ADVANCED ACCOUNTING

B.Com. SECOND YEAR

Semester – 3

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B.Com . SECOND YEAR : Semester - 3

ADVANCED ACCOUNTING

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FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging ahead in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining a 'A' Grade from the NAAC in the year 2014, the Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 285 affiliated colleges spread over the two districts of Guntur and Prakasam.

The University has also started the Centre for Distance Education with the aim to bring higher education within reach of all. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even housewives desirous of pursuing higher studies. With the goal of bringing education in the door step of all such people. Acharya Nagarjuna University has started offering B.A, and B, Com courses at the Degree level and M.A, M.Com., L.L.M., courses at the PG level from the academic year 2021-22 on the basis of Semester system.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers invited respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is aim that students getting higher education through the Centre for Distance Education should improve their qualification, have better employment opportunities and in turn facilitate the country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Coordinators, Editors and Lesson -writers of the Centre who have helped in these endeavours.

Prof. P.Rajasekhar
Vice –Chancellor,
Acharya Nagarjuna University

PROGRAMME : THREE – YEAR B.Com
(General & Computer Applications)

<u>Domain Subject : Commerce</u>

Semester – wise Syllabus under CBCS

(w.e.f. 2020 – 21 Admitted Batch)

II Year B.Com(Gen. & CA) : Semester – III

306 BCO 21 – **<u>Course 3A : Advanced Accounting</u>**

<u>Learning Outcomes :</u>

At the end of the course the student will be able to :

- Understand the concept of Non-profit organisations and its accounting process
- Comprehend the concept of single – entry system and preparation of statement of affairs.
- Familiarize with the legal formalities at the time of dissolution of the firm
- Prepare financial statements for partnership firm on dissolution of the firm
- Employ critical thinking skills to understand the difference between the dissolution of the firm and dissolution of partnership.

<u>Syllabus</u> :

Unit – 1 : Accounting for Non-Profit Organisations :

Non Profit Entities – Meaning – Features of Non Profit Entities – Provisions as per section Sec 8 – Preparation of Accounting Records – Receipts and Payments Account – Income and Expenditure Account – Preparation of Balance Sheet (including problems).

Unit – 2 : Single Entry System :

Features – Difference between Single Entry and Double Entry – Disadvantages of Single Entry – Ascertainment of Profit and Preparation of Statement of Affairs (including problems).

Unit – 3 : Hire Purchase System :

Features – Difference between Hire Purchase and Instalment Purchase systems – Accounting treatment in the books of Hire Purchaser and Hire Vendor – Default and Repossession (including problems).

Unit – 4 : Partnership Accounts – 1 :

Meaning – Partnership Deed – Fixed and Fluctuating capitals – Accounting Treatment of Goodwill – Admission and Retirement of a Partner (including problems).

Unit – 5 : Partnership Accounts – 2 :

Dissolution of a Partnership Firm – Application of Garner Vs .Murray rule in India – Insolvency of one or more Partners (including problems).

References :

1. Advanced Accountancy : T.S. Reddy and A. Murthy by Margham Publications.
2. Financial Accounting : SN Maheswari & SK Maheswari by Vikas Publications.
3. Principles and Practice of Accounting : RL Gupta VK Gupta, Sultan Chand & Sons.
4. Advanced Accountancy : R.L.Gupta & Radhaswamy, Sultan Chand & Sons.
5. Advanced Accountancy (Vol - II) : SN Maheswari & VL Maheswari by Vikas Publishers.
6. Advanced Accountancy : Dr. G. Yogeswaran & Julia Allen, PBP Publications.
7. Accountancy – III : Tulasian, Tata Mc.Graw Hill Co.
8. Accountancy – III : S.P. Jain & K.L. Narang, Kalyani Publishers.
9. Advanced Accounting (IPCC) : D.G. Sharma, Tax Mann Publications.
10. Advanced Accounting : Prof. B. Amarnadh, Seven Hills International Publishers.
11. Advanced Accountancy : M. Shrinivas & K. Sivalatha Reddy, Himalaya Publishers.

Suggested Co-Curricular Activities :

- Quiz Programs
- Problem solving Exercises
- Co – operative learning
- Seminar
- Visit a Single Entry Firm, Collect Data and Creation of a Trial Balance of the firm.
- Visit Non-profit Organisation and collect financial statements.
- Critical analysis of rate of interest on hire purchase schemes.
- Visit a partnership firm and collect partnership deed.
- Debate on Garner Vs. Murray rule in India and outside India.
- Group Discussions on problems relating to topics covered by syllabus.
- Examinations (Scheduled and Surprise tests) on all units.

MODEL QUESTION PAPER

B.Com. – Second Year

Semester - 3

ADVANCED ACCOUNTING

Time: Three hours **Max. Marks: 70**

SECTION A **(5 x 4 = 20 Marks)**

Answer any **FIVE** of the following questions.

1. Write any five capital natured expenses.
2. Write difference between Single Entry System and Double Entry System.
3. Explain about statement of affairs.
4. Write the features of Hire Purchase System.
5. Write about the parties in Hire Purchase System.
6. Write the features of Partnership Business.
7. Write about the Revaluation Account.
8. Write about dissolution of Partnership Firm.

SECTION B **(5 x 10 = 50 Marks)**

Answer the following questions.

9. (a) What about the treatment of important items in non trading accounting.

Or

(b) From the following particulars prepare Income and Expenditure account.

Particulars	Rs.
Fees collected (including Rs. 24,000 on account of Last year)	2,24,000
Fees for the year outstanding	40,000
Salary paid (including Rs. 2,400 on account of Last year)	19,200
Salary outstanding	3,200
Entertainment expenses	4,000

Tournament expenses	8,000
Meeting expenses	16,000
Travelling conveyance	6,400
Purchase of books	16,000
Periodicals	8,000
Rent	9,600
Postage, Telephone, Telegrams	13,600
Printing and Stationary	4,000
Donation received	6,400

10. (a) Write disadvantages (limitations) of Single Entry System.

Or

(b) A trader keeps his books by single entry system method. His position on 31st December, 2002 was as 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, 2003 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 31-12-2003.

11. (a) Write the differences between Hire Purchase and Instalment Purchase System.

Or

(b) A railway company purchased wagons on Hire Purchase system over a term of 2 years starting on 1-10-2004. The instalment of Rs. 4,000 each payable half yearly. The cash price of the wagon is Rs. 14,870 and the wagons company charges interest at the rate of 6% pa. Books are closed every year on 31st December. Write the necessary ledger accounts in the books of Railway Company. The first instalment is paid on 30.6.2004.

12. (a) ABC shareprofits and losses in the ration of 5 : 3 : 2. They admit D a partner by giving firm 1/5 share in future profits. He brings Rs. 20,000 as his share of goodwill and also brings Rs. 50,000 as his capital. Old partner withdraw their share of goodwill. Draw journal entries.

Or

(b) Achyut and Ananth are partners in a firm sharing profits and losses in the ratio 3:2. On 1.1.2003 the position of the business was as follows :

Liabilities	Rs.	Assets	Rs.
Creditors	15,000	Goodwill	5,000
Capital Accounts :		Stock	20,000
Achyut	30,000	Plant	25,000
Ananth	25,000	Debtors	18,000
		Cash	2,000
	70,000		70,000

Ajith agrees to join the business on the following conditions :

(i) He will introduce Rs. 20,000 as his capital and pay Rs. 10,000 to partners as premium for goodwill for 1/4th share of future profits of the firm.

(ii) Realuation of assets of the firm will be made by reducing plant to Rs. 20,000 and stock by 10% and by raising a provision for bad debts at 5% of debtors.

(iii) You are asked to show the balance sheet of the new firm. Goodwill is to be appear in its old figure in the new balance sheet.

13. (a) Explain the Garner Vs. Murray case and what are the applications of Garner Vs. Murray in India are.

Or

(b) A, B and C commenced Business on 1.4.2004 with a capital of Rs. 25,000 , Rs. 20,000 and Rs. 15,000 respectively. Profits and losses are shared in the ration of 4:3:3. Capital carried interest @ 5% pa. During the year ended on 31.3.2005 they made a profit of Rs. 12,000 (Before allowing interest on capitals). Drawings of each partner were Rs. 2,500 per year. On 31.3.2005 the firm was disclosed. Creditors on that date were Rs. 6,000. The assets realized Rs. 60,000. Give necessary accounts to close the books.

*****

CONTENTS

LESSON - 1

NON - PROFIT ORGANISATIONS - I

OBJECTIVES : After going through this lesson the student can know what is a Non trading concern What are the books maintained by them ? How a Receipt and Payment account and an Income and Expenditure account is prepared ?

STRUCTURE OF THE LESSON :

1.1 Introduction.
1.2 Capital and Revenue.
1.3 Capital Expenditure.
1.4 Revenue Expenditure
1.5 Revenue Expenditure becoming capital expenditure.
1.6 Usual items of capital expenditure
1.7 Usual items of Revenue expenditure.
1.8 Capital and Revenue Receipts.
1.9 Receipts and Payments Account.
1.10 Income and Expenditure Account.
1.11 Preparation of income and expenditure Account from Receipts and Payment account.
1.12 Summary
1.13 Self Assessment Questions
1.14 Exercises
1.15 Suggested Readings

1.1 INTRODUCTIONS :

The purpose of every trading or manufacturing activity is to make profit. But there are certain charitable and social institutions which are created not with a profit making object but for the development of welfare activities, both for the general public and for its members such as educational institutions, hospitals, clubs, charitable trusts etc. are called non - trading concerns.

These non profitable institution are not interested in the quantum of profits earned by them during the year but certainly they are interested in knowing the receipts and expenditure during the year and their financial position at the end of each year. To achieve these objectives they prepare the following statements.

a. Receipts and payments account.

b. Income and Expenditure account.

c. Balance sheet.

The concepts of capital and revenue are very important in the preparation of Final accounts of Non -Trading concerns, Therefore let us first know the distinction between capital and revenue items.

1.2 CAPITAL AND REVENUE :

One of the objects of Accounting is to determine whether the business has earned profit or not. For this purpose a proper distinction between capital and revenue, as regards expenditure receipts and losses, is required. Failure or neglect to discriminate capital and Revenue will falsify the whole of the results of accounting For example, plant may purchased and charged to the purchases account, some of the fixed assets may be sold and the proceeds may be treated as income. In each case both the profit and loss account and Balance sheet will be affected while preparing the final accounts, all revenue items are included in the revenue account i.e. Trading and profit and loss account and all capital items in the balance sheet. Any error committed in distinguish between "capital" and "Revenue" will effect the ascertainment of correct profit.

