to Profit and Loss Account

Profit and Loss Account	Dr
To Depreciation Account	

d) For sale of an Asset

Cash / Bank Account	Dr
To Asset Account	

e) For transfer of profit on sale of an Asset

Asset Account	Dr
To Profit and Loss Account	

f) For transfer of loss on sale of an Asset

Profit and Loss Account	Dr
To Asset Account	

2.5 Methods of providing depreciation

There are several methods of providing depreciation. The following are the important methods of providing depreciation.

1. Straight Line Method
2. Reducing Balance Method
3. Annuity Method
4. Depreciation Fund Method
5. Insurance Policy Method
6. Revaluation Method
7. Depletion Method
8. Machine Hour Rate Method

However, in this chapter, the first two methods i.e., **Straight Line Method** and **Reducing Balance Method** only are discussed.

2.6 Straight Line Method

Straight Line Method is the simplest and one of the widely used methods of providing depreciation. This method is also called as Fixed Installment Method or Equal Installment Method or Original Cost Method. Under this method, depreciation is calculated at a fixed percentage on original value of the asset in every year. Thus the amount of annual depreciation is uniform in every year.

The annual depreciation amount and rate of depreciation is calculated as under.

a) Annual Depreciation $= \dfrac{\underset{\text{(Purchase price + Crriage + Installation Expenses)}}{\text{Original cost of the Asset}} - \underset{\text{(Scrap Value)}}{\text{Estimated Residual Value}}}{\text{Estimated Useful life of the Asset (in years)}}$

b) Rate of Depreciation $= \dfrac{\text{Annual depreciation}}{\text{Original cost of the Asset}} \times 100$

Merits of Straight Line Method

Straight Line Method has certain merits which are stated below.

a) It is very easy to understand.

b) It is very simple to calculate depreciation.

c) Asset can be depreciated up to the net scrap value or zero value.

d) This method is suitable for those assets whose useful life can be estimated accurately.

e) Depreciation will remain same throughout the life of the Asset.

Demerits of Straight Line Method

The important demerits of this method are as under

a) In this method, the depreciation amount will remain same throughout the life of the Asset. But in reality depreciation and repairs will be lesser in the earlier years and gradually increase in the later part of the life of the Asset.

b) It becomes difficult to ascertain the amount of depreciation if additions are made during the year.

c) This method is not recognized by income tax authorities.

d) No provision is made for interest on amount invested in the Asset.

e) It is very difficult to estimate the life of the asset with accuracy.

Illustrations on Straight Line Method

Illustration 1

An Asset is purchased for Rs 40,000. The useful life of the asset is 10 years and the residual value is Rs 4,000.Find out the annual depreciation and the rate of depreciation under straight line method.

Solution

a) $$\text{Annual Depreciation} = \frac{\text{Original cost of the Asset} - \text{Estimated Residual Value (Scrap Value)}}{\text{Estimated Useful life of the Asset (In years)}}$$

$$\text{Annual Depreciation} = \frac{40{,}000 - 4{,}000}{10} = \text{Rs. } 3{,}600$$

b) $$\text{Rate of Depreciation} = \frac{\text{Annual Depreciation}}{\text{Original cost of the Asset}} \times 100$$

$$\text{Rate of Depreciation} = \frac{3600}{40{,}000} \times 100 = 9\%$$

Illustration 2

Radha & Company purchased machinery for Rs.45,000 on 01st Jan 2010. The estimated life of the machinery is 8 years and residual value at the end of its life period is Rs.5,000. The books are closed on 31st December every year.

Write journal entries and show the Machinery Account and Depreciation Account for 3 years on Straight Line Method.

Solution

a) $$\text{Annual Depreciation} = \frac{\text{Original cost of the Asset} - \text{Estimated Residual Value (Scrap Value)}}{\text{Estimated Useful life of the Asset (In years)}}$$

$$= \frac{45{,}000 - 5{,}000}{8} = \text{Rs. } 5000$$

Annual Depreciation = Rs. 5,000

Journal Entries in the Books of Radha & Company

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
2010	Machinery Account Dr		45,000	
January 01	To Bank Account			45,000
	(Being the machinery purchased)			
2010	Depreciation Account Dr		5,000	
Dec 31	To Machinery Account			5,0000
	(Being deprecation charged on machinery)			
2010	Profit and Loss Account Dr		5,000	
Dec 31	To Depreciation Account			5,000
	(Being Depreciation transferred to P&L A/c)			
2011	Depreciation Account Dr		5,000	
Dec 31	To machinery Account			5,000
	(Being deprecation charged on machinery)			
2011	Profit and Loss Account Dr		5,000	
Dec 31	To Depreciation Account			5,000
	(Being Depreciation transferred to P&L A/c)			
2012	Depreciation Account Dr		5,000	
Dec 31	To machinery Account			5,000
	(Being deprecation charged on machinery)			
2012	Profit and Loss Account Dr		5,0000	
Dec 31	To Depreciation Account			5,000
	(Being Depreciation transferred to P&L A/c)			

Machinery Account (Straight Line Method)

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2010 Jan 01	To Bank Account		45,000	2010 Dec 31	By Depreciation Account		5,000
				Dec 31	By Balance c/d		40,000
			45,000				45,000
2011 Jan 01	To Balance b/d		40,000	2011 Dec 31	By Depreciation Account		5,000
				Dec 31	By Balance c/d		35,000
			40,000				40,000
2012 Jan 01	To Balance b /d		35,000	2012 Dec. 31	By Depreciation Account		5,000
				Dec. 31	By Balance c/d		30,000
			35,000				35,000
2013 Jan 01	To balance b /d		30,000				

Depreciation Account

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2010 Dec 31	To Machinery Account		5,000	2010 Dec 31	By Profit & Loss Account		5,000
			5,000				5,000
2011 Dec 31	To Machinery Account		5,000	2011 Dec. 31	By Profit & Loss Account		5,000
			5,000				5,000
2012 Dec 31	To Machinery Account		5,000	2012 Dec 31	By Profit & Loss Account		5,000
			5,000				5,000

Illustration 3

Vasavi & Co purchased machinery for Rs.80,000 on 1st January 2011. Depreciation is provided annually at 10 % on the original cost every year. The books are closed on 31st December every year.

Prepare Machinery Account for the first 3 years.

Solution

$$\text{Annual Depreciation} = \text{Original cost X} \frac{\text{Rate of depreciation}}{100}$$

$$= 80{,}000 \text{x} \frac{10}{100} = \text{Rs. } 8{,}000$$

Annual Depreciation = Rs.8,000

Books of Vasavi & Co

Machinery Account (Straight line method)

Dr Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2011			
Jan 01	To Bank Account		80,000	Dec 31	By Depreciation Account		8,000
				Dec 31	By Balance c/d		72,000
			80,000				80,000
2012				2012			
Jan 01	To Balance b/d		72,000	Dec 31	By Depreciation Account		8,000
				Dce 31	By Balance c/d		64,000
			72,000				72,000
2013				2013			
Jan 01	To Balance b/d		64,000	Dec 31	By Depreciation Account		8,000
				Dec 31	By Balance c/d		56,000
			64,000				64,000
2014							
Jan 01	To balance b/d		56,000				

Illustration 4

Narayana and Bros purchased a plant for Rs. 2,00,000 on 01st January 2010 and spent Rs. 50,000 for its installation. The salvage value of the plant after its useful life of 10 years is estimated to be Rs. 20,000. The Books are closed on 31st December every year.

Prepare plant account and Depreciation Account for the first 3 years using Straight Line Method.

Solution

Original cost of Plant = Purchase price + Installation expenses

= Rs.2,00,000 + Rs.50,000 = Rs.2,50,000

$$\text{Annual depreciation} = \frac{\text{Original cost of the Asset} - \text{Estimated Residual Value (Scrap Value)}}{\text{Estimated Useful life of the Asset (In years)}}$$

$$= \frac{2,50,000 - 2}{10}$$

Annual depreciation = Rs. 23,000

Books of Narayana and Bros
Plant Account (Straight Line Method)

Dr Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2010				2010			
Jan 01	To Bank Account		2,00,000	Dec 31	By Depreciation Account		23,000
Jan 01	To Bank Account (Installation Expenses)		50,000	Dec 31	By Balance c/d		2,27,000
			2,50,000				2,50,000
2011				2011			
Jan 01	To Balance b/d		2,27,000	Dec 31	By Depreciation Account		23,000
				Dec 31	By Balance c/d		2,04,000
			2,27,000				2,27,000
2012				2012			
Jan 01	To Balance b/d		2.04,000	Dec 31	By Depreciation Account		23,000
				Dec 31	By Balance c/d		1,81,000
			2,04,000				2,04,000
2013							
Jan 01	To balance b/d		1,81,000				

Depreciation Account

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2010				2010			
Dec 31	To Plant Account		23,000	Dec 31	By Profit & Loss Account		23,000
			23,000				23,000
2011				2011			
Dec 31	To Plant Account		23,000	Dec 31	By Profit & Loss Account		23,000
			23,000				23,000
2012				2011			
Dec 31	To Plant Account		23,000	Dec 31	By Profit & Loss Account		23,000
			23,000				23,000

Illustration 5

Rama Rao and sons purchased a machine for Rs.1,40,000 on 01st July 2011, and spent Rs.10,000 for its installation. The firm writes-off depreciation at the rate of 10% on original cost every year. The books are closed on December 31st every year.

Prepare Machine Account and Depreciation Account for three years.

Solution

1. Original cost of Machine = Purchase price + Installation expenses
   = Rs.1,40,000 + Rs.10,000 = Rs.1,50,000

2. Annual depreciation = $1,50,000 \times \frac{10}{100}$ = Rs. 15,000

3. Depreciation for the year 2011 = the Asset is used only 6 months from 01-07-2011.
   Depreciation shall be provided only for 6months
   i.e Rs.7,500

Books of Rama rao and sons

Machine Account (Straight Line Method)

Dr Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2011			
Jul 01	To Bank Account		1,40,000	Dec 31	By Depreciation Account (for 6 months)		7,500
Jul 01	To Bank Account (Installation Expenses)		10,000	Dec 31	By Balance c/d		1,42,500
			1,50,000				1,50,000
2012				2012			
Jan 01	To Balance b/d		1,42,500	Dec 31	By Depreciation Account		15,000
				Dec 31	By Balance c/d		1,27,500
			1,42,500				142,500
2013				2013			
Jan 01	To Balance b/d		1,27,500	Dec 31	By Depreciation Account		15,000
				Dec 31	By Balance c/d		1,12,500
			1,27,500				1,27,500
2014							
Jan 01	To Balance b/d		1,12,500				

Depreciation Account

Dr Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2011			
Dec 31	To Machine Account		7,500	Dec 31	By Profit & Loss Account		7,500
			7,500				7,500
2012				2012			
Dec 31	To Machine Account		15,000	Dec 31	By Profit & Loss Account		15,000
			15,000				15,000
2013				2013			
Dec 31	To Machine Account		15,000	Dec 31	By Profit & Loss Account		15,000
			15,000				15,000

Illustration 6

On 1st January 2010, Sahithi & Co purchased second hand machine for Rs.80,000 and spent Rs.4,000 as carriage inwards, Rs.4000 as repair charges and Rs. 2,000 as installation expenses. It is estimated that the machine will have a scrap value of Rs. 5,000 at end of its useful life which is 10 years. On 31st December 2012 The machine was sold for Rs. 50,000. The books are closed on 31st December every year.

Prepare Machine Account.

Solution

Books of Sahithi & Co

Machine Account (Straight Line Method)

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2010				2010			
Jan 01	To Bank Account		80,000	Dec 31	By Depreciation Account		8,500
Jan 01	To Bank Account (Installation & other Expenses)		10,000	Dec 31	By Balance c/d		81,500
			90,000				90,000
2011				2011			
Jan 01	To Balance c/d		81,500	Dec 31	By Depreciation Account		8,500
				Dec 31	By Balance c/d		73,000
			81,500				81,500
2012				2012			
Jan 01	To Balance c/d		73,000	Dec 31	By Bank Account		50,000
				Dec 31	By Depreciation Account		8,500
				Dec 31	By Profit & Loss A/c (Loss)		14,500
			73,000				73,000

Working Notes

1. Calculation of original cost of machine — Rs.

	Rs.
Purchase cost of second hand machine	80,000
Add : Carriage, repairs, installation expenses	10,000
Original cost of the Machine	90,000

2. $$\text{Annual depreciation} = \frac{\text{Original cost of the Asset} - \text{Estimated Residual Value (Scrap Value)}}{\text{Estimated Useful life of the Asset (In years)}}$$

$$\text{Annual depreciation} = \frac{90{,}000 - 5{,}000}{10} = \text{Rs. } 8{,}500$$

Annual depreciation = Rs. 8,500

3. Calculation of Profit or loss on the sale of Machine

		Rs.
Original cost of the machine		90,000
Less: Depreciation for three years		
For the year 2010	8,500	
For the year 2011	8,500	
For the year 2012	8,500	25,500
Book value of the machine as on 31-12-2012		64,500
Less: Sale proceeds of the machine		50,000
Loss on sale of machine (to be transferred to P&L A/c)		14,500

Illustration 7

Nagaraju & Co purchased a second hand machine on 1st January 2011, for Rs. 45,000 and spent Rs. 5,000 on repairs and installated the same. Depreciation is provided at the rate of 10% p.a. under Straight Line Method. On 1st July 2014 the machine was sold for Rs. 30,000. The books are closed on 31st December every year.

Prepare the Machine Account

Solution

Books of Nagaraju & Co

Machine Account (Straight Line Method)

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2011			
Jan 01	To Bank Account		45,000	Dec 31	By Depreciation Account		5,000
Jan 01	To Bank Account(Repairs)		5,000	Dec 31	By Balance c/d		45,000
			50,000				50,000
2012				2012			
Jan 01	To Balance b/d		45,000	Dec 31	By Depreciation Account		5,000
				Dec 31	By Balance c/d		40,000
			45,000				45,000
2013				2013			
Jan 01	To Balance b/d		40,000	Dec 31	By Depreciation Account		5,000
				Dec 31	By Balance c/d		35,000
			40,000				40,000
2014				2014			
Jan 01	To Balance b/d		35,000	July 01	By Bank Account		30,000
				Dec 31	By Depreciation Account		2,500
				Dec 31	By Profit & Loss A/c (Loss)		2,500
			35,000				35,000

Working Notes

1. Calculation of Profit or loss on the sale of Machine

			Rs.
Original cost of the machine (Rs. 45,000 + Rs.5000)			50,000
Less: depreciation for four years			
	For the year 2011	5,000	
	For the year 2012	5,000	
	For the year 2013	5,000	
	For the year 2014 (for 6 months only)	2,500	17,500
Book value of the machine as on 01-07-2014			32,500
Less: Sale proceeds of the machine			30,000
Loss on sale of machine (To be transferred to Profit & Loss Account)			2,500

2. Depreciation is calculated for 6 months only during the year 2014 up to 1st July 2014 ; 5,000 X 6/12 = Rs.2,500.

Illustration 8

Bhavani traders purchased a machine for Rs. 50,000 on 01-01-2010. Another machine was bought on 01-01-2011 for Rs.60,000 and used from 1st July 2011 onwards. The depreciation is provided at 10% per annum under Straight Line Method. The books are closed on 31st December every year.

Prepare the machinery account for 3 years.

Solution

Books of Bhavani traders
Machinery Account (Straight Line Method)

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2010				2010			
Jan 01	To Bank Account		50,000	Dec 31	By Depreciation Account		5,000
				Dec 31	By Balance c/d		45,000
			50,000				50,000
2011				2011			
Jan 01	To Balance b/d		45,000	Dec 31	By Depreciation Account (Rs.5,000+Rs.3,000 for 6months)		8,000
Jan 01	To Bank Account (Purchase of 2nd Machine)		60,000	Dec 31	By Balance c/d		97,000
			1,05,000				1,05,000
2012				2012			
Jan 01	To Balance b/d		97,000	Dec 31	By Depreciation Account (Rs.5,000+Rs.6,000)		11,000
				Dec 31	By Balance c/d		86,000
			97,000				97,000
2013							
Jan 01	To Balance b/d		86,000				

Working Notes

1. Annual depreciation is calculated as under.

$$1^{st}\text{ Machine} = 50,000 \times \frac{10}{100} = \text{Rs. } 5000$$

$$2^{nd}\text{ Machine} = 60,000 \times \frac{10}{100} = \text{Rs. } 6000$$

2. The second machine was purchased on 1st January 2011, but started working from 1st July2011. Hence the depreciation is calculated for 6months only, i.e from the date of use to the closing date of the year 2011.

$$\text{Depreciation on } 2^{nd} \text{ machine for 6months} = 60,000 \times \frac{6}{12} = \text{Rs. } 3000$$

Illustration 9

On 1st July2011 Anupama Traders purchased a machine for Rs. 80,000. On 1st April 2012 the firm purchased another machine for Rs. 40,000. On 31st March 2014 the machine which was purchased on 1st April 2012 was sold for Rs. 29,000. The firm writes off 10% depreciation on original cost. The books are closed on 31st March every year.

Show the machinery account for three years.

Solution

Books of Anupama Traders

Machinary Account (Straight Line Method)

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2012			
July 01	To Bank Account		80,000	Mar 31	By Depreciation Account (for 9 months)		6,000
				Mar 31	By Balance c/d		74,000
			80,000				80,000
2012				2013			
April 01	To Balance b/d		74,000	Mar 31	By Depreciation Account (Rs.8000 + Rs.4000)		12,000
April 01	To Bank Account (Purchase of 2nd Machine)		40,000	Mar 31	By Balance c/d		1,02,000
			1,14,000				1,14,000
2013				2014			
April 01	To Balance b/d		1,02,000	Mar 31	By Bank Account (Sale of second machine)		29,000
				Mar 31	By Depreciation Account (Rs. 8000 + Rs. 4000)		12,000
				Mar 31	By Profit and Loss A/c (Loss)		3,000
				Mar 31	By Balance c/d		58,000
			1,02,000				1,02,000
2014							
April 01	To balance b/d		58,000				

Working Notes

1. Calculation of Profit or loss on sale of machine

		Rs
Original Cost of Machine		40,000
Less : Depreciation		
For the year 2012-13	4,000	
For the year 2013–14	4,000	8,000
Book value of machine as on 31st March 2014		32,000
Less : Sale Proceeds of the machine		29,000
Loss on sale of machine (to be transferred to Profit & Loss A/c)		3,000

Illustration 10

On 1st April 2011 Rajesh transport company purchased 4 trucks at Rs.6,00,000 each. The company writes-off depreciation @ 10% per annum on original cost. On 1st July 2013 one of the trucks is involved in an accident and completely destroyed. Insurance company paid Rs.3,00,000 in full settlement of the claim. The books are closed on 31st December every year.

Prepare trucks account for three years

Solution

Books of Rajesh Transport Company

Trucks Account (Straight Line Method)

Dr Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2011			
Apr 01	To Bank Account (Purchase of 4 trucks@ Rs.6,00,000)		24,00,000	Dec 31	By Depreciation Account (for 9 months)		1,80,000
				Dec 31	By Balance c/d		22,20,000
			24,00,000				24,00,000
2012				2012			
Jan 01	To Balance b/d		22,20,000	Dec 31	By Depreciation Account		2,40,000
				Dec 31	By Balance c/d		19,80,000
			22,20,000				22,20,000
2013				2013			
Jan 01	To Balance b/d		19,80,000	Jul 01	By Bank Account (Insurance claim)		3,00,000
				Dec 31	By depreciation Account (Rs.1,80,000 + Rs.30,000)		2,10,000
				Dec 31	By Profit and Loss A/c (loss of truck destroyed)		1,65,000
				Dec 31	By Balance c/d		13,05,000
			19,80,000				19,80,000
2014							
Jan 01	To Balance b/d		13,05,000				

Working Notes

1. Calculation of loss on truck destroyed in an accident

		Rs
Original Cost of truck		6,00,000
Less : Depreciation		
For the year 2011, 10% on Rs.6,00,000 for 9months	45,000	
For the year 2012, 10% on Rs.6,00,000	60,000	
For the year 2013, 10% on Rs.6,00,000 for 6 months	30,000	1,35,000
The Book value of truck as on 1st July 2013		4,65,000
Less : Insurance claim received for the truck destroyed		3,00,000
Loss on truck destroyed due to accident (To be transferred to profit and loss account)		1,65,000

2.7 Reducing Balance Method

This method is also known as "Diminishing Balance Method" or "Written Down Value Method". Under this Method, depreciation is charged at a fixed percentage on the book value of the asset. Since book value keeps on reducing by the annual charge of depreciation, It is known as "Reducing Balance Method".

The amount of depreciation decreases year after year. Depreciation is calculated on diminishing value of the Fixed Asset. Under this method, the amount of depreciation is larger in the earlier years than in the later years.

Merits

The main merits of this method are as under

a) The total charge (i.e depreciation plus repairs) remains uniform year after year. Since in earlier years the amount of depreciation is more and the amount of repairs is less, Whereas in later years the amount of depreciation is less and the amount of repairs is more.

b) This method is logical in the sense that as asset grows older, the amount of depreciation also goes on decreasing.

c) Income Tax Act 1961 accept this method for Tax purposes.

d) This method can be used where obsolescence rate is high.

e) This method is suitable for those assets which have a longer life

Demerits

The main demerits of this method are as under

a) It is difficult to calculate the rate of depreciation.

b) The book value of the asset doesn't become Zero.

c) It doesn't take into consideration the interest on amount invested in the asset.

d) It doesn't provide for the replacement of the asset on the expiry of its life.

2.7.1 Difference Between Straight Line Method and Reducing Balance Method

Straight Line Method differs from Reducing Balance Method in the following respects

Basis of Difference	Straight Line Method	Reducing Balance Method
1. Basis of Calculation	Depreciation is calculated on the original cost.	Depreciation is calculated on the Book value. (i.e original cost less depreciation charged till date).
2. Amount of Depreciation	The amount of depreciation remains constant.	The amount of depreciation decreases year after year.
3. Total Charge against Profit & Loss Account in respect of depreciation and repairs	Total charge against profit & loss account in respect of depreciation and repair expenses increases in later years under this method.	Depreciation charge declines in later years. Therefore total of depreciation and repair expenses remains similar or equal every year.
4. Recognition by Income Tax Law	This method is not recognized by Income Tax Act.	This method is recognized by the Income Tax Act.
5. Suitability	This method is suitable for assets in which repair charges are less, the possibility of obsolescence is low.	This method is suitable for assets which are affected by Technological changes and require more repair expenses with passage of time.

Illustrations on Reducing Balance Method

Illustration 11

Nagarjuna & Co purchased plant and machinery for Rs. 70,000 on 1st January 2011 and spent Rs.10,000 for installation expenses. Depreciation is to be provided at 10% on Reducing Balance Method. Books are closed on 31st December every year.

Write the necessary journal entries and prepare Plant and Machinery Account and Depreciation Account for three years.

Solution

Journal Entries in the Books of Nagarjuna & Co

Date	Particulars		L.F	Dr (Rs)	Cr (Rs)
2011 Jan 01	Plant &Machinery Account	Dr		70,000	
	To Bank Account				70,000
	(Being the Plant & machinery purchased)				
2011 Jan 01	Plant & Machinery Account	Dr		10,000	
	To Bank Account				10,000
	(Being installation expenses incurred)				
2011 Dec 31	Depreciation Account	Dr		8,000	
	To Plant & Machinery Account				8,000
	(Being deprecation charged on Plant & Machinery)				
2011 Dec 31	Profit and Loss Account	Dr		8,000	
	To Depreciation Account				8,000
	(Being Depreciation transferred to P&L A/c)				
2012 Dec 31	Depreciation Account	Dr		7,200	
	To Plant & machinery Account				7,200
	(Being deprecation charged on Plant & machinery)				
2012 Dec 31	Profit and Loss Account	Dr		7,200	
	To Depreciation Account				7,200
	(Being Depreciation transferred to P&L A/c)				
2013 Dec 31	Depreciation Account	Dr		6,480	
	To Plant & machinery Account				6,480
	(Being deprecation charged on Plant & machinery)				
2013 Dec 31	Profit and Loss Account	Dr		6,480	
	To Depreciation Account				6,480
	(Being Depreciation transferred to P&L A/c)				

Plant & Machinery Account (Reducing Balance Method)

Dr Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2011			
Jan 01	To Bank Account		70,000	Dec 31	By Depreciation Account		8,000
Jan 01	To Bank Account (Installation Expenses)		10,000	Dec 31	By Balance c/d		72,000
			80,000				80,000
2012				2012			
Jan 01	To Balance b/d		72,000	Dec 31	By Depreciation Account		7,200
				Dec 31	By Balance c/d		64,800
			72,000				72,000
2013				2013			
Jan 01	To Balance b/d		64,800	Dec 31	By Depreciation Account		6,480
				Dec 31	By Balance c/d		58,320
			64,800				64,800
2014							
Jan 01	To Balance b/d		58,320				

Depreciation Account

Dr Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2011			
Dec 31	To Plant & Machinery Account		8,000	Dec 31	By Profit & Loss Account		8,000
			8,000				8,000
2012				2012			
Dec 31	To Plant & Machinery Account		7,200	Dec 31	By Profit & Loss Account		7,200
			7,200				7,200
2013				2013			
Dec 31	To Plant & Machinery Account		6,480	Dec 31	By Profit & Loss Account		6,480
			6,480				6,480

Working Note

Calculation of the amount of depreciation	Rs
Original cost of the plant & machinery as on 01-01-2011	80,000
Less: Depreciation for the year 2011 (@10% on Rs. 80,000)	8,000
Book value of plant & machinery as on 01-01-2012	72,000
Less: Depreciation for the year 2012 (@10% on Rs.72,000)	7,200
Book value of plant & machinery as on 01-01-2013	64,800
Less : Depreciation for the year 2013 (@10% on Rs.64,800)	6,480
Book value of plant & machinery as on 01-01-2014	58,320

Illustration 12

Sujatha enterprises purchased machinery on 1st April 2011 for Rs. 4,00,000. Depreciation is calculated @ 10% per annum on Reducing Balance Method. Books are closed on 31st December every year.

Prepare Machinery Account for the first three years.

Solution

Books of Sujatha Enterprises

Machinery Account (Reducing Balance Method)

Dr Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2011			
Apr 01	To Bank Account		4,00,000	Dec 31	By Depreciation Account (for 9 months)		30,000
				Dec 31	By Balance c/d		3,70,000
			4,00,000				4,00,000
2012				2012			
Jan 01	To Balance b/d		3,70,000	Dec 31	By Depreciation Account		37,000
				Dec 31	By Balance c/d		3,33,000
			3,70,000				3,70,000
2013				2013			
Jan 01	To Balance b/d		3,33,000	Dec 31	By Depreciation Account		33,300
				Dec 31	By Balance c/d		2,99,700
			3,33,000				3,33,000
2014							
Jan 01	To Balance b/d		2,99,700				

Working Notes

Calculation of the amount of depreciation	Rs
Original cost of the machinery as on 01-04-2011	4,00,000
Less: Depreciation for the year 2011 (@10% on Rs. 4,00,000 for 9 months)	30,000
Book value of machinery as on 01-01-2012	3,70,000
Less: Depreciation for the year 2012 (@10% on Rs.3,70,000)	37,000
Book value of machinery as on 01-01-2013	3,33,000
Less : Depreciation for the year 2013 (@10% on Rs.3,33,000)	33,300
Book value of machinery as on 01-01-2014	2,99,700

Illustration 13

Kiran enterprises purchased a printing machine for Rs.80,000 on 1st July 2011 and spent Rs. 10,000 on its transport and installation expenses. Another machine for Rs. 70,000 was purchased on 1st January2013. Depreciation is charged at the rate of 20% on Reducing Balance Method. Books are closed on 31st March every year.

Prepare printing Machine Account for three years.

Solution

Books of Kiran Enterprises
Printing Machinery Account (Reducing Balance Method)

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2012			
Jul 01	To Bank Account		80,000	Mar 31	By Depreciation Account (for 9 months@20%)		13,500
Jul 01	To Bank Account (Installation Expenses)		10,000	Mar 31	By Balance c/d		76,500
			90,000				90,000
2012				2013			
Apr 01	To Balance b/d		76,500	Mar 31	By Depreciation Account (15,300+3,500 for 3 months)		18,800
2013							
Jan 01	To Bank Account (Purchase of 2nd Machine)		70,000	Mar 31	By Balance c/d		1,27,700
			1,46,500				1,46,500
2013				2014			
Apr 01	To Balance b/d		1,27,700	Mar 31	By Depreciation Account		25,540
				Mar 31	By Balance c/d		1,02,160
			1,27,700				1,27,700
2014							
Apr 01	To Balance b/d		1,02,160				

Working Notes

Calculation of the amount of depreciation	Rs
Original cost of the printing machine as on 01-07-2011	
(Rs.80,000+Rs.10,000)	90,000
Less: Depreciation for the year 2011-2012 (for 9 months)	13,500
(@20% on Rs. 90,000 for 9 months)	
Book value of printing machine as on 01-04-2012	76,500
Add: Original cost of new printing machine purchased on 01-01-2013	70,000
Book value of machinery as on 01-01-2013	1,46,500
Less: Depreciation for the year 2012-2013 (15,300+3,500)	18,800
(@20% on Rs.76,500+ @20% on Rs.70,000 for 3 months)	
Book value of machinery as on 01-04-2013	1,27,700
Less : Depreciation for the year 2013-2014 (@20% on Rs.1,27,700)	25,540
Book value of machinery as on 01-04-2014	1,02,160

Illustration 14

On 1st July 2010 Venkatesh & Co purchased a machine for Rs. 40,000. On 30th June 2013 the machine was disposed off for Rs. 26,000. The books are closed on 31st December every year. Depreciation is to be calculated @10% per annum on Reducing Balance method.

Show the machine Account

Solution

Books of Venkatesh & Co
Machine Account (Reducing Balance Method)

Dr Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2010				2010	By Depreciation Account		2,000
Jul 01	To Bank Account		40,000	Dec 31	(for 6 months)		
				Dec 31	By Balance c/d		38,000
			40,000				40,000
2011				2011			
Jan 01	To Balance b/d		38,000	Dec 31	By Depreciation Account		3,800
				Dec 31	By Balance c/d		34,200
			38,000				38,000
2012				2012			
Jan 01	To Balance b/d		34,200	Dec 31	By Depreciation Account		3,420
				Dec 31	By Balance c/d		30,780
			34,200				34,200

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2013				2013			
Jan 01	To Balance b/d		30,780	Jun 30	By Bank Account		26,000
				Dec 31	By Depreciation Account (For 6 months)		1,539
				Dec 31	By Profit & loss A/c (loss)		3,241
			30,780				30,780

Working Notes

Calculation of Profit or loss on the sale of machine	*Rs*
Original cost of the machine as on 01-07-2010	40,000
Less: Depreciation for the year 2010 (@10% on Rs. 40,000 for 6 months)	2,000
Book value of machine as on 01-01-2011	38,000
Less: Depreciation for the year 2011 (@10% on Rs. 38,000)	3,800
Book value of machine as on 01-01-2012	34,200
Less: Depreciation for the year 2012 (@10% on Rs. 34,200)	3,420
Book value of machine as on 01-01-2013	30,780
Less : Depreciation for the year 2013 (@10% on Rs. 30,780 for 6 months)	1,539
Book value of machinery as on 30-06-2013	29,241
Less: Sale proceeds of machine	26,000
Loss on sale of machine (to be transferred to profit & loss A/c)	3,241

Illustration 15

On 1st January 2011, Bhargava traders purchased machinery for Rs. 40,000. On 1st July in the same year the firm purchased additional machinery for Rs. 20,000. On 1st July 2013, The machinery purchased on 1st January 2011 having become obsolete, it was sold for Rs. 32,000. The books are closed on 31st December every year.

Prepare Machinery Account for three years providing depreciation @10% p.a. on Reducing Balance Method.

Solution:

Books of Bhargava Traders

Machinery Account (Reducing Balance Method)

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2011				2011			
Jan 01	To Bank Account		40,000	Dec 31	By Depreciation Account (Rs.4,000 + Rs.1,000)		5,000
Jul 01	To Bank Account (Additional Machinery)		20,000	Dec 31	By Balance c/d		55,000
			60,000				60,000
2012				2012			
Jan 01	To Balance b/d (36000 + 19000)		55,000	Dec 31	By Depreciation Account (Rs.3600 + Rs.1900)		5,500
				Dec 31	By Balance c/d		49,500
			55,000				55,000
2013				2013			
Jan 01	To Balance b/d (32400 + 17100)		49,500	Jul 01	By Bank Account		32,000
Dec 31	To Profit & Loss A/c (Profit)		1,220	Dec 31	By depreciation Account (10% on 17100+ 10% on 32,400 for 6months = Rs.1710+Rs.1620)		3,330
				Dec 31	By Balance c/d		15,390
			50,720				50,720
2014							
Jan 01	To Balance b/d		15,390				

Working Notes

Calculation of Profit or loss on the sale of machinery	Rs
Original cost of the machinery as on 01-01-2011	40,000
Less: Depreciation for the year 2011 (@10% on Rs. 40,000)	4,000
Book value of machinery as on 01-01-2012	36,000
Less: Depreciation for the year 2012 (@10% on Rs. 36,000)	3,600
Book value of machinery as on 01-01-2013	32,400
Less: Depreciation for the year 2013 (@10% on Rs. 32,400 for 6months)	1,620
Book value of machinery as on 01-07-2013	30,780
Less: Sale proceeds of machinery	32,000
Profit on sale of machinery (to be transferred to profit & loss A/c)	1,220

Illustration 16

On 1st January 2010, Manjula & Co purchased a plant for Rs.30,000. The company purchased another plant on 1st January 2011 for Rs. 28,000 and spent Rs.2,000 towards installation expenses. The books are closed on 31st December every year.

Show the plant account for first three years providing depreciation at 10% on first plant and 15% on second plant on Reducing Balance Method.

Solution

Books of Manjula & Co

Plant Account (Reducing Balance Method)

Dr | Cr

Date	Particulars	JF	Amount Rs.	Date	Particulars	JF	Amount Rs.
2010				2010			
Jan 01	To Bank Account (Purchase of 1st plant)		30,000	Dec 31	By Depreciation Account (10% on Rs. 30,000)		3,000
				Dec 31	By Balance c/d		27,000
			30,000				30,000
2011				2011			
Jan 01	To Balance b/d		27,000	Dec 31	By Depreciation Account (10% on Rs. 27,000 + 15% on Rs. 30,000)		7,200
Jan 01	To Bank Account (Purchase of 2nd machine)		28,000	Dec 31	By Balance c/d		49,800
Jan 01	To Bank Account (Installation expenses)		2,000				
			57,000				57,000
2012				2012			
Jan 01	To Balance b/d		49,800	Dec 31	By Depreciation Account (10% on Rs. 24,300 + 15% on Rs. 25,500)		6,255
				Dec 31	By Balance c/d		43,545
			49,800				49,800
2013							
Jan 01	To Balance b/d		43,545				

Summary

Assets are classified as Fixed Assets and Current Assets. Depreciation is provided on Fixed Assets only like plant & machinery, furniture and vehicles etc..Depreciation is permanent, continuous and gradual decrease in the book value of an Asset due to various causes. Main causes of depreciation are wear and tear, physical forces, expiration of legal rights, obsolescence and accidents.

We can ascertain the true profit or loss of business operations and know the true and fair financial position of the firm by providing depreciation on Fixed Assets.

There are several methods of providing depreciation on the assets. Out of these methods most commonly employed methods in industrial and commercial enterprises are the Straight Line Method and Reducing Balance Method. Straight Line Method is simple and is suitable for those assets in which repair charges are less and the possibility of obsolescence is low. Reducing Balance Method is suitable for those Assets which are affected by technological changes and require more repair expenses with passage of time. The Reducing Balance Method is recognized by the Income Tax Authorities.

MODEL QUESTIONS

I. Short Answer type Questions

1. What is depreciation?
2. What are the causes of depreciation?
3. What is obsolescence?
4. What is depletion?
5. Write different methods of providing depreciation.
6. What is Straight Line Method?
7. What is Reducing Balance Method?

II. Essay type Questions

1. Define depreciation. What are the main causes of depreciation?
2. Define depreciation. Explain the need of providing depreciation.
3. Explain the meaning, merits and demerits of Straight Line Method.
4. Explain the meaning, merits and demerits of Reducing Balance Method.
5. What are the differences between Straight Line Method and Reducing Balance Method?

Exercises

Straight Line Method or Fixed Installment Method

1. Praveen traders purchased machine for Rs. 80,000. The life of the machine is estimated at 10 years and the residual value is Rs. 10,000. Calculate the annual amount of depreciation according to Straight Line Method. ***[Ans. Rs. 7,000]***

2. A machine is purchased for Rs. 40,000. It is estimated that the useful life of the machine is 9 years and residual value is Rs.4,000. You are required to find out the annual amount of depreciation and the rate of depreciation under the Straight Line Method.

   [Ans. Rs. 4,000 and 10%]

3. A truck is purchased for Rs. 50,000. It is estimated that the useful life of the truck is 10 years and residual value is Rs. 5,000. Calculate the annual amount of depreciation and the rate of depreciation under the Straight Line method. ***[Ans. Rs. 4,500 and 9%]***

4. On 1st April 2010 Anand traders purchased a machine for Rs. 2,60,000 and spent Rs.40,000 on its installation. It is estimated that working life is 10 years and after 10 years its scrap value will be Rs. 20,000. Books are closed on 31st March every year.

   Write necessary journal entries and prepare machine account for the first three years in the books of Anand traders according to the Straight Line Method

   [Ans. Balance Rs. 2, 16,000]

5. On 1st July 2011, Neeharika & Co purchased a printing machine for Rs. 2,16,000 and spent Rs. 24,000 on its installation. It was estimated that the effective useful life of the printing machine will be 12 years and its scrap value will be Rs. 24,000. The books are closed on 31st December every year.

   Prepare printing machine account and depreciation account for first three years according to the Straight Line Method ***[Ans. Balance Rs. 1, 95,000]***

6. Madan & Company purchased machinery on 1st January 2011 for Rs. 80,000 and spent Rs. 4,000 for its installation. The estimated life of the machinery is 10 years with a scrap value of Rs. 4,000. Books are closed on 31st December every year.

Calculate amount of annual depreciation under the straight line method and prepare machinery account for first three years.

[Ans. Annual Depreciation Rs. 8,000: Balance Rs 60,000]

7. On 1st January 2011, Raghavendra traders purchased Furniture for Rs. 60,000. Depreciation is to be calculated at the rate of 10% p.a. on Straight Line method. The books are closed on 31st December every year. Write necessary journal entries and prepare Furniture Account for first four years. ***[Ans. Balance Rs. 36,000]***

8. On 1st October 2011 Jagannadham & Sons purchased a machine for Rs. 90,000 and spent Rs. 10,000 for its installation. The books are closed on 31st March every year. The firm writes-off depreciation at the rate of 10% on original cost every year.

   Prepare Machine Account and Depreciation Account for first three years.

   [Ans. Balance Rs. 75,000]

9. Venugopal traders limited purchased machinery on 1st July 2010 for Rs. 50,000 and spent Rs. 2,000 on its installation. Depreciation is to be provided @10%p.a. under Straight Line Method. Books of account are closed on 31st December every year.

   Show the machinery account for the first three years. ***[Ans. Balance Rs. 39,000]***

10. On 1st January 2011 Suma purchased Furniture for Rs. 80,000. Depreciation is to be provided annually at 10% under Straight Line Method. On 31st December 2013 furniture was sold for Rs. 40,000.

    Show the Furniture Account assuming that the books are closed on 31st December every year. ***[Ans. Loss on sale of Furniture Rs. 16,000]***

11. Suneetha traders purchased a second hand machine for Rs. 72,000 on 1st January 2011 and spent 8,000 on repairs and installed the same. Depreciation is written-off at 10% p.a. on the Straight Line method. On 30th June 2013 the machine was sold for Rs. 50,000.

    Prepare machinery account assuming that the accounts are closed on 31st December every year.

    [Ans. Loss on sale of Machine Rs. 10,000]

12. Ranadheer & Co purchased a machine for Rs. 60,000 on 1st January 2011. Depreciation is calculated @10% on Straight Line Method. On 1st April 2013 the company sold the machine for Rs. 36,000.

    Prepare machine account assuming that the accounts are closed on 31st December every year. ***[Ans. Loss on sale of Machine Rs. 10,500]***

13. On 1st January 2011, Siva traders purchased a second hand machine for Rs. 40,000 and spent Rs. 5,000 on repairs and installed the same. It is estimated that the working life of the machine is 10 years and scrap value is Rs. 2,500. On 31st December 2013 the machine was sold for Rs. 25,000.

    Prepare machine account assuming that the books are closed on 31st December every year according to Straight Line Method. ***[Ans. Loss on sale of Machine Rs. 7,250]***

14. Manoj & Company purchased a second hand machine for Rs. 18,000 on 1st April 2011 and spent Rs. 2,000 on repairs and installed the same. Depreciation is written-off at10% p.a. on Straight Line Method. On 30th June 2013 it was sold for Rs.13,000.

    Prepare machine account assuming that the accounts are closed on 31stDecember every year. ***[Ans. Loss on sale of Machine Rs. 2,500]***

15. Ramesh & Co purchased machinery on 1st January 2011 for Rs. 3,00,000. On 1st September 2011, another machine was purchased for Rs. 4,20,000. Depreciation is provided on machinery at 10%p.a. on Straight Line method. Books are closed on 31st December every year. Prepare machinery account for three years. ***[Ans. Balance Rs. 5,32,000]***

16. Andhra sugars Ltd purchased a plant for Rs. 1,00,000 on 1st January 2011. On 1st July in the same year additional plant was purchased for Rs. 50,000. On 1st October 2013 the plant purchased on 1st January 2011 having become obsolete, was sold for Rs. 60,000. On the same date a fresh plant was purchased for Rs.1,25,000. Depreciation is provided at 10%p.a. on Straight Line Method.

    Prepare plant account for three years assuming that the accounts are closed on 31st December every year. ***[Ans. Loss on sale of plant Rs. 12,500; Balance Rs. 1,59,375]***

17. On 1st July2010 Ganga & Co purchased second hand machine for Rs. 40,000, and spent Rs. 6,000 on repairs. On 1st January 2011 a new machine was purchased for Rs. 24,000. On 30th June 2012 the machine purchased on 1st January 2011 was sold for Rs. 16,000 and another machine was installed at a cost of Rs. 30,000. The company writes-off depreciation @ 10% p.a. on original cost every year on 31st March.