It is very different to give a clear cut rule as to distinguish capital and revenue expenditure. However, the following rules may serve as a guide for making distinction between capital and revenue expenditure.

1.3 CAPITAL EXPENDITURE :

Capital expenditure is such an expenditure which benefits the business over a long period. It includes assets acquired for the purpose of earning and not for resale, improving and extending fixed assets, increasing the earning capacity of the business and raising capital for the business. Purchase of new plant, additions to the building, brokerage and commission paid for procuring long term loans are a few examples of such expenditure. All items of capital expenditure appear on the asset side of the Balance sheet.

1.4 REVENUE EXPENDITURE :

Revenue expenditure consists of expenditure in cure on one accounting period and the full benefit of it is enjoyed in the same period. Therefore, it is normally of recurring nature. Such an expenditure does not increase the earning capacity of the business and it does not bring into existence an asset. It includes expenses incurred for acquiring assets for resale at a profit or for conversion into finished products, for maintaining fixed assets for resale at a profit or for conversion into finished products for maintaining fixed assets in good working order e.g. normal repairs and renewal of plant, white washing of building replacement of machinery etc; for keeping the organization going eg. Rent, rates and taxes, wages and salaries, insurance and other trade charges. All items of revenue expenditure appear in the trading and profit and loss Account.

1.5 REVENUE EXPENDITURE BECOMING CAPITAL EXPENDITURE OR CAPITALISED EXPENDITURE :

An expenditure which is primarily of revenue nature but incurred for the purpose of acquiring any asset or auditing to its value is termed as capitalised expenditure. The following are some of the examples of revenue expenditure becoming capital expenditure.

1. **Repairs :** Repairs are usually revenue expenditure but if we purchase a second hand machinery and pay for repairs necessary to make it suitable for our purpose, then repairs become capital expenditure and should be added to the cost of the machinery.
2. Wages : Wages are usually a revenue charge but if paid to the employees for the construction or erection or installation of the fixed assets of the business ,then these become capital expenditure and should be added to the cost of the fixed asset concerned.

3. **Legal expenses :** Legal expenses are usually a revenue charge but if paid on acquiring a property should form an additional cost of the asset acquired.

   Those are usually a revenue items but payments made for transporting newly acquired asset will form additional cost of the asset thus being treated as capital expenditure.
4. **Freight and carriage :** These are usually a revenue items but payments made for transporting newly acquired asset will form additional cost of the asset thus being treated as capital expenditure.
5. **Interest :** Interest on borrowing and capital generally a revenue item is allowed to be treated as capital item if paid during the period of construction.
6. **Preliminary expenses :**Initial expenses, connected with the formation of a company though revenue in nature are allowed to be capitalised and can be shown as and asset in the balance sheet.
7. **Brokerage and stamp duty :** Normally these are revenue items but, brokerage paid on the purchase of a property and also the stamp duty on it may be treated as capital expenditure as an additional cost of purchase
8. **Development Expenditure :** In concerns like mines, tea, calories, horticulture, rubber plantations etc. a sizeable amount is spent during the period of development and up to the time they begin to earn. Such expenses must be treated as capital expenditure.
9. **Advertising :** A huge sum spent on advertising in a year, the benefit of which shall accrue in future years, also may have the effect of creating a future good will and thus sums spent may be capitalised. For example, lakhs of rupees are spent in changing the name from Binaca to cibaca and Hutch to oda.
10. **Raw materials and stores :** They are usually a revenue charge but if consumed in making of a fixed assect they must be treated as a part of the cost of the asset.

Deferred revenue Expenditure : It is the expenditure which would normally be treated as revenue expenditure but, it is not written off in one year as its benefit is to completely exhaustible in the year in which it is incurred or is of a non - recurring and special nature and large in amount. It may be spread over a number of years a proportionate amount being charged to the profit and loss account of each year and the balance is carried forward to subsequent years as deferred revenue expenditure and is shown as an asset in the balance sheet. Sometimes extraordinary losses are also treated as deferred revenue expenditure and charged to profit and loss account for four to five years.

1.6 USUAL ITEMS OF CAPITAL EXPENDITURE :

The following items usually represent capital expenditure.

1. Cost of acquisition of fixed asset like good will, land, building, leasehold promises, tools and equipment, furniture, trade marks etc.
2. Expenses of putting a new asset in a working condition like installation and erection expenses of any fixed asset.
3. Additions or extensions or structural improvements to the existing assets leading to their working efficiency or revenue earning capacity or cost reduction e.g. refurnishing of the sitting accommodation of a cinema hall etc.
4. Development nature like development of mines and plantation.
5. Formation expenses of a business are called preliminary expenses like preparing and filing the legal documents required for starting a business etc.

1.7 USUAL ITEMS OF REVENUE EXPENDITURE :

The following are usual items of revenue expenditure.

1. Expenses incurred in the ordinary conduct and administration of the business e.g rents, salaries, wages, advertisement etc.
2. Expenses incurred in purchasing raw materials or stock of finished goods for resale and supplies like grease, cotton, oil for machines etc.
3. Expenses incurred to maintain assets in working order like ordinary repairs renewals or alterations etc.
4. Expenses incurred on maintaining or pushing sales like, carriage of finished goods, commission, travelling expenses, free samples and gifts etc.
5. Loss arising from sale of fixed assets.
6. Loss arising from damage, destruction, theft of stock in trade, cash etc.
7. Loss arising from depreciation in the values of fixed assets or book values of assets discarded.
8. Annual renewal fees of patents etc.

Illustration 1 which of the following expenditures are capital, revenue or deferred revenue expenditure.

1. Rs 10,000 spent on dismantling, removing and reinstallation of machinery.
2. Rs 2,00,000 was spent on putting up a gallery in a theatre hall.
3. Rs 3,000 paid as insurance premium.
4. The freight and cartage on the new machinery amounted to Rs 5,000 and the erection charges cost Rs 1000
5. A machinery whose book value was Rs 17,000 and was sold for Rs 7,000
6. Rs 15,000 was paid as compensation for cancellation of a contract.
7. An amount of Rs 1000 was spent as legal expenses for maintaining an existing title to the assets of the business.
8. Rs 1,50,000 was spent on advertising a new product in the market.
9. Rs 20,000 was spent on white washing and painting of the factory building.
10. Rs 1,500 was spent by a chartered accountant on books helping in his profession.

Solution :

1. Rs 10,000 spent on dismantling, removing and reinstallation is a capital expenditure.
2. Rs 2,00,000 spent on putting up a gallery in a cinema hall is a capital expenditure
3. Insurances premium paid is a revenue expenditure
4. Rs 5,000 spent on freight and cartage and the erection charges Rs 1,000 on new machinery is a capital expenditure and it shall be added to the cost of the machinery
5. Rs. 10,000 incurred as a loss on the sale of an old machinery being manageable is a revenue loss and to be debited to the profit and loss account of the year in which it occurs.
6. Rs 15000 paid for cancellation of contract is a capital expenditure since it has resulted in avoiding an unnecessary investment.
7. Rs 1000 spent as legal expenses on defending the title to the assets of the business as revenue expenditure.

8. Rs 1,50,000 spent on advertising is a heavy amount, so it should be capitalised and the portion of current year should be debited to profit and loss account and the remaining portion should be shown in the balance sheet till it is completely wiped off.
9. Rs 20,000 spent on white washing and painting of the factory building is a revenue expenditure.
10. Rs 1,500 spent by a chartered Accountant on books helping in his profession is a revenue expenditure.

1.8 CAPITAL AND REVENUE RECEIPTS :

Capital receipts of business comprise capital contributed by partner or by the share holders, loans sale proceeds of any fixed assets etc. In case of clubs and associations, receipts on account of life subscriptions, entry free, government grants, legacies and endowments are capital receipts, Revenue receipts, received commission, interest on investment etc. In case of club etc annual subscriptions, sale of golf balls, receipts arising out of the premises being given to others for use on charges are revenue receipts, Revenue receipts are treated in the revenue account while the capital receipts are treated in the balance sheet.

Guidelines for deciding a receipt as capital or revenue :

The following guidelines may be stated to decide whether a particular receipt is capital or revenue.

1. Nature of receipts is to be determined by its character in the hands of the person receiving it not by the source from which payment was made e.g. payment of interest out of capital by a company still under construction is capital expenditure for the company but revenue receipt in the hands of the person receiving it.
2. In case of a single transaction of purchase and sale of property the motive of the owner will decide whether the receipt is capital or revenue ex; A sells shares held by him as investment it is a capital receipt but if A sells the shares with speculative motive it will be a revenue receipt.
3. A receipt on account of fixed asset is a capital receipt while a receipt on account of current assect is a revenue receipt, for ex; sale proceeds of building, plant etc constitute capital receipt while sale of stock - in - trade is revenue receipt.
4. Where a receipt is in substitution of a source of income there it is a capital receipt but if it is in substitution of income alone it is a revenue receipt. For eg; if a railway passenger meets with an accident and dies or is permanently disabled, compensation received from the railway department is capital receipt because this receipt is in substitution of source of income i.e his life, but if he is rendered only temporarily disabled the receipt will be revenue one as it is in substitution of income alone i,e loss of earnings during the period of disablement.
5. Where a sum is received for the surrender of certain right, there it is a capital receipt but where the sum received is in the nature of compensation for loss of future profits there it is a revenue receipt. For eg. A the lease holder of fire field and manufacturer of

   fire - clay goods was prevented by the railway company for working on the field adjacent to the railway lines. Amount paid by the railway company to A is a capital receipt because it is the receipt in lieu of his right to work upon the clay field.

Examples of capital Receipts :

1. Compensation received for the loss of right of future remuneration.
2. Compensation received for suspension of export license.
3. Compensation received by one partner of a partnership from another partner for relinquishing all his rights in the partnership etc.

Examples of Revenue Receipts :

1. Receipts of annuities for transfer of a capital asset.
2. Lump - sum received in consideration of reduction of remuneration
3. Compensation received for premature termination of contract.
4. Considerations received for transfer of permits etc.

Capital and Revenue losses :

Revenue loss is the loss of some revenue receipts in the course of the business and is incidental to it. Any loss which can't be termed as revenue loss is a capital loss. For eg: loss of stock - in - trade by fire, white ants or by theft is a revenue loss where as loss of fixed asset like building plant etc. By fire or accident or earth quake is a capital loss.

Loss caused to the business by reason of cash being is appropriated by an employee is a revenue loss but if the fund reach home of the owner and there after if the funds are lost, then the loss is outside the trade and not incidental to the business therefore it is a capital loss ($Exceptions are banks or lending houses).

1.9 RECEIPTS AND PAYMENTS ACCOUNT :

It is a summary of cash transactions at the end of a particular period showing the receipts and payments of cash during the period under different heads.

Features :

The features of Receipts and payments account are as follows.

1. It is prepared by non - trading concerns in lieu of cash book of trading concerns.
2. It is a real account.
3. It starts with the opening balance of cash in hand and at bank.
4. All receipts and payments of cash are entered on the debit and credit side respectively.
5. No distinction is made between the capital and revenue items while entering the receipts and payments.
6. All receipts and payments whether they are relating to the current, preceding or succeeding period, are written in this account.
7. Opening balance of this account shows cash in hand at the beginning of the accounting period and closing balance shows cash in hand at the end of accounting period.
8. All types of Accounts i,e, personal real and nominal are written in this account.
9. No adjustments, outstanding expenses, prepaid expenses provision for doubtful debts or depreciation are made in this account as it is prepared on cash system of accounting.
10. It does not reveal the financial results or the financial position of the account of the accrued incomes and outstanding expenses.

The following is a specimen of the receipts an payments account of a club for a particular year.

Receipts and payments Account of ....

for the year ending 31 March 2007.

Dr. Cr

Receipt	Rs	Payment	Rs
To Balance b/d	xxx	By Rent	xxx
To Subscriptions	xxx	By Furniture	xxx
To Entrance fee	xxx	By Sports Material purchased	xxx
To Legacy	xxx	By Building	xxx
To Donations for building	xxx	By Ground maintenance	xxx
To Interest received	xxx	By Salaries	xxx
To Sale of furniture	xxx	By Honorarium	xxx
To Sale of old Sports material	xxx	By Match expenses	xxx
To Match fund	xxx	By Stationery	xxx
		By Investments	xxx
		By Entertainment	xxx
		By Balance c/d	xxx
	xxx		xxx

Illustration 1

Jimkhana club kept its accounts on cash basis and the figures for the year 2006-07 are given below. You are required to prepare Receipts and payments Account

	Rs.		Rs.
Subscriptions	received	Watchman s wages	27,200
2005 - 06	8000	salaries	40,000
2006 - 07	72,000	postage	4,800
		stationery	12,000
Receipts from common Room	50,000	Rent	20,000
Hiring Rooms	4,000	cash in hand	
Billiards Rooms	24,000	1 - 4- 2006	7,200
supplies room	34,000		

Receipts and payments Account of JimKhana Club for the year ending on 31 - 3- 2007

Dr. Cr

Receipts	Amount Rs	Payment	Amount Rs.
To Balance b/d	7,200	By supplies for	
To Subscriptions		Entertainment Room	34,000

2005-2006	8,000	By Watchman's wages	27,200
2006-2007	72,000	By Salaries	40,000
To Receipts from		By Postage	4,800
Common Room	50,000	By Stationery	12,000
Hiring Room	4,000	By Rent	20,000
Billiards Rooms	24,000	By Electricity	16,000
		By Balance c/d	11,200
	1,65,200		1,65,200

1.10 INCOME AND EXPENDITURE ACCOUNT :

It is prepared by non - trading concerns in lieu of profit and loss Account. To know whether during a particular period the income of the concern or organisation have exceeded or faller short of the expenses this account is prepared. In this account current expenses are compared with current incomes. The features of this account are.

1. It does not start with any opening balance.
2. It is a nominal account Expenses are shown on the debit side and incomes on the credit side.
3. Only revenue items are recorded in it capital items are totally excluded.
4. Only incomes and expenses of the concerned year are recorded in it and income and expenditure relating to the preceding or succeeding periods are excluded while preparing this account.
5. This account is prepared on mercantile system of accountancy and thus all adjustments relating to prepaid or outstanding expenses and incomes, provision for depreciation or doubtful debts will be made.
6. Only nominal accounts are taken into consideration for the preparation of this account and for personal and real accounts a Balance sheet must be prepared along with this account.

Difference between Receipts and payments.
Account and Income and Expenditure Account

The following are the main differences between a Receipts and payments Account and Income and Expenditure Account.

Receipts and payments account	It come and Expenditure Account.
1. It is a real Account	1. It is a nominal account.
2. It is like cash book prepared by trading concerns.	2. It is like profit and loss account prepared by non - trading concerns.
3. It starts with a balance being cash at the being of the year.	3. It does not start with any opening balance.
4. Receipts are shown on the debit sid and payment on the credit side.	4. Incomes are shown the credit side and expenditure on the debit side.

5. All items whether of capital or revenue nature are shown in this account.
6. All receipts and payments whether they are of preceding, current or succeeding period are entered in it.
7. Outstanding receipts and payments are not shown in it as it is prepared on cash basis.
8. The closing balance represents cash in hand on that date.
9. It is not necessary to prepare Balance sheet along with this account.

5. Only revenue items are shown in this account.
6. Income and expenditure of the current year only shown in it.
7. Income and expenses are shown after including all outstanding income and expenses on accrued basis.
8. The closing balance represents surplus or deficit for the concerned period.
9. The Balance sheet must be prepared in order to accommodate real and personal accounts a long with this account.

1.11 PREPARATION OF INCOME ANDEXPENDITURE ACCOUNT FROM RECEIPTS AND PAYMENTS ACCOUNT :

The following steps are to be taken to convert a receipts and payments account into an Income and Expenditure account:

1. Leave the opening and closing balance of cash given in the Receipts and payments account.
2. Take only revenue items of income and expenditure and leave all those items which are of capital nature.
3. Make all adjustments for outstanding and prepaid incomes and expenses, provision for depreciation or bad debts etc.
4. Take items only of the current period i.e; items relating to the preceding and succeeding periods are to be ignored.
5. In Income and Expenditure account expenditure is recorded on the debit side and income is recorded on the credit side.
6. Once Income and Expenditure Account is balanced it shows either surplus or deficit, If credit balance is more than Debit balance it is called surplus and if the debit balance is more than credit balance, it is called as Deficit.

Illustration – 2 :

From the following particulars prepare Income and Expenditure account of Guntur club for the year ended 31st Dec 2007.

Subscriptions received for 2007	22,000	
Entrance fees received for 2007	3,000	
subscriptions and entrance fee for 2006 (estimated Rs 600 realised)	1120	
subscriptions and entrance fees for 2008	6,200	
subscriptions for 2007 to be taken at	4000	
Miscellaneous Expenses	840	
Expenses for 2007 paid		32,000
Expenses unpaid	920	
Liabilities for 2007 paid (estimated Rs 2800)	2400	
Audit fees for 2007 not paid	800	

Profit on service account net	9200
Interest on loan paid	1280
capital expenditure written off	4800
surplus from 2006 account	1600
capital expenditure in 2007 provide for depreciation	8240
for this year	2680
cash in hand	7200

Solution :

Guntur club Income And Expenditure Account for the year ended 31st December 2007.

Expenditure	Amount Rs	Income	Amount Rs
To Expenses		By subscription and	
(32000 + 920)	32,920	Entrance fees	
To Audit Fees	800	(22000 + 3000 + 4000 +520)	29,520
To Interest on loan	1,280	By Miscellaneous Expenses	8,400
To Capital Expenditure	4,800		
(Written off)		By Liabilities provided	
To Depreciation	2,680	in excess last year	
Surplus	5,040	(2800 - 2400)	400
		By Profit on service account.	9,200
	47,520		4,7520

1.12 SUMMARY :

The institution which are created not with a Profit making object but for the development of Welfare activities both for the General Public and for its members are called Non-trading concerns. Even this concerns are not started with Profit motive these concerns also will have certain expenses and incomes, Assets and Liabilities. At the end of the year to know the total expenses, Incomes and to know the financial positions of the concerns they prepare certain accounts such as receipts and payments account, Income and Expenditure account and Balance sheet. Receipt and Payment account is a in lieu of cash book, and incoming expenditure account is in lieu of profit and loss account of the trading concerns.

1.13 SELF ASSESSMENT QUESTIONS :

1. What is Capital Expenditure ? Illustrate.
2. What is Revenue Expenditure ? Illustrate.
3. Distinguish Capital and Revenue Expenditure giving illustrations.
4. What is Deferred Revenue Expenditure ? Illustrate.

5. What are Capital and Revenue receipts ? Explain with illustrations.
6. Explain the importance of distinguishing the Capital and Revenue items while preparing final accounts of concerns.
7. What types of accounts are prepared by non-trading concerns ?
8. What is Receipts and Payments account ?
9. What is Income and Expenditure account ?

1.14 EXERCISES :

1. From the following items find out which are of Capital and Revenue items.
   - i Amount paid on goods purchased Rs.1,000
   - ii Rs. 2,000 paid for whitewash of cinema theatre.
   - iii Rs. 2,500 paid for repairs of second hand lorry purchased.
   - iv New machinery purchase and erection charges paid Rs.5,000.
   - v Repairs on machinery Rs.1,000.
   - vi Spare parts of machinery Rs.1,500.
   - vii Equipment purchased for improving the production capacity Rs.10,000.

2. The following are the expenses paid by the Padmalaya Ltd. for construction of cinema theatre up to 30th June, 1999. Find out whether they are Capital Expenditure or Revenue Expenditure.

		Rs.
i.	Fire Insurance	2,000
ii.	Construction of temporary accommodation to workers at site, which is demolished after completion of construction work	11,000

3. Out of the followings which are Capital and Revenue items.
   - i. Cost of dismantling, removing and re-installing plant Rs.8,000
   - ii. For transporting goods to the new spot Rs.1,600.
   - iii. Sale of old machinery Rs.6,000 which had a book value of Rs.10,000. Installation of new machinery at a cost of Rs.15,000.
   - iv. Installation expenses of new machinery Rs.500.
   - v. Repairs paid Rs.2,500.
   - vi. Construction of new factory building with a cost of Rs.5,00,000. Cost of preparation of p l a n (blue print) Rs.30,000, repairs of old building Rs.20,000.
   - vii. Fire Insurance Premium Rs.2,000.