Show the machinery account for three years.

[Ans. Loss on sale of machine Rs. 4,400; Balance Rs. 61,100]

18. Rama transport company purchased 6 trucks at Rs. 5,00,000 each on 1st January2011.The company writes-off depreciation @10%p.a. on original cost. The books of account are closed on 31st December every year. On 1st July 2013 one of the trucks is involved in an accident and completely destroyed. A sum of Rs. 2,50,000 is received from insurance company in full settlement. Prepare Trucks Account for first three years

[Ans. Loss on truck destroyed Rs. 1,25,000; Balance Rs. 17,50,000]

Reducing Balance Method

19. Kushal textile mills purchased machinery on 1st April 2011 for Rs. 4,00,000 and spent Rs. 20,000 for its installation. Depreciation is provided @10% p.a. on Reducing Balance Method. Books are closed on 31st March every year.

    Write necessary journal entries and prepare Machinery Account and depreciation Account for first three years

[Ans. Balance Rs. 3,06,180]

20. On 1st July 2010 Pradeep & Co purchased machinery for Rs. 50,000. Depreciation is written-off at the rate of 10% p.a. under Reducing Balance Method. Show the Machinery Account for 3 years assuming that the books are closed on 31st December every year.

[Ans. Balance Rs. 38,475]

21. On 1st January 2012 Siva & Co purchased a second hand machinery for Rs.34,000 and spent Rs. 6,000 on its repairs and installed the same. On 31st December 2014 the machinery was sold for Rs. 26,000. The books are closed on 31st December every year. Depreciation is provided @10% p.a. on Reducing Balance Method. Show the Machinery Account

[Ans. Loss on sale of machinery Rs. 3,160]

22. On 1st January 2011 Geetha traders purchased a printing machine for Rs.3,00,000. On 1st July 2013 the printing machine was sold for Rs. 1,30,000. Depreciation is provided @10% p.a. on Reducing Balance Method. The books are closed on 31st December every year.

    Prepare Printing Machine Account

[Ans. Loss on sale of Printing machine Rs. 1,00,850]

23. Sravanthi enterprises purchased a machine for Rs. 40,000 on 1st July 2011 and spent Rs. 5,000 on its installation. Another Machine for Rs. 35,000 was purchased on 1st January 2013. Depreciation is charged @20% p.a. on Reducing Balance Method. Books are closed on 31st March every year.

    Prepare Machinery Account for three years

[Ans. Balance Rs. 51,080]

24. On 1st January 2012 Swathi & Co purchased plant for Rs 3,00,000. On 1st October 2012 another plant was purchased for Rs. 1,00,000. Depreciation is charged @10% p.a. on Reducing Balance Method. On 1st October 2013, the first plant was Sold for 2,20,000.

    Prepare plant account for three years assuming that the accounts are closed on 31st December every year.

[Ans. Loss on sale of Plant Rs. 29,750; Balance Rs. 78,975]

Chapter

3

Consignment

3.1 Introduction
3.2 Features
3.3 Difference between Consignment and Sale
3.4 Proforma Invoice
3.5 Account sales
36 Commission
3.7 Advance on consignment
3.8 Accounting treatment along with illustrative problems and solutions
3.9 Theoretical questions
3.10 Assignment problems with hints

3.1 Introduction

The word consignment is originated from the French word "consigner" which means "to hand over or transmit". "To consign" means "to send" and therefore consignment means sending goods to another person.

In case of consignment, goods are sent by the owner of goods to the agent for the purpose of sale. The ownership of these goods remains with the sender. The agent sells the goods on behalf of the sender, according to his instructions. The sender of goods is known as consignor and the agent is known as the consignee.

Parties to the Consignment

There are two parties in the Consignment. They are

1. **Sender of the Goods (Consignor):** The person who sends the goods is known as the Consignor. In other words, consignor is the person who "Consigns" the goods. He is the owner of the goods. He sends goods where in the physical delivery is delivered to the receiver without transfer of ownership. That means, even after sending the goods to the recipient, he still continues to be the owner.

2. **Recipient of the Goods (Consignee):** The person who receives the goods sent by the Consignor is known as the Consignee. In other words, Consignee is the person who acts as an Agent of the Consignor. He receives the goods on behalf of the consignor, stores them, incurs expenses and sells the goods as per the specifications of consignor for a consideration called "Commission". He remits the amount of sale proceeds after deducting his expenses and commission.

3.2 Characteristics/Features of Consignment

1) **Parties:** There are two parties in consignment they are consignor and consignee
2) **Relationship** : Relationship between consignor and consignee is that of principal and agent
3) **Ownership:** Ownership is vested with consignor only. In consignment only goods transferred from consignor to consignee but consignor is always owner of such goods.
4) **Risk:** In consignment business all the risk borne by only consignor
5) **Expenses :** All the expenses related to consignment are borne by consignor only. Even the expenses paid by consignee also reimbursed by consignor
6) **Closing Stock:** Any unsold stock left with consignee belongs to consignor only

3.3 Difference between consignment and sale

Basis	Consignment	Sale
1. Ownership of goods	The ownership of goods remain with the consignor and the possession is transferred to consignee	The ownership and possession of goods, both are transferred to the buyer immediately
2. Parties	The two parties involved are known as consignors and consignee	The two parties involved are known as buyer and seller
3. Relation between parties	The relation between them is that of a principal and agent which continues for long period till it is ended	The relation between them is of buyer and seller, which ends immediately after the delivery and payment for of the goods
4. Risk	The risk of loss or damage is of the owner (consignor)	The risk passes with the ownership to the buyer
5. Consideration	The consignee sells goods for commission	The goods are sold for profit against the price
6. Expenses	The expenses are borne by the consignor	After sales, the expenses are borne by the buyer

7. Account sales	Consignee sends to consignor account sales from time to time	The buyer does not needs to send any account sales to seller
8. Profit or Loss	The profit or loss on consignment belongs to the consignor	The profit or loss on sales belongs to the seller

3.4 Important Documents

3.4.1 Proforma Invoice

Along with the goods, a statement is usually forwarded by the consignor to the consignee, giving a description of the goods consigned, the weight, quantity, price and other relevant details. The statement is known as a proforma invoice. It resembles a sales invoice in appearance, but its purpose is quite different. A sales invoice is a document sent by a seller to a buyer which charges the buyer with the value of the goods. A pro-forma invoice sent by a consignor to the consignee, does not charge the consignee with the value; it is intended as an evidence record of consignment and also as an indication of the price at or above which the consignor intends the goods to be sold. The price mentioned in the pro-forma invoice is called the pro-forma invoice price. The pro-forma invoice price may be the cost price of the goods sent, though usually it represents the selling price or the minimum price at which the consignee is expected to sell the goods sent to him.

3.4.2 Account sales

Account sales is a document or a statement sent by the consignee to the consignor from time to time. Since the consignee sells the goods on behalf of the consignor, so he has to send a proper statement either on sale of goods or at the end of a particular period. In account sales, the consignee shows the details of the gross sales proceeds of the consignment. The various expenses, charges incurred by him and the commission due to him is deducted. Any advance payment to the consignor is deducted from the total amount due and the net amount payable is shown. The net amount payable is sent to the consignor by a bank draft or bills of exchange, as agreed.

Chakravarthy & Co sent a account sales to Ganesh for receiving of 200 radios

Date	Particulars	Rs.	Rs.
2015 March 31st	Gross Proceeds from sale of 200 radios @ Rs.400 each		80,000
	Less: Freight inwards	500	
	Insurance	2,000	
	Warehouse charges	1,000	
	Commission 10% on sales	8,000	11,500
			68,500
	Less: Advance (cash, bank are bills payable)		18,500
	Balance remitted with bank draft		**50,000**

E & OE For Chakravarthy & Co

Manager

3.5 Commission

The consignee is remunerated by a commission which is usually calculated as an agreed percentage of the gross proceeds of sale. Commission payable to consignee can be divided into 3 types.

a) Ordinary Commission

b) Del Credre Commission

c) Overriding Commission

3.5.1 Ordinary Commission

Ordinary commission is the commission generally paid by the consignor to the consignee. It is calculated as a fixed percentage on the gross sales proceeds, such a commission does not provide any security to the consigner from bad debts.

3.5.2 Del Credre Commission

The Consignee may sell some part of the goods on credit. When goods are sold on credit, there is always a risk of some amount of bad-debts. In order to avoid the risk of Bad-debts the consignor provides an additional commission known as “Del-credere commission to the consignee who guarantees for the payment in case of credit sale. Del-Credere Commission is paid at pre-determined percentage of Gross Sales proceeds.

However, as regards to payment of del-credere there may be a separate agreement for its payment.

When del-credere commission is given to consignee and he is unable to recover some amount from the debtors, then the amount which is not realized by the consignee is treated as bad debts, No record for this bad debts is made in the books of consignor, because he can recover the whole amount from consignee. This bad debts is really loss to the Consignee. Consignee transfers this bad debts to Commission Account in order to find out his real profit or loss. Debtors Account is opened in consignee's books.

3.5.3 Over- Riding Commission

It is an extra commission allowed over the normal commission. This commission is generally offered when an agent is required to work hard either to introduce a new product in the market or to handle the work of supervising the performance by other agents in a particular area. It is the commission paid by the consignor to the consignee for executing sales on consignment on a price higher than the price fixed by the consignor. In other words, it is the surplus commission allowed to the consignee, calculated on the surplus price realized by him.

3.6 Accounting Treatment in the Books of Consigner

Generally in order to record each and every consignment transactions consignor maintains the following accounts:

They are

1. Consignment Account
2. Consignee Personal Account
3. Goods Sent on Consignment Account

3.6.1 Consignment Account

This account is a nominal account. This account is opened to find out the profit or loss made on each consignment. Generally consignor sent the goods on consignment to difference consignees to different places. To find out profit or loss on each of such consignment, the consignor maintains a separate consignment account for each consignment. For example if consignor send goods to Guntur and Hyderabad then he will maintains Guntur Consignment Account and Hyderabad Consignment Account.

3.6.2 Consignee Personal Account

This account is a personal account. This account is prepared in order to find out balance due to or due from Consignee.

3.6.3 Goods sent on consignment Account

This account is a real account. This account is credited when goods are sent to the consignee and is debited when goods returned by consignee. This account is closed by transferring the balance to the trading account or purchases account.

Journal entries in the Books of Consignor

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
1	When goods are sent on consignment			
	Consignment A/c Dr		xxxx	
	To Goods sent on Consignment A/c			xxxx
	(Being the goods sent on consignment)			
2	When expenses are incurred by the consignment			
	Consignment A/c Dr		xxxx	
	To Bank / Cash A/c			xxxx
	(Being the expenses met by Consignor)			
3	When advance is Received			
	Cash / Bank / Bills receivable Account Dr		xxxx	
	To Consignee's Account			xxxx
	(Being the advance received)			
4	When the bill is discounted with bank			
	Bank Account Dr		xxxx	
	Discount Account Dr		xxxx	
	To Bills receivable Account			xxxx
	(Being the Bill discounted with the Bank)			
5	For expenses incurred by the consignee			
	Consignment Account Dr		xxxx	
	To Consignee's Account			xxxx
	(Being the expenses incurred by the consignee)			
6	For sales reported by Consignee			
	Consignees Account Dr		xxxx	
	To Consignment Account			xxxx

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
7	For commission payable to Consignee			
	Consignment Account Dr		xxxx	
	To Consignee's Account			xxxx
	(Being the commission paid to consignee)			
8	For unsold stock remaining with Consignee			
	Consignment stock Account Dr		xxxx	
	To Consignment Account			xxxx
	(Being the stock transferred to consignment A/c)			
9	For transferring profit to Profit & Loss Account			
	Consignment Account Dr		xxxx	
	To Profit & Loss Account			xxxx
	(Being the profit transferred to consignment A/c)			
10	For transferring loss to Profit & Loss Account			
	Profit & Loss Account Dr		xxxx	
	To Consignment Account			xxxx
	(Being the Loss transferred to consignment A/c)			
11	For the settlement of account with the Consignee			
	Cash / Bank / Bills Receivable Account Dr		xxxx	
	To Consignee's Account			xxxx
	(Being the balance received from consignee)			
12	For closing the Goods Sent on Consignment Account			
	Goods sent on consignment Account Dr		xxxx	
	To Trading Account / Purchase Account			xxxx
	(Being the goods sent on consignment transferred to Trading / Purchases A/c)			

Proforma of Consignment Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Goods Sent on Consignment	Xxxx		By Consignee A/c	
	(value of goods sent to this			(Sales made by him) xxx	
	particular consignment)				
	To Cash / Bank A/c				
	(Expenses incurred by Consignor)	Xxxx		By consignment Stock A/c	xxxx
	To Consignee A/c				
	(Expenses incurred by Consignee)	Xxxx			
	To Consignee A/c (Commission)	Xxxx			
	To Profit & Loss A/c (Profit)	Xxxx		By Profit & Loss A/c	
				(Loss)	xxxx
		Xxxx			**Xxxx**

Proforma of Consignees Personal Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Consignment A/c				
	(For sales made by him)	Xxx		By Cash / Bank/ Bills	xxx
				Receivable A/c	
				(Advance paid by him)	
				By Consignment A/c	xxx
				(Expenses incurred by him)	
				By consignment A/c	xxx
				(Commission Payable)	
				By Cash / Bank / Bills	xxx
				Receivable A/c	
				(Payment received from	
				consignee for settlement of A/c)	
		Xxx			**xxx**

Goods sent on Consignment Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Trading A/c	Xxx		By consignment A/c	xxx
		Xxx			**Xxx**

3.7 Accounting Treatment in the books of Consignee

Goods received by the consignee on account of consignment cannot be treated as purchases because the legal ownership of the goods is not transferred to him. Thus, no entry is passed in his books on the receipt of goods. He maintains only consignor's account and a stock register.

Journal Entries in the books of Consignee

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
	When the goods are received from Consignor			
	No Entry is made in the books of consignee			
	For the Expenses incurred by the Consignor			
	No Entry is made in the books of Consignee			
	For Advance sent to Consignor			
	Consignor Account Dr		xxxx	
	To Cash / Bank / Bills Payable account			xxxx
	(Being the advance paid)			
	For the Expenses incurred by Consignee			
	Consignor Account Dr		xxxx	
	To Cash / Bank			
	(Being the expenses incurred by Consignee)			xxxx
	When Consignee sells goods			
	a. For cash sales			
	Cash / Bank Account Dr		xxxx	
	To Consignor's Account			
	(being the sales made)			xxxx

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
	b. For Credit sales			
	Debtors Account Dr		xxxx	
	To Consignor's Account			xxxx
	(being the Credit sales made)			
	When the commission on Sales is due			
	Consignor's Account Dr		xxxx	
	To Commission Account			xxxx
	(Being the commission due)			
	For the final remittance sent to consignor			
	Consignor's Account Dr		xxxx	
	To Bank / Bills Payable A/c			xxxx
	(Being the Final balance remitted)			
	For unsold stock with the consignor			
	No Entry			

3.7.1 Proforma of Consignors Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Cash /Bank/Bills Payable A/c	xxx		By Bank A/c	
	(Amount of sales realized)	xxx			
	Payable A/c	xxx		By Debtors A/c	xxx
	(Advance paid to Consignor)				
	To Bank A/c	xxx		Credit Sales	xxx
	(Expenses incurred by Consignee)				
	To Commission A/c	xxx			
	To Bank A/c (Balance remitted)	xxx			
		xxx			**xxx**

Illustration 1:

When consignee sold total goods

Sri Manikanta of Guntur consigned goods of the value of Rs.1,00,000 to their agent Sri Rama of Hyderabad. Sri Manikanta paid loading, insurance in transit Rs.5,000. On receiving the consignment Sri Rama sent Rs.50,000 worth of Bank draft as advance.

Sri Rama sent account sales which shows the following particulars

Gross Sales Rs.2,00,000

Godown Rents Rs.1,000

Advertisements Rs.2,000

Commission 10% on sales

Sri Rama attached a bank draft for the balance due to Sri Manikanta your required to pass journal entries and prepare necessary ledger accounts in the books of Sri Manikanta and Sri Rama.

Books of Sri Manikanta (Consignor)

Journal entries

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
	Consignment to Hyderabad A/c Dr		1,00,000	
	To Goods sent on consignment A/c			
	(Being the goods sent on consignment)			1,00,000
	Consignment to Hyderabad A/c Dr		5,000	
	To Cash / Bank A/c			5,000
	(Being Expenses Paid)			
	Bank A/c Dr		50,000	
	To Sri Rama A/c			50,000
	(Being Advance received)			
	Sri Rama A/c Dr		2,00,000	
	To Consignment to Hyderabad A/c			2,00,000
	(Being goods sold by Sri Rama)			
	Consignment to Hyderabad A/c Dr		3,000	
	To Sri Rama A/c (Being the			3,000
	expenses payable to Sri Rama)			

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
	Consignment to Hyderabad A/c Dr To Sri Rama A/c (Commission = 2,00,000 x 10/100) (Being commission payable to Sri Rama)		20,000	20,000
	Consignment to Hyderabad A/c Dr To Profit & Loss A/c (Being profit on Hyderabad consignment transferred to General profit & loss A/c)		72,000	72,000
	Bank A/c Dr To Sri Rama A/c (Being full and final settlement received from Sri Rama)		1,27,000	1,27,000
	Goods Sent on consignment A/c Dr To Trading A/c (Being balance in goods sent on consignment A/c transferred to Trading A/c)		1,00,000	1,00,000

Dr. **Hyderabad Consignment Account** **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Goods Sent on Consignment (value of goods sent to this particular consignment)	1,00,000		By Consignee A/c (Sales made by him) xxx	2,00,000
	To Cash / Bank A/c (Expenses incurred by Consignor)	5,000			
	To Consignee A/c (Expenses incurred by Consignee)	3,000			
	To Consignee A/c (Commission)	20,000			
	To Profit & Loss A/c (Profit)	72,000			
		2,00,000			**2,00,000**

Dr. **Sri Rama Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Consignment A/c	2,00,000		By Cash / Bank/ Bills (For sales made by him)	50,000
				Receivable A/c (Advance paid by him)	
				By Consignment A/c (Expenses incurred by him)	3,000
				By consignment A/c (Commission Payable)	20,000
				By Bank / (Payment received from consignee for settlement of A/c)	1,27,000
		2,00,000			**2,00,000**

Dr. **Goods sent on Consignment Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Trading A/c	1,00,000		By consignment A/c	1,00,000
		1,00,000			1,00,000

Books of Sri Rama (Consignee)

Journal Entries

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
	Sri Manikanta A/c Dr		50,000	
	To Bank A/c			
	(Being advance send to Sri Manikanta)			50,000

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
	Bank A/c	Dr		2,00,000	
	To Sri Manikanta A/c				2,00,000
	(Beinggoods sold on behalf of Sri Manikanta)				
	Sri Manikanta A/c	Dr		3,000	
	To Cash/ Bank A/c				3,000
	(Being expenses paid on behalf of Sri Manikanta)				
	Sri Manikanta A/c	Dr		20,000	
	To Commission A/c				20,000
	(Being commission receivable)				
	Sri Manikanta A/c	Dr		1,27,000	
	To Bank A/c				1,27,000
	(Being full and final settlement on consignment send to Sri Manikanta)				

Sri Manikanta Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Bank A/c (Advance paid to Consignor)	50,000		By Bank A/c (Amount of sales realized)	2,00,000
	To Bank A/c (Expenses incurred by Consignee)	3,000			
	To Commission A/c	20,000			
	To Bank A/c (Balance remitted)	1,27,000			
		2,00,000			**2,00,000**

Illustration 2:

Bhaskar of Rajahmundry consign 500 radio sets each at Rs.600 to Prasad of Tenali on consignment. Bhaskar paid Rs.12,000 as freight and insurance in transit. Bhaskar drawn a bill on Prasad for 3 months for Rs.1,00,000.

Prasad send account sales which shows the following particulars.

1) Gross sale proceeds are Rs.4,50,000
2) Unloading and godown rent Rs.10,000
3) Commission 5% on Gross sales

Prasad send a bank draft for the balance due to Bhaskar.

You are required to prepare necessary ledger accounts in the books of Consignor and Consignee.

Solution:

Books of Bhaskar (Consignor) **Tenali Consignment Account**

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Goods Sent on Consignment (500 radios each at Rs.600)	3,00,000		By Prasad A/c	4,50,000
	To Cash / Bank A/c	12,000			
	To Prasad A/c	10,000			
	To Prasad A/c (Rs.4,50,000 x 5%)	22,500			
	To Profit & Loss A/c (Profit)	1,05,500			
		4,50,000			**4,50,000**

Prasad Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Consignment A/c	4,50,000		By Bills Receivable A/c	1,00,000
				By Consignment A/c	10,000
				By consignment A/c	22,500
				By Bank	3,17,500
		4,50,000			**4,50,000**

Goods sent on Consignment Account

Dr.					Cr.
Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Trading A/c	3,00,000		By consignment A/c	3,00,000
		3,00,000			**3,00,000**

Books of Prasad (Consignee)

Bhaskar Account

Dr.					Cr.
Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Bills Payable A/c	1,00,000		By Bank A/c	4,50,000
	To Bank A/c	10,000			
	To Commission A/c	22,500			
	To Bank A/c	3,17,500			
		4,50,000			**4,50,000**

3.8 Valuation of Unsold Stock

At the end of the accounting period the unsold goods left with the consignees, should be valued properly. Otherwise, true profit cannot be ascertained. Unsold stock is valued either at market price or cost price whichever is less. Cost price of the goods for this purpose does not mean only the cost at which the consignor purchased the goods. But the proportionate nonrecurring or direct expenses incurred by the consignor as well as by the consignee should be added to the cost price. All expenses incurred to bring the goods to the godown of the consignee are treated as non-recurring or direct expenses. These expenses will increase the value of the goods. Therefore, while valuing the stock, they should be added to cost of the goods. Some Examples for het non-recurring expenses incurred by the consignor and consignee are given below:

Non-recurring expenses incurred consignor	Non recurring expenses incurred by consignee
1. Freight	1. Unloading Charges
2. Carriage or Cartage	2. Freight
3. Insurance	3. Dock Dues
4. Packing	4. Customs Duty
5. Dock Dues	5. Octroi
6. Loading Charges	6. Carriage to his Place
7. Customs Duty	

All the expenses incurred by the consignee after the goods reach the godown are treated as recurring expenses or indirect expenses. These expenses do not increase the value of goods. Therefore, in the valuation of the unsold stock they should not be considered. Some of the non-recurring expenses incurred by the consignor and consignee are given below:

Recurring expenses incurred consignor	Recurring expenses incurred by consignee
1. Bank charges for discounting the bills or cheque received	1. Godown Rent
2. Expense incurred on damaged goods	2. Godown Insurance
	3. Salary to salesmen
	4. Advertisement Charges
	5. Selling Expenses
	6. Commission

If detail of expenses are not given, expenses incurred by the consignor should be included for valuing the unsold stock and expenses incurred by the consignee should be ignored.

Illustration 3:

Kishore of Guntur send 200 bicycles costing Rs.1,20,000 to Pavan of Vijayawada on consignment. Kishore spend Rs.6,000 towards freight and insurance in transit. Pavan spent unloading charges Rs.1,200 godown rent Rs.800. consignee sold 180 bicycles at Rs.2,00,000. Calculate the value of closing stock:

Solution:

Particulars	Amount	Amount
Cost of 200 bicycles		1,20,000
Add 1 : Non recurring expenses incurred by	6,000	
Kishore (Consignor)		
2: Non recurring expenses incurred by Pavan	1,200	7,200
(Consignee) (Unloading Charges)		
Value of 200 bicycles		**1,27,200**

Total bicycles = 200

Less: Sold = 180

Unsold 20

Value of unsold bicycles $= 20 \times \frac{1,27,200}{200}$ = Rs.12,720

Note: Godown rent paid by consignee is recurring expenses. Hence godown rent not included in valuation of closing stock.

Illustration 4:

X send 500 radios costing Rs.1,000 each to Y on consignment. X spend Rs.50,000 towards expenses. Y spent Rs.12,000 as advertisement. consignee sold 400 radios each at Rs.1,200. Calculate the value of closing stock:

Solution:

Particulars	Amount	Amount
Cost of 500 radios (500 x Rs.1,000)		5,00,000
Add 1 : Non recurring expenses incurred by X (Consignor)	50,000	
2 : Non recurring expenses incurred by Y (Consignee)	——	50,000
Value of 500 radios		**5,50,000**

Total radios = 500

Less: Sold = 400

Unsold 100

Value of unsold radios $= 100 \times \frac{5,50,000}{500}$ = Rs.1,10,000

Note: Advertisement paid by consignee is recurring expenses. Hence advertisement not included in valuation of closing stock.

Illustration 5:

Murali and Co of Warangal consign 500 radio sets to Hari and Co of Hyderabad. The cost of each radio Rs.500. Murali and Co paid insurance Rs.10,000 and freight Rs.15,000. Account sales was received from Hari and Co showing the following particulars.

1. 400 radio sets sold each at Rs.600
2. Advertisement expenses Rs.20,000
3. Commission 10% on sales

Hari and Co send a bank draft for the balance due to consignor.

Show journal entries and ledger accounts in the books of Both the parties.

Solution:

Books of Murali & Co of Warangal (Consignor)

Journal Entries

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
	Consignment to Hyderabad A/c Dr		2,50,000	
	To Goods sent on consignment A/c			2,50,000
	(Being the goods sent on consignment)			
	Consignment to Hyderabad A/c Dr		35,000	
	To Cash / Bank A/c (Being Expenses Paid)			35,000
	Hari & Co A/c Dr		2,40,000	
	To Consignment to Hyderabad A/c			2,40,000
	(Being goods sold by Sri Rama)			
	Consignment to Hyderabad A/c Dr		20,000	
	To Hari & Co A/c			20,000
	(Being the expenses payable to Sri Rama)			
	Consignment to Hyderabad A/c Dr		24,000	
	To Hari & Co A/c			24,000
	(Commission = 2,40,000 x 10/100)			
	(Being commission payable to Sri Rama)			

	Particulars		Dr (Rs.)	Cr (Rs.)
	Stock on consignment A/c Dr To Consignment to Hyderabad A/c (Being unsold stock taken into account)		57,000	57,000
	Consignment to Profit & Loss A/c Dr To Consignment to Hyderabad A/c (Being Loss on Hyderabad consignment transferred to General profit & loss A/c)		32,000	32,000
	Bank A/c Dr To Hari & Co A/c (Being full and final settlement received from Sri Rama)		1,96,000	1,96,000
	Goods Sent on consignment A/c Dr To Trading A/c (Being balance in goods sent on consignment A/c transferred to Trading A/c)		2,50,000	2,50,000

Hyderabad Consignment Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Goods Sent on Consignment	2,50,000		By Hari A/c	2,40,000
	To Cash / Bank A/c	35,000		By Stock on Consignment A/c	57,000
	To Hari & Co A/c	20,000		By profit & Loss A/c	32,000
	To Hari & Co A/c	24,000			
		3,29,000			**3,29,000**

Hari & Co Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Consignment A/c	2,40,000		By Consignment A/c	20,000
				By consignment A/c	24,000
				By Bank A/c	1,96,000
		2,40,000			**2,40,000**

Goods sent on Consignment Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Trading A/c	2,50,000		By consignment A/c	2,50,000
		2,50,000			**2,50,000**

Working notes:

Computation of Closing stock

Particulars	Amount	Amount
Cost of 500 radios (500 x Rs.500)		2,50,000
Add 1 : Non recurring expenses incurred by Murali & Co (Consignor)	35,000	
2: Non recurring expenses incurred by Hari & Co (Consignee)	——-	35,000
Value of 500 radios		**2,85,000**

Total radios = 500

Less: Sold = 400

Unsold 100

Value of unsold radios $= 100 \times \frac{2,85,000}{500}$ = Rs.57,000

Note: Advertisement paid by consignee is recurring expenses. Hence advertisement not included in valuation of closing stock.

Books of Hari & Co (Consignee)

Journal Entries

Date	Particulars	L.F	Dr (Rs)	Cr (Rs)
	Bank A/c Dr		2,40,000	
	To Murali & Co A/c			2,40,000
	(Being goods sold on behalf of Murali & Co)			

	Murali & Co A/c Dr		20,000	
	To Cash/ Bank A/c			20,000
	(Being expenses paid on behalf of Murali & Co)			
	Murali & Co A/c Dr		24,000	
	To Commission A/c			24,000
	(Being commission receivable)			
	Murali & Co A/c Dr		1,96,000	
	To Bank A/c			1,96,000
	(Being full and final settlement on consignment send to Murali & Co)			

Murali & Co Account

Dr. **Cr.**

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
	To Bank A/c	20,000		By Bank A/c	2,40,000
	To Commission A/c	24,000			
	To Bank A/c	1,96,000			
		2,40,000			**2,40,000**

3.9 Loss of Stock-types

Sometimes, losses may occur to the stock sent on consignment either in the transit or after they reach the consignee. On the basis of their nature, losses can be classified into two categories, namely:

1. Normal Loss
2. Abnormal Loss

3.9.1 Normal Loss

In the case of certain the goods, even after taking all precautions, some loss of quantity is bound to take place. Therefore the loss which is unavoidable, natural and is due to the inherent nature of goods is called as normal loss. For example if coal is consigned, a small portion of coal is bound to be lost, while of loading and unloading. Similarly, in case of oil and petroleum products, a portion may be lost due to evaporation and leakage when they are stored.

Normal loss is unavoidable, therefore, forms part of the cost of the consignment. Since this loss is usual, no separate journal entry is passed in the books of the consignor and consignee. But normal loss is to be considered, while calculating the cost of unsold stock left with the consignee. Normal loss has to spread over the remaining stock. Therefore, for calculating the value of unsold stock, the following formula can be applied.

$$\text{Value of unsold stock} = \text{Total cost of goods consigned} \times \frac{\text{quantity of unsold stock}}{\text{total quantity of goods sent less normal loss in quantity}}$$

Illustration 6

A dealer in apple consign 1,000 tonnes of apples at a cost of Rs.10,000 and paid Rs.2,000 towards freight and insurance. Consignee received 950 tonnes of apples. Consignee sold 500 tonnes of apples. 50 tonnes of apples treated as unavoidable loss. Calculate value of unsold stock.

Solution

Cost of 1,000 tonnes of apples	= Rs.10,000
Add: Consignor expenses	= Rs.2,000
	Rs.12,000

Total quantity of goods less normal loss in quantity = 1,000 – 50 = 950 tonnes

Stock of unsold goods = 950 – 500 = 450 tonnes

$$\text{Therefore value of unsold stock} = \text{Total cost of goods consigned} \times \frac{\text{quantity of unsold stock}}{\text{total quantity of goods sent less normal loss in quantity}}$$

$$\text{Value of unsold stock} = 12000 \times \frac{450}{950} = \text{Rs. } 5{,}684.21 = \text{Rs.}5{,}684.21 \text{ are } 5684$$

MODEL QUESTIONS

Short Answers

1. What do you mean by consignment
2. Briefly explain about consignor and consignee
3. What is a proforma invoice
4. What is a Account sales
5. What is Commission
6. What is Del Credere Commission
7. What is over riding Commission
8. Briefly explain about recurring expenses and non recurring expenses
9. Explain the procedure for valuation of unsold stock in consignment
10. Explain the term of normal loss
11. Accounting treatment for normal loss

Essay Questions

1. What do you mean about consignment? Explain the difference between consignment and sale
2. What is an account Sales? Give a specimen copy of account sales
3. What is meant by Commission? Explain different types of Commission

Exercises

1. On 1st January, 2009, Sudha of Srinagar consigned goods value of Rs.20,000 to Indira of Warangal. Sudha paid cartage and other expenses Rs.1,500. On 1st April, 2009, Indira sent on account sales with following information.

   a) 1/2 of the goods sold for Rs.15,000

   b) Indira incurred expenses of Rs.750

   c) Indira is entitled to receive commission @5% on sales.

Bank draft was enclosed for he balance due. Prepare necessary Ledger accounts in the books of Sudha.

Hint:

Profit 750

Closing stock 10,750

Bank Drafts 13,500

2. On 1st January 2012, Gopi of Hyderabad consigned goods valued at Rs.30,000 to Sudheer of Madras. Gopi paid cartage and other expenses Rs.2,000 on 1st April 2012. Sudheer sent the account sales with the following information:

   a) 50% of the goods sold for Rs.22,000

   b) Sudheer incurred expenses amounting to Rs.1,200

   c) Sudheer is entitled to receive commission @5% on sales.

   Bank draft was enclosed for the balance due. Prepare the necessary ledger accounts in the books of Gopi.

Hint:

Profit 3,700

Closing stock 16,000

Bank Draft 19,700

3. Sai and Co., of Chennai consigned 100 Radios to Deepthi and Co. of Hyderabad. The cost of each Ratio was Rs.500. Sai and Co paid insurance Rs.500; Freight Rs.800. Account sales was received from Deepthi and Co., showing the sale of 80 Radios at Rs.600 each. The following expenses were deducted by them.

Carriage	Rs.20
Selling expenses	Rs.130
Commission	Rs. 2,400

Sai and Co., received a bank draft for the balance due. Prepare important Ledger accounts in the books of Deepthi and Co.,

Hint:

Profit 4,416

Closing stock 10,264

Bank Draft 45,450

4. Raj of Bandar sends 200 T.V. sets each costing Rs.15,000 to Rani of Guntur to be sold on consignment basis. He incurred the following expenses. Freight Rs.2,000; Loading and unloading charges Rs.2,000 and Insurance Rs.5,000.

   Rani sold 185 TVs for Rs.30,00,000 and paid Rs.10,000 as shop rent which is to be borne by Raj as per terms and conditions of consignment. Consignee is entitled for a Commission of Rs.200 per T.V. sold. Assuming that Rani settled the account by sending bank draft to Raj. Prepare the necessary Ledger Accounts in the books of Raj.

   Hint:

   Profit – 1,69,675

   Closing stock 2,25,675

   Bank Draft – 29,53,000

5. Vishnu of Vijayawada consigned goods value of Rs.50,000 to Shiva; of Secundrabad. Vishnu paid transport charges Rs.4,000 and drew a bill of two months on Shiva for Rs.30,000 as advance. The bill was discounted with bankers for Rs.29,500. Shiva sent the account sales of the consignment stating that the entire stock was sold for Rs.72,000; Cartage 2,000; Commission 3,000 and a Bank Draft for the balance.

   Prepare necessary accounts in the books of Vishnu.

   Hint:

   Profit – 13,000

   Bank draft – 37,000

6. Laxmi of Vijayawada consigned goods worth Rs.20,000 to his agent Saraswathi of Kodad on consignment. Laxmi spent Rs.1,000 on transport, Rs.500 on insurance: Saraswathi sent Rs.5,000 as advance. After two months, Laxmi received the account sales as follows:

   a) Half of the goods were sold for Rs.24,000

   b) Selling expenses were Rs.1,200.

   c) 10% commission on sales

   Give ledger accounts in the books of Laxmi.

   Hint:

   Profit – 9,650

   Balance Due – 15,400

7. Robert consigned goods to Rahim value at Rs.5,000 to be sold on 5% commission basis. Robert has paid Rs.500 freight and Rs.550 towards insurance.

   Robert received account sales and a draft for the balance from Rahim showing the following particulars

	Rs.
Gross Sales	7,500
Selling Expenses	450
Commission	375

   Pass necessary entries journal in the and prepare ledger accounts in the books of both the parties.

   Hint:

   Profit 625

   Amount Due 6675

8. Krishna of Mumbai and Gopal of Chennai are in consignment business. Gopal sent goods to Krishna Rs.10,000. Gopal paid freight Rs.500. Insurance Rs.1,500 Krishna met sales expenses Rs.900, Krishna sold the entire stock for Rs.20,000 and he is entitled to a commission of 5% on sales.

   Write the necessary entries in the books of Gopal & Krishna

   Hint:

   Profit 6,100

   Balance due 18,100

9. Manikanta of Vijayawada Consigned goods of value of Rs.20,000 to Ayyappa of Ahmedabad. Manikanta paid forwarding charges Rs.1,000 and drew a bill of two months on Ayyappa for Rs.10,000. The bill was discounted with bankers for Rs.9,500. Ayyappa sent received the account sales of the consignment stating that the entire stock was sold for Rs.28,000 agents commission Rs.2,000 and a bank draft for the balance. Prepare necessary accounts.

   Hint:

   Profit 5,000

   Balance due : 16,000

10. Mrs. Murali sent 50 Bicycles on consignment to Mr.Deepthi invoiced at Rs.800 each on Jan 1st 2009. She has paid the following expenses Rs.1,350 freight, Rs.600 – Insurance Rs.1,500 other expenses. On 5th January, she received a bill from Deepthi for Rs.40,000. On Feb 20th Deepthi sent an account sales showing that the bicycles have realized Rs.1,000 each: He incurred expenditure on carriage Rs.500, warehousing Rs.460 and Rs.300 miscellaneous expenses. He charged commission at 10% on sales. Prepare the books of consignor and consignee.

Hint:

Profit 5,290

Balance Due: 8,740

11. M/s. Robert & Co. of Bangalore consigned 100 cases @ 50 each to Mahathi & Co., of Calcutta. M/s. Robert & Co., spent Rs.700 Carriage and paid insurance Rs.250.

In due course account sales was received with the following details:

		Rs.
Gross sale proceeds 100 x 75		7,500
Less : Cartage	10	
Godown	40	
Commission @ 5% 7,500 x 5/100	375	425
Bank draft enclosed for the balance		7,075

Pass necessary entries in the books of both of the parties

Hint:

Profit 3,865

Balance Due: 7,075

12. A & Co., of Hyderabad consigned 100 Video Games to B & Co., of Delhi to be sold on consignment @ Rs.500 each. He paid transport Rs.2,000 warehouse charges Rs.3,000.

B & Co., sent account sales stating that

100 Video Games sold at100 x 700		Rs.70,000
Less: Cartage	200	
Godown Rent	100	
Insurance	300	
Commission @10%	7,000	7,600
		62,400

(-) Bill accepted as advance 20,000

Bank draft enclosed for the balance 42,400

Prepare necessary ledger accounts of both the books

Hint:

Profit 7,400

Balance Due : 42,400

13. X of Chirala consigned 200 bales of Tobacco @ 250 per bale to V of Vijayawada. X paid cartage of freight etc., Rs.1250. X drew a bill on V for 3 months for Rs.30,000. V sold the entire consignment and rendered account sales showing that the goods realized Rs.60,000 out of which he deducted his charges amounting to Rs.400 and commission at 5% on sales. Make entries in the journal and show necessary ledger accounts in the books of both the parties.

Hint:

Profit 5,350

Balance Due 26,600

14. Amar consigned 100 bales of cloth to Akbar at Rs.5,000 per bale. Amar incurred the following expenses:

Packing and Forwarding Charges Rs. 500

Insurance in Transit Rs.2,000

Akbar received the consignment and sold 80 bales at Rs.8,000 per bale. They incurred the following expenses:

Freight and Cartage Rs.3,000

Insurance of godown Rs. 400

Salesmen's Salary Rs.1,600

Ascertain the value of on consignment.

Hint:

Value of unsold Stock Rs. 1,01,100

15. On January 15, 2009 Dharani of Hyderabad sent 400 Bicycles to be sold on consignment to Dheeraj of Warangal. The Bicycles were invoiced at Rs.1,000 per piece carriage and other expenses amounted to Rs.6,000. Dharani received the following account sales.

    15th March 100 Bicycles were sold at Rs.1,450 per piece on which 5% commission was charged and Rs.3,750 were deducted as expenses.

    10th April – 150 Bicycles were sold at Rs.1,400 per piece on which 5% commission was charged and Rs.2,900 were deducted as expenses incurred after 15th March.

    Prepare consignment Account and Account in the books of Dharani.

    Hint:

    Profit 76,850

    Stock on consignment 1,52,250

    Pass the necessary journal entries in the books of Bhagavan and Lakshman.

Chapter

4

Not-For-Profit Organization

4.1 *Meaning and Definition of Not – For – Profit Organizations.*
4.2 *Characteristics of Not – For – Profit Organizations.*
4.3 *Capital and Revenue Transactions*
4.4 *Distinguish between profitable and Not–For–Profitable Organizations.*
4.5 *Formation of Not-for-Profit Organisations*
4.6 *Accounting Records to be maintained*
4.7 *Preparation of Receipts and Payments Accounts*
4.8 *Preparation of Income and Expenditure Account:*
4.9 *Treatment of Important Items*
4.10 *Balance Sheet*

4.1 Introduction

The sole trader concern, partnership firm and other types of organizations commence business with a view to earn profits. They are known as trading concerns. But, there are certain Organisations like schools, colleges, libraries, athletic clubs, hospitals, charitable trusts, welfare societies, co-operative societies, clubs, etc. are established for providing service to its members or to the public. The main objective of this type of organizations is to do service rather than earning profits by doing business. These organizations are managed by trustees.

Not-For-Profit Organisations refer to the organisations that are used for the welfare of the society and are set up as charitable institutions which function without any profit motive. Their main objective is to provide service to a specific group or the public at large. Normally, they do not manufacture, purchase or sell goods and may not have credit transactions. Hence they need not maintain many books of account like Trading and Profit and Loss Account. The major sources of their income usually are subscriptions of their members, donations, grants-in-aid, income from investments, etc. The main objective of keeping records in such organisations is to meet the statutory requirement and help them in exercising control over utilisation of their funds. They also have to prepare the financial statements at the end of each

accounting period (usually a financial year) and ascertain their income and expenditure and the financial position, and submit them to the statutory authority called Registrar of Societies.

4.2 Characteristics

1. **Working with out profit motive and service moto** : Not-For-Profit organizations are formed for providing service to a specific group or public at large such as education, recreation, health and so on. Its sole aim is to provide service either free of cost or at normal cost and not to earn profit.
2. **Organized bodies**: These are organized as charitable trusts; societies and subscribers to such organizations are called Members.
3. **Source of Income**: The main source of income of such organizations are(1)Donations (2)Legacies (3)Grant-in-aid (4)Subscriptions (5)Income from investments etc.
4. **Elected management**: These organization affairs are usually managed by Managing committee or executive committee elected by members.
5. **No diffusion of surplus**: The surplus generated in the form of excess of income over expenditure is not distributed amongst the members. It is added to capital fund.
6. **Reputation by contribution**: The Not-for-profit organizations earn their reputation on the basis of their contribution to the welfare of the society.
7. **Accounting Information**: The accounting information provided by such organizations is meant for present and potential contributors and to meet the statutory requirement.

4.3 Capital and Revenue Transactions

Transactions in Not-For-Profit organizations may be classified into Capital Transactions and Revenue Transactions

1. **Capital Transactions:** The transactions which provide benefits or supply services to the business in it for more than one year are known as capital transactions. These transactions are known as Capital Expenditure and Capital Receipts.

   a. **Capital Expenditure:** Capital expenditure is that expenditure which is generally incurred for the acquisition of assets and to increase the earning capacity of the business firm. The expenditure gives benefit for number of years. Example: Purchase of tangible and intangible assets like machinery, furniture, buildings, patents, trade marks, goodwill etc.

   b. **Capital Receipts:** Any amount received as investment by owners, or raised by the way of loans and sale of fixed assets are known as capital receipts. These

amounts lies in huge amounts. These are non-recurring in nature. All the items of capital receipts are to be shown on the liabilities side of the balance sheet.

2. **Revenue Transactions:** The transactions which provide benefits to a business unit for one accounting period only are called as Revenue transactions. The transactions are classified into two, they are revenue expenditure and revenue receipts.

   a. **Revenue Expenditure:** Any amount spent to earn revenue or profits is called revenue expenditure. These expenses are having **recurring in nature.** Its useful life also would be less than one year. Example: Salaries, rent, wages, electricity, insurance, repairs etc.

   b. **Revenue Receipts:** Any amount received in the normal course of business is called as revenue receipts. Which is a recurring in nature. Like sales, interest, discount, commission, rent received etc.

4.4 Distinction Between Profitable And Not-for-profit Organizations

Basis of Distinction	Profitable Organizations	Not-For-Profit Organizations
1. Motive	The main motto is to earn profit	The Main motive is to render service to its members and society
2. Funds	Funds are represented by capital contributed by proprietors	Funds are represented by capital fund Comprising in the form of surplus, Legacies, life membership fees etc.,
3. Financial statements	There include manufacturing account Trading and Profit and Loss a/c and Balance Sheet.	They include Receipts and Payments Accounts, Income and Expenditure Account and Balance Sheet.
4. Surplus / Profit	The balance of profit and loss a/c is either Net profit or Net Loss.	The balance in the income and expenditure a/c is either surplus or deficit.

4.5 Formation of Not-For-Profit organizations

Generally these organizations are registered under societies Registration act. But registration is not compulsory. These organizations should prepare its Memorandum of Association and Articles of Association and other necessary documents and submit these documents to Registrar of Societies along with proscribed fees.

4.6 Accounting Records to be maintained in Not-For-Profit Organizations

4.6.1 During the Accounting Period

The main source of their income is subscriptions from the members, donations, financial assistance from governments and income from investments. Most of their transactions are in cash or through bank. In order to avoid the chances of misappropriation of money they used to maintain cash book in which all receipts and payments are duly recorded. At the end of the year the cash book is summarized under suitable heads and the summary thus prepared is called Receipts and Payments Account. They maintain stock register to keep complete record of all fixed assets and consumables and maintain a ledger containing all incomes and expenses, assets and liabilities.

4.6.2 At the end of the Accounting Year

The trading organizations prepare Trading and Profit and Loss Account and Balance at the end of the Accounting Period. The method of preparing final accounts of these organisations is different from trading organisations. As these organizations are not dealing with goods like trading organizations, they cannot prepare a trading and profit and loss account. At the end of the year these organizations prepare Receipt and payments account, Income and expenditure account and a balance sheet in order to ascertain cash in hand or at bank, surplus or deficit and various assets and liabilities and capital fund respectively. The final accounts in not-for-profit organizations consist the following:

1. Receipts and Payments Account
2. Income and Expenditure Account
3. Balance sheet

4.7 Preparation of Receipts and Payments Account

Receipts and payments account is a mere summary of Cash Book for a year. It is maintained prepared by the not-for-profit organizations is lieu of cash book. Like cash book, receipts of cash are written on debit side and payments on credit side. All receipts and payments whether they are relating to current, proceeding, succeeding period or all the receipts & payments are capital or revenue nature are written in this account. Closing balance of this account had shown the cash in hand /at bank at the end of accounting period. No distinction is made whether the payment has been made in cash or cheque. As all types of accounts i.e., Personal, Real and Nominal are written in this account, it is not necessary to prepare Balance Sheet along with this account. No adjustments are made in this account as it is presented on cash basis of accounting. Moreover, it does not include any unpaid expenditure and any unrealized income relating to the period under review.

4.7.1 Distinction between Receipts and Payments Account and Cash Book

Basis of Distinction	Receipts and payments a/c	Cash book
1. Cash Transactions	It is a summary of cash book all cash transactions are recorded	All cash transactions are recorded
2. Period	It is prepared at the end of accounting year.	It is written daily
3. Chronological order	Transactions are not written date wise.	Transactions are written in chronological order.

4.7.2 Features of Receipts & Payment Account

1. It is summary of cash book.
2. All the amounts of receipts & payments irrespective of period are recorded.
3. Irrespective of capital or revenue nature all the receipts and payments are recorded.
4. Non-cash items i.e., depreciations out standing expenses, etc., are not shown in this account.
5. It begins with opening balance of cash in hand and cash at bank or Bank Over Draft and closes with the year end balance of cash in hand / cash at bank or Bank Over Draft

4.7.3 Steps in Preparation of Receipts & Payments A/C

1. Take the opening balances of cash in hand and cash at bank and enter them on the debit side. In case of bank overdraft at the beginning of the year enter the same on credit side of this account.

2. Show the total amounts of all receipts on debit side irrespective of their nature – whether capital or revenue and whether they pertain to past, current and future periods.

3. Neither of the receivable income nor payable expense is to be entered in the account as they do not involve in or outflow of cash.

4. Find out the difference between total debit side and total credit side of the account. If the total of credit is more than the total of debit side, show the difference on the debit side as bank or over draft and vice-versa and close the account.

Receipts and Payments Account (Format)
For the year ended

Dr. **Cr.**

Receipts	Amount in Rs.	Payments	Amount in Rs.
To balance b/d		By salaries	XXX
Cash XXX		By Rent	XXX
Bank XXX	XXX	By Office expenses	XXX
To Subscriptions	XXX	By Sports material purchased	XXX
To Entrance fee	XXX	By stationery	XXX
To Life Membership	XXX	By games and sports expenses	XXX
To Donation for Library Books	XXX	By entertainment expenses	XXX
To Locker Rent	XXX	By investments	XXX
To sale of entertainment tickets	XXX	By Postal Stamps Purchased	XXX
To sale of old newspapers	XXX	By Scholarships paid	XXX
To sale of old furniture	XXX	By Medicines	XXX
		By Books	XXX
		By Subscriptions to News Papers	XXX
		By Balance c/d	XXX
	XXXXX		**XXXXX**

Illustrations – 01

From the following particulars, prepare Receipts and Payments Account.

	Rs.
Cash in hand	2000
Cash at Bank	6000
Subscriptions	3000
Donations received	2400
Furniture purchased	1600
General Expenses	1000
Postage	400
Stationery	600
Lockers Rent Received	1800
Office Expenses	800
Closing balance of Cash	7000

Solution :

Receipts & Payments A/c

Dr. **Cr.**

Receipts	Amount in Rs.	Payments	Amount in Rs.
To balance b/d (Cash)	2000	By furniture	1,600
To balance b/c (Bank)	6000	By General Expenses	1000
To Subscriptions	3000	By Postage	400
To Donations	2400	By Stationery	600
To Locker Rent	1800	By Office Expenses	800
		By Balance c/d (Cash)	7000
		By Balance c/d (Bank) (Balance)	3800
	15200		**15200**

Illustrations – 02

Prepare Receipts and Payments Account of Kurnool Sports Club for the year ended on 31-3-2015

	Rs.
Opening Cash	2250
Bank Balance	750
Sports Material Purchased	1500
Ground Maintenance	250
Tournament Fund Received	1000
Tournament Expenses	450
Stationery	250
Subscriptions received	3000
Purchase of Prizes and Mementoes	1400
Sale of Entertainment Tickets	600
Entertainment Expenses	400
Sports day Function Expenses	500

Solution :

Receipts & Payments of Kurnool sports Club for the year ending 31-3-2015

Dr. **Cr.**

Receipts	Amount in Rs.	Payments	Amount in Rs.
To Balance b/d :		By Sports Material	1500
Cash	2250	By Ground Maintained Charges	250
Bank	750	By Tournament Charges	450
To Tournament Fund	1000	By Stationery	250
To Subscriptions	3000	By Purchase of Prizes and Mementoes	1400
To Sale of Entertainment Tickets	600	By Entertainment Expenses	500
		By Sports day function Expenses	400
		By Balance c/d (Cash & Bank)	2850
	7600		7600

4.8 Preparation of Income and Expenditure Account

Income and expenditure is prepared in these institutions in lieu of profit and loss account. The income and expenditure account is credited with all earnings i.e. both realized and unrealized and debited with all expenses i.e. both paid and unpaid. There is no opening balance but closing balance will show either surplus i.e., excess of income over expenditure. Only revenue items are taken in to consideration i.e., capital items are totally excluded. The income and expenditure of the current year are taken into consideration and income and expenditure relating to preceding and succeeding periods are excluded while preparing this account. This account is prepared on accrual basis of accountancy and this all adjustments relating to prepaid or outstanding expenses and incomes, provisions for depreciation or doubtful debts will be made. Only nominal accounts are taken into considerations for the preparation of this account and for personal and real accounts a balance sheet must be prepared along with this account.

4.8.1 Features of Income and Expenditure Account

1. It is a nominal account
2. It is similar to profit & loss account.
3. Expenditures and losses recorded on credit side and earnings are recorded on debit side.
4. Only revenue expenditure, revenue incomes are recorded, capital expenditure and capital incomes are ignored in the preparation of this account.

5. Only expenses and incomes of current accounting year are taken into consideration.
6. Adjustments for prepaid, outstanding, provisions are made in this account.
7. Difference between two sides will be mentioned either surplus (excess of income over expenditure) or deficit (excess of expenditure over income) such difference will be transferred to capital fund on liabilities side of balance sheet.

4.8.2 Distinction between Receipts and Payments Account and Income and Expenditure Account

Basis of Distinction	Receipts and Payments Account	Income and Expenditure Account
1. Type of account	Real account	Nominal account
2 In lieu of	It is prepared in lieu of cash book	It is prepared in lieu of profit and loss account
3. Sides	Debit side receipts , payments credit side	Payments debit side, receipts credit
4. Opening balance	There can be opening balance which represents cash in hand/cash at bank	No opening balance
5. Closing balance	This shows cash at bank or cash in hand at the end of the accounting year	There is no closing balance but the difference represents either surplus or deficit
6. Capitial and revenue	All items irrespective of capital or items	Only revenue items are taken revenue nature shown in this account into consideration i.e., capital nature items are totally excluded
7. Period	All receipts and payments whether relating to current, succeeding or preceding periods are taken into consideration.	Only current period incomes and expenditures are taken into consideration i.e., preceding and succeeding periods are excluded
8. Balance sheet	It is not necessary to prepare balance sheet along this account real and personal accounts along	The balance sheet must be prepared in order to accommodate with this account
9. Adjustments	No adjustments are required to be made at the end of the year	All adjustment are made at the end of the year
10. Non cash items	It does not record non cash items e.g., depreciation	It records non cash items
11. Basis of accountancy	It is prepared on cash basis of accountancy	It is prepared on accrual basis of accountancy.

4.8.3 Proforma Of Income and Expenditure Account

Revenue expenditure	Amount Rs.	Revenue income	Amount Rs.
To Salaries	xxx	By subscriptions	xxx
To Rent, rates, taxes	xxx	By entrance fees	xxx
To Printing & stationery	xxx	By general donations	xxx
To General expenses	xxx	By rent of hall	xxx
To Charities	xxx	By sale of news papers	xxx
To Wages of ground men	xxx	By sale of grass	xxx
To Honorarium	xxx	By grants from government	xxx
To Postage	xxx	By interest received	xxx
To Bank charges	xxx	By profit on sale of assets	xxx
To Telephone charges	xxx	By fees from non members	xxx
To Up keep of ground	xxx	By dividends received	xxx
To News papers and periodicals	xxx	By annual dinner contributions	xxx
To Entertainment expenses	xxx	By lockers rent	xxx
To Repairs	xxx	By sports fees	xxx
To Electricity Charges	xxx	By miscellaneous receipts	xxx
To Car expenses	xxx	By deficit	xxx
To Audit fees	xxx	(excess of expenditure over	
To Refreshment expenses	xxx	income)	
To Insurance	xxx		
To Miscellaneous expenses	xxx		
To Interest	xxx		
To Sports expenses	xxx		
To Loss on sale of assets	xxx		
To Depreciation on assets	xxx		
To Surplus	xxx		
(excess of income over			
expenditure)			
	xxx		xxx

4.8.4 Conversion of Receipts and Payments Account into Income and Expenditure Account

1. Opening and closing balance of cash and bank given in receipts and payments account should be excluded.
2. Consider only revenue items of income and expenditure and exclude the items of capital receipts and payments.
3. Make all adjustments of outstanding or prepaid incomes orand expenses, provision for depreciation and bad debts.
4. Take only items for current year period and exclude all items relating to preceding and succeeding years.
5. Consider the following items not appearing in the receipts and payments accounts that need to be taken into account for determination of the surplus /deficit for the current year.
   - (a) Depreciation of fixed assets.
   - (b) Provision for doubtful debts.
   - (c) Profit or loss on the sale of fixed assets.

4.9 Treatment of Important Items

There are certain items which are peculiar to not for profit organization and require special treatment while preparing the final accounts of not profit concerns.

1. **Legacy:** It is the amount which a not for profit concerns will receive as per will of a deceased person. It should be capitalized being an item of non recurring nature and should be shown on the liabilities side of balance sheet.
2. **Donations:** Donation are the amounts which are given to the organizations as gift by public. The donations are two types.
   - **(a) General Donations:** when they do not does not lay down any specific condition for using the amount of donation, then it is called general donation and treated as revenue item and shown on credit side of income and expenditure all if the amount is small, can be capitalized if the amount is huge.
   - **(b) Specific Donations:** It the donation is for a specific purpose it is called specific donation e.g., donation for construction of building, room etc. It should be capitalized and shown on the liabilities side of balance sheet.

3. **Sale of Asset:** If the asset is sold, the amount realized should be compared with book value, to find out loss or profit on the sale of the asset. Loss on sale of asset will be shown in debit side and profit on sale of asset shown in credit side of income and expenditure account.

4. **Entrance Fee/Admission Fee:** In the absence of any specific instructions, this amount should be treated as revenue income and be shown on income and expenditure a/c.

5. **Life Membership Fees:** It is paid only once in live of annual subscriptions, so it should be capitalized and should be shown on the liabilities side of balance sheet.

6. **Sale of old News Papers:** Any amount realized from sale proceeds of old papers should be treated as revenue nature and be show3n on credit side of income and expenditure a/c.

7. **Sale of Sports Material:** The amount realized from sale proceeds of sports materials are treated as revenue nature and be shown on the credit side of income and expenditure account.

8. **Fund Based Accounting:** Generally there organizations establish funds for some specific purpose say prize distribution fund or tournament fund tec. The payments are debited to it incomes are credited to it. The accounting of incomes and expenses for which specific fund exists in termed as fund based accounting which is exemption for general rule for revenue nature.

   If there is a specific fund, the expenses of that fund are deducted from that fund and shown on liabilities side and incomes are added to that funds on liabilities side of balance sheet

9. **Endowment Fund**: A fund which provides permanent support for any person or organization is called endowment fund. A donation to cover expenditure on a particular purpose is called endowment fund it is capitalized and shown on liability side

10. **Honorarium**: Any amount paid to outsider for rendering services to the concern in called honorarium. It is revenue nature, and shown on debt side of income and expenditure care.

11. **Other Capital Payment**: purchase of books, furniture, investments, buildings etc., on treated on capital expenditure is shown on liability side of balance sheet.

12. **Other Revenue Receipts**: Proceeds from entertainment concerts, shown, lectures, programmes, interest on investment are treated as revenue expenditure and shown on credit side of income and expenditure account.

4.10 Balance Sheet

Balance Sheet is the statement of assets and liabilities of an accounting unit at a given data. It is prepared at the end of an accounting period after the Income and Expenditure Account has been prepared. It is called a Balance Sheet because it is a sheet of balances of ledger accounts which are open even after the preparation of Income and Expenditure Account. In such organisations, the excess of total assets over total outside liabilities is known as capital. While preparing the Balance sheet, the excess of income over expenditure is added to the opening capital fund and the excess of expenditure over the income is deducted from the Opening Capital Fund.

Proforma of a balance sheet of a Not-For-Profit Organizations

Balance sheet of ______________________ as on ___________________

Liabilities		Rs.	Assets		Rs.
Capital fund opening balance	XXX		Cash in hand		
Add Surplus (or)			Cash at Bank		
Less Deficit	XXX		Outstanding Income		
	XXX		Prepaid expenses		
Add Capitalised income of the			Stock of consumable items		
current year on account			Previous balance	XXX	
of Legacies	XXX		Add Purchases in current period	XXX	
Life Membership Fee	XXX	XXX		XXX	
Special Funds/Donations	XXX		Less value consumed during the		
Add Receipts for the item			period	XXX	
during the period	XXX		Furniture		XXX
	XXX		Investments		XXX
Add income earned on fund/			Closing stock of stamps/	XXX	
Donation/investment	XXX		stationery Sports material	XXX	
	XXX		Fixed Assets		
Less Expenses paid out of			Previous Balance	XXX	XXX
Fund / Donation	XXX		Add purchases during the		
Creditors for purchasers		XXX	current period	XXX	
Balance over Draft.		XXX	Less Book value of Assets		
Outstanding Expenses		XXX	sold on this period off	XXX	XXX
Income received in advance		XXX	Closing balance		
		XXX			XXX

MODEL QUESTIONS

1. State the meaning of Not- for –profit organizations. Give suitable examples.
2. Write the characteristics of Non-for-Profit organizations
3. Distinguish between profitable organizations and Not-for–Profitable organizations.
4. List out the accounts prepared by Not-for-Profit organizations.
5. What do you mean by receipts and payment account?
6. What are the characteristics of receipts and Payments account and characteristics?
7. In what way receipts and payment account differ from cash book?
8. What is an income and expenditure account? And explain its features?
9. Difference between receipts and payments account and Income and Expenditure.
10. What do you mean by Revenue Expenditure? Give examples.
11. What do you mean by capital expenditure? Give examples.
12. How do you prepare receipts and payment account?
13. Explain the procedure to convent Receipts and payment account into Income and Expenditure account.
14. What is capital income? Give two examples.
15. What is revenue income? Give two examples.
16. Distinguish between capital income and revenue income.
17. Distinguish between revenue expenditure and capital expenditure.
18. What is subscription?
19. What is the capital fund?
20. What is Legacy?
21. What is differed Revenue expenditure give examples
22. What is entrance fee
23. What is meant by life membership fee
24. What are Donations? Explain different types.

Excercises

1. From the following particulars, prepare Receipts and Payments A/c

	Rs
Cash in hand	2,000
Cash at bank	4,000
Subscriptions received	30,000
Donations Received	5,600
Purchase of furniture	9,000
Rent Paid	5,000
General Expenses	2,000
Postage and Telegram	800
Sundry Expenses	100
Cash balance at close	200

(Ans: Cash at bank closing Rs.24,300)

2. Prepare a Receipts and Payments Accounts.

		Rs.
Opening Cash Balance		2,000
Rent Paid		250
Stationary Expenses		540
Subscription received		
Previous Year	1500	
Current Year	4350	
Insurance paid		800
Sale of old machinery		1,900
Electricity		684
News Papers purchase		756

(Ans: Cash in hand closing Rs.6,300)

3. From the following details prepare receipts and payments A/c

	Rs.		Rs.
Opening cash in hand	3,400	Tournament Expenses	3,000
Opening cash at bank	23,400	Purchase of Investments	10,000
Subscriptions received	25,000	Interest Received	600
Donations collected	5,000	Sundry Expenses	1,500
Salaries paid	6,000	Electricity Charges	500
Rent Paid	1,000	Cash in hand at the end	700

(**Ans: Receipts and payments A/c Total Rs. 57,400**)

4. From the following particulars Prepare Receipts and Payments A/c.

	Rs.		Rs.
Cash in Hand	100	Cash at Bank	500
Subscriptions Received	3,300	Rent Paid	400
Donations Received	260	Investments Purchased	1,000
General Expenses	210	Postage and Stationery	70
Sundry Expenses	30	Cash balance at end	20

(**Ans: Cash at bank closing Rs.2430**)

5. Following is the receipts and payments A/c of Gandhi cultural Club for the year ended 31-Dec-2014

Dr **Cr**

Receipts	**Rs**	**Payments**	**Rs**
To Donations	20,000	By Salaries	2,900
To Life Membership Fee	7,000	By Investments	7,000
To Sports competitions Fund	4,000	By Cricket	400
To Subscriptions	2,600	By Tennis	170
(Including Rs.200 for 2015)		By Insurance	150
To Locker Rent	200	By Garden Maintenance	85
To Interest on Investments	50	By Stationary	45
To Cricket	100	By Telephone	125
To Tennis	150	By Balance c/d	23,325
To Billiards	100		
	34,200		**34,200**

Subscriptions receivable for the year 2014 Rs. 600,
Outstanding Salaries Rs.400.
Half of the Donations are to be capitalized, accrued interest Rs.60,
Prepaid Insurance Rs.70
Prepare income and Expenditure A/c for the year ended 31-Dec-2014.

Ans: Excess of income over expenditure Rs. 9515

6. Prepare income and expenditure A/c of Tirupathi Club from the following receipts and payments A/c, for the year ending 31-Dec-2014

Dr **Cr**

Receipts	Rs	Payments	Rs
To Balance b/d	1,000	By Salaries	6,000
To Subscriptions		By Rent and Taxes	1,700
(Including Rs.700, for 2015)	6,600	By Stationery	200
To Interest on investments	2,000	By Postage	30
To Bank interest	550	By Cycle Purchase	1,800
To Sale of Furniture	500	By Balance c/d	920
	10,650		**10,650**

Adjustments: a) Rent paid included Rs.200 for December-2013,
b) Salaries Payable Rs.900
c) Subscriptions received included Rs.600 for the year 2013
d) Subscriptions Due for the year 2014, Rs.400
e) Cost of furniture sold Rs.800

Ans: Excess of income over expenditure Rs. 280

7. From the following receipts and payments a/c of the Venkateswara Society for the year ended 31-Dec-2014. Prepare income and expenditure a/c for the year ended 31-Dec-2014.

Dr **Cr**

Receipts	Rs	Payments	Rs
To Balance 01-01-2014	3,485	By Books	6,150
To Entrance Fees	650	By Printing and stationary	465
To Donations	6,000	By News papers	1,110
To Subscriptions	6,865	By sports Materials	5,000
To Interest on bank deposits	1,900	By Repairs	650
To Sale of furniture	685	By Investments	2,000
To Sale of Old News Paper	465	By Furniture	1,000
To Proceeds from entertainments	865	By Salaries	1,500
To Sundry Receipts	125	By Balance (31-Dec-2014)	3,165
	21,040		**21,040**

The entrance fees and donations are to be capitalized. Sports materials value Rs.4,000 as on 31-Dec-2014.

(Ans: Excess of income over expenditure Rs.5,495)

8. Visakha Sports Association extracts the following receipts and payments A/c for the year ended 31-Dec-2014. From the particulars given, prepare income and expenditure a/c.

Dr **Cr**

Receipts	Rs	Payments	Rs
To Balance b/d	1,125	By News Paper	750
To Subscriptions	2,900	By Rent	250
To Tournaments Fund	750	By S alaries	1,800
To Life Membership fee	1,000	By Office Expenses	1,200
To Entrance Fee	100	By Sports Equipments	1,150
To Donations for Building	1,500	By Tournament Expenses	450
To Sale of News Paper	50	By Balance c/d	1,825
	7,425		**7,425**

Adjustments:

a) Subscriptions outstanding on 31-Dec-2013, Rs.450, and on 31-Dec-2014 Rs. 400. Subscriptions received includes Rs.100 on account of the year 2015.

b) Sports equipments was valued on 31-Dec-2013, @ Rs. 550, and on 31-Dec-2014, @ Rs.1090

c) Office expenses include Rs.150, for the year 2013 where as Rs.200 is still payable on this account for 2014. **(Ans: Surplus Rs.1,760)**

9. From the following, Prepare income and expenditure A/c of Tirupathi Sports men Club for the year ended 31-Dec-2010.

Dr Cr

Receipts	Rs	Payments	Rs
To Balance b/d	2,100	By Rent	36,400
To Entrance Fee	3,850	By Stationery	21,476
To Subscriptions		By Wages	37,310
2009	1,400	By Billiards table	27,300
2010	1,18,300	By Repairs	5,642
2011	2,100	By Interest	10,500
To Locker Rent	3,500	By Balance c/d	16,772
To Special Subscriptions for Governer's party	24,150		
	1,55,400		**1,55,400**

Adjustments:

Locker rent Rs.420 pertaining to 2009 and Rs.630 is still owing. Rent Rs.9,100 Pertaining to 2009 and Rs.9,100 is still due. Stationary expenses Rs.2,184 relating to 2009 and Rs.2,548 is still owing. Subscriptions receivable for the year 2010. Rs.3276.

(**Ans: Surplus Rs.17,444**)

10. Sri Hari Sports Club's, Ongole receipts and payments for the year ending 31-Dec-2014. Is given below.

Dr **Cr**

Receipts	Rs	Payments	Rs
To Cash in hand	500	By Salary to gardener	1000
To Cash at bank	2000	By Grass Cutting Machine	2000
To Subscriptions	6750	By Rent	950
To Tournaments Fund	2500	By Tournament expense	3000
To Life membership fund	2000	By Insurance	2750
To Entrance fees	250	By Games Equipment By	2000
To Donations for computer	3500	Balance c/d	
To Sale of Grass	200	Cash in hand	750
		Cash at Bank	5250
	17700		**17700**

Additional Information:

a) Subscription receivable for 2013 were Rs.1,000 and For 2014 Rs. 1,050. Subscription already received including Rs. 400 for the year 2015.

b) Games equipment in the beginning was Rs.1000, and at the end Rs.1,250

c) Provide depreciation @ 10 % Grass cutting machine.

Prepare income and expenditure A/c for the year ending 31-Dec-2014. And opening, closing balance sheet.

Ans: Excess of Income expenditure over income Rs. 50

11. from the following receipts and payments accounts of other information of Kadapa City Club, Prepare income and expenditure A/c as on 31-Dec-2014 and balance sheet as on that date.

Adjustments :

a) Subscriptions received included Rs.1,200 for the year 2013, and Rs.2,400 for the year 2015.

b) Subscriptions due for the year 2014 Rs.1,800.

c) Printing Charges payable for 2014 Rs.240.

d) Salaries payable for the year 2014 Rs.3,600

Dr Cr

Receipts	Rs	Payments	Rs
1.1.2014			
To balance		By Salaries	39000
Cash	1800	By Rent	7200
Bank	5400	By Printing and Stationary	1100
31-12-2014			
To Subscriptions	38400	By Postage	300
To Interest on investments	15000	By Purchase of cycle	1800
To Bank Interest	300	By Government Bonds	9000
To Sale of furniture	3000	31-12-2014	
(Cost of furniture Rs. 3840)		By Balance c/d	
		Cash	180
		Bank	5320
	63900		**63900**

(Ans: Deficit Rs.360), Capital fund on 1-1-2014 Rs. 12,240, Balance Sheet total Rs.18,120)

12. From the following Receipts and payments a/c of Amaravathi Sports Club for the year ended 31st Dec-2008, prepare income and expenditure account.

Dr Cr

Receipts	Rs	Payments	Rs
To Balance b/d	300	By Rent	5200
To Entrance Fees	550	By Stationery Expenses	3068
To Subscriptions		By Wages	5330
2007	200	By Billiards Table	3900
2008	16900	By Repairs	806
2009	300	By Interest	1500
To Lockers Rent	500	By balance c/d	2396
To Special Subscriptions for			
Governer's Party	3450		
	22200		**22200**

Lockers Rent Rs.60, Pertained to 2007 and Rs.90 is still owing. Rent Rs.1,300 pertained to 2007 and Rs.1,300 is still due. Stationery Expenses Rs.312 relating to 2007 and Rs.364 is still owing.

Subscription Receivable for 2008 is Rs.468.

(Ans: Surplus Rs.5,392)

13. From the following Receipts and Payments of Nethajee Sports Club , prepare income and Expenditure A/c for the year ended on 31-Mar-2012.

Dr **Cr**

Receipts	Rs	Payments	Rs
To Balance b/d (01-04-2011)	23000	By Salaries	16000
		By Rent	3000
To Subscriptions	13000	By Stationery	1000
To Interest	1000	By Sports Material Purchased	12000
To Sale of old Furniture (Book value Rs.2000)	1600	By Balance c/d (31-03-2012)	14600
To Entrance Fees	8000		
	46600		**46600**

Additional Information

a) Subscriptions Include Rs.1,000 Received for the last year.

b) Rent Includes Rs.600 paid for the last year

From the above particulars Prepare Income and Expenditure A/c for the year ending 31-03-2012

Ans: Excess of income over expenditure Rs. 1200

14. Visakha Town Club provided Receipts and Payments A/c for the year ended 31-Mar-2013. Prepare Income and Expenditure A/c.

Dr **Cr**

Receipts	Rs	Payments	Rs
To Balance b/d (01-04-2012)	11500	By Salaries	8000
		By Rent	1500
To Subscriptions	6500	By Stationery	500
To Interest	500	By Government Bonds	6000
To Sale of Old Furniture	800	By Balance c/d	7300
To Entrance Fees	4000	(31-03-2013)	
	23300		23300

Adjustments:

a) Subscriptions include Rs.500 received for last year.

b) Rent includes Rs.300 paid for last year

c) Book value of Furniture sold Rs.1,000

(**Ans: Surplus Rs.600**)

15. From the following Receipts and Payments A/c of Guntur Sports Club for the year ending 31-Mar-2012, Prepare income and Expenditure A/c.

Dr **Cr**

Receipts	Rs	Payments	Rs
To Balance b/d	14000	By Salaries	1400
To Subscriptions		By Repairs	600
(Including Rs.1,000 for		By Purchase of Sports Equipment	2000
the Previous year)	18000	By Furniture	8000
To Legacies	2000	By Honorarium paid	5000
To Life Membership Fees	5000	By Books	2000
To Sale of Tickets	500	By Investments	10000
To Lockers Rent	1500	By Office Expenses	1200
To Entrance Fees	1000	By Balance c/d	12000
To Interest on Investments	200		
	42200		**42200**

Additional Information:

a) Outstanding Salaries Rs.600

b) Opening value of sports equipments Rs.1,000, closing value Rs.500

c) Interest accrued on investments Rs.200

d) Subscription receivable for the year 2012 Rs.3,000.

(**Ans: Surplus: Rs.12,100**)

16. From the following Receipts and Payments A/c of Sai Charitable Trust , Anantapur, Prepare Income and Expenditure A/c

Dr **Cr**

Receipts	Rs	Payments	Rs
To Donations	25000	By Rent and Taxes	1300
To Membership Fees	1500	By Printing, Stationery	1200
To Entrance Fees	2400	By Scholarships	2000
To Subscriptions	1400	By Salaries	3000
2010	7500	By News papers and magazines	900
2011	1000	By Government Bonds	14000
2012		By Books	10000
To Sale of Furniture	650	By Balance c/d	7850
(Value Rs.1,000)			
To Interest	800		
	40250		**40250**

Additional information:

a) Subscriptions Receivable for the year 2011 Rs.2,500

b) Prepaid Rent Rs.300

c) Outstanding Stationary Bill Rs.150

d) Capitalize donations

e) Half of the Entrance fees capitalized.

f) Interest Receivable for the year 2011 Rs.200.

Ans: Excess of income over expenditure Rs. 3,600

17. Nellore Sports Club started on 01-01-2010. Their Receipts and Payments A/c for the year ended 31-Dec-2010.

Dr **Cr**

Receipts	Rs	Payments	Rs
To Donations	50000	By Building	40000
To Entrance Fees	4000	By Tournaments Expenses	900
To Tournament Fund	10000	By Furniture	2100
Revenue Receipts		***Revenue Payments***	
To Subscriptions		By Salaries	1800
(Including Rs.100 for 2011)	3200	By Cricket Expenses	1140
To Rent	100	By Insurance	360
To Other Receipts	700	By Garden Expences	600
To Cricket Fees	400	By Investments	18000
		By Balance c/d	3500
	68400		**68400**

Additional information:

a) Subscription receivable for the year 2010 –Rs.300

b) Salaries Unpaid- Rs.170

c) Entrance fees are to be capitalized

d) Insurance includes 9 months premium for 2011.

(**Ans: Surplus Rs.800**)

18. From the following Receipts and Payments A/c of Balaji Trust, prepare Income and Expenditure A/c for the year ending 31-Dec-2008.

Dr **Cr**

Receipts	Rs	Payments	Rs
To Opening Balance		By Salaries	4800
In hand	200	By Rent	500
At Bank	1600	By Stationary and Postage	200
To Subscriptions		By Bicycle Purchase	300
2007	500	By Government Bonds	3000
2008	8300	By Help to need students	2000
2009	600	By Balance	
To Sale of Investments	2000	In Hand	300
To Sale of Old Furniture	300	At Bank	2400
(Book Value Rs.400)			
	13500		13500

Adjustments :

1. Subscriptions for the year 2008 still receivable were Rs.700
2. Interest due on Government Bonds Rs.100.
3. Rent outstanding Rs.60.

(**Ans: Surplus Rs.1,440**)

Chapter

5

Partnership Accounts

5.1 Introduction
5.2 Meaning and Definition
5.3 Features of Partnership Firm
5.4 Partnership Deed
5.5 Distribution of Profit and Loss among the partners
5.6 Maintenance of Partners' Capital Accounts
5.7 Interest on Partner's Loan
5.8 Interest on Capital
5.9 Interest on drawings

5.1 Introduction

Sole proprietorship is the oldest and simplest form of business organisation. It has so many limitations like shortage of funds, unlimited personal liability, uncertainty about existence, limited skills, etc. In such a situation and to overcome the above limitations, people usually adopt the partnership form of organisation. The partnership firm comes into existence when two or more persons come together to establish business and share in its profits.

5.2 Meaning and Definition

Persons who have entered into partnership with one another are called individually, "partners" and collectively "a firm", and the name under which their business is carried on is called the "firm's name". A partnership firm has no separate legal entity, apart from the partners constituting it.

Section 4 of the Indian Partnership Act 1932 defines partnership as the '*relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all*'.

5.3 Features of Partnership Firm

The essential features or characteristics of partnership are:

1. **Two or More Persons**: In order to form a partnership, there should be at least two persons. In other words, the minimum number of partners in a firm should be two. Section 11 of the Indian Partnership Act, 1932 restricts the maximum number of partners to 10 for carrying on banking business and 20 for other kind of business.
2. **Agreement**: Partnership is the result of an agreement (either written or oral) among the partners to do business and share its profits and losses. It is not necessary that such agreement is in written form. An oral agreement is also equally valid. But in order to avoid disputes in future, it is preferred that the partners have a written agreement.
3. **Business:** The agreement should be to carry on some business. For example, if Ramu and Syam jointly purchase a bit of land, they become the joint owners of the property and not the partners. But if they are in the business of purchase and sale of land for the purpose of making profit, they will be called partners.
4. **Mutual Agency**: The business of a partnership concern may be carried on by all the partners or any of them acting for all. Each partner carrying on the business is the principal as well as the agent for all the other partners. Relationship of mutual agency is so important that one can say that there would be no partnership, if the element of mutual agency is absent.
5. **Sharing of Profit**: Another important element of partnership is that, the partners should be shared profits and losses of a business. If some persons join hands for the purpose of some charitable activity, it will not be termed as partnership.
6. **Liability of Partnership**: Each partner is liable jointly with all the other partners and also severally to the third party for all the acts of the firm done while he is a partner. Not only that the liability of a partner for acts of the firm but also unlimited. This implies that his private assets can also be used for paying off the firm's debts.
7. **Transferability of share:** No partner can transfer his/her share to any one including his/her family members without the consent of all other partners.
8. **Management:** All the partners have a right to manage the business. However, they may authorize one or more partners to manage the affairs of the business on their behalf.

5.4 Partnership Deed

Partnership comes into existence as a result of agreement among the partners. The agreement can be either oral or written. The Partnership Act does not require that the agreement must be in

writing. But wherever it is in writing, the document is there, which contains terms of the agreement, is called 'Partnership Deed'. It generally contains the details about all the aspects affecting the relationship among the partners.

A partnership deed should contain the following points:

1. Name and address of the firm
2. Name and addresses of the partners
3. Nature and place of the business
4. Accounting period of the firm
5. Capital contribution by each partner
6. Interest on capital
7. Drawings and interest on drawings
8. Profit sharing ratio
9. Interest on loan
10. Partner's salary/commission etc.
11. Method for valuation of goodwill
12. Rights and responsibilities of each partner
13. Procedures in the event of admission, death, retirement or insolvency of a partner
14. Rights and responsibilities upon dissolution and penalties for failing to comply
15. Methods for settlement of disputes
16. Any other matter relating to the conduct of business

Normally, the partnership deed covers all matters affecting relationship of partners amongst themselves. However, if there is no agreement on any matters, the provisions of the Indian Partnership Act, 1932 shall apply.

5.4.1 Rules Applicable in the Absence of an Agreement

When there is no agreement among the partners, the following rules will be applicable as per Section 13 of the Partnership Act 1932;

1. Profits or losses of the firm will be shared equally by the partners.
2. Interest on capital will not be allowed.
3. No interest will be charged on the drawings of the partners.
4. If any partner has given some loan to the firm, he is entitled to get interest on such amount @ 6% per annum.
5. No salary or commission will be allowed to any of the partners.

Special Issues of Partnership Accounts

Accounting treatment for partnership firm is similar to that of a sole proprietorship business with the exception of the following aspects;

- o Distribution of Profit and Loss among the partners;
- o Maintenance of Partners' Capital Accounts;
- o Reconstitution of the Partnership Firm; and
- o Dissolution of Partnership Firm.

The first two aspects mentioned above have been taken up in the following sections of this chapter.

5.5 Distribution of Profit/Loss among Partners

The profits and losses of the firm are distributed among the partners in an agreed ratio. However, if the partnership deed is silent, the firm's profits and losses are to be shared equally by all partners. In the case of sole proprietorship the profit or loss, as ascertained by the profit and loss account is transferred to the capital account of the proprietor. In case of partnership, however, certain adjustments such as interest on drawings, interest on capital, salary to partners, and commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account.

5.5.1 Profit and Loss Appropriation Account

Profit and Loss Appropriation Account is merely an extension of the Profit and Loss Account of the firm. It shows how the profits are appropriated or distributed among the partners. All adjustments in respect of partners are made through this account. It starts with the net profit/net loss as per Profit and Loss Account is transferred to this account.

The Proforma of Profit and Loss Appropriation Account is given as follows:

Dr. **Profit and Loss Appropriation Account for the year ended————** **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Profit & Loss Account (if there is net loss)	xxx	By Profit & Loss Account (if there is net profit)	xxx
To Interest on capital	xxx	By Interest on Drawings	xxx
To Salary to partner	xxx	By Partners' Capital Accounts (distribution of loss)	xxx
To Commission to partner			
To Reserve Fund (transferred)			
To Partners' Capital Accounts (distribution of profit)			
	xxx		**xxx**

Illustration-1

A, B and C set up a partnership firm on January 1, 2014. They contributed Rs. 50,000, Rs. 40,000 and Rs. 30,000 respectively as their capitals and agreed to share profits and losses in the ratio of 3:2:1. A is to be paid a salary of Rs. 1,000 per month and a Commission for B of Rs. 5,000.It is also provided that interest to be allowed on capital at 6% p.a. The drawings for the year were A-Rs. 6,000, B-Rs. 4,000 and C-Rs. 2,000. Interest on drawings was charged of Rs. 270 on A's drawings, Rs. 180 on B's drawings and Rs. 90 on C's drawings. The net profit as per Profit and Loss Account for the year ending December 31, 2014 was Rs. 35,660. Prepare the Profit and Loss Appropriation Account to show the distribution of profit among the partners.

Solution

Dr. Profit and Loss Appropriation A/c for the year ended 31st December, 2014 Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To A's salary (1000 x 12)	12,000	By Net profit	35,660
To B's commission	5,000	By Interest on Drawings:	
To Interest on capital:		A - 270	
A - 3,000		B - 180	
B - 2,400		C - 90	540
C - 1,800	7,200		
To Partners' Capital Accounts:			
A - 6,000			
B - 4,000			
C - 2,000	12,000		
	36,200		**36,200**

5.6 Maintenance of Capital Accounts of Partners

All transactions relating to partners are recorded in the books of the firm through their capital accounts. This includes the amount of money brought in as capital, withdrawal of capital, share of profit/loss, interest on capital, interest on drawings, partner's salary, partner's commission, etc.

There are two methods by which the capital accounts of partners can be maintained.

These are:

(i) Fixed capital method, and

(ii) Fluctuating capital method.

(i) Fixed Capital Method: Under the fixed capital method, the capitals of the partners shall remain fixed unless additional capital is introduced or apart of the capital is withdrawn as per the agreement among the partners. All items like share of profit or loss, interest on capital, drawings, interest on drawings, etc. are recorded in a separate account, called Partner's Current Account.

The partner's capital account and the current account under the fixed capital method would appear as shown below:

Dr. **Partner's Capital Account** Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Bank (withdrawal of capital)	xxx	To Balance b/d (opening balance)	xxx
To Balance c/d (closing balance)	xxx	By Bank (additional capital)	xxx
	xxx		**xxx**

Dr **Partner's Current Account** Cr

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Balance b/d (in case of debit opening balance)	xxx	By Balance b/d (in case of credit opening balance)	xxx
To Profit & Loss Appropriation (for share of loss)	xxx	By Profit & Loss Appropriation (for share of Profit)	xxx
To Drawings	xxx	By Commission	xxx
To Interest on drawings	xxx	By Salaries	xxx
To Balance c/d (closing balance)	xxx	By Interest on capital	xxx
		By Balance c/d (closing balance)	xxx
	xxx		**xxx**

Illustration-2

Vijay and Kumar are partners in a firm. Following information is provided as on 31 December, 2014:

	Vijay (Rs.)	Kumar(Rs.)
Capital (as on 01.01.2014)	40,000	30,000
Drawings	3,000	2,000
Interest on Capital	2,000	1,500
Interest on Drawings	360	180
Share of Profit	5,000	4,000

Prepare necessary accounts of each partner if capital is fixed.