1.	Purchased second hand furniture	50,000
	Repairs of furniture	5,000
	Wages paid for erection	4,000
2.	Licence fee	25,000
3.	Fine paid for violation of rules	1,000

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

	Rs.	
Cash in hand	1,000	
Cash at Bank	5,000	
Subscription Receive	33,000	
Donations received	2,600	
Investments purchased	10,000	
Rent paid	4,000	
General expenses	2,100	
Postage & Stationery	700	
Sundry expenses		300
Cash balance at close	200	

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

5. Prepare a Receipt and Payment account from the following particulars.

		Rs.
Opening balance of cash in hand		1,800
Rent paid		450
Stationery purchased		540
Subscriptions received		
Previous year	1,800	
Current year	4,050	5,850
Flood relief expenses		684
Repairs		756

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

6. From the following particulars prepare Income and Expenditure account Rs.

Fees collected (Including Rs.24,000 on account of last year)	2,24,000	
Fees for the year outstanding	40,000	
Salary paid (including Rs.2,400 on account of last year)	19,200	
Salary outstanding	3,200	
Entertainment expenses	4,000	
Tournament expenses	8,000	
Meeting expenses	16,000	
Honorarium paid		810
Sale of old furniture	1,890	

Travelling & Conveyance	6,400	
Purchase of books	16,000	
Periodicals		8,000
Rents	9,600	
Postage, Telephone and Telegrams	13,600	
Printing and Stationery	4,000	
Donations received	6,400	

(Ans : Surplus Rs.1,56,800)

7. Following is the Receipt and Payments account of Visakapatnam cultural club for the year ended 31-12-2000.

Dr. Cr.

Receipts	Rs	Payments	Rs
To Donations	25,000	By Salaries	900
To Life membership	2,000	By Cricket	300
To Sports competition fund	5,000	By Tennis	270
To Subscription	1,600	By Inusrance	180
(including Rs.50 for 2001)		By Garden maintenance	85
To Locker rent	50	By Printing	15
To Interest on securities	200	By Telephone	125
To Cricket	150	By Investments	9,000
To Tennis	100	By Balance c/d	1,825
To Billiards	100		
	34,200		34,200

Subscriptions receivable for 2000 Rs.150, outstanding salaries Rs.100. Half of the donations are to be capitalised, accrued interest Rs.300, Prepaid insurance Rs.30.

Prepare Income and Expenditure Account for the year ended 31-12-2000. (Asn : Surplus Rs.13,155)

1.15 SUGGESTED READINGS :

Financial Accountancy	:	Shukla Grewal
Financial Accountancy	:	Jain and Narang
Financial Accountancy	:	R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda

LESSON - 2
NON - PROFIT ORGANISATIONS - II

OBJECTIVES : In the previous lesson you learned what is a Non trading concern and how a receipt and payment account and an Income and Expenditure Account is prepared? After going through this lesson the student can know how the Balance sheet of a Non - Trading concern is prepared ? And what are the items appear in this statement ?.

STRUCTURE OF THE LESSON :

2.1 Introduction

2.2 Some special terms pertaining to Non -Profit Organisations

2.3 Illustrations

2.4 Summary

2.5 Self Assessment Questions

2.6 Exercises

2.7 Suggested Readings

2.1 INTRODUCTION :

Even a non - Trading concern is established with service motive , these concerns also will have some assets as well as liabilities for expenses etc. Hence the Income and Expenditure Account is accompanied by the Balance sheet like in trading concerns a balance sheet is to be prepared even by non - Trading concerns to complete the double entry effect. The Balance sheet covers all those items such as assets, capital fund etc. Capital Fund is similar to capital Account of Trading concerns. Non - Trading concerns do not have formal capital like that of Trading concerns. Hence, excess of income over expenditure and capital receipts or receipts that are capitalised are accumulated under the heading " capital Fund" and shown as liability in the Balance sheet.

2.2 SOME SPECIAL TERMS PERTAINING TO NON - TRADING ORGANISATIONS :

While preparing final accounts of non - profit organisations the following items are often used:

1. **Legacy :** When an amount is received as per the will of some person it is called legacy As it is non - recurring and capital nature, it is to be capitalised. But if the amount is small it can be taken as an in come.

2. **Donation :** Donations are often received by these organisations from both individuals and institutions, Donation is the amount received as a gift. Donations may be broadly classified into two categories; viz : specific donations and general donations.

3. **Specific Donations :** A donation received for a specific purpose, whether big or small is capitalised and is taken to the liabilities side of the balance sheet For example a donation for the construction of a building. This amount should be utilised only for the purpose for which it is received.

4. **General Donations :** A general donation is the amount given by parties without specifically mentioning the purpose for which it should be utilised. This amount can be spent for any purpose.

   However, normally general donations of big amounts are capitalised and small amounts are treated as revenue income.

5. **Endowment Fund :** " Endowment is the money or property given by parties so as to provide a permanent source of income to support the institution, e.g: the corpus fund of a university since the fund provides a permanent means of support, any amount received on account of this

6. is capitalised and shown as a liability, but the interest or dividend received on account of this fund is treated as income.

7. **General fund :** Amounts which are received for no specific purpose and which are capitalised are shown under this head on the liabilities side of Balance sheet. But the income obtained on account of this fund is taken to the credit side of income and expenditure account.

8. **Specific funds :** Amounts received for a specific purpose are capitalised and shown in the Balance sheet on its liablities side e.g; price fund tournment fund, building fund, receipts and incomes on account of these specific funds should be added to the fund account and should not be taken to Income and Expenditure Account. All expenses on account of these funds should be deducted from the particular fund in the Balance sheet only. In case the expenses exceed the fund amount the excess expenses should be charged to the debit side of the income and Expenditure Account.

9. **Subscription :** Amounts agreed to be paid by the members or subscribers regularly at periodical intervals are called subscriptions : They are a regular source of income to the organisation.
Hence subscriptions are shown as income.

10. **Admission or Entrance fees :** This is the amount received from a member at the time of his initial admission or readmission into the organisation. There is a difference of opinion about the treatment of this item in accounts. Some people argue that it should be capitalised since it is not a recurring item as each member pays it only once. However, there are others who contend that though it is paid by each member only once, the club or college receives it regularly and that as such, according to them, it should be treated as income, whatever the arguments are, in the absence of specific instructions to capitalise. entrance or admission fees, it may be treated as revenue income i.e. shown as the credit side of income and expenditure account.

11. **Honourarium :** It is taken payment made to certain people for their services. It is generally treated as revenue expenditure and charged to the Income and Expenditure Account. But if the amount is paid on account of a specific programme conducted in connection with a specific fund the amount should be deducted from the specific fund in the Balance sheet.

12. **Sale of old Assets :** Any receipt from the sale of an old asset such as furniture, is a capital receipt and as such it should not be taken to Income and Expenditure account, It should be deducted from the concerned asset in the Balance sheet. However, any loss on the sale of asset is charged to income and expenditure account. In case of gain on the sale of an asset, if the amount is small, it is taken to the Income and Expenditure Account, but if it is a big amount it is treated as a capital gain and shown in the Balance sheet.

13. **Sale of old news papers etc:** The amount received on account of sale of old news papers or old sports material etc. treated as revenue income.

2.3 ILLUSTRATIONS :

From the following Receipts and payments account of a Hospital for the year ending 31-122007 prepare an Income and Expenditure Account and Balance sheet as at the date.

Receipts and Payments Account for
the year ended 31-12-2007.

Receipts	Amount Rs	Payment	Amount Rs
To Cash in hand	3,565	By Medicine	15,295

To Subscriptions	23,998	By Doctors honourarium	4,500
To Donations	7250	By Salaries	13,750
To Interest on		By petty expenses	230
investments @ 7%	3,500	By Equipment	7,500
To Proceeds from charity	5,225	By Expenses on charity show	375
		Cash in hand	1,888
	43,538		43,538

Additional Information

	1-1-2007	31-12-2007
1. Subscriptions due	120	140
2. Subscriptions received in Advance	32	55
3. Stock of medicines	4405	4870
4. Estimated value of equipment	10,600	15,800
5. Buildings (cost less depreciation)	20,000	19,000

Solution :

Balance sheet as on 1-1-2007

Liabilities	Rs	Assets	Rs
Subscriptions received		Buildings	20,000
in advance	32	Equipment	10,600
Capital fund		Stock of medicines	4,405
(Balancing figure)	88,658	Investments	50,000
		Cash in hand	3565
		Subscriptions due	120
	88,690		88,690

Income and Expenditure Account for the year ended 31st December , 2007.

Dr Cr

Expenditure	Amount Rs	Assets	Amount Rs
To cost of medicines	14,830	By subscription	23,995
To Salaries	13,750	By Donations	7,259
To Doctors honourarium	4,500	By Interest on investments	3,500
To Petty expences	230	By proceeds from	
To Depreciation		charity show	5m225
Equipment 2300			
Buildings 1000	3,300	Less expenses 375	4850
To Excess of Income over expenditure	2985		

	39,595		39595

Dr Balance sheet as on 31-12-2007 Cr

Liabilities	Amount Rs	Assets	Amount Rs
subscription received		Buildings 20,000	
in advance	55	less Depreciation 1,000	19,000
Capital fund 88658	4,500	Equipment 10,600	
Add Excess		Add additions 7,500	
of Income		18,100	
Over expend		Less: Depreciation 2,300	15,800
deture 2,985	91,643	Stock of medicines	4,870
		Investments	50,000
		Cash in hand	1,888
		Subscriptions due	140
	91,698		91,698

Working Notes :

1. Cost of Medicines used

		Rs.
Stock of Medicines 1-1-2007		4,405
Add Purchases during the year	15,295	
	19,700	
Less Stock of Medicines on 31-12-2007	4,870	
	14,830	

2. Subscriptions :

		Rs
Actual amount received		23,998
less Received for 2006	120	
Received in advance	55	
	175	
Add Due at the end of the year	140	
Received in advance in 2006		
	23,995	

3. Depreciation on Equipment

	Rs.
Equipment on 1-1-2007	10,600
Add Additional during the year	7,500
less Equipment on 31-12-2007	18,100
	15,800
	2,300

Illustration II

The following is the statement of assets and liabilities of the city central library as at 30-62006.

Liabilities	Amount Rs	Assets	Amount Rs
Out standing expences	6,500	Cash	32,000
Capital Fund	4,43,500	Furniture	48,500
		Debtors : Subscriptions outstanding 7500 For use of lecture hall 3500	11,000
		Books Account	1,68,500
		Investments	50,000
		Buildings	1,40,000
	4,50,000		4,50,000

The following were the cash transactions for the year ending 30-6-2007

Particulars	Amount Rs	Particulars	Amount Rs
To Balance b/d	32,000	By salaries	24,000
To Entrance Fee	26,000	By Municipal taxes	7,000
To subscriptions	85,000	By Insurance on builder	5,000
To sale of furniture	6,000	By Additions to library	12,500
To sale of old News		By Outstanding creditors	
Papers	600	of last year paid	6,500
		Repairs	2,500

To rent on library hall By Electric installation expenses 45,000

To proceeds from By printing & stationery

4,000 lectures and entertainments

By postage	500
By sundry expenses	1500
Balance c/d	81,500
	1,90,000

It was ascertained that Rs 11,000 was outstanding by way of subscriptions and Rs 3,750 for use of library hall. Insurance on building was prepaid to the extent of 1,750. There were creditors outstanding for expenses to the extent of Rs 8000,

You are required to prepare an Income and Expenditure Account and Balance sheet as at 30-6-2007 after providing for depreciation on building @ 2 1/2% and writing down investments by 5% and library books by 10%.