Solution

Dr. **Partner's Capital Accounts** Cr.

Particulars	Vijay (Rs.)	Kumar (Rs.)	Particulars	Vijay (Rs.)	Kumar (Rs.)
To Balance c/d (closing balance)	40.000	30.000	To Balance b/d	40,000	30,000
	40.000	**30.000**		**40,000**	**30,000**

Dr. **Partner's Current Accounts** Cr.

Particulars	Vijay (Rs.)	Kumar (Rs.)	Particulars	Vijay (Rs.)	Kumar (Rs.)
To Drawings	3.000	2,000	By Interest on Capital	2,000	1,500
To Interest on drawings	360	180	By P&L Appropriation A/c	5,000	4,000
To Balance c/d	3,640	3,320			
	7,000	**5,500**		**7,000**	**5,500**

(ii) Fluctuating Capital Method: Under the fluctuating capital method, only one account, i.e. capital account is maintained for each partner. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawings, salary or commission to partners, etc. are recorded directly in the capital accounts of the partners. This makes the balance in the capital account to fluctuate from time to time. That's the reason why this method is called fluctuating capital method. In the absence of any instruction, the capital account should be prepared by this method.

The proforma of capital accounts prepared under the fluctuating capital method is given below:

Dr. Partner's Capital Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Bank	xxx	By Balance b/d	xxx
(withdrawal of capital)		(opening balance)	
To Drawings	xxx	By Bank	xxx
To Interest on drawings	xxx	(additional capital introduced)	
To Profit & Loss Appropriation	xxx	By Commission	xxx
(for share of Loss)		By Salaries	xxx
To Balance c/d	xxx	By Interest on capital	xxx
(closing balance)		By Profit & Loss Appropriation	xxx
		(for share of Profit)	
	xxx		**xxx**

Illustration-3

X,Y and Z entered into partnership on 1st April, 2013 to share profits & losses in the ratio of 4:3:3. Interest on Capital @ 5% p.a. The Capital contributions were: X -Rs. 3,00,000; Y -Rs. 2,00,000 and Z -Rs. 1,50,000and drawings were: X - Rs. 10,000, Y - Rs. 8000, and Z -Rs. 6,000 in this year. The profit for the year ended 31st March, 2014 amounted to Rs. 1,60,000. Show the necessary Accounts.

Solution

Dr. Profit and Loss Appropriation A/c for the year ended 31st March, 2014 Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Interest on capital:		By Net profit	1,60,000
X - 15,000			
Y - 10,000			
Z - 7,500	32,500		
To Partner's Capital Accounts			
X - 51,000			
Y - 38,250			
Z - 38,250	1,27,500		
	1,60,000		**1,60,000**

Dr. Partner's Capital Accounts Cr.

Particulars	X (Rs.)	Y (Rs.)	Z (Rs.)	Particulars	X (Rs.)	Y (Rs.)	Z (Rs.)
To Drawings	10,000	8,000	6,000	By Cash	3,00,000	2,00,000	1,50,000
To Balance c/d	3,41,000	2,30,250	1,82,250	By P&L Appro A/c	51,000	38,250	38,250
	3,51,000	**2,38,250**	**1,88,250**		**3,51,000**	**2,38,250**	**1,88,250**

Illustration-4

Amar and Kalesha commenced business as partners on April 1, 2013. Amar Rs. 40,000 and Kalesha Rs. 25,000 contributed as their capital. The partners decided to share their profits in the ratio of 2:1. Amar was entitled to a salary of Rs. 6,000 p.a. Interest on capital was to be provided @ 6% p.a. The drawings of Amar and Kalesha for the year ending March 31, 2014 were Rs. 4,000 and Rs. 8,000 respectively. The profits of the firm after providing Amar's salary and interest on capital were Rs. 12,000.

Draw up the Capital Accounts of the partners; (i) When capitals are fixed, and (ii) When capitals are fluctuating.

Solution

(i) When capitals are fixed

Dr. Partner's Capital Accounts Cr.

Particulars	Amar (Rs.)	Kalesha (Rs.)	Particulars	Amar (Rs.)	Kalesha (Rs.)
To Balance c/d (closing balance)	40,000	25,000	By Cash	40,000	25,000
	40,000	**25,000**		**40,000**	**25,000**

Dr. Partner's Current Accounts Cr.

Particulars	Amar (Rs.)	Kalesha (Rs.)	Particulars	Amar (Rs.)	Kalesha (Rs.)
To Drawings	4,000	8,000	By Profit & Loss Appropriation A/c (2/3 & 1/3 of 12,000)	8,000	4,000
To Balance c/d	12,400	-	By Salaries	6,000	-
			By Interest on capital	2,400	1,500
			By Balance c/d	-	2,500
	16,400	**8,000**		**16,400**	**8,000**

(ii) When capitals are fluctuating

Dr. Partner's Capital Accounts Cr

Particulars	Amar (Rs.)	Kalesha (Rs.)	Particulars	Amar (Rs.)	Kalesha (Rs.)
To Drawings	4,000	8,000	By Cash	40,000	25,000
To Balance c/d	52,400	22,500	By Profit & Loss Appropriation A/c	8,000	4,000
			By Salaries	6,000	-
			By Interest on capital	2,400	1,500
	56,400	**30,500**		**56,400**	**30,500**

Illustration-5

A and B are partners sharing profits in the ratio of 3: 2 with capitals of Rs. 5,00,000 and Rs. 3,00,000 respectively. Interest on capital is agreed @ 6% p.a. B is to be allowed an annual salary of Rs. 25,000. During the year 2014, the profit prior to calculation of interest on capital but after charging B's salary amounted to Rs. 1,25,000. A provision of 5% of the profits is to be made in respect of Manager's commission.

Prepare an account showing the allocation of profits and partners' capital accounts.

Solution

Dr. **Profit and Loss Appropriation A/c for the year ended 31st Dec, 2014** **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Interest on Capital:		By Profit after B's Salary but before other adjustments	1,25,000
A - 30,000			
B - 18,000	48,000		
To Manager's Commission (5% of Rs. 1, 50,000)	7,500		
To Profit transferred to:			
A's Capital A/c - 41,700			
B's Capital A/c - 27,800	69,500		
	1,25,000		**1,25,000**

Dr. **Partner's Capital Accounts** **Cr.**

Particulars	Amar (Rs.)	Kelasha (Rs.)	Particulars	Amar (Rs.)	Kelasha (Rs.)
To Balance c/d	5,71,700	3,70,800	By Balance b/d	5,00,000	3,00,000
			By Interest on Capital	30,000	18,000
			By salary	-	25,000
			By Profit and Loss Appropriation A/c	41,700	27,800
	5,71,700	**3,70,800**		**5,71,700**	**3,70,800**

5.7 Interest on Partner's Loan

When a partner gives loan to the firm, it should be credited to a separate loan account and calculate interest on it as per the interest rate in the agreement. In absence of agreement, Partnership Act provides that interest @ 6% p.a. shall be allowed on such loan irrespective of the profit. Interest on loan is an expenditure, so that, it has to be debited to Profit & Loss Account and credited to Partner's Loan A/c or Capital/Current A/c.

5.8 Interest on Capital

Interest on partners' capital will be allowed only when it has been specifically mentioned in the partnership deed. In absence of agreement among partners, no interest is allowed. The interest on capital is loss or expense to the firm and thus debited to Profit &Loss Appropriation Account and credited to Capital Account/Current Account as it is gain or income to the partners. Interest on capital is generally provided for in two situations: (i) when the partners contribute unequal amounts of capitals, and (ii) where the profit sharing is unequal. The interest on capital should always be calculated on the time basis after considering the additional capital and withdrawal of capital. Interest on Capital is always calculated on the opening balance.

The interest on capital is allowed only when the firm has earned profit during the accounting year. Hence, no interest will be allowed during the year the firm has incurred net loss. In case of insufficient profits, interest on capital is allowed only to the extent of profits in the ratio of interest on capital of each partner.

$$\text{Interest on capital} = \text{Share Capital} \times \frac{\text{Interest Rate}}{100}$$

The following Journal entries are to be passed to record the interest on capital;

Date	Particulars	L.F	Dr	Cr
	Interest on Capital A/c Dr		xxx	
	To Partners' Capital/Current A/c			xxx
	(Being interest on capital credited to Capital/ Current A/c)			
	Profit & Loss Appropriation A/c Dr.		xxx	
	To Interest on Capital A/c			xxx
	(Being interest on capital transferred to Profit & Loss Appropriation A/c)			

Illustration-6

P, Q and R entered into partnership, bringing capital in Rs. 3,00,000, Rs. 2,00,000 and Rs.1,00,000 respectively into the business. They decided to share profits and losses equally and agreed that interest on capital will be provided to the partners @10 per cent per annum.

Solution

The interest on capital

For P = Rs. 30,000 (10% on 3,00,000)

For Q = Rs. 20,000 (10% on 2,00,000)

For R = Rs.10,000 (10% on 1,00,000).

Illustration-7

M and N who are partners in a firm and their capital accounts showed the balance of Rs.4,00,000 and Rs. 2,50,000 respectively on April 1, 2014. M introduced additional capital of Rs. 1,00,000 on August 1, 2014 and N brought in further capital of Rs. 1,50,000 on October 1, 2014. Interest is to be allowed @ 6% p.a. on the capitals.

Solution:

Interest on capital shall be worked as follows:

$$\text{For } M = \left[4,00,000 \times \frac{6}{1000}\right] + \left[1,00,000 \times \frac{6}{1000} \times \frac{8}{12}\right]$$

= 24,000 + 4,000

= Rs. 28,000

$$\text{For } N = \left[2,50,000 \times \frac{6}{1000}\right] + \left[1,50,000 \times \frac{6}{1000} \times \frac{6}{12}\right]$$

= Rs. 15,000+Rs. 4,500

= Rs. 19,500

Illustration-8

Lal and Pal are partners in a firm. Their capital accounts as on April 01, 2013 showed a balance of Rs. 4,00,000 and Rs. 6,00,000 respectively. On July 01, 2013, Lal introduced additional capital of Rs. 1,00,000 and Pal, Rs. 60,000. On October 01,2013Lal withdrew Rs.50,000, and on January 01, 2014 Pal withdrew, Rs. 25,000 from their capitals. Interest is allowed @ 8% p.a. Calculate interest payable on capital to both the partners during the financial year 2013–2014.

Solution

Calculation of Interest on Capital

$$\text{For Lal} = \left[4,00,000 \times \frac{8}{100}\right] + \left[1,00,000 \times \frac{8}{100} \times \frac{9}{12}\right] - \left[50,000 \times \frac{8}{100} \times \frac{6}{12}\right]$$

= 32,000 + 6,000 – 2,000

= Rs. 36,000

$$\text{For Pal} = \left[6,00,000 \times \frac{8}{100}\right] + \left[25,000 \times \frac{9}{12}\right] - \left[50,000 \times \frac{8}{100} \times \frac{3}{12}\right]$$

= 48,000 + 3600 – 500

= Rs. 51,100

Illustration-9

X and Y are Partners sharing Profit and Loss in the ratio of 2:3 with a capital of Rs. 20,000 and Rs. 10,000 respectively. Show distribution of Profit/losses for the year ended 31st March 2015 by preparing P & L Appropriation A/c in each of the alternative cases.

***Case 1*:** If Partnership deed is silent as to the interest on capital and the profit for year ended is Rs.2,000.

***Case 2*:** If Partnership deed provides for the interest on capital @ 6% p.a. and loss for the year is Rs. 1,500.

***Case 3*:** If Partnership deed provides for interest on capital @ 6% p.a. and trading profit is Rs.2,100.

Solution

Case 1:

Dr. Profit and Loss Appropriation A/c for the year ended 31st March, 2015 Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Profit transferred to: X's capital A/c - 800 Y's capital A/c - 1,200	2,000	By Net Profit	2,000
	2,000		**2,000**

Case 2:

Dr. Profit and Loss Appropriation A/c for the year ended 31st March, 2015 Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Net loss (Trading loss)	1,500	By Loss transferred to: X's Capital - 600 Y's Capital - 900	1,500
	1,500		**1,500**

Note: No interest on capital will be allowed the firm has net loss, even though they have an agreement.

Case 3:

Dr. Profit and Loss Appropriation A/c for the year ended 31st March, 2015 Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Interest on Capital: X - 1,200 Y - 600	1,800	By Net Profit	2,100
To Profit transferred to: X's capital A/c - 120 Y's capital A/c - 180	300		
	2,100		**2,100**

5.9 Interest on Drawings

Partners may be allowed to draw either money or goods from the business to meet their private needs. As stated earlier, no interest is charged on the drawings if there is no agreement among the partners about it. If the partnership deed so provides for it, the interest is charged at an agreed rate, for the period money remained outstanding from the partners during an accounting year. Charging interest on drawings discourages excessive amounts of drawings by the partners. Interest on drawings is an income to the firm and should be credited to profit & Loss Appropriation Account and debited to partners' Capital/Current Accounts being a loss to the partners.

$$= \frac{\text{Interest Rate}}{100} \times \frac{\text{Time left after drawings}}{12}$$

The calculation of interest on drawings under different situations is shown as hereunder

Case 1:- When Rate of Interest on Drawings is given in % without per annum, in this case Interest on Drawings is calculated with a flat rate irrespective of date of drawings.

Case 2:- Amount, rate of interest and date of withdrawal is given:

Illustration-10

Johnson is a partner who withdrew Rs. 20,000 on October 1, 2014. Interest on drawings is charged @ 10% per annum and the accounts were closed every year on December 31. Calculate interest on drawings.

Solution

$$\text{Interest on Drawings} = 20,000 \times \frac{10}{100} \times \frac{3}{12}$$

$$= \text{Rs. } 500$$

Case-3:- Amount and rate of interest are given but date of withdrawal is not specified:

Illustration–11

Ahmed is a partner who withdraws Rs. 30,000 and interest on drawings is charged @ 15% per annum. Calculate interest on drawings.

Solution

$$\text{Interest on Drawings} = 30,000 \times \frac{15}{100} \times \frac{6}{12}$$

$$= \text{Rs. } 2,250$$

Here, it is noted that in the absence of any particular date of withdrawal, it is assumed that withdrawals are made evenly throughout the year. Hence, interest is charged for the average of the period of the year, i.e., six months.

Case-4: Fixed amount is withdrawn every month

- If withdrawn on the first day of every month, interest on total amount will be calculated for 6½ months,
- if withdrawn at the end at every month, it will be calculated for 5½ months, and
- if withdrawn during the middle of the month, it will be calculated for 6 months.

Table showing the average period when withdrawals are made regularly

	Date of Withdrawal	Average Period in Months		
1	Beginning of every month	(12+1)/2	=	6.5
	Middle of every month	(11.5+0.5)/2	=	6
	End of every month	(11+0)/2	=	5.5
2	Beginning of every quarter	(12+3)/2	=	7.5
	End of every quarter	(9+0)/2	=	4.5
3	Beginning of half year	(12+6)/2	=	9
	End of half year	(6+0)/2	=	3

Illustration-12

Shanu withdrew Rs. 10,000 per month from the firm for her personal use during the year 2014. Find out the interest on drawings, in different situations @ 8% p.a.

Solution

(a) When the amount is withdrawn at the beginning of every month

Total drawings = 10,000 x 12 = Rs. 1,20,000

Interest on drawings $= 1,20,000 \times \frac{8}{100} \times \frac{6.5}{12}$

= Rs. 5,200

(b) When the amount is withdrawn at the end of every month;

Interest on drawings $= 1,20,000 \times \frac{8}{100} \times \frac{5.5}{12}$

= Rs. 4,400

(c) When money is withdrawn in the middle of every month /date of Drawings is not given;

Interest on drawings $= 1,20,000 \times \frac{8}{100} \times \frac{6}{12}$

= Rs. 4,800

Illustration-13

Ratna and Manikyam are partners in a firm, sharing profits and losses equally. During financial year 2014–2015, Ratna withdrew Rs. 50,000 quarterly. If interest is to be charged on drawings @10% per annum, calculate interest on drawings in different situations.

Solution

(a) If the amount is withdrawn at the beginning of each quarter;

Total drawings = 50,000 x 4 = Rs. 2,00,000

Interest on drawings $= 2,00,000 \times = \frac{10}{100} \times \frac{7.5}{12}$

= Rs. 12,500

(b) If the amount is withdrawn at the end of every quarter;

Interest on drawings $= 2,00,000 \times = \frac{10}{100} \times \frac{4.5}{12}$

= Rs. 7,500

Case-5: When different amounts are withdrawn on different dates:

The following are the two methods to calculate the amount of Interest on Drawings:

1. Simple Interest Method: in this method, interest on drawings is calculated for each amount of drawings individually on the basis of periods.

2. Product Method: In this method, the amounts of drawings are multiplied by the period for which it remained withdrawn during the period, Interest for 1 month is calculated on the sum of these products.

Illustration-14

Vamshi and Krishna are partners in a firm. During the year ended 31st March 2015 Vamshi makes the drawings as under:

Date of Drawing	Amount (Rs.)
01-08-2014	5,000
31-12-2014	10,000
31-03-2015	15,000

Partnership Deed provided that partners are to be charged interest on drawings @ 12% p.a. Calculate the interest on Vamshi's drawings by using Simple Interest Method and Product Method.

Solution

1. Simple Interest Method

Date	Drawings (Rs.)	Months till March 31st 2015	Interest @ 12% p.a.
01-08-2014	5,000	08	$5,000 \times = \frac{12}{100} \times \frac{8}{12} = 400$
31-12-2014	10,000	03	$10,000 \times = \frac{12}{100} \times \frac{3}{12} = 300$
31-03-2015	15,000	00	00
			Total Interest = 700

2. Product Method.

Date	Drawings (Rs.)	Months till March 31st 2015	Product (Rs.)
01-08-2014	5,000	08	40,000
31-12-2014	10,000	03	30,000
31-03-2015	15,000	00	00
			7,0000

Interest on Drawings $= \text{Sum of Productsx} \times \frac{\text{Rate}}{100} \times \frac{1}{12}$

$= 70,000 \text{ x } \frac{12}{100} \times \frac{1}{12}$

$=$ Rs. 700

Illustration-15

Thanvika withdrew the following amounts for her personal use from her firm during the year ending March 31, 2014. Calculate interest on drawings with product method, if the rate of interest to be charged is 7 % per annum.

April 1, 2013, Rs. 16,000,
June 30, 2013, Rs. 15,000,
October 31, 2013, Rs. 10,000,
December 31, 2013, Rs. 14,000, and
March 1, 2014, Rs. 11,000.

Solution

Statement Showing Calculation of Interest on Drawings

Date	Amount (Rs.)	Months till March 31st 2015	Product (Rs.)
April 1, 2013	16,000	12 Months	1,92,000
June 30, 2013	15,000	9 Months	1,35,000
October 31, 2013	10,000	5 Months	50,000
December 31, 2013	14,000	3 Months	42,000
March 1, 2014	11,000	1 Month	11,000
			4,30,000

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

$= \text{Rs. } 4{,}30{,}000 \times \frac{7}{100} \times \frac{1}{12}$

= Rs. 2,508 (approx.)

Summary

- **Meaning and Definition:** When two or more persons enter into an agreement to carry on business and share its profits/losses is called partnership. Partnership is defined as "Relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all".
- **Features:** The essential features of partnership are : (i) To form a partnership, there must be at least two persons; (ii) It is created by an agreement; (iii) The agreement should be for carrying on some legal business; (iv) sharing of profits and losses; and (v) relationship of mutual agency among the partners.
- **Partnership deed**: A document which contains the terms of partnership as agreed among the partners is called 'Partnership Deed'. It usually contains information about all aspects affecting relationship among partners.
- **Rules applicable in the absence of Partnership Deed** :
  - ❖ Profit sharing ratio will be equal
  - ❖ No Interest on Capital and Drawings
  - ❖ No Remuneration or Salary to the partners.
  - ❖ Interest on Loan advanced by the partner @ 6% p.a.

- **Profit and Loss Appropriation Account** : After the preparation of Profit and Loss Account, entries pertaining to partners like interest on capital, drawings, salaries among the partners, etc. are shown separately in a newly opened Profit and Loss Appropriation Account.
- **Fixed and Fluctuating Capital Accounts** :
  - ❖ Under fixed capital method, the amount of capital remains fixed, the transactions like interest on capital, drawings, interest on drawings, salary, commission, share of profits/losses are recorded in a separate account called 'Partner's Current Account'.
  - ❖ Under fluctuating capital method, all the transactions relating to a partner are directly recorded in the capital account.
- **Interest on Capital:** The interest on partner's capital is not allowed unless it is specifically mentioned in partnership deed. It should be calculated on the time basis after considering the additional and withdrawal of capital.
- **Interest on Drawings**: Interest on drawings is charged by the firm only when it is clearly mentioned in Partnership Deed. It is calculated with reference to the time period for which the money was withdrawn.

MODEL QUESTIONS

Very Short Answer Questions

1. Define partnership.
2. What are the features of Partnership firm?
3. What is meant by partnership deed?
4. Why is it important to have a partnership deed in writing?
5. In the absence of partnership deed, what are the rules applicable to partnership firm?
6. Why is Profit and Loss Appropriation Account prepared? Explain
7. What do you understand by fixed capital of partners?
8. What do you understand by fluctuating capital of partners?
9. How will you deal with the following terms while preparing partnership accounts?
   (i) Interest on capital
   (ii) Interest on drawings
   (iii) Interest on loan

Exercises

1. Ram and Shyam started a partnership firm on 1st January, 2014. Their capital contributions were Rs. 2,00,000 and Rs. 1,00,000 respectively. The partnership deed

provided:

i. Interest on capitals @10% p.a.

ii. Ram to get a salary of Rs. 2,000 p.a. and Shyam Rs. 3,000 p.a.

iii. Profits are to be shared in the ratio of 1:2.

The profits for the year ended 31st December, 2014 before making above appropriations were Rs. 2,16,000. Prepare Profit and Loss Appropriation Account.

(**Ans:** Profit transferred to Ram's Capital Rs. 60,333 and Shyam's Capital Rs. 1,20,667)

2. Lakshmi and Bhuvaneswari are partners with capitals of Rs.15,00,000 and Rs. 10,00,000 respectively. They agree to share profits in the ratio of 3:2. Show how the following transactions will be recorded in the capital accounts of the partners in case the capitals are fixed. The books are closed on March 31, every year.

Particulars	Lakshmi (Rs.)	Bhuvaneswari(Rs.)
Additional capital contributed on July 1, 2014	3,00,000	2,00,000
Interest on capital	82,500	55,000
Drawings (during 2014)	30,000	20,000
Interest on drawings	1,800	1,200
Salary	20,000	-
Commission	10,000	7,000
Share in loss for the year 2014	60,000	40,000

(**Ans:** Capital Accounts of Lakshmi, Rs. 18,00,000 and Bhuvaneswari, Rs. 12,00,000;Current Accounts of Lakshmi, Rs. 20,700 and Bhuvaneswari, Rs. 800)

3. On March 31, 2013, after the close of books of accounts, the capital accounts of Seenu, Prasad and Sudarsan showed balance of Rs. 24,000 Rs. 18,000 and Rs. 12,000 respectively. After all adjustments profit for the year ended March 31, 2014, amounted to Rs. 36,000 and the partner's drawings had been Seenu, Rs. 3,600; Prasad, Rs. 4,500 and Sudarsan, Rs. 2,700. The interest on capital @ 8% and the profit sharing ratio of Seenu, Prasad and Sudarsan was 3:2:1. Prepare Partners' capital Accounts.

(**Ans:** Capital Accounts of Seenu Rs. 40,320; Prasad, Rs. 26,940; Sudarasan, Rs. 16,260)

4. Venu and Subbu are partners sharing profits in the ratio of 3:2, with capitals of Rs. 1,00,000 and Rs. 60,000 respectively. Interest on capital is agreed @ 10% p.a. Subbu is to be allowed an annual salary of Rs. 2,500. During the year 2014-15, the profits prior to the calculation of interest on capital but after charging Subbu's salary amounted to Rs. 22,500.

Prepare Profit and Loss Appropriation Account and the partners' capital accounts for the year ending March 31, 2015.

(**Ans:** Profit transferred to capital A/c Rs. 6,500; Venu's Capital A/c Rs. 1,13,900 and Subbu's Capital A/c Rs. 71,100)

5. A and B are partners sharing profits in the ratio of 3:2, with capitals of Rs. 50,000 and Rs. 30,000 respectively. Interest on capital is agreed to be paid @ 6% p.a. calculate interest on capital.

(**Ans:** Interest on capital of A, Rs. 3,000 and B, Rs. 1,800)

6. P and Q are partners sharing profits and losses in the ratio of 3:2. On 1st April 2014 their capital balances were Rs. 50,000 and Rs. 40,000 respectively. On 1st July 2014, P brought Rs.10,000 as his additional capital, whereas Q brought Rs. 20,000 as additional capital on 1st October 2014. Interest on capital was provided @ 10% p.a. Calculate the interest on capital of P and Q on 31st March 2015.

(**Ans:**Interest on Capital for P is Rs. 5,750 and for Q is Rs. 5,000)

7. Rama and Krishna are partners sharing profits and losses in the ratio of 5:1. Their capitals at the end of the financial year 2013-14 were Rs. 1,50,000 and Rs. 75,000. On October 1st, 2014 Rama and Krishna had brought additional capitals of Rs. 16,000 and Rs. 14,000 respectively. On November 1st 2014 Rama withdrew Rs. 6,000 and on December 1st 2014 Krishna withdrew Rs. 9,000 from their capitals. Calculate interest on capital @ 15% p.a. for the year 2014-15.

(**Ans:** Interest on Capital for Rama is Rs. 23,325 and for Krishna is Rs. 11,850)

8. Priya and Mani are partners, sharing profits and losses in the ratio of 5:3. The balances in their capital accounts as on April 1, 2013 were; Priya, Rs. 6,00,000 and Mani, Rs. 8,00,000. Calculate interest on capital; (a) when there is no agreement in respect of interest on capital, and (b) when there is an agreement that the interest on capital will be allowed @ 7% p.a.

(**Ans:**(a) No interest on Capital; (b) for Priya is Rs. 4,200 and for Mani is Rs. 5,600)

9. Mohith is a partner, who withdrew Rs. 5,500 at the end of June, 2014. The Partnership deed provides for charging the interest on drawings @ 12% p.a. Calculate interest on Mohith's drawings for the year ending 31st December, 2014.

(**Ans:** Interest on Drawings Rs.330)

10. Amar and Gul are partners in a firm. They share profits in the ratio of 3:2. As per their partnership agreement, interest on drawings is to be charged @ 10% p.a. Their drawings during 2014 were Rs. 24,000 and Rs. 16,000, respectively. Calculate interest on drawings.

(**Ans:** Interest on Amar's Drawings, Rs. 1,200 and Gul's, Rs.800)

(Hint: If the date of Drawings is not given in the question, interest on drawings will be charged and average period of 6 months)

11. Bose is a partner in a firm. He withdraws Rs. 3,000 at the starting of each month for 12 months. The books of the firm close on March 31 every year. Calculate interest on drawings if the rate of interest is 10% p.a.

(**Ans:** Interest on Drawings, Rs.1,950)

12. Vishnu and Thomas are partners in a firm. They share profits equally. Vishnu's monthly drawings are Rs. 2,000. Interest on drawings is to be charged @ 10% p.a. Calculate interest on Vishnu's drawings for the year 2014, assuming that money is withdrawn: (i) in the beginning of every month, (ii) in the middle of every month, and (iii) at the end of every month.

(**Ans:** Interest on Drawings(i) Rs.1,300; (ii) Rs.1,200; (iii) Rs.1,100)

13. A and B are partners sharing profits and losses in the ratio of 4:1. A withdraws Rs. 2,500 at the beginning of each month and B withdrew Rs. 1,500 at the end of each month for 12 months period. Interest on drawings was charged @ 8% p.a. Calculate the interest on drawings of A and B for the year ended 31st December 2014.

(**Ans:** Interest on Drawings for A is Rs. 1,300 and for B is Rs. 660)

14. Aparna is a partner in a firm. She withdrew the following amounts during the year ended March 31, 2015.

May 01, 2014	Rs. 12,000
July 31, 2014	Rs. 6,000
September 30, 2014	Rs. 9,000
November 30, 2014	Rs. 12,000
January 01, 2015	Rs. 8,000
March 31, 2015	Rs. 7,000

Interest on drawings is charged @ 9% p.a. Calculate interest on drawings

(**Ans:** Interest on Drawing Rs. 2,295)

15. John, a partner in Kaveri Tours and Travels withdrew money for his personal use from his capital account during the year ending March 31, 2015. Calculate interest on drawings in each of the following alternative situations, if rate of interest is 9 per cent per annum.

(a) If he withdrew Rs. 3,000 at beginning of each month.

(b) If an amount of Rs. 3,000 per month was withdrawn by him at the end of each month.

(c) If the amounts withdrawn were:

Rs. 12,000 on June 01, 2014, Rs. 8,000 on August 31, 2014
Rs. 3,000 on September 30, 2014, Rs. 7,000, on November 30, 2014, and
Rs. 6,000 on January 31, 2015.

(**Ans:**Interest on Drawings (a) Rs. 1,755, (b) Rs. 1,485, and (c) Rs. 1,755)

Chapter

6

Admission of a Partner

6.1 Introduction

6.2 New profit sharing ratio

6.3 Revaluation of Assets and Liabilities

6.4 Adjustment of undistributed profit

6.5 Treatment of Goodwill

6.6 Adjustment of Partners' capitals

6.1 Introduction

An existing partnership firm may take up expansion/diversification of the business. In that case it may need managerial help or additional capital. An option before the partnership firm is to admit partner/ partners. When a new partner is admitted in a running business due to the requirement of more capital, to take advantage of the experience, technical skills and managerial ability of new partner or any other reason, it is called admission of a partner in partnership firm.New partner is admitted to the partnership if it provided in the partnership deed or all the existing partners unanimously agree to admit the new partner.

According to section 31(1) of Indian partnership Act, 1932, 'A new partner can be admitted only with the consent of all the existing partners'

When a partner joins the firm, he gets the following two rights along with others:

i) Right to share future profit of the firm and

ii) Right to share the assets of the firm

When a new partner is admitted in the firm the agreement among the existing partners terminates and a new agreement will come into force. It is due to this, certain adjustments must be made at the time of admission. The following are the important points which require attention at the time of admission of a new partner:

1. New profit sharing ratio;
2. Revaluation of assets and liabilities;
3. Distribution of accumulated profits/losses, and reserves;
4. Treatment of Goodwill; and
5. Adjustment of partners' capitals.

6.2 New Profit Sharing Ratio

When a new partner is admitted, he acquires his share in profits from the old partners. The calculation of new profit sharing ratio will depend on the agreement between the old partners and the new partner.

New Share = Old Share – Sacrificing Share

The following situations may arise while calculating the new ratio;

Case-1: if the new partner share is given along with old ratio.

Illustration-1

Anil and Vishal are partners sharing profits in the ratio of 3:2. They admitted Sumit as a new partner for 1/5 share in the future profits of the firm. Calculate new profit sharing ratio of Anil, Vishal and Sumit.

Solution

If we assume the total share is 1

The new partner Sumit's share = $\frac{1}{5}$ share out of 1

Rest of the share = $1-\frac{1}{5}=\frac{4}{5}$

Old Ratio = 3:2

New Share = Rest of the share x old share

Anil's new share = $\frac{4}{5}\times\frac{3}{5}=\frac{12}{25}$

Vishal's new share = $\frac{4}{5}\times\frac{2}{5}=\frac{8}{25}$

New Ratio = $\frac{12}{25}:\frac{8}{25}:$

New profit sharing ratio of Anil, Vishal and Sumit = 12 : 8 : 5

Case-2: **if the new partner gets his share equally from old partners.**

Illustration-2

Akshay and Bharat are partners sharing profits in the ratio of 3:2. They admit Dinesh as a new partner for 1/5th share in the future profits of the firm which he gets equally from Akshay and Bharat. Calculate new profit sharing ratio of Akshay, Bharat and Dinesh.

Solution

New partner Dinesh's share = $\frac{1}{5}$

This share equally from Akshay and Bharat, i.e., 1/2 of the Dinesh share = $\frac{1}{5} \times \frac{1}{2}$

$= \frac{1}{10}$ from each partner.

Old Ratio = 3:2

New share = Old share – Sacrificing share

Akshay'snew share = $\frac{3}{5} - \frac{1}{10} = \frac{5}{10}$

Bharat's new share = $\frac{2}{5} - \frac{1}{10} = \frac{3}{10}$

New Ratio = $\frac{5}{10} : \frac{3}{10} : \frac{1}{5}$

New profit sharing ratio among Akshay, Bharat and Dinesh will be 5:3:2

Case-3: **if profit share of a new partner takes particular ratio from old partners.**

Illustration-3

Anusha and Nitu are partners sharing profits in the ratio of 3:2. They admitted Jyoti as a new partner for 3/10 share, which she acquired 2/10 from Anusha and1/10 from Nitu. Calculate the new profit sharing ratio of Anusha, Nitu and Jyoti.

Solution

New partner Jyoti's share= $\frac{3}{10}$ (this acquired 2/10 from Anusha and 1/10 from Nitu)

Old Ratio = 3 : 2

New share = Old share – Sacrificing share

Anusha's new share $= \frac{3}{5} - \frac{2}{10} = \frac{4}{10}$

Nitu's new share $= \frac{2}{5} - \frac{1}{10} = \frac{3}{10}$

The new ratio $= \frac{4}{10} : \frac{3}{10} : \frac{3}{10}$

The new profit sharing ratio among Anusha, Nitu and Jyoti will be 4 : 3 : 3.

Case-4: ***if the old partners sacrifice a particular proportion of their shares to new partner.***

Illustration-4

Ram and Shyam are partners in a firm sharing profits in the ratio of 3:2. They admit Ganesh as a new partner. Ram surrenders 1/4 of his share and Shyam1/3 of his share in favour of Ganesh. Calculate new profit sharing ratio of Ram, Shyam and Ganesh.

Solution

New partner Ganesh's profit share = 1/4 of Ram's share + 1/3 of Shyam's share

$$= \frac{3}{5} \times \frac{1}{4} + \frac{2}{5} \times \frac{1}{3}$$

$$= \frac{3}{20} + \frac{2}{15}$$

$$= \frac{17}{60}$$

Old Ratio = 3 : 2

Ram's new share = Old Share – Scarifying Share

$$= \frac{3}{5} - \frac{3}{20} = \frac{9}{20}$$

Shyam's new share $= \frac{2}{5} - \frac{2}{15} = \frac{4}{15}$

New ratio $= \frac{9}{20} : \frac{4}{15} : \frac{17}{60}$

New profit sharing ratio among Ram, Shyam and Ganesh will be 27:16:17

Case-5: ***if the new partner share takes entire from one partner.***

Illustration-5

Das and Sinha are partners in a firm sharing profits in 3:2ratio. They admitted Pal as a new partner for 1/4 share in the profits, which he acquired wholly from Das. Determine the new profit sharing ratio of the partners.

Solution

New partner Pal's share = 1/4

Das's new share $= \frac{3}{5} - \frac{1}{4} = \frac{7}{20}$

Sinha's old and new share $= \frac{2}{5}$

New ratio $= \frac{7}{20} : \frac{2}{5} : \frac{1}{4}$

New profit sharing ratio among Das, Sinha and Pal will be 7 : 8 : 5

6.2.1 Sacrificing Ratio

The ratio in which the old partners agree to sacrifice their share of profit in favour of the incoming partner is called sacrificing ratio.

Sacrificing Share of Profit = Old Share of Profit – New Share of Profit

Illustration-6

Rohit and Mohit are partners in a firm sharing profits in the ratio of 5:3. They admit Sarma as a new partner for 1/7 share in the profit. The new profit sharing ratio will be 4:2:1. Calculate the sacrificing ratio of Rohit and Mohit.

Solution

Rohit and Mohits' old Ratio = 5:3

Rohit, Mohit and Sarmas' New Ratio = 4:2:1

Rohit's old share = 5/8

Rohit's new share = 4/7

Sacrifice share =Old Share of Profit – New Share of Profit

Rohit's sacrifice share $= \frac{5}{8} - \frac{4}{7} = \frac{3}{56}$

Mohit's old share = 3/8

Mohit's new share = 2/7

Mohit's sacrifice share $= \frac{3}{8} - \frac{2}{7} = \frac{5}{56}$

Sacrificing ratio $= \frac{3}{56} : \frac{5}{56}$

Sacrificing ratio of Rohit and Mohit will be 3:5.

Note: The old partners' sacrificing ratio is equal to old ratio, if the new partner share is given along with old ratio (i.e. case-1).

Illustration-7

R and S are partners, sharing profits in the ratio of 1:2. T admits for 1/5 share. State the sacrificing ratio.

Solution

If we assume the total share is 1

The new partner T's share = $\frac{1}{5}$ share out of 1

Rest of the share = $1-\frac{1}{5}=\frac{4}{5}$

Old Ratio = 1 : 2

New Share = Rest of the share x old share

R's new share = $\frac{4}{5}\times\frac{1}{3}=\frac{4}{15}$

S's New share = $\frac{4}{5}\times\frac{2}{3}=\frac{8}{15}$

Sacrifice share = Old Share of Profit – New Share of Profit

R's sacrificing share = $\frac{1}{3}-\frac{4}{15}=\frac{1}{15}$

S's sacrificing share = $\frac{2}{3}-\frac{8}{15}=\frac{2}{15}$

Sacrificing Ratio = $\frac{1}{15}:\frac{2}{15}$

Sacrificing ratio of R and S= 1:2

6.3 Revaluation of Assets and Liabilities

On admission of a new partner, the firm stands reconstituted and consequently the assets are revalued and liabilities are reassessed. It is necessary to show the true position of the firm at the time of admission of a new partner. If the values of the assets are raised, i.e., gain, the capital of the existing partners will increase. Similarly, any decrease in the value of assets, i.e. loss, the capital of the existing partners will decrease. For this purpose a 'Revaluation Account' is prepared. It is a nominal account. This account is credited with all increases in the value of assets and decrease in the value of liabilities. It is debited with decrease in value of assets and increase in the value of liabilities. The balance of this account shows a gain or loss on revaluation which is transferred to the existing partner's capital account in old profit sharing ratio. The following journal entries made for this purpose are:

		Dr.		
(i)	For increase in the value of Assets:			
	Asset A/c	Dr.	xxx	
	To Revaluation A/c			xxx
(ii)	For decrease in the value of Assets:			
	Revaluation A/c	Dr.	xxx	
	To Asset A/c			xxx
(iii)	For increase in the value of Liabilities:			
	Revaluation A/c	Dr.	xxx	
	To Liabilities A/c			xxx
(iv)	For decrease in the value of Liabilities:			
	Liabilities A/c	Dr.	xxx	
	To Revaluation A/c			xxx
(v)	For unrecorded Assets			
	Asset A/c	Dr.	xxx	
	To Revaluation A/c			xxx
(vi)	For unrecorded Liability:			
	Revaluation A/c	Dr.	xxx	
	To Liability A/c [unrecorded]			xxx
(vii)	For transfer of gain on revaluation (as per old ratio):			
	Revaluation A/c	Dr.	xxx	
	To Old Partners' Capital A/c			xxx
(viii)	For transfer of loss on revaluation (as per old ratio):			
	Old Partners' Capital A/c	Dr.	xxx	
	To Revaluation A/c			xxx

Pro-forma of Revaluation Account is given as under;

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

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Assets Account (if decrease in value)	xxx	By Assets account (if increase in value)	xxx
To Liabilities Account (if increase in value)	xxx	By Liabilities Account (if decrease in value)	xxx
To Liabilities Account (if unrecorded liabilities)	xxx	By Assets Account (if unrecorded assets)	xxx
To Old Partners' Capital A/c (if distribution of profit)	xxx	By Old Partners' Capital A/c (if distribution of loss)	xxx
	xxx		**xxx**

Illustration-8

Following is the Balance Sheet of Anusha and Pranusha sharing profit as 3:2.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	18,000	Debtors	21,000
Bills Payable	25,000	Land & Buildings	18,000
Workmen's compensation fund	15,000	Plant &Machinery	12,000
Capitals:		Stock	11,000
Anusha – 15,000		Bank	21,000
Pranusha – 10,000	25,000		
	83,000		**83,000**

On admission of Tanusha for 1/6th share in the profit it was decided that:

(i) Provision for doubtful debts to be created by Rs. 1,500.

(ii) Value of land and building to be increased to Rs. 21,000.

(iii) Value of stock to be increased to Rs. 13,500.

(iv) Tanusha was to bring further cash of Rs. 15,000 for her capital.

Prepare Revaluation A/c and Capital Accounts.

Solution

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

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Provision for doubtful debts	1,500	By Land & Buildings	3,000
To Partners' Capital A/c:		By Stock	2,500
Anusha - 2,400			
Pranusha- 1,600	4,000		
	5,500		**5,500**

Dr. **Partner's Capital Accounts** **Cr.**

Particulars	Annusha (Rs.)	Paranusha (Rs.)	Tannusha (Rs.)	Particulars	Annusha (Rs.)	Paranusha (Rs.)	Tannusha (Rs.)
To Balance c/d	17,400	11,600	15,000	By Balance b/d	15,000	10,000	-
				By Bank	-	-	15,000
				By Revaluation A/c	2,400	1,600	-
	17,400	**11,600**	**15,000**		**17,400**	**11,600**	**15,000**

Illustration-9

Following is the Balance Sheet of A and B who share profits in the ratio of 3:2.

Balance Sheet of A and B as on April 1, 2015

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	20,000	Plant &Machinery	30,000
Capitals:		Furniture	10,000
A – 30,000		Stock	15,000
B – 20,000	50,000	Debtors	12,000
		Cash in Hand	3,000
	70,000		**70,000**

On that date C is admitted into the partnership on the following terms:

1. C is to bring in Rs. 15,000 as capital for 1/6 share.

2. The value of stock is reduced by 10% while plant and machinery is appreciated by 10%.
3. Furniture is revalued at Rs. 9,000.
4. A provision for doubtful debts is to be created on sundry debtors at 5%.
5. Investment worth Rs. 1,000 and electricity bills outstanding Rs. 200 (not mentioned in the balance sheet) are to betaken into account.
6. A creditor of Rs. 100 is not likely to claim his money and is to be written off.