Solutions:

Dr City Central Library Income & Expenditure for year ending 30-6-2007 Cr

Expenditure	Amount Rs	Income		Amount Rs
To Salaries	24,000	By subscriptions	85,000	
To municipal taxes	1,000	Add Outstand	11,000	
			96,000	
To insurance 5000 less prepaid 1750	3250	less last year	7500	88,500
To repairs	2500	By sale of old Newspaper		600
To sundry expenses	1500	By rent of library hall	10,400	
To printing & stationery	4000	Add Out standing	3,750	
To postage	500		14,150	
To outstanding expenses	8000	less Last year	3500	10,650
To Depreciation	3500	By proceeds from		
Buildings				
Investment	25,00	lectures and entertainment		30,000
Library books	18,700			
To surplus (excess of income over expenditure)	54,100			
	1,29,750			1,29,750

Dr City central Library Balance sheet as on 30-6-2007 Cr

12,500	1,62,900
1,81,100	
18,100	47,500
50,000	
2,500	11,000
	3,750
	1,750
	81,500
	5,32,400

Add Additions

less Depreciation Investments

Amount Assets Amount

Liabilities

(1) Rs. (2) (3) (4)Rs

5,32,400

Capital fund	4,43,500		Buildings	1,40,000	
Add surplus	54,900		less Depreciation	3,500	1,36,500
Entrance fees outstanding express	26,000		Furniture less furniture sold		42,500
				48,500	
				6,000	
		5,24,400			
		8,000			
			Electric Installation		45,000
			Library books	1,68,500	

Less Depreciation

Sundry debtors

For subscriptions

For rent of library hall Prepaid insurance

Cash

Sometimes income and Expenditure and Recipts and payment amounts are given in the question and it is required to prepare the balance sheet both at the beginning and at the end of the period, in such case following procedure may be adopted.

1. From the particulars given in the questions prepare the balance sheet in the beginning of the year.

2. Compare the 'receipts side' of the Receipts and payments amount to income side of income and expenditure about to ascertain
   (i). Subscription in arears, previous and current years
   (ii). income received in advance and
   (iii) sale of an asset during the year
3. Similarly compare the payment side of the Receipts and payment account to expenditure side of the income and expenditure account to ascertain,
   (i) outstanding expenses during the year.
   (ii) prepaid expenses during the year.
   (iii) stock of stationery in hand
   (iv) depreciation on assets and
   (v)purchase of an asset during the year.

Illustration 5 :

From the following information relating to Hyderabad sports club prepare the balance sheet as on 1-1-2007 and 31-12-2007. Assets and liabilities as on 1-1-2007 club grounds and pavilion Rs,250,000 sports equipment's Rs, 1,50,000, Furniture Rs 3,51,000 and subscription in assets on that date Rs 5000. Creditors For stationery Rs 5,000.

Receipts and payment for the year
Ending on 31-12-2007

Receipts	Amount Rs	Payment	Amount Rs
To Balance b/d	25,000	By printing and stationery	15,000
To Subscription			
2006	4,500	By Salaries	55,000
2007	90,000	By Advertising	10,000
2008	2,500	By Fire insurance	7,500
To Sale of old news papers	1,500	By Furniture	10,000
To Rent received	11,000	By Investment	90,000
To Entrance fees	60,000	By Balance c/d	7,000
	1,94,500		1,94,500

Dr Income and expenditure Account for the year ending on 31-12-2007 Cr

Expenditure	Amount Rs	Income	Amount Rs
To Salaries	60,000	By subscriptions	95,000
To Printing and stationery	14,000	By entrance fees	60,000
To Audit fees	2500	By rent received	12,000
To Advertising	10,000	By sale of old news paper	1,500
To fire insurance	6,000		

Dr	Rs		Rs
Creditors for stationery	4000	Cash	7000
Salary outstanding	5000	Ground and pavilion	2,50,000
Audit fees out standing	2500	Sports equipment	1,20,000
		(1,50,000 - 30,000)	1,20,000
Subscriptions in advance	2500	Furniture (35,000 + 10,000 - 4000)	41,000
Capital Fund 4,60,000 <u>Add</u> surplus 42,000	5,02,000	Investments	90,000
		Subscription outstanding 2006 500 207 5000	5,500
		Insurance prepaid (7500 - 6000)	1,500
		Rent Due (12000 - 11,000)	1000

To Depreciation on sports equipment	30,000		
To Furniture	4,000		
To excess of income over Expenditure	42,000		
	1,68,500		1,68,500

Solution :

Dr Balance sheet As on 1-1-2007 Cr

Liabilities	Amount Rs	Asserts	Amount Rs
Creditors for stationery	5000	Cash	25,000
Capital Fund	4,60,000	Ground and pavilion	2,50,000
		Sports equipment	1,50,000
		Furniture	35,000
		Subscription outstanding	3,000
	4,65,000		4,65,000
	5,16,000		5,16,000

Some times Income and expenditure account is given along with notes and it is required to prepare the receipts and payments account. In such a case the following producer may be adopted.

1. All expenditure, whether capital or revenue or relating to the current succeeding and preceding period incurred during the year must be shown on the credit side of this account.
2. All receipt of cash, whether capital. Revenue or relating to the current, sending and preceding period, should go to debit side of this account.

3. Opening and closing balance of receipts and payment account are to be taken into consideration.
4. Eliminate all adjustments relating to provisions for doubtful debts or depreciation which are made for preparing income and expenditure account.
5. Purchase or sale of assets can be calculated by comparing the net value of asset on two dates beginning and the end of the year.

Illustration 6 :

The following is the Income and expenditure account of Guntur stadium club for the year ended 31st March 2007.

Dr Income and Expenditure Account Cr

For the year ended 31-3-2007

Expenditure	Amount Rs	Income	Amount Rs
To salaries	7,800	By subscription	27,200
To Rent	1,800	By Donation	2000
To Printing	300		
To Insurance	200		
To Audit fees	300		
To Games & sports	1,400		
To Subscription written off	140		
To Miscellaneous expences	5,800		
To loss on sales of furniture	1,000		
To Depreciation on sports Equipment	24,00		
To furniture	1,240		
To excess of income over expenditure	6,820		
	29,200		29,200

Additional information :

	31-3-2006	31-3-2007
Subscription in areas	1040	1,480
Advance subscription	400	600
<u>Outstanding expences</u>		
Rent	200	320
Salaries	480	140
Audit fees	200	300
Sports equipment loss depreciation	10,000	9,600
Furniture less depreciation	12,000	11,160
Prepaid Insurance	-----	60

Book value of furniture sold is Rs 2,800

Entrance fees capitalised Rs 1600. On 1st April 2007 there was no cash in hand but there is bank overdraft for Rs. 6,000 on 31st march 2007, cash in hand amounted to Rs 340 and the remaining was Bank balance.

Prepare the receipts and payment amount of the club for the year ended 31st march 2007.

Solution:

Dr Guntur stadium club receipt and Cr

payments Account for the year ended 31-3-2007

Receipts	Amount Rs	Income	Amount Rs
To subscription Received		By Balance b/d	6000
(27,200 + 1040)+ 600) - (1480 - 400)	26,820	By sports equipment s	2000
-140)	2000	(9600 + 2400 – 10,000)	
To Donations received	1,600	By Furniture purchased	32,00
To Entrance Fees	1,800	(11,160 + 2800 + 1240	
To sale of furniture		- 12,000)	
(2800 - 1000)		By salaries	8140
		(7800 + 480 – 140)	
		By Rent	
		(1800 + 200 – 320)	1680
		By printing	300
		By Insurances (200 + 60)	260
		By Games & Sports	1,400
		By Misc, expences	5,800
		By closing balance	
		Cash in hand 340	
		Cash in hand 2900	3,240
	32,220		32,220

Illustration – 7 :

Secunderabad club had the following assets and liabilities as on 1-1-2007. cash in hand Rs 12,000, subscription receivable Rs 12,00. Furniture Rs 6000, Sports material Rs 3600. Investments Rs 15,000, buildings Rs 30,000 outstanding for supplies Rs 1,800 and capital fund Rs 66,000 During the year 2007 the club did the following business.

Subscriptions received (including the arrears) Rs 18,000 subscriptions due Rs 18,00 paid to the outstanding creditors for supplies, subscriptions to News papers Rs 3000, Sports material purchased Rs 6,000, sale of old newspapers Rs 300, meeting expenses Rs 2,700; lighting charges Rs 2,400 salaries of establishments RS 6,000 stocks of sports material at the end Rs 3,000 interest received on investment

RS 450 (outstanding Rs 150) Borrowing Rs 12,000, donations received Rs 10,800 (hay to be capitalised) provide depreciation at 5% on furniture and buildings

Prepare a Receipts and payment amount an Income and expenditure amount for the year 31st Dec 2007, and a Balance sheet as on that date.

Secundrabad club Receipts and payment Account for the
year ended 31-12-2007

Dr Cr

Receipts	Amount Rs	Payments	Amount Rs
To Balance b/d	12,000	By outstanding creditors	1800
To Subscriptions	18,000	for supplies	
To Sale of old news paper	300	By subscription to news papers	3,000
To Interest on investments	450	By purchase of sports materials	
To Borrowings	12,000	By meeting expenses	6,000
To Donations	10,800	By lighting charges	2,700
		By salaries of establishment	6,000
		By purchase of furniture	2,400
		By Annual function expenses	2,250
		By Balance c/d`	27,000
	53,550		53,550

Income and expenditure Account for the year 31-12-2007

Dr Cr

24,900

Buildings	1500	1,800
To Surplus		150
		24,900

Dr Balance sheet as on 31-12-2007 Cr

Expenditure	Amount Rs	Income	Amount Rs
To subscription to		By subscription	
News papers	3000	(18000 + 1800 – 1200)	18,600
To sports materials used (6000 + 3,600 – 3,000)	6,600	By sale of old News papers	300
To Meeting expenses	2,700	By interest on investments	600
To lighting charges	2,400	By Donations	5,400
To salaries of establishment	6,000		
To functions expenses	2,250		
To annual function expenses			
To Depreciation on			
Furniture 300			

Liabilities	Amount Rs	Assets	Amount Rs
Borrowing	12,000	Cash in hand	27,000
Capital fund 66,000		Subscriptions due	18,00
Add surplus 150		Furniture	8,100
Donations 5,400	71,550	(6000 + 2400 – 300)	
		Stock of sports material	3000
		Investment	15,000
		Accured Interest	150
		Buildings (30,000 - 1,5000)	28,500
	83,550		83,550

2.4 SUMMARY :

Non trading concerns Income and Expenditure account is accompanied by the Balance sheet like in case of Trading concerns. Capital Fund appear in the Balance sheet of Non-Trading concerns is similar to capital Account of Trading concerns, Non - trading concerns do not have formal capital like that of Trading concerns. The Exceed of income over expenditure and capital receipts or receipts that are capitalised are accumulated under the heading “Capital fund” and shown as liability in the Balance sheet. While preparing Final accounts of Non - Trading organisations special items like legacies

Donations Endowment fund, general fund , special fund Entrance fees, Honorarium etc should be given importance.