Record journal entries and prepare Revaluation Account, Partners' Capital Accountand New Balance Sheet of the firm.

Solution **Journal Entries in the Books of A & B**

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
April 2012,	Cash A/c Dr. To C's capital A/c (Being cash brought in by C as capital)		15,000	 15,000
1	Revaluation A/c Dr. To Stock A/c To Furniture A/c (Being decrease in the value of assets on revaluation)		2,500	 1,500 1,000
1	Revaluation A/c Dr. To Provision for Doubtful Debdts A/c (Being 5% Provision for Doubtful Debdts)		600	 600
1	Plant & Machinery A/c Dr. To Revaluation A/c (Being increase in the value of Assests on (revaluation)		3,000	 3,000
	Investment A/c Dr. To Revaluation A/c (Being findout the unrecorded investments)		1,000	 1,000
1	Revaluation A/c Dr. To Outstanding electricity bills A/c (Being amount provided for outstanding electricity bill)		200	 200
1	Sundry creditors A/c Dr. To Revaluation A/c (Being the creditors amount written off)		100	 100
1	Revaluation A/c Dr. To A's capital A/c To B's capital A/c (Being revaluation profit distributed between old partners)		800	 480 320

Dr. **Revaluation Account** Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Stock	1,500	By Plant & Machinery	3,000
To Furniture	1,000	By Investments	1,000
To Provision for doubtful debt	600	By Sundry creditors	100
To Outstanding electricity bills	200		
To Partners' Capital A/c:			
A - 480			
B - 320	800		
	4,100		**4,100**

Dr. **Partner's Capital Accounts** Cr.

Particulars	A (Rs.)	B (Rs.)	C (Rs.)	Particulars	A (Rs.)	B (Rs.)	C (Rs.)
To Balance c/d	30,480	20,320	15,000	By Balance b/d	30,000	20,000	-
				By Cash A/c	-	-	15,000
				By Revluation A/c	480	320	-
	30,480	**20,320**	**15,000**		**30,480**	**20,320**	**15,000**

New Balance Sheet as on April 1, 2015

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors - 20,000		Pant &Machinery – 30,000	
Less: Written off - 100	19,900	Add: Appreciation - 3,000	33,000
Electricity bills outstanding	200	Furniture (10,000 – 1,000)	9,000
Partners' Capital A/c:		Stock - 15,000	
A – 30,480		Less: Decrease 10% - 1,500	13,500
B – 20,320		Debtors - 12,000	
C – 15,000	65,800	Less: Provision - 600	11,400
		Cash in Hand (3000 + 15,000)	18,000
		Investment	1,000
	85,900		**85,900**

6.4 Adjustments of Reserves and Accumulated Profit or Losses

Any accumulated profit or reserve appearing in the balance sheet at the time of admission of a new partner is credited to the existing partners' capital account in the existing profit sharing ratio. If there is any loss, the same will be debited to the existing partners in the existing ratio. For this purpose the following journal entries are made as:

(i)	For distribution of undistributed profit and reserves (as per old ratio).			
	Reserves A/c	Dr	xxx	
	Profit & Loss A/c(Profit)	Dr.	xxx	
	To Partners' Capital A/c			xxx
(ii)	For distribution of loss (as per old ratio)			
	Partners' Capital A/c	Dr.	xxx	
	To Profit and Loss A/c [Loss]			xxx

Illustration-10

Rajendra and Surendra are partners in a firm sharing profits in the ratio of 4:1. On April 1, 2015 they admit Narendra as a new partner. On that date there was a balance of Rs. 20,000 in general reserve and a debit balance (loss) of Rs. 10,000 in the profit and loss account of the firm. Pass necessary journal entries regarding adjustment of accumulated profit or loss.

Solution

Journals in the Books of Rajendra, Surendra and Narendra

Date	Particulars		L.F.	Debit (Rs.)	Credit (Rs.)
April, 1	General Reserve A/c	Dr.		20,000	
	To Rajendra's capital A/c				16,000
	To Surendra's capital A/c				4,000
	(Being General Reserve transferred to the capital account of Rajendra and Surendra on Narendra's admission)				
	Rajendra's Capital A/c	Dr.		8,000	
	Surendra's Capital A/c	Dr.		2,000	
	To Profit and Loss A/c				10,000
	(Being debit balance of Profit and Loss A/c transferred to old partners' capital A/c)				

Illustration-11

A & B are partners in a firm, sharing Profits and Loss in the ratio of 5:3. On 31 Dec, 2014 their Balance sheet was as under;

Balance sheet as on 31st Dec, 2014

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	28,000	Machinery	1,20,000
General Reserve	32,000	Stock	80,000
Capitals:		Sundry Debtors	70,000
A – 1,00,000		Cash at Bank	7,000
B – 1,20,000	2,20,000	Cash in Hand	3,000
	2,80,000		**2,80,000**

On the above date they decided to admit C as a new partner on the following terms;

a) A,B and C's new profit sharing ratio will be 7:5:4.

b) C will bring Rs. 1,00,000 as his capital.

c) Machine is to be valued at Rs. 1,50,000, Stock Rs. 1,00,000 and provision for doubtful debt of Rs. 10,000 is to be created.

Prepare Revaluation A/C, Partners' Capital A/C and new Balance Sheet of the firm.

Solution

Dr. **Revaluation Account** Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Provision for doubtful debt	10,000	By Machine	30,000
To Partners' Capital A/c:		By Stock	20,000
A - 25,000			
B - 15,000	40,000		
	50,000		**50,000**

Dr. **Partner's Capital Accounts** Cr.

Particulars	A (Rs.)	B (Rs.)	C (Rs.)	Particulars	A (Rs.)	B (Rs.)	C (Rs.)
To Balance c/d	1,45,000	1,47,000	1,00,000	By Balance b/d	1,00,000	1,20,000	-
				By Cash A/c	-	-	1,00,000
				By Revluation A/c	25,000	15,000	-
				By General Reserve	20,000	12,000	-
	1,45,000	**1,47,000**	**1,00,000**		**1,45,000**	**1,47,000**	**1,00,000**

New Balance Sheet as on 31st Dec, 2014

Liabilities			Amount (Rs.)	Assets		Amount (Rs.)
Sundry Creditors			28,000	Machinery		1,50,000
Capitals:				Stock		1,00,000
A	–	1,45,000		Sundry Debtors -	70,000	
B	–	1,47,000		Less: Provision -	10,000	60,000
C	-	1,00,000	3,92,000	Cash at Bank		7,000
				Cash in Hand (3,000+1,00,000)		1,03,000
			4,20,000			**4,20,000**

6.5 Goodwill

Over a period of time, a well-established business develops an advantage of good name, reputation and wide business connections. This helps the business to earn more profits as compared to a newly set up business. In accounting, the monetary value of such advantage is known as "goodwill". It is regarded as an intangible asset. In other words, goodwill is the value of the reputation of a firm in respect of the profits expected in future over and above the normal profits.

Goodwill is also one of the special aspects of partnership accounts which require adjustment at the time of reconstitution of a firm viz., a change in the profit sharing ratio, the admission of a partner, retirement or death of a partner.

6.5.1 Methods of Valuation of Goodwill

Since goodwill is an intangible asset it is very difficult to accurately calculate its value. Various methods have been advocated for the valuation of goodwill of a partnership firm. Goodwill calculated by one method may differ from the goodwill calculated by another method. Hence, the method by which goodwill is to be calculated may be specifically decided between the existing partners and the incoming partner.

The important methods of valuation of goodwill are as follows:

1. Average Profits Method
2. Super Profits Method
3. Capitalisation Method

1. Average Profits Method: Under this method, the goodwill is valued at agreed number of 'years' purchase of the average profits of the past few years.

Goodwill = Average Profit x No. of Years' Purchase

Ilustration-12

The profit for the five years of a firm are as follows – year 2009 Rs. 4,00,000;year 2010 Rs. 3,98,000; year 2011 Rs. 4,50,000; year 2012 Rs. 4,45,000 and year 2013 Rs. 5,00,000. Calculate goodwill of the firm on the basis of 4 years purchase of 5 years average profits.

Solution

$$\text{Average Profit} = \frac{\text{Total Profit of Last 5 Years}}{\text{No. of Years}}$$

$$= \frac{4,00,000 + 3,98,000 + 4,50,000 + 4,45,000 + 5,00,000}{5}$$

$$= \frac{21,93,000}{5}$$

= Rs. 4,38,600

Goodwill = Average Profit × No. of years' purchase

= Rs. 4,38,600 × 4

= Rs. 17,54,400

2. Super Profit Method: Super Profit is the profit earned by the business that is in excess of the normal profit. Goodwill is determined by multiplying the super profit by the number of years' purchase.

Normal Profit = Capital Employed x Normal Rate of Return/100

Actual Profit = This is the profit earned by the firm during the year or it is also taken as the average of the last few years profit.

Super Profit = Actual Profit – Normal Profit

Goodwill = Super Profit × No. of Years' Purchase

Ilustration-13

A firm earns profit of Rs.65,000 on a capital of Rs.4,80,000 and the normal rate of return in similar business is 10%. 3 years' purchase value of super profit will be treated as goodwill.

Solution

Normal profit = Capital employed x normal rate of return/100

= 4,80,000 × 10/100

= Rs. 48,000

Actual Profit = Rs. 65,000

Super profit = Actual profit – Normal profit

= Rs.65,000 – Rs.48,000

= Rs.17,000

Goodwill = Super Profit × No. of Years' Purchase

= 17,000 × 3

= Rs.51,000

3. Capitalisation Method: Under Capitalisation Method, capitalized value of the business is determined by capitalizing the average profit by the normal rate return. Out of the value so determined, value of net assets/capital employed is deducted, the balance amount is the value of goodwill.

Goodwill = Capitalised Value – Net Assets or Capital employed

Ilustration-14

A firm earned average profit during the last few years is Rs.40,000 and the normal rate of return in similar business is 10%. The total assets is Rs.3,60,000 and outside liabilities is Rs.50,000. Calculate the value of goodwill with the help of Capitalisation of Average profit method.

Solution

Capital employed = Total assets - Outside liabilities
= Rs.3,60,000 - Rs.50,000
= Rs.3,10,000

Capitalised value of average profit = Average Profit $\times$ 100/ Normal rate of profit
= Rs. 40,000 $\times$ 100/10
= Rs. 4,00,000

Goodwill = Capitalised value – Capital employed
= Rs. 4,00,000 – Rs. 3,10,000
= Rs. 90,000

6.5.2 Treatment of Goodwill

There are different situations relating to treatment of goodwill at the time of admission of a new partner. Goodwill is credited to old partners' in sacrificing ratio. These are discussed as under:

Case-1: **when the amount of goodwill is paid privately by the new partner**; no journal entries are made in the books of the firm.

Case-2: **when the new partner brings his/her share of goodwill in cash**; the journal entries are as follows:

(i) For bringing cash for Capital as well as for goodwill:		
Cash/Bank A/c Dr.	xxx	
To Goodwill A/c		xxx
To New partner's Capital A/c		xxx
(ii) For the goodwill transferred to old partners' capital A/c (as per sacrificing ratio):		
Goodwill A/c Dr.	xxx	
To Old Partners' Capital A/c		xxx
(iii) For the amount of goodwill withdrawn by old partners:		
Old Partner's Capital A/c Dr.	xxx	
To Cash A/c		xxx

llustration-15

Sunil and Gavaskar are partners in a firm sharing profits and losses in the ratio of 5:3. Sachin is admitted in the firm for 1/5 share of profits. He is to bring in Rs. 20,000 as capital and Rs. 4,000 as his share of goodwill. Give the necessary journal entries,

(a) When the amount of goodwill is retained in the business.

(b) When the amount of goodwill is fully withdrawn.

(c) When 50% of the amount of goodwill is withdrawn.

Solution

(a) When the amount of goodwill is retained in the bunsiness.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
(i)	Cash A/c Dr.		24,000	
	To Sachin's Capital A/c			20,000
	To Goodwill A/c			4,000
	(Being the amount brought in by Sachin as Capital and Goodwill)			
(ii)	Goodwill A/c Dr.		4,000	
	To Sunil's Capital A/c			2,500
	To Gavaskar's Capital A/c			1,500
	(Being goodwill transferred to Sunil and Gavaskar A/c in the ratio of 5:3)			

(b) When the amount of goodwill is fully withdrawn.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
(i)	Cash A/c Dr.		24,000	
	To Sachin's Capital A/c			20,000
	To Goodwill A/c			4,000
	(Being the amount brought in by Sachin as Capital and Goodwill)			
(ii)	Goodwill A/c Dr.		4,000	
	To Sunil's Capital A/c			2,500
	To Gavaskar's Capital A/c			1,500
	(Being goodwill transferred to Sunil and Gavaskar A/c in the ratio of 5:3)			

(iii)	Sunil's Capital A/c Dr.		2,500	
	Gavaskar's Capital A/c Dr.		1,500	
	To Cash A/c			4,000
	(Being cash of goodwill withdrawn by Sunil and Gavaskar)			

(c) When 50% of the amount of goodwill is withdrawn.

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
(i)	Cash A/c Dr.		24,000	
	To Sachin's Capital A/c			20,000
	To Goodwill A/c			4,000
	(Being the amount brought in by Sachin as Capital and Goodwill)			
	Goodwill A/c Dr.		4,000	
	To Sunil's Capital A/c			2,500
	To Gavaskar's Capital A/c			1,500
	(Being goodwill transferred to Sunil and Gavaskar A/c in the ratio of 5:3)			
	Sunil's Capital A/c Dr.		1,250	
	Gavaskar's Capital A/c Dr.		750	
	To Cash A/c			2,000
	(Being cash withdrawn by Sunil and Gavaskar equal to 50% of goodwill)			

Case-3: **when the new partner does not bring his/her share of goodwill in cash**;

The journal entries are as under:

(i) For creation of goodwill in the books (as per sacrificing ratio)

Goodwill A/c	Dr.	xxx	
To Old Partner's Capital A/c			xxx

(ii) If goodwill writing off in the books of the firm (as per new ratio)

All Partners' Capital A/c	Dr.	xxx	
To Goodwill A/c			xxx

Illustration-16

Srikant and Ramana are partners in a firm sharing profits and losses in the ratio of 3:2. They decide to admit Venkat into partnership firm with 1/3 share in the profits. Venkat brings in Rs 30,000 as his capital. On the date of admission, the goodwill has been valued at Rs 24,000. Record the necessary journal entries in the books of the firm.

Solution

Date	Particulars	L.F.	Debit (Rs.)	Credit (Rs.)
(i)	Cash A/c Dr.		30,000	
	To Venkat's Capital A/c			30,000
	(Being the amount brought in by Venkat as Capital)			
	Goodwill A/c Dr.		24,000	
	To Srikant's Capital A/c			14,400
	To Ramana's Capital A/c			9,600
	(Being goodwill transferred to old partners in the ratio of 3:2)			

Illustration-17

Dinesh and Ramesh are partners in a firm sharing profits and losses in the ratio of 3:2. They decided to admit Vasu as a partner with 1/5 share in the profits. Their Balance Sheet as on March 31, 2015 was as follows:

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors		1,50,000	Cash at Bank	40,000
General Reserve		80,000	Bills Receivables	50,000
Bank O.D		70,000	Debtors	60,000
Partners' Capitals:			Stock	1,20,000
Dinesh –	1,00,000		Fixed Assets	2,80,000
Ramesh –	1,50,000	2,50,000		
		5,50,000		**5,50,000**

It was also decide that:

1. The fixed assets should be valued at Rs. 3,31,000.
2. A provision of 5% on sundry debtors to be made for doubtful debts.
3. The value of stock be reduced to Rs. 1,12,000.
4. Vasu brings Rs. 75,000 as capital and Rs. 15,000 as goodwill.

Prepare the revised Balance sheet of the firm after admission of the partner.

Solution

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

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
To Provision for Doubtful Debt		3,000	By Fixed Assets	51,000
To Stock		8,000		
To Partners' Capital A/c:				
Dinesh -	24,000			
Ramesh -	16,000	40,000		
		51,000		**51,000**

Dr. **Partner's Capital Accounts** **Cr.**

Particulars	Dinesh (Rs.)	Ramesh Rs.)	Vasu (Rs.)	Particulars	Dinesh (Rs.)	Ramesh (Rs.)	Vasu (Rs.)
To Balance c/d	1,81,000	2,04,000	75,000	By Balance b/d	1,00,000	1,50,000	-
				By Bank	-	-	75,000
				By Goodwill	9,000	6,000	-
				By Revaluation A/c	24,000	16,000	-
				By Gen. Reserve	48,000	32,000	-
	1,81,000	**2,04,000**	**75,000**		**1,81,000**	**2,04,000**	**75,000**

Dr. **Bank Account** **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Balance b/d	40,000	By Balance c/d	1,30,00
To Vasu's capital A/c	75,000		
To Goodwill	15,000		
	1,30,000		**1,30,000**

Revised Balance Sheet as on 31st March, 2015

Liabilities			Amount (Rs.)	Assets		Amount (Rs.)
Sundry Creditors			1,50,000	Cash at Bank		1,30,000
Bank O.D			70,000	Bills Receivable		50,000
Partners' Capitals:				Debtors -	60,000	
Dinesh	–	1,81,000		Less: provision -	3,000	57,000
Ramesh	–	2,04,000		Stock		1,12,000
Vasu	-	75,000	4,60,000	Fixed Assets		3,31,000
			6,80,000			**6,80,000**

Illustration-18

M and N were partners in a firm sharing profits in 5:3 ratios. They admitted O as a new partner for 1/3rd share in the profits. O was to contribute Rs. 20,000 as his capital. The Balance Sheet of M and N as on 1.4.2015 was as follows:

Liabilities			Amount (Rs.)	Assets		Amount (Rs.)
Creditors			27,000	Land and Building		25,000
Capitals:				Plant and Machinery		30,000
M	-	50,000		Stocks		15,000
N	-	35,000	85,000	Debtors -	20,000	
General Reserve			16,000	Less: Provision -	1,500	18,500
				Investments		20,000
				Cash		19,500
			1,28,000			**1,28,000**

Other terms agreed upon were:

(i) Goodwill of the firm was valued at Rs. 12,000.

(ii) Land and Building were to be valued at Rs. 35,000 and Plant and Machinery at Rs. 25,000.

(iii) The provision for doubtful debts was found to be in excess by Rs. 400.

(iv) A liability for Rs. 1,000 included in sundry creditors was not likely to arise.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance sheet of the new firm.

Solution

Dr. Revaluation Account Cr.

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
To Plant & Machinery		5,000	By Land & Buildings	10,000
To Old Partners' Capital A/c:			By Provision for bad debts	400
M -	4,000		By Creditors	1,000
N -	2,400	6,400		
		11,400		**11,400**

Dr. Partner's Capital Accounts Cr.

Particulars	M (Rs.)	N (Rs.)	O (Rs.)	Particulars	M (Rs.)	N (Rs.)	O (Rs.)
To Balance c/d	71,500	47,900	20,000	By Balance b/d	50,000	35,000	-
				By Cash A/c	-	-	20,000
				By Revluation A/c	4,000	2,400	-
				By General Reserve	10,000	6,000	-
				By Goodwill	7,500	4,500	-
	71,500	**47,900**	**20,000**		**71,500**	**47,900**	**20,000**

New Balance Sheet as on 1-4-2015

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Creditors -	27,000		Land and Building		35,000
Less: written off -	1,000	26,000	Plant and Machinery		25,000
			Stocks		15,000
Capitals:			Debtors -	20,000	
M -	71,500		Less: Provision -	1,100	18,900
N -	47,900		Investments		20,000
O -	20,000	1,39,400	Cash		39,500
			(19,500 + 20,000)		
			Goodwill		12,000
		1,65,400			**1,65,400**

6.6 Adjustment of Partners' Capital

Sometime, at the time of admission, the partners' agree that their capitals be adjusted in proportion to their profit sharing ratio. For this purpose, the capital accounts of the existing partners are to be made all adjustments like, on account of goodwill, general reserve, revaluation of assets and liabilities, etc., and then the partner whose capital falls short, will bring in the necessary amount to cover the shortage and the partner who has a surplus, will withdraw the excess amount of capital. The journal entries will be:

(i)	For withdrawal of excess capital			
	Partners' Capital A/c	Dr.	xxx	
	To Cash A/c			xxx
(ii)	For bringing the shortage of capital			
	Cash A/c	Dr.	xxx	
	To Partners' Capital A/c			xxx

Illustration-19

A and B are partners in a firm who are sharing profits in the ratio of 2:1. C is admitted into the firm for 1/5 share in profits and he is to bring in cash of Rs. 40,000 amount as his capital. The capitals of other partners are to be adjusted according to the new partner. The capitals of A and B after all adjustments are Rs. 1,00,000 and Rs. 70,000 respectively. Calculate the new capitals of A and B, and record the necessary journal entries.

Solution

Calculation of new profit sharing ratio;

If we assume the total share is 1

The new partner C's share = $\frac{1}{5}$ share out of 1

Rest of the share = $1 - \frac{1}{5} = \frac{4}{5}$

A's new share = $\frac{4}{5} \times \frac{2}{3} = \frac{8}{15}$

B's new share = $\frac{4}{5} \times \frac{1}{3} = \frac{4}{15}$

New partner C's capital for $1/5^{th}$ share= 40,000

The total capital of the firm = $40,000 \times \frac{5}{1}$ = Rs. 2,00,000

A's new capital = $2,00,000 \times \frac{8}{15}$ = 1,06,667

B's new capital = $2,00,000 \times \frac{4}{15}$ = 53,333

Hence, A will bring in Rs. 6,667 (Rs. 1,06,667 –Rs. 1,00,000),

B will withdraw Rs. 16,667 (Rs. 70,000 – Rs. 53,333)

The journal entries in this regard will be recorded as follows:

Journal Entries in the Books of A, B & C

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Cash A/c Dr.		40,000	
	To C's capital A/c			40,000
	(Being the amount brought in by C as capital)			
	Cash A/c Dr.		6,667	
	To A's capital account			6,667
	(Being shortage of capital brought by A)			
	B's Cpital A/c Dr.		16,667	
	To Cash A/c			16,667
	(Being excess capital withdrawn by B)			

Illustration-20

A and B share profits in the proportions of 3/5 and 2/5. Their Balance Sheet on Dec. 31, 2014 was as follows;

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry creditors	41,500	Cash in hand	26,500
Bills Payable	4,000	Bills receivables	3,000
Capitals:		Debtors	16,000
A – 30,000		Stock	20,000
B – 16, 000	46,000	Fixtures	1,000
		Land & buildings	25,000
	91,500		**91,500**

On that date C was admitted into partnership on the following terms:

(a) That C pays Rs. 10,000 as his capital and Rs. 5,000 as goodwill for his 1/6th share in profits.

(b) That stock and fixtures be reduced by 10% and 5% provision for doubtful debts be created on Sundry Debtors and Bills Receivables.

(c) That the value of land and buildings be appreciated by 20%.

Prepare necessary Accounts and the new Balance Sheet on the admission of C.

Solution

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

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Stock	2,000	By Land & Buildings	5,000
To Fixtures	100		
To Provision for doubtful debts	800		
To Provision on Bills receivable	150		
To Partners' Capital A/c:			
A - 1,170			
B - 780	1,950		
	5,000		**5,000**

Dr. **Partner's Capital Accounts** **Cr.**

Particulars	A (Rs.)	B (Rs.)	C (Rs.)	Particulars	A (Rs.)	B (Rs.)	C (Rs.)
To Balance c/d	34,170	18,780	10,000	By Balance b/d	30,000	16,000	-
				By Cash A/c	-	-	10,000
				By Revluation A/c	1,170	780	-
				By Goodwill	3,000	2,000	-
	34,170	**18,780**	**10,000**		**34,170**	**18,780**	**10,000**

New Balance Sheet as on Dec 31, 2014

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry creditors	41,500	Cash in hand (26,500+10,000+5,000)	41,500
Bills Payable	4,000	Bills receivables - 3,000	
Capitals Accounts:		Less: Provision - 150	2,850
A – 34,170		Debtors - 16,000	
B – 18,780		Less: Provision - 800	15,200
C – 10,000	62,950	Stock - 20,000	
		Less: Decrease - 2,000	18,000
		Fixtures - 1,000	
		Less: Decrease - 100	900
		Land & buildings – 25,000	
		Add: Appreciation - 5,000	30,000
	1,08,450		**1,08,450**

Illustration-21

On 31st March, 2014, the Balance sheet of P and Q shared profits in 3:2 ratio was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	40,000	Cash	10,000
Profit and loss A/c	30,000	Sundry Debtors 40,000	
Capital Accounts:		Less: Provision 1,400	38,600
P - 80,000		Stock	50,000
Q - 60,000	1,40,000	Plant and Machinery	70,000
		Patents	41,400
	2,10,000		**2,10,000**

On that date, R was admitted as a partner on the following conditions:

(a) R will get 4/15th share of profits. R had to bring Rs. 60,000 as his capital.

(b) The assets would be revalued as under:

Sundry debtors at book value less 5% provision for bad debts. Stock at Rs. 40,000, plant and Machinery at Rs. 80,000.

Prepare Revaluation A/c, Partner's Capital A/c and the Balance Sheet of the new firm.

Solution

Dr. Revaluation Account Cr.

Particulars	Amount (Rs.)	Particulars		Amount (Rs.)
To Provision for doubtful debts	600	By Plant and Machinery A/c		10,000
To Stock A/c	10,000	By Capitals A/c:		
			P - 360	
			Q - 240	600
	10,600			**10,600**

Dr. Partner's Capital Accounts Cr.

Particulars	P (Rs.)	Q (Rs.)	R (Rs.)	Particulars	P (Rs.)	Q (Rs.)	R (Rs.)
To Revluation A/c	360	240	-	By Balance b/d	80,000	60,000	-
To Balance c/d	97,640	71,760	60,000	By Cash A/c	-	-	60,000
				By P&L A/c	18,000	12,000	-
	98,000	**72,000**	**60,000**		**98,000**	**72,000**	**60,000**

Balance Sheet as on 31st March 2014

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Creditors		40,000	Cash (10,000+60,000)		70,000
Capital Accounts:			Sundry Debtors	- 40,000	
	P - 97,640		Less: Provision	- 2,000	38,000
	Q - 71,760		Stock		40,000
	R - 60,000	2,29,400	Plant and Machinery		80,000
			Patents		41,400
		2,69,400			**2,69,400**

Illustration-22

Sanjay and Ramaswamy were partners in a firm sharing the profits in the ratio of 2:3. On 31-03-2015 they admitted Mehra as a new partner for 1/5th share in the profits. Their balance sheet was as follows;

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Capitals:		Land & Buildings	3,00,000
Sanjay – 2,00,000		Stock	1,00,000
Ramaswamy – 3,00,000	5,00,000	Debtors	1,50,000
Creditors	1,05,000	Bank	1,55,000
Workmen Compensation Fund	1,00,000		
	7,05,000		**7,05,000**

On Mehra's admission it was agreed that;

1. Mehra will bring Rs. 4,00,000 as his capital and Rs. 16,000 for his share of goodwill, half of which was withdrawn by Sanjay and Ramaswamy.
2. A provision of 5% for bad and doubtful debts was to be created.
3. A provision was to be made for an outstanding telephone bills Rs. 3,000.
4. Land & Buildings are valued at Rs. 3,50,000.

After the above adjustments prepare necessary accounts and the new balance sheet.

Solution

Dr. Revaluation Account Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Provision for bad debts	7,500	By Building	50,000
To Outstanding Telephone bill	3,000		
To Old Partners' Capital A/c:			
Sanjay – 15,800			
Ramaswamy – 23,700	39,500		
	50,000		**50,000**

Dr. **Partner's Capital Accounts** **Cr.**

Particulars	Sanjay (Rs.)	R.Swamy (Rs.)	Mehra (Rs.)	Particulars	Snajay (Rs.)	R. Swamy (Rs.)	Mehra (Rs.)
To Bank A/c	3,200	4,800	-	By Balance b/d	2,00,000	3,00,000	-
To Balance c/d	2,19,000	3,28,500	4,00,000	By Bank	-	-	4,00,000
				By Revaluation A/c	15,800	23,700	-
				By Goodwill	6,400	9,600	-
	2,22,200	**3,33,300**	**4,00,000**		**2,22,200**	**3,33,300**	**4,00,000**

Dr. **Bank Account** **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Balance b/d	1,55,000	By Sanjay's capital A/c	3,200
To Mehra's Capital A/c	4,00,000	By Ramaswamy's capital A/c	4,800
To Goodwill A/c	16,000	By Balance c/d	5,63,000
	5,71,000		**5,71,000**

New Balance Sheet as on Dec 31st, 2014

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Capitals:		Land & Buildings	3,50,000
Sanjay - 2,19,000		Stock	1,00,000
Ramaswamy - 3,28,500		Debtors - 1,50,000	
Mehra - 4,00,000	9,47,500	Less: Provision - 7,500	1,42,500
Creditors	1,05,000	Bank	5,63,000
Workmen Compensation Fund	1,00,000		
Outstanding telephone bill	3,000		
	11,55,500		**11,55,500**

Summary

Admission of a partner – Meaning: When a partner so admitted to the existing partnership firm, it is called admission of a partner.

On the admission of a new partner, the following adjustments become necessary:

1. Adjustment in profit sharing ratio;
2. Adjustment for revaluation of assets and reassessment of liabilities;
3. Distribution of accumulated profits and reserves;
4. Adjustment of Goodwill; and
5. Adjustment of partners' capitals.

Adjustment in Profit sharing Ratio: When new partner is admitted he/she acquires his/her share in profit from the existing partners. As a result, the profit sharing ratio in the new firm is decided mutually between the existing partners and the new partner.

Sacrificing Ratio: At the time of admission of a partner, existing partners have to surrender some of their share in favour of the new partner. The ratio in which they surrender their profits is known as sacrificing ratio.

Revaluation of assets and liabilities: On admission of a new partner, the firm is reconstituted and the assets are revalued and liabilities are reassessed. It is necessary to show the true position of the firm at the time of admission of a new partner.

Adjustments of reserves and accumulated profit or losses: Any accumulated profit or reserve appearing in the balance sheet at the time of admission of a new partner, are credited in the existing partner's capital account in old profit sharing ratio. If there is any loss, the same will be debited to the existing partners' capital account in the old ratio.

Meaning of Goodwill: An established firm develops wide business connections. This helps the firm to earn more profits as compared to a new firm. The monetary value of such advantage is known as Goodwill .

Methods of valuation of Goodwill

(i) Average Profit Method

(ii) Super Profit Method

(iii) Capitalisation Method

Adjustment of partners' capital: Sometimes, at the time of admission, the partners' agreed that their capitals are adjusted to the proportionate of their profit sharing ratio. The partners may decide to calculate the capitals which are to be maintained in the new firm either on the basis of new Partner's Capital and his profit sharing ratio or on the basis of the existing partner's capital accounts.

MODEL QUESTIONS

Very Short Answer Questions:

1. What are the aspects that need adjustment at the time of admission of a new Partner
2. Sacrificing Ratio.
3. Revaluation Account
4. Goodwill
5. What are the methods of goodwill valuation

Exercises

1. M and N are partners sharing profit and losses in the 1:2 ratio. They have decided to admit 'O' by giving him 1/4th share in future profits. Calculate the New profit sharing ratio.

(**Ans**: New profit sharing ratio is 1:2:1)

2. P & Q are partners sharing in the ratio of 2:3. They admit R for 1/4th share and he gets this share equally from P & Q. Calculate new ratio.

(**Ans:** New Profit sharing Ratio is 11:19:15)

3. X and Y share profits and losses in the Ratio of 4:3, they admit Z with 3/7th share; which he gets 2/7th from X and 1/7 from Y. What is the new profit sharing ratio?

(**Ans:** New Profit sharing Ratio is 2:2:3)

4. A & B are partners sharing in the ratio of 3:2. C is admitted and he gets 3/20th from A and 1/20th from B. calculate new ratio.

(**Ans**: New Profit sharing Ratio is 9: 7: 4)

5. X & Y are partners share profits in the ratio of 5:3. Z the new partner gets 1/5 of X's share and 1/3rd of Y's share. Calculate new ratio.

(**Ans**: New Profit sharing Ratio is 4:2:2)

6. If Tarun and Nisha are partners sharing profits in the ratio of 5:3. What will be their sacrificing ratio if Rahul is admitted for 1/8 share of profit in the firm?

(**Ans:** Sacrificing Ratio – 5:3)

7. Amar and Bahadur are partners in a firm sharing profits in the ratio of 5:2. They admitted Mary as a new partner for 1/4 share. The new profit sharing ratio of the partners will be 2:1:1. Calculate their sacrificing ratio.

(**Ans**: Sacrificing Ratio – 6:1)

9. Vijay and Sanjay are partners in a firm sharing profits and losses in the ratio of 1:2. They decide to admit Ajay into partnership with 1/4 share in profits. Ajay brings in Rs. 30,000 for capital and Rs. 15,000 for goodwill. Give necessary journal entries,
   (a) When the amount of goodwill is retained in the business.
   (b) When the amount of goodwill is fully withdrawn.
   (c) When 50% of the amount of goodwill is withdrawn.

10. A and B are partners sharing profits and losses equally. They admit C into partnership and the new ratio is fixed as 4:3:2. C is unable to bring anything for goodwill but brings Rs 25,000 as capital. Goodwill of the firm is valued at Rs 18,000. Give the necessary journal entries assuming that the partners do not want goodwill to appear in the Balance Sheet.

11. Rahul and Gandhi are partners sharing profit in the ratio of 4:5. On 1st April 2015 they admit Sonia as a new partner for 1/6 share in profits. On that date the balance sheet of the firm shows a balance of Rs.60,000 in general reserve and debit balance of Profit and Loss A/c of Rs.25,000. Make the necessary journal entries.

12. A and B are equal partners in a firm. They decide to admit C as a new partner for 1/5th share in profit. On the date of admission the balance sheet of firm was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	60,000	Cash at Bank	40,000
Bills Payable	30,000	Debtors	30,000
Capitals:		Buildings	50,000
A – 45,000		Machinary	25,000
B – 25,000	70,000	Furniture	15,000
	1,60,000		**1,60,000**

The terms of agreement on C's admission were as follows:-

(a) Building will be valued at Rs. 65,000 and machinery at Rs. 20,000

(b) Creditors included Rs. 1,000 no longer payable.

Pass necessary Journal entries for revaluation of assets and liabilities.

(**Ans:** Revaluation Profit-Rs. 11,000)

13. Karna and Balaram are partners sharing profit and losses in the ratio of 4 : 1. Their Balance Sheet was as follows:

Balance Sheet of Karna and Balaram as on December 31st, 2014

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	10,000	Cash in hand	7,000
Bills Payable	7,000	Sundry debtors	26,000
Capitals:		Stock	6,000
Karna – 40,000		Buildings	20,000
Balaram – 30,000	70,000	Machinery	13,000
		Investments	15,000
	87,000		**87,000**

Nikhil is admitted as a partner and assets are revalued and liabilities reassessed as follows:

(i) Create a Provision for doubtful debt on debtors at Rs.800.

(ii) Building and investment are appreciated by 10%.

(iii) Machinery is deprecated at 5%

(iv) Creditors were overestimated by Rs.500.

Make journal entries and Prepare revaluation account before the admission of Nikhil.

(**Ans:** Revaluation Profit-Rs. 2550)

14. Balance Sheet of A and B as on 31.03.2014

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	36,000	Cash	10,000
Bills Payable	20,000	Debtors	34,000
General reserve	24,000	Stock	24,000
Capitals:		Machinery	42,000
A – 1,50,000		Buildings	2,00,000
B – 80,000	2,30,000		
	3,10,000		**3,10,000**

The other terms of agreements on C's admission were as follows :

(i) C will bring Rs. 12,000 for his share of capital.

(ii) Building will be valued at 1,85,000 and Machinery at Rs. 40,000.

(iii) A provision of 6% will be created on debtors for bad debts.

Prepare Revaluation Account and Partners Capital Accounts.

(**Ans:** Loss on Revaluation -Rs. 19,040)

15. The following is the balance sheet of Ram and Shyam, who are sharing profit as 2/3 and 1/3 on 31st March 2014.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Capitals:		Buildings	25,000
Ram – 15,000		Plant & Machinery	17,500
Syam – 20,000	35,000	Stock	10,850
Creditors	32,950	Debtors	4,000
		Cash at Bank	10,600
	67,950		**67,950**

They agree to admit Mohan into partnership on the following terms:-

(a) Mohan was to be given 1/3 share in the profit and to bring Rs. 7,500 as his capital and 3000 as his share of goodwill.

(b) That the value of stock and plant & Machinery were to be reduced by5%.

(c) That a reserve of 10% was to be created in respect of Sundry Debtors.

(d) The buildings were to be depreciated by 10%.

Pass Journal Entries and necessary Accounts.

(**Ans:** Loss on Revaluation -Rs.;4,318)

16. A and B are partners in a firm, sharing profits and losses in the ratio of 5:3, on31st December, 2014 their Balance sheet was as under :

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	30,000	Machinery	1,20,000
Bills Payable	30,000	Stock	80,000
Capitals:		Debtors	70,000
A – 1,00,000		Cash at Bank	7,000
B – 1,20,000	2,20,000	Cash in hand	3,000
	2,80,000		**2,80,000**

On the above date they decided to admit C as a partner on the following terms:

(a) C will bring Rs. 90,000 as his capital and Rs. 24,000 for his share of goodwill for $1/4^{th}$ share in the profit.

(b) Machinery is to be valued at Rs. 1,50,000, stock 1,00,000 and provision for bad debts of Rs. 10,000 is to be created.

Prepare Revaluation A/C, partners' capital A/C and new Balance Sheet.

(**Ans:** Revaluation Profit-Rs. 40,000; Balance Sheet –Rs. 4,34,000)

17. Rashmi and Pooja are partners in a firm. They share profits and losses in the ratio of 2:1. They admit Santoshi into partnership firm on the condition that she will bring Rs. 1,50,000 for capital and she will be given 1/3 share in future profits. At the time of admission the Balance Sheet of Rashmi and Pooja was as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Bills Payable	10,000	Cash	90,000
Creditors	30,000	Machinery	1,20,000
Capitals Accounts:		Furniture	10,000
Rashmi - 1,35,000		Stock	50,000
Pooja - 1,25,000	2,60,000	Debtors	30,000
	3,00,000		**3,00,000**

It was decided to:

a. Revaluate stock at Rs. 45,000.

b. Depreciate furniture by 10% and machinery by 5%.

c. Make provision of Rs. 3,000 on sundry debtors for doubtful debts.

Prepare Revaluation Account, Partners Capital Accounts and Balance Sheet of the new firm.

(**Ans :**Loss on Revaluation Rs. 15,000 and Balance Sheet Total Rs. 4,35,000)

18. Venu & Venkat are partners in a business sharing profits and losses equally. Their Balance Sheet on 31-3-2014 stood as under;

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	12,000	Cash at Bank	11,000
Capitals Accounts:		Sundry Debtors	35,000
Venu	1,40,000	Stock	80,000
Venkat	1,28,000	Plant & Machinery	78,000
		Buildings	71,000
		Furniture	5,000
	2,80,000		**2,80,000**

They decided to admit Naidu into firm on 1st April, 2014 on following terms and conditions.

a. Naidu has to pay Rs. 1,25,000/- for ¼ share in future profits.

b. Naidu has to pay Rs.38,000/- for goodwill.

c. Plant and Machinery to be depreciated by 10%.

d. Buildings to be appreciated by 20%.

e. 5% reserve for doubt full debts to be created on debtors

Prepare necessary accounts in the books of the firm after admission of Naidu with new Balance Sheet.

(**Ans :**Gain on Revaluation Rs. 4,650 and Balance Sheet Total Rs. 4,47,650)

19. Rao and Raju are carrying on business in a partnership, sharing profit & loss in the ratio of 2:3. Their Balance sheet as on 31-12-2014 was as under.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry creditors	10,000	Cash at bank	10,000
Capital Accounts:		Debtors	50,000
Rao - 1,40,000		Stock	1,00,000
Raju - 2,10,000	3,50,000	Furniture	25,000
		Buildings	1,75,000
	3,60,000		**3,60,000**

On that day they admitted Reddy into partnership and gave him 1/6th share in the future profits on the following terms.

a) Reddy is to bring in Rs. 1,50,000 as his capital and Rs.50,000 as good will, which sum is to remain in the business.

b) Stock and furniture are to be reduced in value by 5%.

c) Buildings are to be appreciated by Rs. 25,000.

d) A provision of 5% to be created on sundry debtor for doubtful debts.

Write Journal entries to record the above arrangement and show the opening Balance sheet of the new firm.

(**Ans:** Revaluation Profit-Rs. 16,250; Balance Sheet –Rs.5,76,250)

20. Bhanu and Prasad are partners sharing profit and losses in the ratio of 3:2 respectively. Their Balance Sheet as on March 31, 2015 was as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	28,000	Cash in hand	3,000
Capitals:		Cash at bank	23,000
Bhanu – 70,000		Debtors	19,000
Prasad – 70,000	1,40,000	Buildings	65,000
		Furniture	15,000
		Machinery	13,000
		Stock	30,000
	1,68,000		**1,68,000**

On that date, they admit Deepak into partnership for 1/3 share in future profit on the following terms:

(i) Furniture and stock are to be depreciated by 10%.

(ii) Building is appreciated by Rs.20,000.

(iii) 5% provision is to be created on Debtors for doubtful debts.

(iv) Deepak is to bring in Rs.50,000 as his capital and Rs.30,000 as goodwill.

Make necessary Ledger Account and Balance Sheet of the new firm.

(**Ans:** Revaluation Profit-Rs. 14,550; Balance Sheet –Rs. 2,62,550)

21. The following is the Balance Sheet of Arun and Tarun sharing profit and losses in the ratio of 2:1.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	20,000	Cash	12,000
Capitals:		Sundry debtors	50,000
Arun – 50,000		Stock	12,000
Tarun – 40,000	90,000	Furniture	6,000
		Buildings	30,000
	1,10,000		**1,10,000**

They agreed to admit Varun into partnership on the following terms:

(i) Varun to pay Rs.9,000 as Goodwill.

(ii) Varun brings Rs. 11,000 as Capital for 1/4 share of profit in the business.