2.5 SELF ASSESSMENT QUESTIONS :

1. Explain the meaning of the following terms
   a. Legacies
   b. Donation for specific purpose
   c. Life member ship fees
   d. Entrance fees
   e. Endowment fees.
   f. Receipts for tournament fund.
2. How will you prepare the Balance sheet both at the beginning and at the end of the accounting period from a given Receipts and payments Account and an income and Expenditure Account.
3. What special items are considered while preparing accounts of Non-trading Concerns?
4. What is legacy ?
5. How will you treat the following items while preparing final accounts of non-trading concerns ?
   a) Specific donations
   b) Entrance fees
6. How do you convert Income and Expenditure account into Receipts and Payments account?

2.6 EXCERCISES :

1. From the following Trial Balance prepare an Income and Expenditure Account of the Mumbai club for the year ended 31-12-2007 and a Balance sheet as on that date.

Depreciate furniture by 10% billards tabels and accessories by 20% China glass cuttlery etc. by 33 1/3. of the subscriptions Rs 2,400 is paid in advance and Rs 1500 is in arrears Rs 1,800 is owing for salaries to staff.

	Debit Rs		Credit Rs
Furniture	15,000	Members subscription	63,360
Billiards table (brought in 2005)	7500	Sundry receipts from	
Chinaglass cuttlery	1998	Billiards etc	10,458
Repairs	4404	Sale of Tickets for	
Salaries and wages	13,572	entertainment	19,404
Rent and Telephone	19,164	Sundry creditors	15,600
Fuel and light	9,708	Entrance fees	2,688
Cost of entertainment	13,140	capital fund	24,000
Sundry expences	9,600		

Cost of annual dinner	4,560		
Sundry debtors	7020		
Cash at bank	28,800		
Cash in hand	1,044		
	1,35,510		135,510

2. From the following receipts and payments account for the year ending 31-12-2007 prepare an income and Expenditure account for the period ending 31-12-2007 and a Balance sheet as on that date.

Receipts	Rs	Payments	Rs
To Donations	35,000	By salaries	37,500
To subscriptions	1,15,000	By Help to poor	37,000
To life membership fees	50,000	By Expenses on free	
To Legacy	75,000	dispensary	34,500
To Interest received	4000	By postage & stationery	3,500
		By Furniture	50,000
		By Investments	75,000
		By Cash in hand	41,500
	2,79,000		2,79,000

Additional Information :

1. Subscriptions outstanding for the current year Rs 5,000.
2. Salaries unpaid Rs 5,000
3. Help to poor students promised but unpaid Rs 16,000
4. Expenses of dispensary outstanding Rs 3,000
5. Postage and stationery expenses yet to be paid Rs 4,000

3. Prepare Income and Expenditure account and Balance sheet for 2007 from the Balance sheet and Receipts and payments account.

Balance sheet As on 31-12-2007

Liabilites	Amount Rs	Assets	Amount Rs
Capital Fund	13,448	Building	12,000
Subscriptions received		Outstanding subscriptions	152
in advance	240	Outstanding lockers rent	96
Out standing expenses	560	Cash	4000
loan	2,000		
	16,248		16,248

Receipts and Payment Account for the year ended 31-12-2007

	Rs			Rs
To Balance 1-12007	4,000	By Expenses	2006	480
			2007	800
To Subscriptions : 2006	80	By Land		1,600
2007	840	By Interest		160
2008	40	By Mic. expenses		800
To Entrance fees	320			
To Lockers rent	280	To Balance c/d		3,320
Misc. Income	1600			
	7,160			7,160

Guntur sports club started on 1-1-2007, Their Receipts and payment A/c for the year 2007 is given below. Receipts	Rs	Payment	Rs
To Donations	50,000	By Buildings	40,000
To Entrance fees	4000	By Tournment expenses	900
To Tournament Fund	10,000	By Furniture	2,100
Revenue receipts		By Revenue Payments	

To Subscriptions By salaries	18,000
(including Rs.100 for 2008)By cricket expenses	1140
	360
	600
To rent By Insurance	18,000
To other receipts By gardener	3,500
	68,400
To Cricket fees By Investments	
By Balance c/d	

To Subscriptions By salaries	3,200		18,000
(including Rs.100 for		2008)By cricket expenses	1140
To rent By Insurance	100		360
To other receipts By gardener	700		600
To Cricket fees By	400	Investments	18,000
		By Balance c/d	3,500
	68,400		68,400

Additional Information :

1. Subscriptions receivable for the year 2007 Rs 300/-
2. Salaries un paid Rs 170/-
3. Entrance fees are to be capitalised
4. Insurance include 9 months premium for 2008.

4. From the following particulars prepare Income and Expenditure account Rs.

Fees collected (Including Rs.24,000 on account of last year)	2,24,000	
Fees for the year outstanding	40,000	
Salary paid (including Rs.2,400 on account of last year)	19,200	
Salary outstanding	3,200	
Entertainment expenses	4,000	
Tournament expenses	8,000	
Meeting expenses	16,000	
Travelling & Conveyance	6,400	
Purchase of books	16,000	
Periodicals		8,000
Rents	9,600	
Postage, Telephone and Telegrams	13,600	
Printing and Stationery	4,000	
Donations received	6,400	

(Ans : Surplus Rs.1,56,800)

5. Following is the Receipt and Payments account of Visakapatnam cultural club for the year ended 31-12-2000.

Dr. Cr.

Receipts	Rs	Payments	Rs
To Donations	25,000	By Salaries	900
To Life membership	2,000	By Cricket	300

To Sports competition fund By	5,000	Tennis	270
To Subscription By Inusrance	1,600		180
(including Rs.50 for 2001)By		Garden maintenance	85
To Locker rent By Printing	50		15
To Interest on securities By	200	Telephone	125
To Cricket By Investments	150		9,000
To Tennis By Balance c/d	100		1,825
To Billiards	100		
	34,200		34,200

Subscriptions receivable for 2000 Rs.150, outstanding salaries Rs.100. Half of the donations are to be capitalised, accrued interest Rs.300, Prepaid insurance Rs.30.

Prepare Income and Expenditure Account for the year ended 31-12-2000. (Ans : Surplus Rs.13,155)

6. The Receipts & Payments account of the Hyderabad Friends Club for the period ending 31st December, 2000 is given below.

Receipts	Rs	Payments	Rs
To Donates received	25,000	By Buildings	20,000
To Reserve fund (Being		By Furniture	1,050
life numbers fees received)	2,000	By Tournament Expenses	
quadrangular match fund	5,000	quadrangular matches	450
Revenue Receipts		Revenue payments	
To subscriptions (including		By salaries	900
Rs. 50 for 2001)	1,600	By Cricket	300
To Lockers rent	50	By Tennis	270
To interest on securities	50	By Insurance (Paid up	
To cricket	200	30th September 2001)	180
To sundries	25	By Gardening	85
To Tennis	175	By Printing	15
To Billiards	100	By Telephone	125
		By sundries	75
		By Investments (at cost)	9,000
		By Balance c/d	1,750
	34,200		34,200

Subscription fees outstanding for the year 2000 was Rs. 150. Salaries up paid for 2000 Rs, 85, From the particulars given above prepare an Income and Expenditure account of the club for the year ended 31st December, 2000 and the Balance Sheet as on that date.

(Ans : Excess of income Over Expenditure, Rs. 400, Balance Sheet Total Rs. 32,085)

7. Tarakarama Sports Club's Receipts and Payments amount for the year ending 31st Dec.,20000 is given here under.

Receipts	Rs	Payments	Rs
To Cash in hand	250	By Salary workmen	2,000
To Cash at Bank	2,250	By Grass cutting machine	1,000
To subscriptions	6,750	By Rent	450
To tournament fund	2,500	By Games expenditure	3,500
To Life members fees	1,500	By Tournament expenditure	1,000
To Entrance fees	250	By office expenditure & Postage	2,250
To Donation Pavilion	4,000	By Games equipment	1,500
To sale of glass	200	By Balance c/d	
		Cash in hand	750
		Cash at Bank	5,250
	17,700		17,700

Additional information.

1. Subscriptions receivable for 1999 Rs. 1,000 and for 2,000 Rs. 1,050
2. Games equipment in the beginning was Rs. 250 for 2001.
3. Provide depreciation at 10% on Gras cutting machine.

Prepare Income and Expenditure account for the year ending 31st Dec., 2000 and opening and closing Balance sheet.

(Ans : Excess of Expenditure Over Income Rs.2,550 Capital fund Rs. 4,500 Balance sheet Total Rs. 9,200)

8. Prepare the final a/c of Hyderabad Club from the particulars given below for the year ending31-12-2000.

Receipts	Rs	Payments	Rs
To Balance b/d	1,200	By Salaries	6,500
To Subscriptions		By Rent	1,200
(including 400 for 2001)	6,400	By Printing & Stationery	180
To Interest on investment		By postage	50
(Investment cost Rs.40,000)	2,500	By Cycle purchase	800
To Bank interest	50	By Govt. Bands	1,000
To Sale furniture	500	By Balance c/d.	920
	10,650		10,650

Adjustments

Subscriptions received included Rs.200/-of 1999

Rent paid included Rs.100/- for Dec.,1999.

Subscriptions due for 2000 Rs. 300/-

Salaries payable Rs. 600/-

Cost of Furniture sold was Rs.640/-

(Ans : Excess of Income over Expenditure Rs. 80 Capital Fund Rs. 14,940 Balance Sheet Total Rs. 43,020)

9. From the following Receipts and Payments account and other information of City Club,prepare Income and Expenditure account as on 31-12-2000 and Balance Sheet as on that date.