(iii) Building and furniture to be depreciated at 5%. Stock is reduced by Rs. 1,600 and Bad Debt Reserve Rs.1,300 to be provided for.

Prepare necessary ledger account and balance sheet after admission.

(**Ans:** Revaluation Loss -Rs. 4,700; Balance Sheet –Rs. 1,25,300)

22. A and B are partners in a firm sharing profits in the ratio 2:1. C is admitted into the firm with 1/4 share in profits. He will bring in Rs. 30,000 as capital and capitals of A and B are to be adjusted in the profit sharing ratio. The Balance Sheet of A and B as on March 31, 2014 (before C's admission) was as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	8,000	Cash in hand	2,000
Bills Payable	4,000	Cash at bank	10,000
General Reserve	6,000	Sundry debtors	8,000
Capitals:		Stock	10,000
A – 50,000		Furniture	5,000
B – 32,000	82,000	Machinery	25,000
		Buildings	40,000
	1,00,000		**1,00,000**

Other terms of agreement are as under:

1. C will bring in Rs. 12,000 as his share of goodwill.
2. Building was valued at Rs. 45,000 and Machinery at Rs. 23,000.
3. A provision for bad debts is to be created @ 6% on debtors.
4. The capital accounts of A and B are to be adjusted.

Record necessary journal entries, show necessary ledger accounts and prepare Balance Sheet after C's admission.

(**Ans:** Revaluation Profit-Rs. 2520; Balance Sheet –Rs. 1,44,520)

23. Ashish and Pankaj are partners sharing profit in the ratio of 5:2, their Balance sheet on March 31, 2015 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	38,000	Cash in hand	15,000
Bills Payable	40,000	Cash at Bank	62,000
Salaries outstanding	5,000	Debtors	58,000
Profit & Loss A/c	40,000	Stock	85,000
Capital:		Machinery	1,45,000
Ashish – 1,50,000		Goodwill	38,000
Pankaj – 1,30,000	2,80,000		
	4,03,000		**4,03,000**

They admitted Gurudeep into partnership on the following terms on March 31, 2015.

(a) New profit sharing ratio is agreed as 3 : 2 : 1.

(b) He will bring in Rs.1,00,000 as his shared capital and Rs.30,000 as his share of goodwill.

(c) Machinery is appreciated by 10%

(d) Stock is valued at Rs. 87,000.

(e) Creditors are unrecorded to the extent of Rs.6,000.

(f) A provision for doubtful debts is to be created by 4% on debtors.

Prepare Revaluation account, Capital Accounts, Bank account and Balance Sheet of the new firm after admission of Gurdeep.

(**Ans :**Gain on revaluation Rs. 8,180; Balance Sheet Total Rs. 5,47,180)

24. The Balance Sheet of Sarath and Sindhu as on 31.12.2014 who are sharing profits and losses in the ratio of 4:1 is as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	3,50,000	Cash at bank	3,00,000
General Reserve	1,00,000	Debtors	2,00,000
SarathCapital	3,00,000	Stock	1,50,000
Sindhu Capital	2,00,000	Land & Buildings	2,00,000
		Furniture	1,00,000
	9,50,000		**9,50,000**

They have agreed to admit Sameer under the following conditions:

a) Sameer has to bring a capital of Rs.2,00,000 for his 1/5th share of profits.

b) Furniture and stock have to be depreciated by 10% and a reserve of 5% has to be created on debtors for bad and doubtful debts.

c) Land and Buildings has to be appreciated by 20%

d) Goodwill has to be raised by Rs.80000

Prepare necessary ledger A/c and the balance sheet of the new firm.

(**Ans:** Revaluation Profit-Rs.5,000; Balance Sheet –Rs.12,35,000)

25. Given below is the Balance Sheet of A and B, who are carrying on partnership business on 31.12.2014. A and B are sharing profits and losses in the ratio of 2:1.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Bills Payable	10,000	Cash in hand	10,000
Creditors	58,000	Cash at bank	40,000
Outstanding Expenses	2,000	Sundry debtors	60,000
Capitals:		Stock	40,000
A – 1,80,000		Plant	1,00,000
B – 1,50,000	3,30,000	Buildings	1,50,000
	4,00,000		**4,00,000**

C is admitted as a partner on the date of the balance sheet on the following terms:

(i) C will bring in Rs. 1,00,000 as his capital and Rs. 60,000 as his share of goodwill for 1/4 share in the profits.

(ii) Plant is to be appreciated to Rs. 1,20,000 and the value of buildings is to be appreciated by 10%.

(iii) Stock is found over valued by Rs. 4,000.

(iv) A provision for bad and doubtful debts is to be created at 5% of debtors.

(v) Creditors were unrecorded to the extent of Rs. 1,000.

Pass the necessary journal entries, prepare the revaluation account and partners' capital accounts, and show the Balance Sheet after the admission of C.

(**Ans :**Gain of Revaluation Rs. 27,000. Balance Sheet Rs. 5,88,000)

26. Following is the Balance Sheet of Satyam and Murthi sharing profit as 3:2.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	18,000	Debtors – 22,000	
General reserve	25,000	Less: provision – 1,000	21,000
Bills receivables	15,000	Land & Buildings	18,000
Capitals:		Plant & machinery	12,000
Satyam – 15,000		Stock	11,000
Murthi – 10,000	25,000	Bank	21,000
	83,000		**83,000**

On admission of Tayaru for 1/6th share in the profit it was decided that:

(i) Provision for doubtful debts to be increased by 1,500.

(ii) Value of land and building to be increased to 21,000.

(iii) Value of stock to be increased by 2,500.

(iv) The liability of workmen's compensation fund was determined to be 12,000.

(v) Tayaru brought in as her share of goodwill 10,000 in cash.

(vi) Tayaru was to bring further cash of 15,000 for her capital.

Prepare Revaluation A/c, Capital A/c and the Balance Sheet of the new firm.

(**Ans:** Revaluation Profit-Rs. 4,000; Balance Sheet –Rs. 1,12,000)

27. Ramesh, Suresh and Naresh are partners sharing profits and losses in the ratio of 1:2:3. On 31st March 2014, their Balance Sheet was as follows;

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	64,000	Cash	18,000
Bills Payable	32,000	Bills receivable	24,000
P & L Account	14,000	Furniture	28,000
Capitals:		Stock	44,000
Ramesh - 30,000		Debtors	42,000
Suresh - 40,000		Investments	52,000
Naresh - 62,000	1,32,000	Machinery	34,000
	2,42,000		**2,42,000**

They admit Dinesh into partnership on the following terms:

(i) Furniture and Machinery to be depreciated by 5%.

(ii) Stock is revaluated at 48,000.

(iii) Outstanding rent amount to 1,800.

(iv) Dinesh to bring 32,000 towards his capital for 1/6th share.

Prepare Revaluation Account, Partners Capital Accounts and Balance Sheet of the new firm.

(**Ans:** Revaluation loss -Rs. 900; Balance Sheet –Rs. 2,74,900)

28. Ashish and Dattu were partners in a firm sharing profits in 3:2 ratio. On Jan. 01, 2014 they admitted Vimal for 1/5 share in the profits. The Balance Sheet of Ashish and Dattu as on Jan. 01, 2014 was as follows:

Balance Sheet of A and B as on 1.1.2014

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Bills Payable		10,000	Land &Buldings		35,000
Creditors		15,000	Plant		45,000
Capitals Accounts:			Debtors	– 22,000	
Ashish	– 80,000		Less: Provision	– 2,000	20,000
Dattu-	35,000	1,15,000	Stock		35,000
			Cash		5,000
		1,40,000			**1,40,000**

It was agreed that:

i) The value of Land and Buildings be increased by Rs. 15,000.

ii) The value of plant be increased by 10,000.

iii) Goodwill of the firm be valued at Rs. 20,000.

iv) Vimal to bring in capital to the extent of 1/5th of the total capital of the new firm.

Record the necessary journal entries and prepare the Balance Sheet of the firm after Vimal's admission.

(**Ans :**Gain on Revaluation Rs. 25,000. Balance Sheet Total Rs. 2,25,000).

29. The following was the Balance Sheet of Arun, Babu and Charan sharing profits and losses in the ratio of 6: 5: 3 respectively.

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Bills Payable		3,000	Cash in hand	900
Creditors		9,000	Sundry debtors	12,600
Capitals Accounts:			Stock	14,000
Arun	– 19,000		Land & Buildings	24,000
Babu	– 16,000		Furniture	3,500
Charan	- 8,000	43,000		
		55,000		**55,000**

They agreed to take Deepak into partnership and give him a share of 1/8 on the following terms: (a) that Deepak should bring in Rs. 4,200 as goodwill and Rs. 7,000 as his Capital; (b) that furniture be depreciated by 12%; (c) that stock be depreciated by 10% (d) that a Reserve of 5% be created for doubtful debts; (e) that the value of land and buildings having appreciated be brought upto Rs. 31,000;(f) that after making the adjustments the capital accounts of the old partners be adjusted on the basis of the proportion of Deepak's Capital to his share in the business, i.e., actual cash to be paid off, or brought in by the old partners as the case may be.

Prepare Necessary Accounts and the Opening Balance Sheet of the new firm.

(**Ans :** Gain on revaluation Rs. 4,550. Balance Sheet Total Rs. 68,000)

Chapter

7

Retirement/Death of a Partner

7.1 Introduction
7.2 New Profit Sharing Ratio
7.3 Revaluation of Assets and Liabilities
7.4 Treatment of Undistributed Profits& Losses
7.5 Treatment of Goodwill
7.6 Continuing Partners' Capital Adjustment
7.7 Settlement of total Amount Due to the Retiring Partner
7.8 Share of Profits/Losses up to date of deceased partner

7.1 Introduction

On the retirement or death of a partner, the existing partnership deed comes to an end, and in its place, a new partnership deed needs to be framed whereby, the remaining partners continue to do their business on changed terms and conditions. There is no much difference in the accounting treatment at the time of retirement or in the event of death. In both the cases, we are required to determine the amount due to the retiring partner (in case of retirement) and to the legal representatives (in case of deceased partner) after making necessary adjustments in respect of goodwill, revaluation of a assets and liabilities and transfer of accumulated profits and losses. In addition, we may also have to compute the new profit sharing ratio among the remaining partners and also their gaining ratio.

Ascertaining the Amount Due to Retiring/Deceased Partner

The amount due to the retiring partner (in case of retirement) and to the legal representatives/ executors (in case of death) includes:

(a) Credit balance of his capital account;
(b) Credit balance of his current account (if any);
(c) His share of goodwill;
(d) His share of accumulated profits (reserves);

(e) His share in the gain of revaluation of assets and liabilities;

(f) His share of profits up to the date of retirement/death;

(g) Interest on his capital; and

(h) Salary/commission, if any, due to him up to the date of retirement/death.

The following deductions, if any, may have to be made from his share:

(a) Debit balance of his current account (if any);

(b) His share of goodwill to be written off; if necessary;

(c) His share of accumulated losses;

(d) His share of loss on revaluation of assets and liabilities;

(e) His share of loss up to the date of retirement/death;

(f) His drawings up to the date of retirement/death;

(g) Interest on drawings, if involved, up to the date of retirement/death.

Thus, as in the case of admission, the various accounting aspects involved on retirement or death of a partner are as follows:

1. New profit sharing ratio and gaining ratio;
2. Revaluation of assets and liabilities;
3. Distribution of accumulated profits/losses, and reserves;
4. Treatment of Goodwill;
5. Adjustment of partners' capitals; and
6. Settlement of the amounts due to retired/deceased partner;

7.2 New Profit Sharing Ratio

New profit sharing ratio is the ratio in which the remaining partners will share future profits after the retirement or death of any partner. The new share of each of the remaining partner will consist of his own share in the firm plus the share acquired from the retiring /deceased partner.

The following are the various situations where the remaining partners will continue the partnership firm and share the future profits:

Case-1: Normally, the continuing partners acquire the share of retiring or deceased partner in the old profit sharing ratio, and there is no need to compute the new profit sharing ratio among them, as it will be same as the old profit sharing ratio among them. In fact, in the absence of any information regarding profit sharing ratio in which the remaining partners' share the future profits in their old ratio.

For example: Asha, Deepti and Nisha are partners in a firm sharing profits and losses in the ratio of 3:2:1. If Deepti retires, the new profit sharing ratio between Asha and Nisha will be 3:1.

Case-2: The continuing partners may acquire the share in the profits of the retired/deceased partner in a proportion other than their old ratio. In that case, there is a need to compute the new profit sharing ratio among them.

New share of Continuing Partners' = Old Share + Gaining Share

Illustration-1

Naveen, Suresh and Tarun are partners sharing profits and losses in the ratio of 5:3:2. Tarun retires from the firm and his share was acquired by Naveen and Tarun in the ratio of 2:1. In such a case, calculate the new profitsharing ratio.

Solution

Old ratio of Naveen, Suresh and Tarun = 5:3:2

Gaining ratio of Naveen and Suresh after retirement of Tarun = 2:1

New share of Continuing Partner = Old Share + Acquired share from the Outgoing Partner

Share acquired by Naveen $= \frac{2}{10} \times \frac{2}{3} = \frac{4}{30}$

Naveen's new share $= \frac{5}{10} + \frac{4}{30} = \frac{15+4}{30} = \frac{19}{30}$

Share acquired by Suresh $= \frac{2}{10} \times \frac{1}{3} = \frac{2}{30}$

Suresh's new share $= \frac{3}{10} + \frac{2}{30} = \frac{9+2}{30} = \frac{11}{30}$

New ratio $= \frac{19}{30} : \frac{11}{30}$

Thus, the new profit sharing ratio of Naveen and Suresh will be = 19 : 11.

Case-3: The continuing partners may agree on a specified new profit sharing ratio, in that case the ratio so specified will be the new profit sharing ratio.

7.2.1 Gaining Ratio

The ratio in which the continuing partners have acquired the share from the retiring/deceased partner is called the gaining ratio.

Gaining share of continuing partners = New share – Old share

Illustration-2

Anil, Dinesh and Ganga are partners sharing profits in the ratio of 6:5:4. Dinesh retires. Anil and Ganga decide to share the profits of the new firm in the ratio of 3:2. Calculate the gaining ratio.

Solution

Old ratio of all partners = 6:5:4

New ratio of continuing partners = 3:2

Gaining share of continuing partners = New share – Old share

Anil's Gaining Share $= \frac{3}{5} - \frac{6}{15} = \frac{9-6}{15} = \frac{3}{15}$

Ganga's Gaining Share $= \frac{2}{5} - \frac{4}{15} = \frac{6-4}{15} = \frac{2}{15}$

Gaining ratio $= \frac{3}{15} : \frac{2}{15}$

Thus, the gaining ratio of Anil and Ganga = 3 : 2

7.3 Revaluation of Assets and Liabilities

At the time of retirement/death of a partner, Revaluation Account is prepared in order to ascertain net gain/loss on revaluation of assets and liabilities and bringing unrecorded items into firm's books and the same is transferred to the capital account of all partners including retiring/deceased partners in their old profit sharing ratio. Revaluation account is done on the same basis as was done in case of admission of a partner.

Illustration-3

M, I and G are partners sharing profits and losses in the ratio of 2:2:1 respectively. On March 31, 2015, their Balance Sheet was as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors	55,000	Furniture	25,000
Reserve Fund	30,000	Buildings	1,00,000
Capital Accounts:		Patents	30,000
M - 1,50,000		Machinery	1,50,000
I - 1,25,000		Stock	50,000
G - 75,000	3,50,000	Debtors	40,000
		Cash	40,000
	4,35,000		**4,35,000**

G retires on the above date. It was agreed that Machinery be valued at Rs.1,40,000; Patents at Rs. 40,000; and Buildings at Rs. 1,25,000. Record the necessary journal entries and prepare the Revaluation Account.

Solution

Journal Entries

Date	Particulars		L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
2015					
March,	Revaluation A/c	Dr.		10,000	
31	To Machine A/c				10,000
	(Being decrease in the value of machinery)				
31	Patents A/c	Dr.		10,000	
	Buildings A/c	Dr.		25,000	
	To Revaluation A/c				35,000
	(Being increase in the value of Patents and Buildings)				
31	Revaluation A/c	Dr		25,000	
	To M's Capital A/c				10,000
	To I's Capital A/c				10,000
	To G's Capital A/c				5,000
	(Being revaluation profit transferred to old partners' capital A/c)				

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

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
To Machinery		10,000	By Patents	10,000
To Capital Accounts:			By Buildings	25,000
M -	10,000			
I -	10,000			
G -	5,000	25,000		
		35,000		**35,000**

7.4 Adjustment of Accumulated Profits and Losses

Sometimes, the Balance Sheet of a firm may show accumulated profits/losses in the form of general reserve and profit and loss account. The retiring/deceased partner is entitled to his share in the accumulated profits and is also liable to share the accumulated losses, if any. These accumulated

profits or losses belong to all the partners and should be transferred to the capital accounts of all partners in their old profit sharing ratio.

7.5 Treatment of Goodwill

The partner is entitled to his share of goodwill at the time of retirement/death because the goodwill has been earned by the firm with the efforts of all the existing partners. Hence, at the time of retirement/death of a partner, goodwill is valued as per agreement among the partners the retiring/ deceased partner compensated for his share of goodwill by the continuing partners in their gaining ratio.

The accounting treatment for goodwill in such a situation depends upon whether or, not goodwill already appears in the books of the firm.

Case-1: When Goodwill does not appear in the Books

When goodwill does not appear in the books of the firm there are four ways in which the retiring partner can be given the necessary credit for loss of his share of goodwill, these are as follows:

(a) Goodwill is raised at its full value and retained in the books;

(b) Goodwill is raised at its full value and written off immediately;

(c) Goodwill is raised to the extent of retired/deceased partner's share and written off immediately;

(d) No goodwill account is raised at all in firm's books; in that case it is adjusted discretely through partners' capital accounts by recording the following journal entry.

Continuing partners' capital A/c's	Dr.	xxx	
To Retiring/Deceased Partner's Capital A/c			xxx

(Retiring/deceased partner's goodwill amount should adjust with the remaining partners' capital accounts into their gaining ratio)

Illustration-4

A, B and C are partners in a firm sharing profits in the ratio of 3:2:1. B retires. The goodwill of the firm is valued at Rs. 60,000 and the remaining partners A and C continue to share profits in the ratio of 3:1. Pass the journal entries under various alternatives:

(a) If goodwill is raised at full value and retained in books

(b) If goodwill is raised at full value and written off immediately

(c) If goodwill is raised to the extent of retiring partner's share and written off immediately

(d) If goodwill is not to after in firm's books at all

Solution

(a) If goodwill is raised at full value and retained in books

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Goodwill A/c Dr.		60,000	
	To A's Capital A/c			30,000
	To B's Capital A/c			20,000
	To C's Capital A/c			10,000
	(Being goodwill raised at full value and distributed in old ratio)			

(b) If goodwill is raised at full value and written off immediately

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Goodwill A/c Dr.		60,000	
	To A's Capital A/c			30,000
	To B's Capital A/c			20,000
	To C's Capital A/c			10,000
	(Being goodwill raised at full value and distributed in old ratio)			
	A's Capital A/c Dr.		45,000	
	C's Capital A/c Dr.		15,000	
	To Goodwill A/c			60,000
	(Being goodwill written off in the new profit sharing ratio)			

(c) If goodwill is raised to the extent of retiring partner's share and written off immediately

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Goodwill A/c Dr.		20,000	
	To B's capital A/c			20,000
	(Being goodwill raised to the extent of B's share)			

	A's Capital A/c Dr. C's Capital A/c Dr To Goodwill A/c (Being goodwill written off in the gaining ratio)		15,000 5,000	 20,000

(d) If goodwill is not to after in firm's books at all

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	A's Capital A/c Dr. C's Capital A/c Dr. To B's Capital A/c (Being B's goodwill written off in the gaining ratio)		15,000 5,000	 20,000

Working Note: Calculation of gaining Ratio

Old ratio of all partners = 3:2:1

New ratio of continuing partners = 3:1

Gaining share of continuing partners = New share – Old share

A's Gaining Share $= \frac{3}{4} - \frac{3}{6} = \frac{9-6}{12} = \frac{3}{12}$

C's Gaining Share $= \frac{1}{4} - \frac{1}{6} = \frac{3-2}{12} = \frac{1}{12}$

Gaining ratio $= \frac{3}{12} : \frac{1}{12}$

Thus, the gaining ratio of A and C =3 : 1

Case-2: When Goodwill is already appeared in the Books

If value of goodwill is already appeared in the books of the firm equals with the present value of goodwill, normally no adjustment is required. In case the present value of goodwill is different from its book value, an adjustment entry is required. In such a situation, there are two possibilities:

(a) The book value of goodwill is lower than its current value, and

(b) The book value is greater than its current value. These are discussed as follows.

Illustration-5

D, P and R are partners sharing profits in the ratio of 5:3:2. Goodwill appears in the books at a value of Rs. 20,000. P retires from the business. Pass the necessary journal entries in the following cases;

a) On the day of P's retirement, goodwill is valued at Rs. 24,000, and

b) At the time of retirement goodwill is valued Rs. 18,000.

Solution

a) On the day of P's retirement, goodwill is valued at Rs. 24,000.

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Goodwill A/c Dr.		4,000	
	To D's capital A/c			2,100
	To P's capital A/c			1,200
	To R's capital A/c			800
	(Being Increase in the value of goodwill distribute among old partners in their old profit sharing ratio of 5:3:2)			

b) At the time of retirement goodwill is valued Rs. 18,000.

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	D's capital A/c Dr.		1,000	
	P's capital A/c Dr.		600	
	R's capital A/c Dr.		400	
	To Goodwill A/c			2,000
	(Being decrease in the value of goodwill distribute among old partners in their old profit sharing ratio of 5:3:2)			

7.6 Adjustment of Capitals

Sometimes after the retirement/deceased of a partner, the continuing partners decide to adjust their capital according to their new profit sharing ratio. After all adjustments in the continuing partners' capital accounts, if surplus, the amount will be withdrawn by the partners and if shortage, the required amount will be supplied by the partners. The process of adjustments in capital accounts is same in the admission of a partner.

Illustration–6

John, Sundar and Rao are partners in a firm sharing profits in the ratio of 2:1:1. John retires from the firm and Sundar and Rao decided that the capital of the new firm will be fixed at Rs. 1,20,000. The capital accounts of Sundar and Rao show a credit balance of Rs. 82,000 and Rs. 41,000 respectively after making all the adjustments. Calculate the actual cash to be paid off or to be brought in by the continuing partners and pass the necessary journal entries.

Solution:

The New Profit Sharing Ratio between Sundar and Rao = 2 : 1

Total capital of the firm = Rs. 1,20,000

New Capital based on new ratio of Sundar = 1,20,000 x 2/3 = 80,000

Existing Capital (after adjustments) = 82,000

Cash to be Paid off =Rs. 2,000

New Capital based on new ratio of Rao = 1,20,000 x 1/3 = 40,000

Existing Capital (after adjustments) = 41,000

Cash to be Paid off = Rs. 1,000

Journal Entries in the Books of Sundar and Rao

Date	Particulars		L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Sundar's Capital A/c	Dr.		2,000	
	Rao's Capital A/c	Dr.		1,000	
	To Cash A/c				3,000
	(Being excess capital withdrawn by Sundar and Rao)				

7.7 Disposal of Amount Due to Retiring Partner

The outgoing partner's account is settled as per the terms of partnership deed i.e., in lumpsum immediately or in various instalments with or without interest. In the absence of any agreement, Section 37 of the Indian Partnership Act, 1932 is applicable, which states that the outgoing partner has an option to receive either interest @ 6% p.a. till the date of payment or such share of profits which has been earned with his/her money (i.e., based on capital ratio). Hence, the total amount due to the retiring partner which is ascertained after all adjustments have been made is to be paid immediately to the retiring partner. In case the firm is not in a position to make the payment immediately, the amount due is transferred to the retiring Partner's Loan Account.

The necessary journal entries recorded are as follows;

1. For retiring partner is paid cash in full.

Retiring Partner's Capital A/c	Dr.	xxx	
To Cash/Bank A/c			xxx

2. For retiring partner's total amount is treated as loan.

Retiring Partner's Capital A/c	Dr.	xxx	
To Retiring Partner's Loan A/c			xxx

3. For retiring partner is partly paid in cash and the remaining amount treated as loan.

Retiring Partner's Capital A/c	Dr.	xxx	
To Cash/Bank A/c			xxx
To Retiring Partner's Loan A/c			xxx

4. For Loan account is settled by paying in instalment includes principal and interest.

a) For interest on loan

Interest A/c	Dr.	xxx	
To Retiring Partner's Loan A/c			xxx

b) For payment of instalment

Retiring Partner's Loan A/c	Dr.	xxx	
To Cash/Bank A/c			xxx

Note:

1. The balance of the retiring partner's loan account is shown on the liabilities side of the Balance Sheet till the last instalment is paid to him.
2. Entry numbers 4 (a) and (b), above will be repeated till the loan is paid off.

Illustration-7

Geethika, Rishitha and Pravalika are partners in a firm. Geethika retires from the firm. On her date of retirement, Rs. 50,000 becomes due to her. Prepare necessary entries in the following cases:

1. When payment is made immediately;
2. When payment is not made immediately
3. When they agree to pay 50% immediately;

Solution

1. When payment is made immediately

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Geethika's capital A/c Dr.		50,000	
	To Cash A/c			50,000
	(Being paid the entire amount due on the date of retirement)			

2. When payment is not made immediately

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Geethika's capital A/c Dr.		50,000	
	To Geethika's Loan A/c			50,000
	(Being the entire amount due transfer to Geethika's Loan account)			

3. When they agree to pay 50% immediately

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Geethika's capital A/c Dr.		50,000	
	To Cash A/c			25,000
	To Geethika's Loan A/c			25,000
	(Being paid 50% of amount due on the date of retirement)			

Illustratio-8

X, Y and Z were partners in a firm sharing profits in 3:2:1 ratio. On 31.03.2015 Z retires from the firm. On the date of Z's retirement the balance sheet of the firm was as follows:

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Creditors		54,000	Bank		55,200
Bills Payable		24,000	Debtors -	12,000	
Outstanding Rent		4,400	Less: Provisions -	800	11,200
General Reserve		12,000	Stock		18,000
Capitals:			Furniture		8,000
X -	92,000		Premises		1,94,000
Y -	60,000				
Z -	40,000	1,92,000			
		2,86,400			**2,86,400**

On Z's retirement it was agreed that;

i. Premises will be appreciated by 5% and furniture will be appreciated by Rs. 2, 000.

ii. Stock will be depreciated by 10%.

iii. Provision for bad debts was to be made at 10% on debtors

iv. Goodwill of the firm is valued at Rs. 48,000.

v. Z's amount will be paid by cheque.

Prepare Revaluation A/C, Partners' Capital A/Cs and New Balance Sheet.

Solution

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

Particulars		Amount (Rs.)	Particulars	Amount (Rs.)
To Stock		1,800	By Premises	9,700
To Provision for bad debts		400	By Furniture	2,000
To Capital Accounts:				
X -	4,750			
Y -	3,167			
Z -	1,583	9,500		
		11,700		**11,700**

Dr. **Partner's Capital Accounts** Cr.

Particulars	X (Rs.)	Y (Rs.)	Z (Rs.)	Particulars	X (Rs.)	Y (Rs.)	Z (Rs.)
To Bank	-	-	51,583	By Balance b/d	92,000	60,000	40,000
To Balance c/d	1,26,750	83,167	-	By Revluation A/c	4,750	3,167	1,583
				By General Reserve	6,000	4,000	2,000
				By Goodwill	24,000	16,000	8,000
	1,26,750	**83,167**	**51,583**		**1,26,750**	**83,167**	**51,583**

New Balance Sheet as on 31st March, 2015

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	54,000	Bank (55,250-51,583)	3,617
Bills Payable	24,000	Debtors - 12,000	
Outstanding Rent	4,400	Less: Provisions - 1200	10,800
		Stock (18,000-1,800)	16,200
Capitals:		Furniture (8,000+2,000)	10,000
X - 1,26,750		Premises (1,94,000+7000)	2,03,700
Y - 83,167	2,09,917	Goodwill	48,000
	2,92,317		**2,92,317**

Illustration-9

Sai, Suresh and Naresh who were sharing profits in the ratio of 2:3:5.Balance Sheet of Sai, Suresh and Nares has on March 31, 2015.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Capitals:		Land	4,00,000
Sai – 7,20,000		Buildings	3,80,000
Suresh – 4,15,000		Plant & Machinery	4,65,000
Naresh – 3,45,000	14,80,000	Furniture & Fittings	77,000
Reserve Fund	1,80,000	Stock	1,85,000
Sundry Creditors	1,44,000	Debtors	1,92,000
Outstanding Expenses	16,000	Cash in hand	1,21,000
	18,20,000		**18,20,000**

Suresh retires on the above date and the following adjustments are agreed upon his retirement.

1. Stock was valued at Rs. 1,80,000.
2. Furniture and fittings were valued at Rs. 90,000.
3. An amount of Rs. 12,000 was doubtful and a provision for the same was required.
4. Goodwill of the firm was valued at Rs. 2,00,000.
5. Suresh was paid Rs. 40,000 immediately on retirement and the balance was transferred to his loan account.
6. Sai and Naresh were to share future profits in the ratio of 3:2.

Prepare Revaluation Account, Capital Account and Balance Sheet of the reconstituted firm.

Solution

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

Particulars	Amount (Rs.)	Particulars			Amount (Rs.)
To Stock	5,000	By Furniture & Fittings			13,000
To Provision for bad debts	12,000	By Capital Accounts:			
		Sai	–	800	
		Suresh	–	1,200	
		Naresh	–	2,000	4,000
	17,000				**17,000**

Dr. **Partner's Capital Accounts** **Cr.**

Particulars	Sai (Rs.)	Suresh (Rs.)	Naresh (Rs.)	Particulars	Sai (Rs.)	Suresh (Rs.)	Naresh (Rs.)
To Revaluation a/c	800	1,200	2,000	By Balance b/d	7,20,000	4,15,000	3,45,000
To Cash c/d	-	40,000	-	By Reserve Fund	36,000	54,000	90,000
To Suresh a/c	-	4,87,800	-	By Goodwill	40,000	60,000	1,00,000
To Balance c/d	7,95,200	-	5,33,000				
	7,96,000	**5,29,000**	**5,35,000**		**7,96,000**	**5,29,000**	**5,35,000**

New Balance Sheet as on 31st March, 2015

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
Capitals:			Land		4,00,000
Sai –	7,95,200		Buildings		3,80,000
Naresh –	5,33,000	13,28,200	Plant & Machinery		4,65,000
Sundry Creditors		1,44,000	Furniture & Fittings		90,000
Outstanding Expenses		16,000	Stock		1,80,000
Suresh Loan A/c		4,87,800	Debtors –	1,92,000	
			Less: Provision –	12,000	1,80,000
			Cash in hand (1,21,000 – 40,000)		81,000
			Goodwill		2,00,000
		19,76,000			**19,76,000**

7.8 Share of Profits/Losses up to date of deceased Partner

As stated earlier, the accounting treatment in the event of death of a partner is similar to that in case of retirement of a partner, and that in case of death of a partner his claim is transferred to his executors and settled in the same manner as that of the retired partner. However, there is one major difference that, while the retirement normally takes place at the end of an accounting period, the death of a partner may occur any time. Hence, in case of a partner, his claim shall also include his share of profit or loss, interest on capital, interest on drawings (if any) from the date of the last Balance Sheet to the date of his death.

The main problem relates to the calculation of profit for the intervening period (i.e., the period from date of the last balance sheet to the date of the partner's death). Since, it is considered burdensome to close the books and prepare final account, for the period, the deceased partner's share of profit may be calculated on the basis of last year's profit (or average of past few years) or on the basis of sales.

The journal entry will be recorded as follows:

(1) For transfer of profit to a deceased partner

		Dr.	Cr.
Profit & Loss Suspense A/c	Dr.	xxx	
To Deceased Partner's Capital A/c			xxx

(ii) For transfer of deceased partner's amount due to the Executers A/c

Deceased Partner's Capital A/c Dr. xxx

To Deceased Partner's Executers A/c xxx

Illustration-10

B, C and D were partners in a firm sharing profits in the ratio of 5:4:1. The profit of the firm for the year ending on March 31, 2014 was Rs.1,00,000. C dies on June 30, 2014. Calculate C's share of profit and pass journal entry.

Solution

Profit for the period from April 1 to June 30, 2014, shall be calculated as follows:

Total profit for the year ending on 31st March, 2014 = Rs.1,00,000

C's share of profit = Preceding Year's Profit × Proportionate Period Share of Deceased Partner

$$= \text{Rs. } 1,00,000 = \frac{3}{12} \times \frac{4}{10}$$

= Rs. 10,000

The journal entry will be recorded as follows:

Profit & Loss Suspense A/c Dr. 10,000

To C's Capital A/c 10,000

(C's share of profit transferred to his capital account)

Illustration 11

Anil, Bhanu and Chandu were partners in a firm sharing profits in the ratio of 5:3:2. On March 31, 2014, their Balance Sheet was as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	11,000	Buildings	20,000
Reserve Fund	6,000	Machinery	30,000
Anil's Capital	30,000	Stock	10,000
Bhanu's capital	25,000	Patents	11,000
Chandu's Capital	15,000	Debtors	8,000
		Cash	8,000
	87,000		**87,000**

Anil died on October 1, 2014. It was agreed between his executors and the remaining partners that:

(a) Goodwill to be valued at 2½ years' purchase of the average profits of the previous four years which were:

2010-11 – Rs.13,000, 2011-12 – Rs. 12,000,

2012-13 – Rs.20,000, 2013-14 – Rs.15,000.

(b) Patents be valued at Rs.8,000; Machinery at Rs.28,000; and Building at Rs.25,000.

(c) Profit for the year 2014-15 to be taken as having accrued at the same rate as that of the previous year.

(d) Interest on capital provided at 10% p.a.

(e) Half of the amount due of Anil to be paid immediately.

Prepare Anil's Capital Account and Anil's Executor's Account as on October 1, 2014.

Solution

Dr. Revaluation A/c Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Patents A/c	3,000	By Buildings	5,000
To Machinery A/c	2,000		
	5,000		**5,000**

Dr. Anil's Capital A/c Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Anil's Executers A/c	57,000	By Balance b/d	30,000
		By Reserve Fund	3,000
		By Interest on capital	1,500
		By Profit & Loss (suspense)	3,750
		By Bhanu's capital(goodwill)	11,250
		By Chandu's capital(goodwill)	7,500
	57,000		**57,000**

Dr. Anil's Executers A/c Cr.

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Cash A/c	28,500	By Anil's Capital A/c	57,000
To Balance b/d	28,500		
	57,000		**57,000**

Working Note:

1. Goodwill = Average Profit x 2½ years' purchase

   Average Profit for 4 years = Rs. 60,000 / 4

   = Rs. 15,000

   Goodwill = $15,000 \times \frac{5}{2}$

   = Rs. 37,500

   Anil's Share of Goodwill = $37,500 \times \frac{5}{10}$

   = Rs. 18,750

   This goodwill amount will adjust with 3:2 ratio between Bhanu and Chandu.

2. Profit from the date of last balance sheet to date of death (April 1, 2014 to October 1, 2014) = 6 months

   Profit for 6 months = Rs. $15,000 \times \frac{6}{12}$

   = Rs. 7,500

   Anil's share of profit = Rs. $7,500 \times \frac{5}{10}$

   = Rs. 3,750

3. Interest on Anil's Capital (April 1, 2014 to October 1, 2014)

   = Rs. $30,000 \times \frac{10}{100} \times \frac{6}{12}$

   = Rs. 1,500

Illustration-12

You are given the Balance Sheet of Mohit, Sohan and Rahul who are partners sharing profits in the ratio of 2:2:1, as on March 31, 2014.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	40,000	Goodwill	30,000
Reserve Fund	25,000	Fixed Assets	60,000
Capitals:		Stock	10,000
Mohit - 30,000		Debtors	20,000
Sohan - 25,000		Cash at Bank	15,000
Rahul -15,000	70,000		
	1,35,000		**1,35,000**

Sohan died on June 15, 2014. According to the Deed, his legal representatives are entitled to:

(a) Balance in Capital Account;

(b) Share of goodwill valued on the basis of thrice the average of the past 4 years' profits.

(c) Share in profits up to the date of death on the basis of average profits for the past 4 years.

(d) Interest on capital account @ 12% p.a.

Profits for the year ending on March 31 of 2011, 2012, 2013 and 2014 were Rs. 15,000, Rs. 17,000, Rs. 19,000 and Rs. 13,000 respectively.

Mohit and Rahul continued as partner by taking over Sohan's share equally. Work out the amount payable to Sohan's legal representatives.

Solution

Dr. **Sohan's Capital A/c** **Cr.**

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
To Goodwill A/c	12,000	By Balance b/d	25,000
To Sohan's Executers A/c	44,158	By Reserve Fund	10,000
		By Interest on capital	625
		By Profit & Loss (suspense)	1,333
		By Mohit's capital (goodwill)	9,600
		By Rahul's capital (goodwill)	9,600
	56,158		**56,158**

Working Notes;

1. Goodwill = Average Profit x 3 years' purchase

Average Profit for 4 years = Rs. 64,000 / 4

= Rs. 16,000

Goodwill = 16,000 x 3

= Rs. 48,000

Sohan's Share of Goodwill = $48,000 \times \frac{2}{5}$

= Rs. 19,200

2. Profit from the date of last balance sheet to date of death (April 1, 2014 to June 15, 2014) = 2½ months

Profit for 2.5 months $= \text{Rs. } 16{,}000 \times \frac{2.5}{12}$

$= \text{Rs. } 3{,}333$

Sohan's share of profit $= \text{Rs. } 3{,}333 \times \frac{2}{5}$

$= \text{Rs. } 1{,}333$

3. Interest on Sohan's Capital (April 1, 2014 to June 15, 2014)

$= \text{Rs. } 25{,}000 \times \frac{12}{100} \times \frac{2.5}{12}$

$= \text{Rs. } 625$

Summary

Retirement of a Partner: Retirement of a partner is one of the modes of reconstituting the firm under which an old partnership deed comes to an end and a new one between the continuing partners (i.e. partners other than the outgoing partner) comes into existence. However, the firm continues its business.

New Profit sharing ratio after retirement/death: New profit sharing ratio is the ratio in which the remaining partner will share future profits after the retirement or death of any partner.

New Share = Old share + Gaining share.

Gaining ratio of remaining partners: Gaining ratio is the ratio in which the continuing partners have acquired the share from the retiring/deceased partner.

Gaining ratio = New ratio – Old Ratio

The basic rule is that gaining partner share compensates the sacrificing partner to the extent of their gain for the respective share of goodwill.

Revaluation of Assets and Liabilities: At the time of retirement/death of a partner, there may be some assets/liabilities which may not have been shown at their current values.

Adjustment of Accumulated Profits and Losses: The reserves (Accumulated profits) or losses belong to all the partners and should be transferred to capital account of all partners on retirement/ death.

Adjustment of Goodwill: If goodwill already appears in the books, it will be written off by debiting all partners' capital account in their old profit sharing ratio.

Give credit for outgoing partners' (i.e. retiring/deceased partner) share of goodwill to outgoing partner capital account.

Computation of amount due to retiring/deceased partner: Retiring partner/deceased partner may be paid in one lumpsum or instalments with interest.

Adjustment of Capital: At the time of retirement/death of a partner, the remaining partners may decide to keep their capital contributions in their profit sharing ratio. For this purpose the continuing partners will be adjusted their share capital in new profit-sharing ratio.

MODEL QUESTIONS

Very Short Answer Questions

1. What is meant by retirement of a partner
2. What do you understand by 'Gaining Ratio
3. What are the adjustments required on the retirement or death of a partner?
4. How is the account of deceased partner settled
5. Explain the modes of payment to a retiring partner.

Exercises

1. Madhu, Nehra and Tina are partners sharing profits in the ratio of 5:3:2. Calculate new profit sharing ratio if

   1. Madhu retires

   2. Nehra retires

   3. Tina retires

(**Ans**: New Profit Sharing Ratio: 1= 3:2, 2 = 5:2 and 3 = 5:3)

2. Hari, Prasad and Anwar are partners sharing profits in the ratio of 3:2:1. Hari retires and his share is taken up by Prasad and Anwar in the ratio of 3:2. Calculate the new profit sharing ratio.

(**Ans:** New Profit Sharing Ratio of Prasad and Anwar= 19:11)

3. Ranjana, Sadhna and Kamana are partners sharing profits in the ratio 4:3:2. Ranjana retires, Sadhna and Kamana decided to share future profits in the ratio of 5:3. Calculate the Gaining Ratio.

(**Ans**: Gaining ratio = 21:11)

4. Murali, Naveen and Omprakash are partners sharing profits in the ratio of 3:4:1 Murali retires and surrenders 2/3rd of his share in favour of Naveen and the remaining share in favour of Omprakash. Calculate new profit sharing and the gaining ratio of the remaining partners.

(**Ans**: New Profit Sharing Ratio= 3:1 and gaining ratio= 2:1)

5. Vasu, Dasu and Bosu are partners sharing profits in the ratio of 1:2:3. Dasu retires and at the time of retirement, goodwill is valued at Rs. 84,000. Vasu and Bosu decided to share future profits in the ratio of 2:1. Record the necessary journal entries.

6. Rama, Krishna and Reddy are partners in a firm sharing profits and losses in the ratio of 2:2:1. On Rama's retirement, the goodwill of the firm is valued at Rs. 46,000. Krishna and Reddy decided to share future profits equally. Record the necessary journal entry for the treatment of goodwill without opening' Goodwill Account'.

7. Shanu, Nicee and Jwalitha are partners sharing profits in the ratio of 1:3:5. Goodwill is appearing in the books at a value of Rs. 60,000. Nicee retires and goodwill is valued at Rs. 90,000. Shanu and Jwalitha decided to share future profits equally. Record necessary journal entries.

8. Asha, Deepa and Lata are partners in a firm sharing profits in the ratio of 3:2:1. Deepa retires. After making all adjustments relating to revaluation, goodwill and accumulated profit etc., the capital accounts of Asha and Lata showed a credit balance of Rs.1,60,000 and Rs. 80,000 respectively. It was decided to adjust the capitals of Asha and Lata in their new profit sharing ratio. They decided that the requirement of capital is Rs. 2,50,000. You are required to calculate the new capitals of the partners and record necessary journal entries for bringing in or withdrawal of the necessary amounts involved.