Adjustments :

1. Subscriptions received include Rs. 1,200 - for the year 1999 and Rs.2,400/- for the year2001.
2. Subscriptions due for the year 2000 - Rs.1,800/-
3. Printing charges payable for 2000 - Rs.240/-
4. Salaries payable for 2000 - Rs. 3,600/-

Receipts & Payment Account on 31-12-2000

Receipts	Rs	Payments	Rs
1.1.2000		By Salaries	39,000
To Balance of		By Rent	7,200
Cash 1800		By printing and stationary	1,080
Bank 5400		By postage	300
	7,200	By Purchase of a cycle	1,800
31-12-2000		By Purchase of Govt. Bonds	9,000
To Subscriptions	38,400	31-12-2000	
To interest on investments	15,000	By Balance C/D	
To Bank interest	300	Cash 180	
To sale of furniture	3,000	Bank 5,340	
(Cost of furniture			5,520
on 1-1-2000 Rs. 3,840)	63,900		63,900

(Ans: Excess of Expenditure over Income - Rs. 360, Capital Fund - Rs 12,240 Balance Sheet Total - Rs. 18,120)

10. From the under mentioned Receipts and Payment account for the year ending 31-12-2000 of French Recreation Club, prepare Income and Expenditure account and Balance Sheet as on that date.

Receipts and Payments Account (For the year ended 31-12-2000)

Receipts	Rs	Payments	Rs
To Balance b/d (Bank)	25,000	By purchase of furniture (1-4-200	5,000
To subscriptions		By salaries	2,000
1999 1,500		By Telephone expenses	300
2000 10,000		By Electricity charges	600

2001 500	12,000	By postage and stationery	150
To Donations	2,000	By Purchase of books	2,500
To Rent	300	By Entertainment expenses	900
To Interest on bank deposits	450	By Purchase of Govt. Bonds 5%	
To Entrance fee	1,000	(1-7-2000)	8,000
		By Miscellaneous expenses	600
		By Balance c/d :	
		Cash 300	
		Bank 20,400	20,700
	40,750		40,750

The following additional information is available :

1. Salaries outstanding Rs, 1,500.
2. Entertainment expenses outstanding Rs 500
3. Bank interest receivable Rs. 150
4. Subscriptions accrued Rs. 400
5. 50% of entrance fee is to be capitalised.
6. Furniture is to be depreciated at 10% (per annum).

(Ans : Excess of Income over Expenditure - Rs. 7,075 Capital Fund Rs. 26,500, Balance sheet Total Rs. 36,575)

11. The following is the Receipts and payments statement of the Secunderabad sports Club for the year ended 31st December, 2000

Receipts	Rs	Payments	Rs
To Balance 1-1-2000	2,400	By Secretary's salary	3,600
To Entrance fees	500	By Up-keeps of grounds (c)	2,100
To subscriptions (a)	8,700	By Wages of grounding (d)	2,400
To proceeds of		By found rent	150
Concerns	1,500	By Sundry repairs	175
To Interest on (b)		By Printing and postage	200
Investment	500	By Balance 31-12-2000	4,945
	13,600		13,600

a) This item included subscriptions outstanding brought over from previous year, Rs. 300

b) This item includes Rs. 150 in respect of interest accrued in the preceding period.

c) This item includes Rs. 400 applicable to the previous year.

d) This item includes Rs. 200 applicable to the previous year.

Other ledger balance at the commencement of the financial period were :

Capital fund Rs. 40,100 Income and Expenditure account Credit Balance brought forward Rs. 8,900, Club premises and Grounds (as per valuation) Rs. 31,000, Investments Rs. 10,000, Sports material Rs. 2,450, Furniture and Fixtures Rs. 4,000, Books - Rs. 300.

From the above particulars, prepare a Balance sheet at the commencement of the period, and income end Expenditure account for the period, and a Balance Sheet as the close of the period.

Entrance fees are to be capitalised. The outstanding labilities on 31st December, 2000 were wages Rs. 200 and Printing Rs. 100. Interest occurred and outstanding on investments was Rs 120. Depreciate Club premises by 2 per cent, Furniture by 5 per cent and sports Equipment by 331/ 3 percent.

(Ans : Excess of Income over Expenditure Rs. 428. Balance sheet total Rs. 50,228)

12. The receipts and payments account of the Hyderabad Athlete, Society, for the year ending 31st December, 2000 is given below. In the Society's ledger, the following balance are found on the date.

	Rs.
Capital account (Donations etc.)	30,000
Club House and grounds	18,000
Investments at cost	8,000
Furniture & fittings	4,500
Income & expenditure (Cr.)	2,500

Receipts and payment Account for the year ended 31st December, 2000

Receipts	Rs	Payments	Rs

To Balance 1-1-2000 2,085 By Upkeep of grounds 3,300 To subscriptions 7,200 By Secretary's salary (c) 2,400 To Entrance fees 320 By Wages of groundman (d) 2,800

To proceeds of By ground rent 150 Lectures 3,500 By Sundry repairs 140 To Interest on By Printing and postage 80

Investment	360	By Balance 31-12-2000	5,595
	13,465		13,465

a) This item includes Rs 400, in respect of subscriptions brought over from previous year.

b) This item included Rs. 90, by way of interest occurred in the previous year.

c) This included Rs.400 applicable to the previous ear.

d) This item included Rs. 175, which relates to the previous year.

Other adjustments are :

1) Entrance fees are to be capitalised.

2) Charge 10% depreciation on furniture and 2 percent of club house and grounds.

From these particulars, prepare the final accounts of the Society for the yea 2000.

(Ans Excess of Income over Expenditure Rs. 2,465, Balance Sheet Total Rs. 35,285.) 13. The following particulars related to Cucullate club. Income and Expenditure Account

(For the year ended 31-12-2000)

Receipts	Rs	Payments	Rs
To Salaries	4,800	By Entrance fees	36,000
To subscriptions	6,300	By Subscriptions	42,300
To Advertising	5,400	By Rent	12,000
To Audit fees	900		

To Fire insurance	3,000		
To Depreciation	24,000		
To Excess of Income over Expenditure	45,900		
	90,300		90,300

Receipts and Payment Account
(For the year ended 31-12-2000)

Receipts	Rs	Payments	Rs
To Balance b/d	12,600	By Salaries	3,600
To Entrance fees	36,000	By Printing & Stationery	7,500
To Subscriptions		By Advertising	5,400
1999	1,800	By Fire Insurance	3,600
2000	40,500	By Investments	60,000
2001	1,200	By Balance c/d	22,500
To Rent received	10,500		
	1,02,600		1,02,600

The assets on 1-12000 included land and buildings Rs. 1,50,000, sports equipment Rs. 75,000, Furniture Rs. 12,000, Subscriptions in arrears on that date were Rs. 2,400, Subscriptions in arrears on 31-12-2000 amounted to Rs. 1,800.

Prepare Balance sheet as at 31-12-2000.

(Ans Capital fund the being Rs.2,52,000 B/s total Rs. 3,01,200)

14. From the following information given the books of a sports club, prepare the Balance sheet as on 31-12-2000.

Receipts and Payment Account for the year ended 31-12-2000.

Receipts	Rs	Payments	Rs
To Balance b/d	16,800	By Salaries	32,600
To Entrance fees	8,000	By Printing & Stationery	80,000
To Subscriptions		By Advertising	2,000
1999	2,400		7,200
2000	40,500	By printing & Stationery	60,000
2001	1,200	(including Rs.1,200 of the previous year)	22,500
		By Insurance Premium	4,800
		By Balance c/d	10,800
To Interest received	8,000		
	1,36,800		1,36,800

Income and Expenditure Account for the year ended 31-12-2000.

Receipts	Rs	Payments	Rs
To Salaries	33,600	By Subscriptions	1,02,000
To Advertising	2,000	By Entrance fees	8,000
To Printing & Stationery	6,000	By Interest received	8,000
To Audit fees	4,000		
To Insurance premium	4,000		
To Depreciation	24,000		
on sports - equipment	30,000		
Furniture	1,600		
To Excess of over Expenditure	45,900		
	1,18,000		1,18,000

Assets of the club on 1-1-2000 including Sports equipment Rs. 1,00,000, Ground and pavilion Rs. 1,60,000 and Furniture Rs. 16,000. Subscription in arrears on that date was Rs, 3,200 and subscription received in advance was Rs. 1,000.

(Ans : B/s Total Rs 3,37,800; Opening capital fund Rs 2,93,800) 15.

Andhra Cricket club gives you the following information.

Income and Expenditure Account for
the year ended 31-12-2000.

Expenses	Amount Rs	Income	Amount Rs
To Remuneration	9,000	By Donation and	
To Salaries and wages	12,000	Subscription	51,000
To Rent	6,000	By Barroom receipts 12,000	

To Repairs5,500Less expenses Miscellaneous expenses3,500By secretary9,000By Hire of club To Depreciation on equipment2,500 To Surplus12,500	Bank	10,000 2,000 To Interest1,000 To Honorium to hall6,000	
		60,00060,000	

Balance Sheet as on 31-12-2000.

1999 Rs	Labilities	2000 Rs.	1999 Rs.	Assets	2000 Rs.
	Capital Fund as		12,500	Equipment	10,000

	On 31-12-99 24,000			Outstanding	
	Entrench fee 5,000		3,000	Subscription	4,000
24,000	Surplus 12,500	41,500	2,500	Cash in hand	2,000
	Subscription in		1,250	Cash at bank	5,000
2,000	advance	15,00	10,000	Fixed deposits	25,000
	Outstanding expenses				
750	Miscellaneous	500			
1,000	Salaries and wages	1,500			
	Honorarium to				
1,500	Secretary	1,000			
29,250		46,000	29,250		46,000

Prepare the Receipts and payments Account of the club for the year ended 31-12-2000.

(Donations subscriptions received Rs, 49,500, Salaries and wages paid Rs. 11,500, Misc. expenses paid Rs. 3,750, Honorarium to secretary paid on 9,500).

2.7 SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal
Financial Accountancy : Jain and Narang
Financial Accountancy : R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda

LESSON - 3

SINGLE ENTRY SYSTEM - I

OBJECTIVES : After going through this lesson the student can know a different system of accounting, (other than double entry) which is usually adopted by small proprietors, traders and professional people, famously known as single entry system of accounting.