(**Ans:** Asha's capital brought – Rs. 27,500 & Lata's capital withdrew – Rs. 17,500)

9. A, B, and C are partners in a firm. B retires from the firm on 1st Jan 2015.On the date of his retirement Rs. 55,000 were due to him. It was decided that the payment will be done in 3 equal yearly instalments together with interest @ 10% p.a. on the unpaid balance. Prepare necessary entries.

10. The Balance Sheet of Mohit, Neeraj and Sohan who are partners in a firm sharing profits according to their capitals as on March 31, 2015 was as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	21,000	Buildings	1,00,000
Mohit's capital	80,000	Machinery	50,000
Neeraj's capital	40,000	Stock	18,000
Sohan's capital	40,000	Debtors - 20,000	
General reserve	20,000	Less: Provision - 1,000	19,000
		Cash at Bank	14,000
	2,01,000		**2,01,000**

On that date, Neeraj decided to retire from the firm and was paid for his share in the firm subject to the following:

1. Buildings to be appreciated by 20%.
2. Provision for Bad debts to be increased to 15% on Debtors.
3. Machinery to be depreciated by 20%.

Prepare necessary accounts and new Balance Sheet after retirement.

(**Ans**: Gain on Revaluation – Rs. 8,000; Mohit's capital A/c – Rs. 94,000, Sohan's capital A/c – Rs. 47,000; Neeraj's loan A/c – Rs.47,000; New Balance Sheet – Rs. 2,09,000).

11. Siva, Rama and Krishna were partners in a firm sharing profits in the ratio of 2:2:1. Their Balance Sheet as on March 31, 2015 was as follows:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	49,000	Cash	8,000
Reserve Fund	18,500	Debtors	19,000
Siva's Capital	82,000	Stock	42,000
Rama's Capital	60,000	Buildings	2,07,000
Krishna's Capital	75,500	Patents	9,000
	2,85,000		**2,85,000**

Rama retired on March 31, 2015 on the following terms:

(i) Goodwill of the firm was valued at Rs. 70,000 and was not to appear in the books.

(ii) Bad debts amounting to Rs. 2,000 were to be written off.

(iii) Patents were considered as valueless.

Prepare Revaluation Account, Partners' Capital Accounts and the Balance Sheet

(**Ans:** Loss on Revaluation-Rs. 11,000; Siva's capital A/c – Rs. 66,333, Krishna's capital A/c – Rs. 67,667; Rama's loan A/c – Rs.91,000, Balance Sheet Total Rs. 2,74,000).

12. Radha, Krishna and Satya were in partnership sharing profit and losses in the ratio of 4:2:1. On April 1, 2015, Krishna retires from the firm. On that date, their Balance Sheet was as follows:

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Creditors		3,000	Cash in hand	1,500
Bills Payable		4,500	Cash at Bank	7,500
Expenses Owing		4,500	Debtors	15,000
General Reserve		13,500	Stock	12,000
Capitals:			Premises	22,500
Radha -	15,000		Machinery	8,000
Krishna -	15,000		Loose Tools	4,000
Satya -	15,000	45,000		
		70,500		**70,500**

The terms were:

a) Goodwill of the firm was valued at Rs. 13,000.

b) Expenses owing to be brought down to Rs. 3,750.

c) Machinery and Loose Tools are to be valued at 10% less than their book value.

d) Factory premises are to be revalued at Rs. 24,300.

Prepare: 1. Revaluation account

2. Partner's capital accounts and

3. Balance sheet of the firm after retirement of Krishna

(**Ans:** Profit on Revaluation Rs. 1,350; Radha's capital A/c – Rs. 30,914, Satya's capital A/c – Rs. 18,979; Krishna's loan A/c – Rs. 22,957, Balance Sheet Total = Rs. 81,100).

13. Suresh, Naresh and Ramesh are partners sharing profits in the ratio of 3:2:1. Naresh retired from the firm due to his illness. On that date the Balance Sheet of the firm was as follows:

Books of Suresh, Naresh and Ramesh Balance Sheet as on March 31, 2015

Liabilities		Amount (Rs.)	Assets		Amount (Rs.)
General Reserve		12,000	Bank		7,600
Sundry Creditors		15,000	Debtors -	6,000	
Bills Payable		12,000	Less: Provisions -	400	5,600
Outstanding Salary		2,200	Stock		9,000
Provision for Legal Damages		6,000	Furniture		41,000
Capitals:			Premises		80,000
Suresh –	46,000				
Naresh –	30,000				
Ramesh –	20,000	96,000			
		1,43,200			**1,43,200**

Additional Information:

(i) Premises have appreciated by 20%, stock depreciated by 10% and provision for doubtful debts was to be made 5% on debtors.

(ii) Goodwill of the firm valued at Rs. 42,000.

(iii) Rs. 46,000 from Naresh's Capital account be transferred to his loan account and balance be paid through bank.

(iv) New profit sharing ratio of Suresh and Ramesh is decided to be 5 : 1.

Give the necessary ledger accounts and balance sheet of the firm after Naresh's retirement.

(**Ans:** Profit on Revaluation Rs. 15,200; Suresh's capital A/c – Rs. 80,600, Ramesh's capital A/c – Rs. 31,533; Paid to Naresh – Rs. 7,067; Balance Sheet -Rs. 1,93,333).

14. R, S and T were carrying on business in partnership sharing profits in the ratio of 3:2:1 respectively. On March 31, 2015, Balance Sheet of the firm stood as follows:

Liabilities		Amount (Rs.)	Assets	Amount (Rs.)
Sundry Creditors		16,000	Buildings	23,000
Capital:			Debtors	7,000
R –	20,000		Stock	12,000
S –	7,500		Patents	8,000
T –	12,500	40,000	Bank	6,000
		56,000		**56,000**

S retired on the above mentioned date on the following terms :

(a) Buildings to be appreciated by Rs.8,800.

(b) Provision for doubtful debts to be made @ 5% on debtors.

(c) Goodwill of the firm to be valued at Rs.9,000.

(d) Rs.5,000 to be paid to S immediately and the balance due to him to be treated as a loan carrying interest @ 6% per annum.

Prepare the balance sheet of the reconstituted firm.

(**Ans:** Profit on Revaluation Rs. 8,450; R's capital A/c – Rs. 28,725, T's capital A/c – Rs. 15,408; S's Loan A/c – Rs. 8,317; Balance Sheet - Rs. 68,450)

15. The Balance Sheet of A, B and C who were sharing the profits in proportion to their capitals stood as on March 31, 2015.

Balance Sheet as on March 31, 2015

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Bills Payable	6,250	Land & Buildings	12,000
Sundry Creditors	10,000	Debtors - 10,500	
Reserve Fund	2,750	Less: Provisions - 500	10,000
Capitals:		Bills Receivables	7,000
A – 20,000		Stock	15,500
B – 15,000		Plant & Machinery	11,500
C – 15,000	50,000	Cash at Bank	13,000
	69,000		**69,000**

B retired on the date of Balance Sheet and the following adjustments were to be made:

(a) Stock was depreciated by 10%.

(b) Factory building was appreciated by 12%.

(c) Provision for doubtful debts to be created up to 5%.

(d) Provision for legal charges to be made at Rs.265.

(e) The goodwill of the firm to be fixed at Rs.10,000.

(f) The capital of the new firm to be fixed at Rs.30,000.

The continuing partners decide to keep their capitals in the new profit sharing ratio of 3:2.Work out the final balances in capital accounts of the firm, and the amounts to be brought in and/or withdrawn by A and C to make their capitals proportionate to then new profit sharing ratio.

(**Ans:** Loss on Revaluation - Rs. 400; A's capital A/c – Rs. 18,000, C's capital A/c – Rs. 12,000; cash withdrawn by A - Rs. 6,940 & C – Rs. 6,705; B's Loan A/c – Rs. 18,705; Balance Sheet - Rs. 65,220)

16. N, S and B are partners in a firm sharing profits and losses in ratio of 3:1:2. The Balance Sheet on April 1, 2015 was as follows:

Liabilities			Amount (Rs.)	Assets		Amount (Rs.)
Bills Payable			12,000	Freehold premises		40,000
Creditors			28,000	Machinery		30,000
Reserves			12,000	Furniture		12,000
Capital Accounts:				Stock		22,000
N	-	30,000		Debtors	- 20,000	
S	-	20,000		Less: Provisions	-1,000	19,000
B	-	28,000	78,000	Cash		7,000
			1,30,000			**1,30,000**

B retires from the business and the partners agree to the following:

a) Freehold premises and stock are to be appreciated by 20% and 15% respectively.

b) Machinery and furniture are to be depreciated by 10% and 7% respectively.

c) Bad Debts reserve is to be increased to Rs. 1,500.

d) Goodwill is valued at Rs. 21,000 on B's retirement.

e) The continuing partners have decided to adjust their capitals in their new profit sharing ratio after retirement of B. Capital requirement to continue the firm is Rs. 72,000. Surplus/deficit, if any, in their capital accounts will be adjusted.

Prepare necessary ledger accounts and draw the Balance Sheet of the reconstituted firm.

(**Ans:** Profit on Revaluation, Rs. 6,960; N's Capital A/c - Rs. 54,000, S's Capital A/c - Rs.18,000; Cash supplied by N – Rs. 4,020, Cash withdrawn by S – Rs. 8,660; B's Loan A/c-Rs. 41,320; Balance Sheet – Rs. 1,53,320).

17. On December 31, 2014, the Balance Sheet of P, Q and R showed as under:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry creditors	25,000	Buildings	26,000
Reserve Fund	20,000	Investments	15,000
Capitals:		Debtors	15,000
P -	15,000	Bills Receivable	6,000
Q -	10,000	Stock	12,000
R-	10,000	Cash	6,000
	80,000		**80,000**

The partnership deed provides that the profit be shared in the ratio of 2:1:1 and that in the event of death of a partner, his executors entitled to be paid out:

(a) The capital of his credit at the date of last Balance Sheet.

(b) His proportion of reserves at the date of last Balance Sheet.

(c) His proportion of profits to the date of death based on the average profits of the last three completed years.

(d) By way of goodwill, his proportion of the total profits for the three preceding years. The net profits for the last three years were:

2012- 16,000; 2013 -16,000; 2014 - 15,400

R died on April 1, 2015. He had withdrawn Rs.5,000 to the date of his death. Prepare R's Capital Account that of his executors.

(**Ans:** R's share in profits – Rs. 988; R's Executers A/c – Rs. 14,938)

18. Following is the Balance Sheet of P, Q and R as on March 31, 2014.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	16,000	Bills Receivables	16,000
General Reserve	16,000	Furniture	22,600
Capital Accounts:		Stock	20,400
P – 30,000		Debtors	22,000
Q – 20,000		Cash in Hand	18,000
R – 20,000	70,000	Cash at Bank	3,000
	1,02,000		**1,02,000**

Q died on June 30, 2014. Under the terms of the partnership deed, the executors of a deceased partner were entitled to:

a) Amount standing to the credit of the Partner's Capital account;

b) Interest on capital at 5% per annum;

c) Share of goodwill on the basis of twice the average of the past three years' profit;

d) Share of profit from the closing date of the last financial year to the date of death on the basis of last year's profit.

Profits for the year ending on March 31, 2012, 2013 and 2014 were Rs. 12,000, Rs. 16,000 and Rs. 14,000 respectively. Profits were shared in the ratio of capitals.

Pass the necessary journal entries and draw up Q's capital account to be rendered to his executor.

(**Ans:** Q's Executor Account is Rs. 33,821)

Chapter

8

Company Accounts

8.1 Introduction
8.2 Categories of Share Capital
8.3 Issue of Shares
8.3.1 Issue of Share at Par
8.3.2 Issue of Shares with Premium
8.3.3 Issue of Shares with Discount

8.1 Introduction

A company form of organisation it is third state in the evolution of forms of organisation. Its capital is contributed by a large number of persons called shareholders who are the real owners of the company. But neither it is possible for all of them to participate in the management of the company nor considered desirable. Therefore, they elect a Board of Directors as their representative to manage the affairs of the company. In fact, all the affairs of the company are governed by the provisions of the Companies Act, 1956. A company means a company incorporated or registered under the Companies Act. According to Chief Justice Marshal, "a company is a person, artificial. Invisible, intangible ad existing only in the eyes of law. Being a mere creation of law it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence".

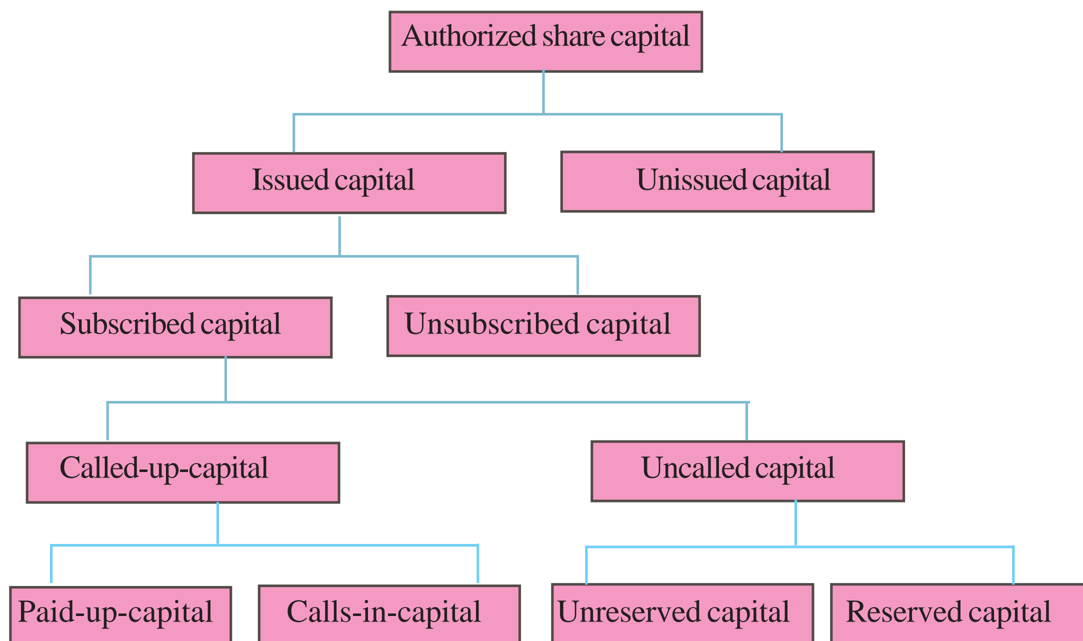
A company usually raises its capital in the form of shares (called share capital) and debentures (debt capital). This chapter deals with the accounting for share capital of companies

8.2 Categories of Share Capital

A company, being an artificial person, cannot generate its own capital which has necessarily to be collected from several persons. There persons are known as shareholders and the amount contributed by them is called share capital. Since the number of shareholders is very very large, a separate capital account cannot be opened for each one of them. Hence, innumerable streams of capital contribution merge their identities in a common capital account called as 'share capital account'.

8.2.1 Categories of share capital

From accounting point of view the share capital of the company can be classified as follows:



1) **Authorised capital**: Authorised capital is the amount of share capital which a company is authorised to issue to the public by the Memorandum of Association. It is also called nominal or registered capital.

2) **Issued Capital**: Issued capital is that part of the authorised capital which is actually issued to the public for subscription. A company may issue its entire authorised capital or may issue in parts from time to time as per the needs of the company.

3) **Subscribed Capital**: It is the part of the issued capital which has been actually subscribed by the public. This capital can be equal to or less than the issued capital.

4) **Called-up capital**: It is the part of the subscribed capital which is called-up by the company to pay on the allotted shares. The company may decide to call the entire amount or part of the face value of the shares.

5) **Un called Capital**: Uncalled capital is that portion of the issued/ subscribed capital that is not called up by the company on the shares allotted.

6) **Paid-up Capital**: It is the portion of the called up capital which is actually paid by the share holders.

7) **Unpaid-Capital**: That part of the called up capital which is called but not paid by the shareholders is called unpaid capital, ie: calles – in-arrears.

8) **Reserve Capital**: A company may reserve a portion of its uncalled capital to be called only in the event of winding up of the company. Such uncalled amount is called' Reserve-capital" of the company.

8.2.2 Types of shares

Shares, as applied to the capital of a company, refer to the units into which the total share capital of a company is divided. Thus, a share is a fractional part of the share capital and forms the basis of ownership interest in a company. The persons who contribute money through shares are called shareholders.

The amount of authorised capital, together with the number of shares in which it is divided, is stated in the Memorandum of Association but the classes of shares in which the company's capital is to be divided, along with their respective rights and obligations, are prescribed by the Articles of Association of the company. A per Section 86 of The Companies Act, a company can issue two types of shares (1) preference shares, and (2) equity shares (also called ordinary shares).

1) **Preference shares**: According to section 85 of the companies Act, 1956, a preference share is one which fulfils the following conditions

a) That it carries a preferential right to dividend, to be paid wither as a fixed amount payable to preference share holders or an amount calculated by a fixed rate of the nominal value of each share before any dividend is paid to the equity share holders.

b) That with respect to capital it carries or will carry, on the winding up of the company, the preferential right to the repayment of capital before anything is paid to equity share holders.

2) **Equity Shares or ordinary Shares:** The equity shares are also called as ordinary shares .According to section 85 of the companies Act, 1956, an equity share is a share which is not a preference share. In other words, shares which do not enjoy any preferential right in the payment of dividend or repayment of capital are called as equity shares. The equity shareholders are entitled to share the distributable profits of the company after satisfying the dividend rights of the preferences share holders. The dividend on equity shares is not fixed and it may vary from year to year depending upon the amount of profits available for distribution.

8.3 Issues of shares

A salient feature of the share capital of a company is that the amount on its shares can be gradually collected in easy installments spread over a period of time depending upon its growing financial requirement. The first installment is collected along with application and is known as application money, the second on allotment (termed as allotment money), and the remaining money is collected in installment are termed as first call, second call and final call. The word final is suffixed to the last installment. However, this in no way prevents a company from calling the full amount on shares right at the time of application.

Accounting Treatment

Normally the shares of a company are issued at par value. However, the shares of a company can be issued at a premium or at a discount. The following is the accounting treatment for issue of shares.

8.3.1 Shares issued at Par or Face value

When a company issues its shares at their face value, the shares are known to have been issued at par.

Example: The face value of the share is Rs. 100 and it is issued for Rs. 100.

The following journal entries are required.

1) For Receipt of application money.

Bank A/c Dr

To share Application A/c.

(Amount received on Application for …….. shares @Rs……per share)

2) For Transfer of Application money to share capital A/c

Share application A/c Dr

To share capital A/c

(Application many on….shares is transferred to share capital A/c)

3) For amount due on allotment.
Share allotment A/c
To share Capital A/c
(Share allotment money due on….. shares @Rs……per share)

4) For receipt of allotment money
Bank A/c Dr
To share Allotment A/c.
(Allotment money received on ….. shares @ Rs……per share)

When call is made and the amount of the same is received, the journal entries are required.

5) For call amount due
Share first call A/c
To share Capital A/c
(Call money due on……shares @ Rs…..per share)

6) For Receipt of call amount.
Bank A/c Dr
To Share first call A/c
(Call money received on….shares)

Note:- If a company makes more than one call the same accounting treatment is followed for recording the second call or third call money due and their receipts the last call made is known as final call.

Illustration 1

Pavithra Ltd issued 10,000 shares of Rs. 10 each for the subscription. Payable at Rs.3 per share on application, Rs.4 per share on allotment and the balance on first and final call. All the amounts were duly received. Make journal entries in the books of the company.

Books of Pavithra Ltd Journal.

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr To share Application A/c. (Amount received on Application for 10000 shares @Rs 3 per share)		30,000	30,000

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Share application A/c Dr To share capital A/c (application many on 10000 shares transferred to share capital A/c)		30,000	30,000
	Share allotment A/c Dr To share Capital A/c (Share allotment money due on10000 shares @Rs 4 per share)		40,000	40,000
	Bank A/c Dr To share Allotment A/c. (Allotment money received on 10000 shares @ Rs 4 per share)		40,000	40,000
	Share first & final call A/c Dr To share Capital A/c (Call money due on 10000 shares @ Rs 3 per share)		30,000	30,000
	Bank A/c Dr To Share first & final call A/c (call money received on 10000 shares)		30,000	30,000

Illustration 2

Bhavani Ltd issued 20,000 shares of Rs. 20 each to the public for subscription as follows, Payable Rs. 5 on application, Rs. 10 on allotment and the remaining balance on first and final call.

Give the Journal entries in the books of the company.

Books of Bhavani Ltd Journal.

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr To share Application A/c. (Amount received on Application for 20000 shares @Rs 5 per share)		1,00,000	1,00,000

	Share application A/c Dr To share capital A/c (application many on 20000 shares transferred to share capital A/c)		1,00,000	1,00,000
	Share allotment A/c Dr To share Capital A/c (Share allotment money due on20000 shares @ Rs 10 per share)		2,00,000	2,00,000
	Bank A/c Dr To share Allotment A/c. (Allotment money received on 20000 shares @ Rs 10 per share)		1,00,000	1,00,000
	Share first & final call A/c Dr To share Capital A/c (Call money due on 20000 shares @ Rs 5 per share)		1,00,000	1,00,000
	Bank A/c Dr To Share first & final call A/c (call money received on 20000 shares)		1,00,000	1,00,000

Illustration 3

Siva Ltd issued 30000 shares of Rs 30 each to the public for subscription as follows, payable Rs 5 on application, Rs 10 on allotment, and the remaining balance on first call Rs 5,second call Rs5, and final call Rs 5.Give the journal entries in the books of the company.

Books of Siva Ltd Journal.

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr To Share Application A/c. (Amount received on Application for 30000 shares @Rs 5 per share)		1,50,000	1,50,000

	Share application A/c Dr To share capital A/c (application many on 30000 shares transferred to share capital A/c)		1,50,000	1,50,000
	Share allotment A/c Dr To share Capital A/c (Share allotment money due on30000 shares @Rs 10 per share)		3,00,000	3,00,000
	Bank A/c Dr To share Allotment A/c. (Allotment money received on 30000 shares @ Rs 10 per share)		3,00,000	3,00,000
	Share first call A/c Dr To share Capital A/c (Call money due on 30000 shares @ Rs 5 per share)		1,50,000	1,50,000
	Bank A/c Dr To Share first call A/c (call money received on 30000 shares)		1,50,000	1,50,000
	Share second call A/c Dr To share Capital A/c (Call money due on 30000 shares @ Rs 5 per share)		1,50,000	1,50,000
	Bank A/c Dr To Share second call A/c (call money received on 30000 shares)		1,50,000	1,50,000
	Share final call A/c Dr To share Capital A/c (Call money due on 30000 shares @ Rs 5 per share)		1,50,000	1,50,000
	Bank A/c Dr To Share final call A/c (Call money received on 30000 shares)		1,50,000	1,50,000

8.3.2 Shares issued at Premium (Section 52)

When a company issues its shares at a price of more than the face value, it is said to be an issue at a premium. The money collected more than the face value is "Premium".

For example:-If the face value of the share is Rs100 and issued at Rs 110. The excess amount Rs. 10 is treated as capital income. It is transferred to securities premium account and will be shown in the liabilities side of the balance sheet under the head "Reserves and Surplus".

When the issue of shares is at a premium, the amount of premium may technically be called at any stage of the issue of shares. However, premium is generally called with the amount due on allotment, sometimes with the application money and rarely with the call money

The journal entries required issues of shares at a premium are as follows

1) For premium amount called with application money.

a) Bank A/c Dr

To Share application A/c

(Money received on application for ….shares @Rs….per share including premium)

b) Share application A/c Dr

To Share capital A/c

To securities premium A/c

(Transfer of application money to share capital and premium account)

2) Premium amount called with allotment money

a) Share allotment A/c Dr

To Share capital A/c

To securities premium A/c

(Amount due on allotment of shares @ Rs…..per share including premium)

b) Bank A/c Dr

To Share allotment A/c

(Allotment money received including premium)

Illustration 4

Sarojanamma Ltd issued 20,000 shares of Rs 10 each at a premium of Rs 5 per share, payable as follows, on application ,Rs 5(including Rs 2 Premium) per share, on allotment Rs 7 (including premium Rs3) per share, and the balance on first and final call Rs 3. Applications were received for 20000 shares and allotment was made to all, make journal entries.

Books of Sarojanamma Ltd Journal.

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr To share Application A/c. (Amount received on Application for 20000 shares @Rs 5 per share including premium Rs 2)		1,00,000	 1,00,000
	Share application A/c Dr To share capital A/c To securities premium A/c (application money on 20000 shares transferred to share capital A/c and premium A/c)		1,00,000	 60,000 40,000
	Share allotment A/c Dr To share Capital A/c To securities premium A/c (Share allotment money due on20000 shares @Rs 7 per shares including premium Rs 3)		1,40,000	 80,000 60,000
	Bank A/c Dr To share Allotment A/c. (Allotment money received on 20000 shares @ Rs 7 per share including premium)		1,40,000	 1,40,000
	Share first & final call A/c Dr To share Capital A/c (Call money due on 20000 shares @ Rs 3 per share)		60,000	 60,000
	Bank A/c Dr To Share first & final call A/c (Call money received on 20000 shares)		60,000	 60,000

Illustration 5

Ramaiah Ltd issued 50,000 shares of Rs 10 each at a premium of Rs 5 per share, payable as follows, on application Rs 5(including premium Rs 2) per share, on allotment Rs 6 (including premium Rs3) per share, the remaining balance Rs 4 on first and final call, the issue was fully subscribed .All the money was duly received.

Make Journal entries.

Books of Ramaiah Ltd Journal.

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr		2,50,000	
	To share Application A/c.			2,50,000
	(Amount received on Application for 50000 shares @Rs 5 per share including premium Rs 2)			
	Share application A/c Dr		2,50,000	
	To share capital A/c			1,50,000
	To securities premium A/c			1,00,000
	(application many on 50000 shares transferred to share capital and premium A/c)			
	Share allotment A/c Dr		3,00,000	
	To share Capital A/c			1,50,000
	To securities premium A/c			1,50,000
	(Share allotment money due on50000 shares @Rs 6 per share including premium Rs 3)			
	Bank A/c Dr		3,00,000	
	To share Allotment A/c.			3,00,000
	(Allotment money received on 50000 shares @ Rs 6 per share including premium Rs 2)			

	Share first & final call A/c Dr To share Capital A/c (Call money due on 50000 shares @ Rs 4 per share)		2,00,000	2,00,000
	Bank A/c Dr To Share first & final call A/c (Call money received on 50000 shares)		2,00,000	2,00,000

8.3.3 Shares Issued at Discount (Section 53)

When a company issues its shares at a price less than the face value, it is said to be an issue at a discount. The difference between the face value and issue price is called "Discount". It is a capital loss. It will be shown in the asset side of the balance sheet under the head "Miscellaneous Expenditure". Maximum rate of discount is 10 per cent only.

For example:-If the face value of the share is Rs100 and issued at Rs 90.

Whenever shares are issued at a discount, the amount of discount is brought into the books at the time of allotment by debiting an account called 'Discount on the issue of shares account'

The journal entries required issues of shares at a discount are as follows

a) Share allotment A/c Dr
Discount on the issue of shares A/c
To Share capital A/c
(Amount due on allotment of …..shares @ Rs…..per share and discount on issue brought into account)

b) Bank A/c Dr
To Share allotment A/c
(Allotment money received on ….shares)

Illustration 6

Suguna motors Ltd issued to the public for subscription of 10,000 shares of Rs 10 each at a discount of 10% per share , payable at Rs 4 on application, Rs 3 on allotment and Rs 2 on first and final call, the issue was fully subscribed .All the money was duly received.

Write the Journal entries in the books of the suguna motors Ltd

Books of Suguna Motors Ltd

Journal

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr To share Application A/c. (Amount received on Application for 10000 shares @Rs 4 per share)		40,000	 40,000
	Share application A/c Dr To share capital A/c (application many on 10000 shares transferred to share capital A/c)		40,000	 40,000
	Share allotment A/c Dr Discount on issue of shares A/c Dr To share Capital A/c (Amount due @ Rs 3 per share on allotment and discount Rs 1 per share on 10000 shares)		30,000 10,000	 40,000
	Bank A/c Dr To share Allotment A/c. (Allotment money received on 10000 shares @ Rs 3 per share)		30,000	 30,000
	Share first & final call A/c Dr To share Capital A/c (Call money due on 10000 shares @ Rs 2 per share)		20,000	 20,000
	Bank A/c Dr To Share first & final call A/c (Call money received on 10000 shares)		20,000	 20,000

Illustration 7

Ravi Tractor Ltd issued to the public for subscription of 20,000 shares of Rs 10 each at a discount of 10% per share , payable at Rs 2 on application, Rs 3 on allotment and Rs 4 on first and final call, the issue was fully subscribed .All the money was duly received.

Prepare the Journal entries in the books of the company

Books of Ravi tractor company Ltd Journal.

Date	Particulars	L.F.	Debit Amount (Rs.)	Credit Amount (Rs.)
	Bank A/c Dr To share Application A/c (Amount received on Application for 20000 shares @Rs 2 per shares)		40,000	 40,000.
	Share application A/c Dr To share capital A/c (application money on 20000 shares transferred to share capital A/c)		40,000	 40,000
	Share allotment A/c Dr Discount on issue of shares A/c Dr To share Capital A/c (Amount due @ Rs 3 per share on allotment and discount Rs 1 per share on 20000 shares)		60,000 20,000	 80,000
	Bank A/c Dr To share Allotment A/c. (Allotment money received on 20000 shares @ Rs 3 per share)		60,000	 60,000
	Share first & final call A/c Dr To share Capital A/c (Call money due on 20000 shares @ Rs 4 per share)		80,000	 80,000
	Bank A/c Dr To Share first & final call A/c (Call money received on 20000 shares)		80,000	 80,000

Summary

Company is an organisation consisting of individuals called 'shareholders 'by virtue of their holding the shares of a company, who can act as one legal person as regards its business through an elected board of directors.

Share is a Fractional part of the capital, and form the basis of ownership in a company; shares are generally of two types, viz., equity shares and preference shares, according to the provisions of The Companies Act, 1956. Preference shares again are of different types based on vary shades of rights attached to them.

Share capital of a company is collected by issuing shares to either a select group of persons through the route of private placements and / or offered to the public for subscription. Thus, the issue of shares is basic to the capital of a company. Shares are issued either for cash or for consideration other than cash, the former being more common. Shares are said to be issued for consideration other then cash when a company purchases business, or some asset/ assets, and the vendors have agreed to receive payment in the form of fully paid shares of a company.

Stages of Share Issue are The issue of shares for cash is required to be made in strict conformity with the procedure laid down by law for the same. When shares are issued for cash, the amount on them can be collected at one or more of the following stages:

(i) Application for shares

(ii) Allotment of shares

(iii) Call/ calls on shares.

Calls in arrears as the full amount called on allotment and/ or call (calls) is not received from the allottees/ shareholders. The amount not so received are cumulatively called unpaid calls or calls-in-Arrears. However, it is not mandatory for a company to maintain a separate calls in arrears to pay a part or whole of the amount not yet called up on the shares allotted to them. Any amount paid by a shareholder in the excess of the amount due from him on allotment/call (calls) is known as Calls in Advance or which a separate account is maintained. A company has the power to charge interest on calls in arrears and is under an obligation to pay interest on calls in advance if it accepts them in accordance with the provisions of Articles of Association.

MODEL QUESTIONS

Short Answer Questions.

1) What is authorized capital?
2) What is a preference share?
3) What is an Equity share?
4) Explain the issue of shares at par.
5) Explain the issue of shares at premium.
6) Explain the issue of shares at discount.

Essay type Questions.

1) Explain the categories of share capital.
2) Explain the classes of shares.
3) Explain the types of issue of shares.

Exercises

1) Dhana Ltd issued 20,000 shares of Rs. 100 each for the subscription. Payable at Rs.40 per share on application, Rs.40 per share on allotment and the balance Rs 20 on first and final call. All the amounts were duly received. Make journal entries in the books of the company

2) Charan Ltd decided to issue 10,000 shares of Rs. 200 each for the subscription. Payable at Rs.50 per share on application, Rs.100 per share on allotment and the balance Rs 50 on first and final call. All the money was duly received. Write journal entries in the books of the company

3) Gayatri cloths Ltd issued 15,000 shares of Rs. 150 each, Payable at Rs.50 per share on application, Rs.50 per share on allotment and the balance Rs 20 on first call, Rs 20 on second call and Rs 10 final call. All the money was duly received. Prepare journal entries in the books of the company

4) Jayaram Furniture's Ltd issued 20,000 shares of Rs 100 each at a premium of Rs 10 per share payable as follows, on application Rs 40(including premium Rs 5 per share), on allotment Rs 40 (including premium Rs 5 per share) the remaining balance Rs 30 on first and final call, the issue was fully subscribed .All the money was duly received. Make the Journal entries in the books of the company.

5) Anusha Ltd having an authorized capital of Rs 100,00,000 in share of 10 each issued 10,000 at a premium of Rs 2 per share payable at Rs4 on application(including premium Rs 1 per share), Rs 5 on allotment (including premium Rs 1 per share) the remaining balance Rs 3 on first and final call, the issue was fully subscribed .All the money was duly received. Prepare the Journal entries in the books of the company.

6) Karthik Ltd issued 50,000 shares of Rs 100 at a premium of Rs 10 per share, payable at Rs40 on application(including premium Rs 5 per share), Rs 40 on allotment (including premium of Rs 5 per share) the remaining balance Rs 30 on first and final call, the issue was fully subscribed .All the money was duly received. Record the Journal entries in the books of the company.

7) Padmavati Ltd issued to the public for subscription of 10,000 shares of Rs 100 each at a discount of 10% per share, payable at Rs30 on application, Rs 40 on allotment and Rs 20 on first and final call, the issue was fully subscribed .All the money was duly received. Write the Journal entries in the books of the company.

8) Abishek Ltd issued 20,000 shares of Rs 100 each at a discount of 10% per share , the shares were payable at Rs. 40 on application, Rs 30 on allotment and Rs 20 on first and final call, the issue was fully subscribed .All the money was duly received. Record the Journal entries in the books of the company.

9) Venkat Ltd issued 50,000 shares of Rs 10 each at a discount of 10% per share , the shares were payable at Rs3 on application, Rs 3 on allotment and Rs 3 on first and final call, the issue was fully subscribed .All the money was duly received. Give Journal entries in the books of the company.

Chapter

9

Computerised Accounting System

9.1 Introduction
9.2 Computers in Accounting
9.3 Process of Computerised Accounting System
9.4 Driving Forces of Computerised Accounting System
9.5 Comparison of Manual and Computerized Accounting System
9.6 Advantages of Computerized Accounting System
9.7 Limitations of Computerized Accounting System
9.8 Sources of Accounting Software
9.9 Accounting Packages

9.1 Introduction

Manual system of accounting has been the most popular method of maintaining records of financial transactions of an organisation, which requires maintaining books of accounts such as Journal, Cash Book, Special Purpose Books, Ledger, etc., so as to prepare a summary of transactions and final accounts manually. Gradually, with the development of technology, machine ware started to be used in accounting process. Billing machine is a popular example in this regard. This machine is capable of computing discount, adding net total and posting requisite data to relevant accounts. The customer's bill is generated automatically once the operator has entered the necessary information. These machines combine the features of a typewriter and various kinds of calculators. With the development of technology, not only computer started playing an important role in accounting process but the newer versions of these machines have also started operating through computers.

The success of a growing organisation with a complexity of transactions trends to depend on resource optimisation, quick decision-making and control. Traditional, periodic accounting takes

place over regular intervals, during which financial statements are prepared. Since traditional reporting provides a company's financial position, results of operations, cash flows, and other financial information of several weeks or even months after the reporting period has ended, the information reported is not as relevant as it could be. The sooner a company issues its financial statements for a particular period, the more useful it would be to users, as long as accuracy is not compromised in order to issue statements quickly.

As a result, the maintenance of accounting data on a real-time (or spontaneous) basis became almost essential. Maintaining real-time accounting records is possible only through accounting system under a computerised environment.

Real-Time Accounting: In real-time accounting system once a transaction is entered and saved, the information is immediately posted to all appropriate journals, ledger and financial statements. Real-Time accounting allows management to quickly adapt to opportunities and address problems. Daily reporting greatly eases the stress involved in preparing quarterly and year-end financial statements. Rather than spending long hours in preparing periodic financial statements, management executives, accountants and other business professionals are allowed more time for other tasks, such as financial management, product development a and customer relations. Businesses are becoming increasingly reliant on financial information that is reported as transactions and events occur.

9.2 Computers in Accounting

Accounting refers to identifying transactions and events of financial nature and recording them in the books of accounts and producing meaningful information for the users. Thus, the foremost function of accounting is to identify transactions and events of financial nature and record them in the books of accounts.

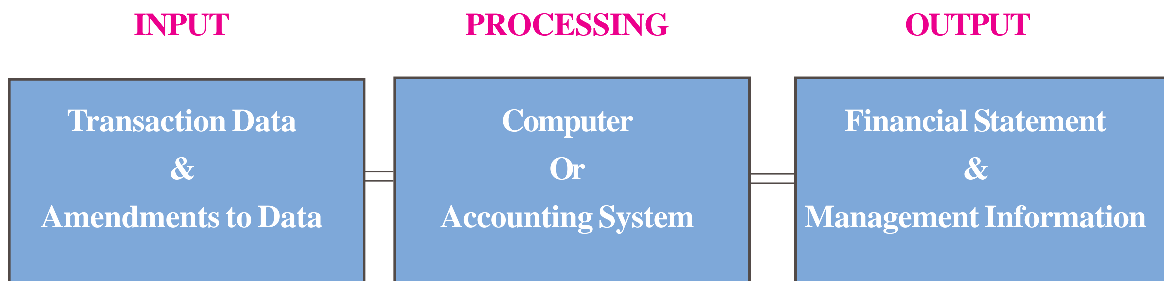
Accounting process means preparing vouchers for the transactions, writing them in the Journal, posting the recorded transactions in the Ledger Accounts, drawing Trial Balance and thereafter preparing Financial Statements, i.e., Trading Account, Profit and Loss Account and Balance Sheet.

Accounting process, whether carried out manually or by use of computers, generates accounting records such as Cash Book, Bank Book, Journal, Purchases Book, Sales Book, Ledger and Tail Balance. Besides the accounting records, certain reports such as Payroll, Stock Report, Statutory Returns (VAT, CST, etc), Debtors Report, Creditors Report and Exception Report, etc., are also prepared under both the methods.

9.3 Process of Computerised Accounting System

Accounting software is used to perform the function of accounting. The software functions on the concept of database. As discussed above, accounting software eliminates the process of posting

a transaction into the Ledger account, that is, when a transaction is entered in the computer system, the function of posting in the ledger amount is automatic due to instructions in the software. The software is so designed that a transaction, once entered, is automatically transported or transferred or posted to the Ledger account also. Computerised accounting can be explained as a processing function. Data processing has three distinct stages.



Input

The input to a computerised accounting system is the accounting data, which is obtained from the details of each transaction. In practice, the data originates from a source document. A source document is the document, which is produced as a result of the happening of a transaction and is kept as a proof of the transaction. In fact, source documents are used to trace the transactions later on. The examples of source documents include invoices, cheques received, sales order form, credit note, debit notes etc. In a computerised accounting system, computers are used to produce source documents and the data is automatically inputted to the system for storage and further processing.

Another input to the computerised accounting system is the set of accounting rules and procedures, which are programmed to process the accounting data as per the accounting theory and conventions. These accounting rules and procedures are coded in the accounting software, which is loaded and run by the computer, when the transactions are to be processed by the system.

Processing

Computers are the fastest computing machines available to the mankind. The computerised accounting systems are built to take advantages of the fast processing capabilities of the modern day computers. In this stage, the accounting data is processed as per the accounting rules of double entry book keeping. The only addition here is that unlike manual accounting systems, computerised accounting systems are very fast and error free.

Output

The basic output of computerised accounting system is the Trading and Profit & Loss account and the Balance Sheet. Computerised accounting system produces these final accounts automatically and on the user's request. The most interesting thing to note is that in computerised accounting, these statements can be produced as often as desired but in the manual system of accounting the

production of final accounts is a very tedious and time consuming activity and sometimes takes as long as two or three months to finalise the accounts. Also the computers automatically transfer the output of one component of computerised accounting to another component as input. That is, data sharing is possible.

9.4 Driving Forces for Computerised Accounting

When the computers were first put to use by the business communities the accounting function was the first application for computerization. Organizations intending to use computers invariably make the computerization of the accounting function their first priority because of the following reasons.

1. Computers can process numeric data more easily than the textual data and the very nature of accounting work is numeric. Therefore, it is a simple task for computer programmers to codify numeric calculations.
2. Computers can take up a job if the same can be solved by a precise step by step procedure, i.e., if the task is algorithmic. And the accounting system is algorithmic because it has a set of standards, clearly defined and unambiguous rules and procedures to prepare books of accounts. This factor makes accounting easy to be explained in a precise step by step sequence, using tools like Flowcharts etc., and programmers can easily convert a Flowchart into a source code.
3. The basic method of recording transactions, irrespective of the natures of the firm, is almost the same. Therefore, the programmers can develop general purpose accounting packages. This can be used by any kind of business firm with minor modifications. This factor also became a temptation for amateur programmers to write software for accounting, which can be run on any computer without any difficulty.
4. The volume of accounting data is always very high, especially in large size organizations. Thus it becomes difficult and error-prone to process manually thousands of transactions every day. Introduction of computers in accounting assured speedy processing of voluminous data and that too without errors in calculations.

9.5 Comparison of Manual and Computerized Accounting System

Aim of both manual and computerized accounting is to record, classify and summarize the accounting transactions. Both are used for preparing financial statements but the difference in the

system. We can write the difference between manual accounting and computerized accounting on the following basis.

Basis of Difference		Manual Accounting	Computerized Accounting
1	Definition	Manual accounting is the system in which we keep physical register of journal and ledger for keeping the records of each transaction.	In this system of accounting, we use computer and different accounting software for digital record of each transaction.
2	Calculation	In manual accounting, all calculation of adding and subtracting are done manually. For example, we find the balance of any ledger account, we will calculate the debit and credit side and then we will find its difference for showing balance.	In computerized accounting, our duty is to record the transactions manually in the database. All the calculations are done by computer system. We need not to calculate each account's balance, it is calculated automatically by computerized accounting system.
3	Ledger Accounts	In manual accounting, we check the journal and then we transfer figures to related accounts' debit or credit side through manual posting.	Computerized accounting system will automatically process the system and will make all the accounts ledgers because we have pass the voucher entries under its respected ledger account.
4	Trial Balance	In this system of accounting, we have to collect the information of the balances of all accounts in our ledger, on this basis, we have prepared the trial balance manually.	Our computerized accounting system will produce trial balance automatically.
5	Adjustment Entries Record	Both adjustment journal entries and its posting in the ledger accounts will be done manually one by one.	Only adjustment entries will pass in the computerized accounting system, posting in the ledger accounts will be done automatically.
6	Financial Statements	We have to make the financial statements manually by careful transferring trial balance's figures in income statement and balance sheet.	We need not prepare financial statement manually, financial statements will become automatically. It will also change after each voucher entry in the system this facility is not available in the manual accounting system.

9.6 Advantages of Computerised Accounting System

Computerised accounting offers several advantages vis-a-vis manual accounting, these are summarized as follows;

1. **Speed:** Accounting data is processed faster by using a computerised accounting system than it is achieved through manual efforts. This is because computers require far less time than human beings in performing a task.

2. **Accuracy:** The possibility of error is eliminated in a computerised accounting system because the primary accounting data is entered once for all the subsequent usage and processes in preparing the accounting reports. Normally, accounting errors in a manual accounting system occur because of repeated posting of same set of original data by several times while preparing different types of accounting reports.

3. **Reliability:** The computer system is well-adapted to performing repetitive operations. They are immune to tiredness, boredom or fatigue. As a result, computers are highly reliable compared to human beings. Since computerised accounting system relies heavily on computers, they are relatively more reliable than manual accounting systems.

4. **Up-to-Date Information:** The accounting records, in a computerised accounting system are updated automatically as and when accounting data is entered and stored. Therefore, latest information pertaining to accounts get reflected when accounting reports are produced and printed. For example, when accounting data pertaining to a transaction regarding cash purchase of goods is entered and stored, the cash account, purchase account and also the final accounts (trading and profit and loss account) reflect the impact immediately.

5. **Real Time User Interface:** Most of the automated accounting systems are inter-linked through a network of computers. This facilitates the availability of information to various users at the same time on a real time basis (that is spontaneously).

6. **Automated Document Production:** Most of the computerised accounting systems have standardised, user defined format of accounting reports that are generated automatically. The accounting reports such as Cash book, Trial balance, Statement of Accounts are obtained just by click of a mouse in a computerised accounting environment.

7. **Scalability:** In a computerised accounting system, the requirement of additional manpower is confined to data entry operators for storing additional vouchers. The additional cost of processing additional transactions is almost negligible. As a result the

computerised accounting systems are highly scalable.

8. **Legibility:** The data displayed on computer monitor is legible. This is because the characters (alphabets, numerals, etc.) are type written using standard fonts. This helps in avoiding errors caused by untidy written figures in a manual accounting system.

9. **Efficiency:** The computer based accounting systems ensure better use of resources and time. This brings about efficiency in generating decisions, useful information and reports.

10. **Quality Reports:** The inbuilt checks and untouchable features of data handling facilitate hygienic and true accounting reports that are highly objective and can be relied upon.

11. **MIS Reports:** The computerised accounting system facilitates the real time production of management information reports, which will help management to monitor and control the business effectively. Debtors' analysis would indicate the possibilities of defaults (or bad debts) and also concentration of debt and its impact on the balance sheet. For example, if the company has a policy of restricting the credit sales by a fixed amount to a given party, the information is available on the computer system immediately when every voucher is entered through the data entry form. However, it takes time when it comes to a manual accounting system. Besides, the results may not be accurate.

12. **Storage and Retrieval:** The computerised accounting system allows the users to store data in a manner that does not require a large amount of physical space. This is because the accounting data is stored in hard-disks, pendrive, CD/DVD-ROMs, floppies that occupy a fraction of physical space compared to books of accounts in the form of ledger, journal and other accounting registers. Besides, the system permits fast and accurate retrieval of data and information.

13. **Motivation and Employees Interest:** The computer system requires a specialised training of staff, which makes them feel more valued. This motivates them to develop interest in the job. However, it may also cause resistance when we switch over from a manual system to a computer system.

9.7 Limitations of Computerised Accounting System

The main limitations emerge out of the environment in which the computerised accounting system is made to operate. These limitations are as given below;

1. **Cost of Training:** The sophisticated computerised accounting packages generally require specialised staff personnel. As a result, a huge training cost is incurred to

understand the use of hardware and software on a continuous basis because newer types of hardware and software are acquired to ensure efficient and effective use of computerised accounting systems.

2. **Staff Opposition:** Whenever the accounting system is computerised, there is a significant degree of resistance from the existing accounting staff, partly because of the fear that they shall be made redundant and largely because of the perception that they shall be less important to the organisation.

3. **Disruption:** The accounting processes suffer a significant loss of work time when an organisation switches over to the computerised accounting system. This is due to changes in the working environment that requires accounting staff to adapt to new systems and procedures.

4. **System Failure:** The danger of the system crashing due to hardware failures and the subsequent loss of work is a serious limitation of computerised accounting system. However, providing for back-up arrangements can Inability to Check Unanticipated Errors: Since the computers lack capability to judge, they cannot detect unanticipated errors as human beings commit. This is because the software to detect and check errors is a set of programmes for known and anticipated errors.

5. **Breaches of Security:** Computer related crimes are difficult to detect as any alteration of data may go unnoticed. The alteration of records in a manual accounting system is easily detected by first sight. Fraud and embezzlement are usually committed on a computerised accounting system by alteration of data or programmes. Hacking of passwords or user rights may change the accounting records. This is achieved by tapping telecommunications lines, wire-tapping or decoding of programmes. Also, the people responsible for tampering of data cannot be located which in a manual system is relatively easier to detect.

6. **Ill-effects on Health:** The extensive use of computers systems may lead to development of various health problems: bad backs, eyestrain, muscular pains, etc. This affects adversely the working efficiency of accounting staff on one hand and increased medical expenditure on such staff on the other. Obviate this limitation. Software damage and failure may occur due to attacks by viruses. This is of particular relevance to accounting systems that extensively use Internet facility for their online operations. No foolproof solutions are available as of now to tackle the menace of attacks on software by viruses.

9.8 Sourcing of Accounting Software

Accounting software is an integral part of the computerised accounting system. An important factor to be considered before acquiring accounting software is the accounting expertise of people responsible in organisation for accounting work. People, not computers, are responsible for accounting. The need for accounting software arises in two situations:

a. When the computerised accounting system is implemented to replace the manual system or

b. When the current computerised system needs to be replaced with a new one in view of changing needs.

9.9 Accounting Packages

Every Computerised Accounting System is implemented to perform the accounting activity (recording and storing of accounting data) and generate reports as per the requirements of the user. From this perspective the accounting packages are classified into the following categories:

(a) Ready to use

(b) Customised

(c) Tailored

Each of these categories offers distinctive features. However, the choice of the accounting software would depend upon the suitability to the organisation especially in terms of accounting needs.

Ready-to-Use

Ready-to-Use accounting software is suited to organisations running small/ conventional business where the frequency or volume of accounting transactions is very low. This is because the cost of installation is generally low and number of users is limited. Ready-to-Use software is relatively easier to learn and people (accountant) adaptability is very high. This also implies that level of secrecy is relatively low and the software is prone to data frauds. The training needs are simple and sometimes the vendor (supplier of software) offers the training on the software free. However, these software offer little scope of linking to other information systems.

Customised

Accounting software may be customised to meet the special requirement of the user. Standardised accounting software available in the market may not suit or fulfil the user requirements. For example, standardised accounting software may contain the sales voucher and inventory status as separate options. However, when the user requires that inventory status to be updated immediately upon entry of sales voucher and report be printed, the software needs to be customised. Customised software is suited large and medium businesses and can be linked to the other information systems.

The cost of installation and maintenance is relatively high because the high cost is to be paid to the vendor for customisation. The customisation includes modification and addition to the software contents, provision for the specified number of users and their authentication, etc. Secrecy of data and software can be better maintained in customised software. Since the need to train the software users is important, the training costs are therefore high.

Tailored

The accounting software is generally tailored in large business organisations with multi users and geographically scattered locations. This software requires specialised training to the users. The tailored software is designed to meet the specific requirements of the users and form an important part of the organisational MIS. The secrecy and authenticity checks are robust in such softwares and they offer high flexibility in terms of number of users.

To summarise, the following table represents the comparison between the various categories of accounting software:

Basis	Ready to Use	Customised	Tailored
Nature of Business	Small, conventional business	Large, medium business	Large, typical business
Cost of installation and maintenance	Low	Relatively high	High
Expected Level of secrecy (Software and Data)	Low	Relatively high	Relatively high
Number of users and their interface	Limited	As per specifications	Unlimited
Linkage to other information system	Restricted	Yes	Yes
Adaptability	High	Relatively high	Specific
Training requirements	Low	Medium	High

Summary

Computerised Accounting is accounting done with the aid of computer. It trends to involve dedicated accounting software and digital spreadsheets to keep track of a business or client's financial transaction. computerised accounting is benificial use of current technological advances. Not only has it revolutionised the traditional paper methods of accounting, but it has also created new types of accounting applications for business. Computerised Accounting System have replaced mannual based accounting in virtually all businesses and organisations, providing accountants, managers, employees and stakeholders access to vital accounting information at the touch a button. Computerised accounitn systems automate the accounting process, improving efficiency and cutting down costs. Computerised accounting has many advantages like Speed, Accuracy, Reliability, Up-to-Date Information, Real Time User Interface, Automated Document Production, Scalability, Legibility, Efficiency, Quality Reports, MIS Reports, Storage and Retrieval.Limitations of Computerised Accounting System:Cost of Training, Staff Opposition, Disruption, System Failure, Breaches of Security, and Ill-effects on Health. The Accounting Packages are broadly classified into three categories viz.,Ready-to-Use, Customized, and Tailored.

MODEL QUESTIONS

Very Short Questions

1. What is Computerised Accounting?
2. What is MIS?
3. Ready to Use accounting software.
4. Customised accounting software.
5. Tailored accounting software.

Long answer Questions

1. Define a computerised accounting system. Distinguish between a manual and computerised accounting system.
2. Discuss the advantages of computerised accounting system over the manual accounting system.
3. Explain the limitations of a Computerised accounting system
4. Explain the various categories of accounting package.

Chapter

10

Accounts from Incomplete Records (Single Entry System)

10.1 Meaning and definition of accounts from incomplete records.

10.2 Features of Accounts from incomplete records.

10.3 Uses of Accounts from incomplete records

10.4 Limitations of Accounts from incomplete records.

10.5 Differences between Single Entry System and Double Entry System

10.6 Preparation of statement of affairs

10.7 Differences between statement of affairs and a balance sheet

10.8 Ascertainment of profit or loss of sole trading concerns

10.9 Application of Single Entry System to partnership firm

10.1 Introduction

We have so for studied accounting records of firms, which follow the double entry system of book keeping. This gives us an impression that all business units follow this system. However, in practice all firms do not maintain accounting records strictly as per the double entry system. Many small size enterprises keep incomplete records of their transactions. But, they also have to ascertain the profit or loss for the year and the financial position of the firm as at the end of the year. This chapter deals with the ascertainment of profit or loss and financial position of the firm that have not been maintaining records as per double entry book keeping or whose records are otherwise incomplete.

10.1 Meaning and Definition

Accounting records, which are not strictly kept according to double entry system are known as Accounts from Incomplete Records. It simply means that principles of the double entry system are not being followed for all transactions. Under this method, usually the personal accounts of the debtors and creditors are kept and impersonal accounts (i.e. real and nominal accounts) may not be maintained in the books. Usually only one aspect of every transaction

is recorded under this system. This system is named as Accounts from Incomplete records or single entry system. It should be noted that the system which does not totally follow the principles of double entry system, is called Accounts from Incomplete records or single entry system.

Definition : According to R.N. Carter, single entry cannot be termed as a system, as it is not based on any scientific system like Double Entry System, for this purpose, single entry is now-a-days known as preparation of accounts from incomplete records.

Generally, the Single Entry System can be classified into the following three categories.

1. **Pure Single Entry system:** Under this type of single entry system, the dual aspect of each transaction is ignored. Only personal accounts of debtors and creditors are kept. No records are kept for real and nominal accounts. This type of single entry is not popular because even cash book which is a very important book is not maintained.
2. **Simple single entry system:** Under this system, personal accounts and cashbook are maintained.
3. **Quasi Single Entry System:** Under this system personal accounts, cash book and some subsidiary books are also maintained.

10.2 Features of Accounts from Incomplete Records

a) It is unsystematic method of recording transactions.

b) It is very common to keep only personal accounts.

c) It avoids real and nominal accounts.

d) It is very common to keep a cash book to record all cash receipts and cash payments

e) This system lacks uniformity as it differ from firm to firm.

f) It is mostly suitable and used by sole traders and partnership concerns.

10.3 Uses of Accounts from Incomplete Records

a) Single entry is a simple method of recording transaction.

b) It is less expensive when compared to double entry system of book keeping.

c) It is mainly suitable to small business concerns with limited number of transactions.

d) It is very easy to follow, a person without any adequate knowledge of principles of accounting can also understand it.

e) Ascertainment of profit or loss is very easy.

10.4 Limitations of Accounts from Incomplete records

1. It is not scientific method of accounting because it does not record the two-fold aspect of each transaction.
2. No trail balance can be prepared as it does not record the dual aspect of each transaction, so the arithmetical accuracy of the books cannot be checked.
3. In the absence of nominal accounts, trading and profit and loss account cannot be prepared.
4. In the absence of real accounts, it is not possible to know the exact financial position of the business on any particular day by preparing a balance sheet.
5. Internal check is not possible, so the possibility of fraud or misappropriation is greater in case of single entry than in the case of double entry system.
6. Accounts prepared on the basis of the single entry do not inspire confidence in the outsiders owing to the lack of any test for their arithmetical accuracy.
7. It is to difficult to ascertain the value of the business, specially of good will if the proprietor wishes to sell his business.

10.5 Differences Between Single Entry System and Double Entry System

	Basis of Difference	Double Entry System	Single Entry System
1.	Type	It is perfect and complete system of book keeping.	It is an incomplete system and a crude from of book keeping
2.	Nature	This system is scientific and follows certain accounting principles	This system is unscientific and does not follow accounting principles
3.	Two aspects	Both debit and credit aspects of each transaction are recorded	Both the aspects are not recorded
4.	Records	It provides complete and detailed records of business	It does not provide complete and detailed records of business
5.	Accounts	In this, all types of accounts namely, personal, real and nominal accounts are maintained	In this, all personal accounts are maintained except cash book, all other real accounts and nominal accounts are ignored.

6.	Trail Balance	Arithmetical accuracy of accounts can be checked by preparing a trail balance	Trail balance cannot be prepared to check the Arithmetical accuracy
7.	Ascertainment of profit	Profit can be ascertained by preparing a trading and profit and loss account	Regular trading and profit and loss account cannot be prepared and profit cannot be can ascertained
8.	Cost	Relatively it is a more expensive system	Relatively it is a less expensive system
9.	Suitability	It is suitable to all types of business organization	It is suitable only for small business concerns
10.	Errors	Errors can easily be detected and rectified	Errors cannot be detected and rectified
11.	True financial position	Balance sheet can be prepared to know the true and fair financial position	Balance sheet cannot be prepared and only a statement of affairs is prepared to know the financial position in a rough manner

10.6 Preparing Statement of Affairs

Under this method, statements of assets and liabilities as at the beginning and at the end of the relevant accounting period are prepared to ascertain the amount of change in the capital during the period. Such a statement is known as statement of affairs, shows assets on one side and the liabilities on the other just as in case of a balance sheet. The difference between the totals of the two sides (balancing figure) is the capital. Though statement of affairs resembles balance sheet , it is not called a balance sheet because the data is not wholly based on ledger balances. The amount of items like fixed assets, outstanding expenses, bank balances, etc., are ascertained from the relevant documents and physical count.

Proforma statement of affairs as at ....

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	***	Land and Building	***
Bills Payable	***	Plant and Machinery	***
Bank overdraft	***	Furniture	***
Outstanding expenses	***	Stock	***
Capital (Balancing Figure)	***	Debtors	***
		Bills receivables	***
		Cash at Bank	***
		Prepaid Expenses	***
	***		***

Illustration 1 : From the following information prepare statement of affairs and find out the capital at the beginning.

Cash in Hand	10,000	Building	40,000
Cash at Bank	40,000	Plant	60,000
Debtors	60,000	Creditors	30,000
Stock	30,000	Bills payable	10,000

Solution :

Statement of affairs at the beginning

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	30,000	Cash in Hand	10,000
Bills payable	10,000	Cash at Bank	40,000
		Debtors	60,000
		Stock	30,000
Capital (Balancing figure)	2,00,000	Building	40,000
		Plant	60,000
	2,40,000		**2,40,000**

Illustration 2 : Prepare statement of affairs from the following information and find out the capital at the end of the year

Stock	95,000	Bank over draft	6,000
Debtors	1,30,000	Creditors	37,000
Cash	8,000	Machinery	15,000
Bills receivables	1,000	Furniture	1,000

Solution :

Statement of affairs at the end of the year

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Bank over draft	6,000	Stock	95,000
Creditors	37,000	Bills receivables	1,000
		Debtors	1,30,000
		Cash	8,000
Capital (Balancing figure)	2,07,000	Machinery	15,000
		Furniture	1,000
	2,50,000		**2,50,000**

10.7 Difference between Statement of Affairs and Balance Sheet

Both statement of affairs and balance sheet show the assets and liabilities of a business entity on a particular date. However, there are some fundamental differences between the two.

	Basics	Statement of affairs	Balance sheet
1.	Purpose	It shows the financial position as well as to find out the capital in ascertaining the trading profit or loss for a particular period	It shows the financial position of the business as on a particular date
2.	Source	It is prepared from ledger balances and partly from other particulars and estimates, etc.	It is prepared from balances only
3.	Accounting method	It is prepared when accounts are maintained under single entry system	It is prepared when accounts are maintained under double entry system
4.	Reliability	It is not regarded as reliable as it is based partly on accounts and partly on other information	It is reliable as it is based on actual figures
5.	Capital account	Capital is the excess of assets over liabilities	Capital account is taken from the ledger
6.	Trail balance	Trail Balance is not prepared	Trail Balance is prepared before balance sheet
7.	Omission	In this statement omission of assets or liabilities cannot be traced	In it omission of any asset or liability can be easily be traced as the totals will not tally

10.8 Ascertainment of Profit or Loss of Business

Under Accounts from incomplete records of book keeping, it is not possible to prepare a trading and profit and loss account as no record is kept of the nominal accounts and the exact profit or loss for the period cannot be ascertained. However, the net profit can be calculated by any two of the following methods:

i) Statement of Affairs method and ii) Conversion Method)

i) statement of Affairs Method (capital comparison method)

- Under this Method, the net profit for a particular period can be calculated by comparing the opening capital with the closing capital.
- Opening and closing capitals can be the ascertained by preparing two statements of affairs, one at the beginning and the other at the end of the period and comparison of the capitals at the two dates will reveal either profit or loss.
- Then adjustments are to be made in respect of drawings and additions to capital during the period under consideration. If there are withdrawals during the period, these must be added to the capital at the end for the reason that the closing capital would have been more if these drawings have not been made.
- Similarly the additional capital should be deducted from the capital at the end for the reason that the closing capital would have been less if the additions to capital have not been made.

Proforma statement of profit or loss for the period……

	Particulars	Amount (Rs.)
	Capital as at the end of year(computed from statement of affairs at the end of the year)	****
Add	Drawings during the year	****
		****
Less	Additional capital introduced during the year	****
	Adjusted capital at the end of year	****
Less	Capital as at the beginning of year (computed from statement of affairs as at the beginning of the year)	****
	Profit or loss made during the year	****

- The above statement can also be shown as under:

Net profit or net loss = Capital at the end + Drawings – additional capital = Adjusted Capital – capital at the beginning

Note: When adjusted capital is less than the capital at the beginning, it indicates net loss. If the closing capital is more than the opening capital, it shows a profit, if the closing capital is less than the opening capital it indicates a loss.

Illustration:3

From the following information compute the net profit of a trader under single entry

Capital at the beginning of the year	**100000**
Capital at the end of the year	**150000**

Solution :

Particulars	Amount (Rs.)
Capital at the end of the year	1,50,000
Less Capital at the beginning of the year	1,00,000
Net profit for the year	**50,000**

Illustration4:

Compute the net profit for the year ending 31-03-2014 from the information given below.

Capital as on 1-4-2013	Rs 80000
Capital as on 31-3-2014	Rs 75000

Statement of profits or loss

Particulars	Amount (Rs.)
Capital at the end of the year(31-3-2014)	75,000
Less Capital at the beginning of the year	80,000
Net loss for the year 2013-2014	**(-) 5,000**

Note: The above calculation indicates only the initial figures of income. Any fresh amount is introduced as capital during the period by the trader or any drawings made by him will affect the amount of the profit. Therefore, if any amounts are given for additional capital or for drawings, than the profit can be calculated as follows.

Illustration5:

The following information is given below prepare the statement of profit or loss

Capital at the beginning of year, i.e.	April 01,2013	Rs	7,50,000
Capital at the end of year, i.e. on	March 31,2014	Rs	5,00,000
Capital brought in by the proprietor during the year		Rs	50,000
Withdrawals by the proprietor during the year		Rs	3,75,000

Solution :

Statement of profit or loss for the year ended on march 31, 2014

	Particulars	Amount (Rs.)
	Capital as on March 31, 2014	5,00,000
Add	Drawings during the year	3,75,000
		8,75,000
Less	Additional capital introduced during the year	50,000
	Adjusted capital at the end i.e. March 31,2014	8,25,000
Less	Capital in the beginning i.e. April 01, 2013	7,50,000
	Profit made during the year	75,000

Illustration6:

Find out the missing value?

Capital at the beginning of the year	30,000
Capital at the end of the year	45,000
Drawings	5,000
Profit	4,000
Additional capital brought in	?

	Particulars	Amount (Rs.)
	Capital at the end of the year	45,000
Add	Drawings	5,000
	Adjusted capital	50,000
Less	Capital at the beginning	30,000
		20,000
Less	Net profit	4000
	Additional capital brought in	**16,000**

Illustration7:

Gopal started his business on January 01, 2014 with a capital of Rs 4,50,000 on December 31, 2014 his position was as under

	Rs.
Cash	99,000
Bills Receivables	75,000
Plant	48,000
Land and building	1,80,000
Furniture	50,000
Creditors	30,000

He owned Rs 45000 from his friend Sukumar on that date. He withdrew Rs.8000 per month for his household purposes. Ascertain his profit or loss for this year ended December 31, 2014.

Solution :

Books of Mr. Gopal statement of affairs as on December 31, 2014.

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Creditors	30,000	Cash	99,000
Capital (Balancing figure)	4,22,000	Bills Receivables	75,000
		Plant	48,000
		Land and Building	1,80,000
		Furniture	50,000
	4,52,000		**4,52,000**

Statement of profit or loss for the year ended December 31, 2014

	Particulars	Amount (Rs.)
	Capital as on December 31, 2014	4,22,000
Add	Drawings Rs 8,000 ×12 months	96,000
		5,18,000
Less	Additional Capital introduced	45,000
	Adjusted capital at the end of the year i.e. December 31, 2014.	4,73,000
Less	Capital as on January 01, 2014	4,50,000
	Profit made during the year	**23,000**

Note: drawings per month Rs. 8000x12 months = 96000 per year

Illustration 8:

Mr. Ashok keeps his books on incomplete records following information is given below.

	April 01 2013	March 31 2014
	Rs	Rs
Cash in hand	1,000	1,500
Cash at bank	15,000	10,000
Stock	1,00,000	95,000
Debtors	42,500	70,000
Business premises	75,000	1,35,000
Furniture	9,000	7,500
Creditors	66,000	87,000
Bills payable	44,000	58,000

During the year he withdrew Rs. 45,000 and introduced Rs. 25000 as further capital in the business compute the profit or loss of the business.

Solution :

Books of Mr. Ashok statement of affairs as on April 01, 2013 and as on March 31, 2014

Liabilities	April 01, 2013 Rs.	March 31, 2014 Rs.	Assets	Amount (Rs.)	Amount (Rs.)
Creditors	66,000	87,000	Cash in hand	1,000	1,500
Bills Payable	44,000	58,000	Cash at Bank	15,000	10,000
Capital (Balancing figure)	1,32,500	1,74,000	Stock	1,00,000	95,000
			Debtors	42,500	70,000
			Business premises	75,000	1,35,000
			Furniture	9,000	7,500
	2,42,500	**3,19,000**		**2,42,500**	**3,19,000**

Statement of profit or loss for the year ended on March 31, 2014.

	Particulars	Amount (Rs.)
	Capital as on March 31, 2014	1,74,000
Add	Drawings during the year	45,000
		2,19,000
Less	Additional Capital introduced during the year	25,000
	Adjusted capital at the end of the year(31.03.14)	1,94,000
Less	Capital as on April 01, 2013	1,32,500
	Profit made during the year	**61,500**

Illustration 9:

Mr. Shankar keeps his books under single entry system and the following information is available from his records.

	31-3-2014 Rs.
Plant	1,35,000
Furniture	37,500
Stock	60,000
Outstanding expenses	7,500
Creditors	1,05,000
Bank balance	82,500

Sankar commenced business 1st April 2013 with a capital of Rs 1,27,500. During the year he withdrew Rs 750 per month for his personal use. Charge depreciation on plant at 10% and on furniture at 5% you are required to prepare a statement showing profit or loss for the year ended 31.3.2014

Solution :

Statement of affairs as on 31-03-2014 (Before adjustments)

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Sundry creditors	1,05,000	Plant	1,35,000
Outstanding expenses	7,500	Furniture	37,500
Capital(balancing figure)	2,02,500	Stock	60,000
		Bank balance	82,500
	3,15,000		**3,15,000**

Statement of profit or loss for the year ended 31-03-2014.

	Particulars		Amount (Rs.)
	Capital at the end of the year (31.03,2014)		2,02,500
Add	Drawings (Rs. 750x12 months)		9,000
Less	Capital at the beginning of the year (01.4.2013)		2,11,500
	Net profit for the year i.e. 31.03.2014 (before adjustments)		1,27,500
Less	Depreciation on plant	Rs. 13,500	84,000
	Depreciation on furniture	Rs. 1,875	15,375
	Net profit for the year after adjustments		**68,625**

10.9 Application of Single Entry System to Partnership Firms

When the accounts of a partnership firm are maintained under single entry system, the calculation of profit or loss is made along the lines indicated earlier. The statement of affairs of partnership firms are prepared to ascertain the amount of combined capitals of the partners at the beginning and at the end of the period. A statement of profit and loss is prepared to show the profit made during the period, which should be divided among the partners in agreed proportions. The profit is ascertained by comparing the combined capitals of the partners at the beginning and at the end of the period, after taking into account drawings made by the partners during the year and the additional capitals introduced.

Therefore, a statement of profit or loss in a partnership firm will be prepared as follows.

Statement of profit and loss for the period ended............

	Particulars	Amount (Rs.)	Amount (Rs.)
	Combined capital at the end of the period		****
Add	Combined drawings for the period		****
			*****
Less	Combined additional capital	****	
Less	Combined capital at the beginning of the period	****	****
	Profit before adjustments		****
Less	Adjustments:		
	Depreciation	****	
	Provision for Bad debts	****	****
	Net profit for the period		****
Less	Appropriations: Interest on capital salary of the partners	****	
Add	Interest on drawings	****	****
	Divisible profit		****

Illustration 10:

Suresh and Ramesh are equal partners in a business in which the books of accounts are kept by single entry system. Their combined capitals stood at the beginning of the year at Rs 1,25,000 and the combined capital at the end of the year stood at Rs 1,75,000. During the year they have withdrawn Rs 50000 equally for their personal use and introduced Rs 37,500 as fresh capital. Compute the profit for the year by preparing a statement of profit.

Solution :

Statement showing profit or loss

	Particulars	Amount (Rs.)
	Combined Capital at the end of the year	1,75,000
Add	Drawings (combined)	50,000
		2,25,000
Less	Additional Capital	37,500
	Adjusted combined closing capital	1,87,500
Less	Combined capital at the beginning of the year	1,25,000
	Divisible profit for the year of the partners	**62,500**
	Suresh share of profit 62500 x 1 / 2 = 31250	
	Ramesh share of profit 62500 x 1 / 2 = 31250	

Illustration 11:

X and Y are partners sharing profits and losses in the ratio of 3:2 who keep their books on single entry system on 1st April 2013. Their capital accounts show a balance of Rs 60,000 and 70,000 respectively. During the year they have withdrew Rs 2000 and 3000 for their personal use. Find out the capitals at the end of the year. Also calculate the divisible profit for the year ending 31-03-2014.

	31-3-2014 Rs.
Stock in trade	50,000
Debtors	1,30,000
Furniture	40,000
Cash	80,000
Sundry creditors	1,10,000

Solution:

Statement of affaires as on 31-3-2014

Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Sundry creditors	1,10,000	Sundry Debtors	1,30,000
Combined Capital (balancing figure)	1,90,000	Closing stock	50,000
		Cash	80,000
		Furniture	40,000
	3,00,000		**3,00,000**

Statement of profit or loss as on 31-03-2014

	Particulars	Amount (Rs.)
	Combined capital at the end of the year 31-03-2014	1,90,000
Add	Drawings (2000+3000)	5,000
	Adjusted capital at the end	1,95,000
Less	Capital at the beginning of the year 01-04-2013 (60,000+70,000)	1,30,000
	Net profit for the year 2013-2014	65,000
	X's Share of profit (65,000 x 3 / 5) 39,000	
	Y's share of profit (65,000 x 2 / 5) 26,000	

Summary

Single entry system is an incomplete system and crude form of book keeping under this accounting, only one aspect of every business transaction is recorded. In this system scientific principles of double entry are not followed. Single entry system may be implemented by the traders who are not well-versed with accounting principles.

MODEL QUESTIONS

Short Answer questions.

1) What is meant by accounts from Incomplete records ?
2) Define accounts from Incomplete records
3) What are the uses of Incomplete records?
4) Write briefly the salient features of Incomplete records.
5) Give two main differences between a statement of affairs and a balance sheet.
6) How to ascertain profit under Incomplete records?
7) Write in brief the limitations of Incomplete records of book keeping.
8) Write any differences between double entry system and single entry system.

Excercises

1. From the following find the profit earned by a trader.

Capital at the beginning of the year	Rs	7,500
Capital at the end of the year	Rs	10,000

[**Ans:** Profit Rs 2,500]

2. Calculate the profit or loss of a concern

Capital at the beginning of the year	Rs	15,000
Capital at the end of the year	Rs	14,000

[**Ans:** Net Loss Rs 1,000]

3. Calculate the missing figure

Capital at the beginning		?
Capital at the end	Rs	36,000
Capital introduced	Rs	9,400
Drawings	Rs.	5,600
Loss	Rs.	2,800

[**Ans:** 35,000]

4. Find out the profit from the following data:

Capital at the beginning for the year	Rs. 40,000
Capital at the end of the year	Rs. 45,000
Drawings during the year	Rs. 5,000
Capital introduced during the year	Rs. 2,500

[**Ans:** Profit Rs 7,500]

5. Find out the profit from the following data:

Capital at the beginning for the year	Rs. 60,000
Capital at the end of the year	Rs. 67,500
Drawings during the year	Rs. 7,500
Additional capital introduced during the year	Rs. 3,750

[**Ans:** Profit Rs 11,250]

6. Ascertain profit earned by a trader who keeps this books under single entry system.

(i) Excess of assets over liabilities as on 31-12-2014	Rs. 26,150
(ii) Additional capital introduced during the year	Rs. 7,500
(iii) Drawings during the year	Rs. 4,800
(iv) capital as on 01-01-2014	Rs. 15,000

[**Ans:** Profit Rs 8,450]

7. Following information given below prepare this statement of profit or loss

(i) Capital at the end of the year	Rs.2,00,000
(ii) Capital in the beginning of the year	Rs.1,20,000
(iii) Drawings made during the period	Rs. 30,000
(iv) Additional capital introduced	Rs. 50,000

[**Ans:** Profit Rs 60,000]

8. Mr. Gopal maintains his books on single entry method he gives the following information :

Capital on 01-04-2013	Rs. 38,000
Capital on 31-3-2014	Rs. 44,000
Drawings during the year	Rs. 14,000
Additional capital introduced during the year	Rs. 8,000

You are required to calculate profit or loss

[**Ans:** Profit Rs 12,000]

9. Mr Jeevan maintains his books in the single entry system he gives the following information:

Capital on 01-04-2013	Rs. 48,000
Drawings during the year	Rs. 15,000
Capital as on 31-03-2014	Rs. 54,000
Additional capital introduced during the year	Rs. 9,000

You are requested to prepare a statement of profit or loss for the 31-03- 2014

[**Ans:** Profit Rs 12,000]

10. Mr. Ramesh commenced business on 1st April 2013 with a capital of Rs 35000. On 31st March 2014 his position was as follows.

Furniture	Rs. 2,000
Cash in hand	Rs. 10,000
Machinery	Rs. 18,000
Creditors	Rs. 5,000
Debtors	Rs. 20,000
Bills payable	Rs. 3,000

During the year he withdrew Rs. 12,000 for his personal use and introduced additional capital Rs 6,000 find out profit or loss made by Mr. Ramesh during the year.

[**Ans:** Capital on 31-3-2014 Rs 42,000
Profit Rs 13,000]

11. Mr Harsha maintains his books on single entry system he gives you the following informations.

Capital on 01-04-2013	Rs. 8,000
Capital on 31-03-2014	Rs. 9,500
Drawings for the year	Rs. 2,000
Capital introduced during the year	Rs. 1,500

You are required to calculate the profit that Harsha earned.

[**Ans:** Net profit Rs 2,000]

12. Mr Ganesh maintain his books on single entry method. He gives you the following information.

Capital on 01-01-2013	Rs.	40,000
Drawings during the year	Rs.	15,000
Capital on 31-12-2014	Rs.	45,000
Fresh capital during the year	Rs.	6,000

Prepare the statement of profit or loss.

[**Ans:** Net profit Rs 14,000]

13. Mr. X keeps books in the single entry system. Find the profit from the following particulars.

Capital on 31-03-2014	Rs.	80,000
Capital on 1-04-2013	Rs.	70,000
Additional capital as on 2013 -2014	Rs.	4,000
Drawings made during the year	Rs.	3,000

[**Ans:** profit Rs 9,000]

14. From the following details, ascertain Raju's capital as on 01-01-2014.

Cash in hand	Rs.	20,000
Building	Rs.	80,000
Cash at Bank	Rs.	80,000
Plant	Rs.	1,20,000
Debtors	Rs.	1,20,000
Creditors	Rs.	60,000
Stock	Rs.	60,000
Bills payable	Rs.	20,000

[**Ans:** Capital as on 1-1-14 RS 4,00,000]

15. Mr. Mehta started his readymade garments business on April 1, 2013 with a capital of Rs 50,000. He did not maintain his books according to double entry system. During the year he introduced fresh capital of 15,000. He withdrew Rs 10,000 for personal use. On March 31, 2014, his assets and liabilities were as follows:

Total creditors Rs 90,000; Total Debtors Rs 1,25,600;Stock Rs 24,750; cash at bank Rs 24,980

Calculate profit or loss made by Mr. Mehta during the first year of his business using the statement of affairs method.

[**Ans:** Capital as on March 31, 2014 Rs 85,330, Profit Rs 30,330]

16. Mr. J.Keeps his books by single entry. He started business on 1st January 2014 with Rs. 20,000 on 31st December, 2014 his position was as under:

Assets: cash in hand Rs. 500; cash at bank Rs 1,000; Furniture Rs 2,500; plant Rs 10000; sundry debtors Rs. 5,000; stock Rs 9,000 and bills receivables Rs 1,000.

Liabilities: sundry creditors Rs 4,000; bills payable Rs 500 and outstanding expenses Rs. 500 Ascertain the profit or loss made by J.

[**Ans:** Profit Rs 4,000; capital on 31-12-2014 Rs 24,000]

17. Mr. Ravikumar keeps his books on single entry his position on 31st December, 2013 was as follows cash at bank Rs. 3,000, stock Rs. 20,000; Debtors Rs 30,000 Machinery Rs 50,000 and creditors Rs 25,000, His position on 31st December, 2014 was as follows. Cash at bank Rs.4,000; stock Rs.25,000 ; (over draft) debtors Rs.45,000; Machinery Rs.50,000 and creditors Rs 25,000. During the year he introduced Rs 10,000 as further capital and withdrew from business Rs. 3,000 per month.

From the above information ascertain the profit or loss made by Mr. Ravikumar for the year ended 31st December 2014.

[**Ans:** profit Rs.47,000;capital on 31-12-2013 Rs.78,000, 31-12-2014 -99,000]

Note: Drawings 3,000 per month, per year 36,000 (3,000x12 months)

18. From the following particulars prepare a statement of profit and loss for the year ended 31st December 2014.

	Opening	Closing
	1-1-2014	31-12-2014
	Rs	Rs
Cash	4,000	3,000
Bank	10,000	5,000
Debtors	80,000	75,000
Stock	30,000	28,000
Creditors	42,000	37,000

Machinery	10,000	15,000
Furniture	1,000	1,000

The proprietor drew at the rate of Rs 750 per month he introduced Rs. 3,000 as fresh capital.

[**Ans:** Loss Rs 7,000; Capital on 1-1-2014 Rs 93,000 on 31-12-2014, Rs. 80,000, Drawings 750x12=9,000]

19. A Trader keeps his books by the single entry method. His position on 31st December, 2013 was follows. Cash at bank Rs 9,000, stock Rs. 60,000 Debtors Rs 90,000, Machinery Rs 1,50,000 and creditors Rs 69,000. His position on 31st December 2014 was as follows. Cash at bank Rs 12,000 stock Rs. 75,000, Debtors Rs 1,35,000, Machinery Rs 1,35,000 and creditors Rs. 75,000

    During the year the trader introduced Rs 30,000 as further capital in business and withdrew Rs 900 per month. From the above you are required to ascertain the profit or loss made by the trader for the year ended 31-12-2014.

    [**Ans:** Capital as on 31-12-2013 Rs 2,40,000;Capital as on 31- 12 – 2014 Rs 2,82,000;Net profit Rs. 22,800]

20. The assets and liabilities of Mr. well on 01-01-14 and on 31-12-2014 were as follows

	01-01-2014	31-12-2014
	Rs.	Rs.
Cash in hand and at bank	4,005	3,000
Bills receivable	2,000	3,500
Sundry debtors	15,000	25,000
Stock in trade	3,700	3,800
Fixed assets	60,000	65,400
Creditors	5,705	6,700

Calculate the profit after charging interest on capital in the beginning at 5 percent per annum after providing interest on drawings 6 percent. Drawings were Rs 14.000

[**Ans:** Profit Rs 25,890; capital on 1-1-2014 Rs 79,000; Capital on 31-12-2014 Rs 94,000]

21. Mr Vijay starts his business with Rs 30,000 in cash as his capital on 1st April 2013. At the end of the year his position was as follows. Creditors Rs 7,500; Debtors Rs 6,000; Cash at Bank Rs 12,750; Stock Rs 7,500; and Machinery Rs 15,000. During

the year he withdrew Rs 1,125 every month. on 1st October 2013 he introduced a further capital of Rs 7,500. You are required to ascertain profit or loss made by him during the year after considering the following adjustments. Machinery was to depreciated at 12% and a reserve of 2% was to be raised against Debtors. Also prepare a statement of affairs as at 31 March 2014.

[**Ans:** Capital at the end Rs 31,830 Net profit Rs 7,830]

22. Gopal and Krishna kept their books of accounts under single entry system. Their capital accounts on 1st April 2013 show a balance of Rs 2,00,000 and 1,00,000 respectively. The net profits are to be shared as Gopal 2/3 and Krishna 1/3. During the year they have withdrawn Rs 10,000 and Rs 7,500. On March 2014 their assets and liabilities were as follows.

    Assets: Furniture Rs 75,000; stock Rs 1,75,000; Debtors Rs 1,25,000; Bills Receivable Rs 25,000; cash at bank Rs 10,000.

    Liabilities: Sundry creditors Rs 25,000; Bills payable Rs 12,500

    Prepare a statement of affairs on 31st March 2014 and calculate the divisible profits of the partners.

    [**Ans:** Combined capital of the partner at the end of the year Rs 3,72,500. Net profit Rs 90,000; Gopal's share of profit Rs 60,000 and Krishna's share of the profit Rs 30,000]

23. Ramesh and Rajesh are partners sharing the profit and losses in the ratio of 4:1 on 31st March 2013, their capital accounts show a credit balance of Rs 1,00,000 and Rs 25,000 respectively. During the year they have introduced a fresh capital of Rs. 25,000 and 6,250 respectively. Also they have withdrawn Rs 1,875 and Rs 625 each month respectively for their personal use. On 31st March 2014. Their business position was as follows:

    Assets: Machinery Rs 58,750; stock Rs 61,500; sundry debtors Rs 33,125; Bills Receivable Rs 5,375; cash in hand Rs 3,750

    Liabilities: sundry creditors Rs 25,000. You are asked to prepare a statement of affairs and statement of profit on 31st March 2014 and calculate the divisible profits or losses of the partners.

    [**Ans:** Combined capital of the partners at the end of the year Rs 1,37,500; Net profit for the year Rs 11,250; Ramesh share Rs 9,000; Rajesh share Rs 2,250]

24. Anil and Sunil are partners sharing the profit and losses in the ratio of 3:2 on 31 March 2013, their capital accounts show a credit balance of Rs 12,000 and Rs 8,000 respectively. On 31st March 2014 their business position was as follows.

    Assets: Machinery Rs 15,000; stock Rs 4,000; Bills Receivables Rs. 5,000; sundry debtors Rs 7,000;

    Liabilities: sundry creditors Rs 8,000; Bills payable Rs 3,000

    You are required to prepare a profit and loss statement of affairs as at the date after taking into the following.

    a) Drawings made during the year by Anil Rs 3,000 sunil Rs 2,000

    b) Interest on capital is to be allowed at 6%.

    [**Ans:** combined capital at the end of the year Rs 20,000; Divisible profit Rs 3,800; Anil's share of profit 2,280; Sunil share of profit 1,520]