STRUCTURE OF THE LESSON :

3.1 INTRODUCTION :

Single Entry system is the method of maintaining accounts which does not exactly follow the principles of double entry system. Under this method the principles of the double entry system are not being followed for all transactions, that means both the aspects of certain transactions are recorded while only one aspect is recorded for certain transactions. Under this methods usually the personal accounts of the debtors and creditors are kept and real and nominal accounts may not be maintained in the books. Small traders general merchants, medical practitioners, lawyers and other professional people usually adopt this system joint stock companies cannot adopt this system because they are required to maintain complete records of all transactions under the companies Act 1956.

3.2 DEFINITION :

Kohler defines it as “A system of book - keeping in which as a rule only records of cash and of personal accounts are maintained, it is a always incomplete double entry varying with circumstances”.

Thus single entry is not any practical system of accounting but rather the double entry system in an incomplete and disjoined form.

There are two types of single entry.

1. Pure single Entry : Under this system only the personal accounts of the debtors and creditors are kept, all real and nominal accounts are not maintained.
2. Single Entry in the popular sense: This method of single entry along with personal accounts of Debtors and creditors, real accounts like cash and bank accounts are maintained.

3.3 FEATURES :

Single entry system has the following features :

1. Books according to this system can be kept only by a sole trader or by a partnership firm. Joint stock companies cannot keep books on single entry system.
2. In this system it is very common to keep only personal accounts and to avoid real and nominal account.
3. It is vert common in this system to keep one cash book which mixes up business as well as private transactions.
4. Under this system for any information one has to depend on original vouchers, For example in the case of credit sales, the proprietor may keep the invoice without recording it any where and at the end of the year the total of the invoices gives an idea of total credit sales of the business.
5. This system lacks uniformity as it is a mere adjustment of double entry system according to the convenience of the person.
6. It is difficult to prepare trading, profit and loss account and balance sheet due to the absence of nominal and real accounts in the ledger.

3.4 DIFFERENCE BETWEEN SINGLE ENTRY AND DOUBLE ENTRY :

The following are the main differences between these two systems

Single Entry	Double Entry
1. It is an incomplete record of final transactions	1. It is a complete record of the financial transactions
2. Under this system only personal accounts are maintained.	2. All accounts personal as well as in personal are maintained in the double entry method.
3. Books maintained by the single entry system are not reliable because a complete record of transactions is not maintained.	3. As the books are maintained systematically, they are reliable.
4. Due to lack of complete record of transactions trial Balance can not be prepared to check arithmetical accuracy.	4. Trial Balance can be prepared under this system.
5. In the absence of nominal accounts a Trading and profit and loss Account can not be prepared to ascertain profit.	5. Profit and loss account can be prepared because a complete record of all transactions is available in the books.
6. As The information regarding Assets is not available, we cannot prepare the Balance sheet.	6. Under this system a complete record of real accounts is available so we can prepare the Balance sheet.

3.5 DEFECTS OF SINGLE ENTRY :

Single entry system is an incomplete system of accounts. Hence it suffers from the following defects or limitations.

1. This system is an unscientific method of accounting.
2. It does not record both the aspects of a transactions therefore at the end of the year arithmetical accuracy of the books cannot be checked by preparing a trial balance.
3. In the absence of check the possibility of fraud or misappropriation is grater in case of single entry than in the case of double entry system.
4. In the absence of nominal accounts, trading and profit and loss account can be prepared to ascertain profit or loss.
5. 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.
6. No correct price of the business is available and thus it is a set back at the time of sale of the business.
7. Information obtained from the records cannot be relied upon because of lack of test and free from doubt.
8. It is difficult to get loans from banks and other financial institutions as proper and reliable balance sheet is absent.
9. Financial strength or soundness of the firm cannot be judged because true and reliable figure of net profit or asset and liabilities is not available.
10. It is very difficult to ascertain the value of goodwill of the business.
11. The proprietor cannot know the progress made by the business over past year as the figures of sales and net profit and rate of net profit on sales cannot be known.

Inspite of the above defects the single entry method of maintaining accounts is quite popular with small firms which cannot afford to spend money on maintenance of accounts under double entry.

3.6 METHODS OF ASCERTAINING PROFITS :

In the absence of real accounts in the books maintained on the single entry it is not possible to prepare the Balance sheet of the business. Similarly in the absence of nominal accounts profits cannot be calculated by preparing trading and profit and loss account. Therefore to find the profit of a period and to judge the financial position of the business we can adopt any of the two methods.

a. Statement of Affairs or net worth Method.
b. Conversion Method. The working of both the methods has been discussed one after the other.

3.7 PREPARATION OF STATEMENT OF AFFAIRS :

The following points should be considered while preparing statement of Affairs.

1. The cash book should be balanced. Cash in hand should be verified with the balance as shown by the cash book.
2. The bank balance as per cash book should be reconciled with the pass book balance.
3. The list of debtors and creditors should be prepared from the personal accounts maintained in the ledger.
4. Stock in trade should be taken and valued at cost or market price whichever is lower
5. The values of fixed assets should be ascertained from the information as may be available.

6. Depreciation if any on fixed assets should be provided.
7. All out standing expenses and incomes should be considered and shown in statement of Affairs.
8. Expenses paid in advance and incomes received in advance should also be provided and shown in the statement of Affairs.
9. The excess of assets over liabilities will represent the capital on that date.

3.8 DIFFERENCE BETWEEN STATEMENT OF AFFAIRS AND BALANCE SHEET:

The purpose of preparation of both the statements is to show the financial position of the business on a particular date but there are certain differences between these two, those can be explained as follows.

Statement of Affairs	Balance sheet
1. The Financial position disclosed by the Statement of Affairs is not reliable.	1. Financial position disclosed by the Balance Sheet is reliable.
2. It is prepared with the information Available in the incomplete books.	2. It is prepared with balances extracted from Books maintained on the double entry system.
3. It helps in ascertainment of trading profit Or loss for a particular period, as well as The financial position on a particular Date.	3. The primary purpose of a Balance sheet is to show the financial position of the business on a particular date.
4. Due to incomplete record there is a Possibility of omission of some facts.	4. No fact is omitted or committed because Complete record for the transactions Takes .

3.9 STATEMENT AFFAIRS OR NET WORTH METHOD :

Statement of Affairs method is one of the methods of ascertaining profits under the single Entry system. Trading and profit and loss account cannot be prepared from books maintained on single entry basis because nominal accounts are not maintained in the ledger. Hence we prepare a statement of affairs for the purpose of calculation of profits. The following procedure is followed:

1. First of all, a statement of affairs at the beginning of the year is prepared to determine the amount of capital at the beginning of the year.
2. Similarly, a statement of Affairs at the close of the year is prepared to determine the amount of capital at the end of the year.
3. Drawings are added to the capital at the end because drawings made during the year can reduce capital at the end.
4. Similarly capital introduced during the year should be deducted from the capital at the end for the reason that the capital at the end would have been less by that amount if such addition to the capital is not made during the year.
5. Capital at the beginning of the year as ascertained in step one should be deducted from the adjusted capital ascertained in step four and the difference will be either a trading profit

or ;loss. If the adjusted capital at the end exceeds will be profit for the year. If the adjusted capital at the end of the year is less than the capital at the beginning of the year, the difference will be loss for the year.

6. Interest on capital and interest on drawings is adjusted to profit or loss to arrive at the net profit or loss for the year.

This can be betterly understood with the following illustration.

Illustration I

Arun keeps his books on the single entry system and the following information is available.

	1st Jan 2007	31st Dec 2007
	Rs.	Rs.
Furniture	4,000	4,000
Stock	56,000	61,000
Sundry Debtors	42,000	68,000
Cash	3,000	4,000
Sundry creditors	35,000	38,000
Bills payable	------	6,000
loan	------	10,000
Investments	------	20,000

He has drawn out of the business Rs 10,000 during the year.

Prepare a statement showing his profit for the year ended 31st December 2007 after writing off 10% depreciation on furniture and making a provision for bad debts of 10% on sundry debtors.

Solution:

Statement of Affairs of Mr. Arun as on 1-1-2007

Liabilities	Amount Rs	Assets	Amount Rs
Sundry creditors	35,000	Cash	3,000
Capital Account	70,000	Sundry debtors	42,000
(Balancing figure)		Stock	56,000
		Furniture	4,000
	1,05,000		1,05,000

Statement of Affairs of Mr. Arun as on 1-1-2007

Liabilities	Amount Rs	Assets		Amount Rs
Bills payable	6000	Cash		4,000
Sundry creditors	38,000	Investments		20,000
Loan	10,000	Sundry Debtors	68,000	

Capital Account (Balancing figure)	95,800	Less Provision for bad debts	6,800	61,200
		Stock		61,000
		Furniture	4,000	
		Less Depreciation	400	3,600
	1,49,800			1,49,800

Statement of profit of Mr. Arun for the year ended 31st December 2007 Rs.

Capital at the end of the year		95,800
Add : Drawings during the year		10,000
	1,05,800	
less : Capital at the beginning of the year		70,000
Profit for the year.		35,800

Illustration 2 :

Varun keeps his books by the single Entry method. His position on 31st March 2007 was as follows.

Cash in hand Rs 7,200; cash at Bank Rs 76,500 Debtors Rs 55,200; stock Rs 85,800 Furniture Rs 15,000; creditors for goods Rs 56,100 Expenses outstanding Rs 6,000

On 1st october, 2007, varun introduced Rs 30,000 as further capital in the business and withdrew on the same date Rs 21,000 out of which he spent Rs 15,000 on the purchase of a machine for the business on 31st March 2008 his position was as follows :

Cash in hand Rs 6,300; cash at bank Rs. 82,500; stock Rs 94,500; Debtors Rs 72,600 Furniture Rs 18,000; creditors Rs 75,600; prepaid Insurance Rs 600.

Prepare the necessary statement showing the profit or loss made by him during the year ended 31st March 2008 after making the following adjustment. Depreciate Furniture and Machine @ 10% p.a ; baddebts Rs.3,600 for doubtful debts @5%. Goods taken for personal use amounted to Rs.4,500. Also provide interest on capital @ 10% p.a.

Solution :

Statement of Affairs of Varun as on 31st March 2007.

Liabilities	Amount Rs	Assets	Amount Rs
Creditors	56,100	Cash in hand	7,200
Expenses outstanding	6000	Cash at Bank	76,500
Capital (Balancing figure)	1,77,600	Debtors	55,200
		Stock	85,800
		Furniture	15,000
	2,39,700		2,39,700

Statement of Affairs of Varun as on 31st March 2008.

Liabilities	Amount	Assets	Amount	Amount

	Rs		Rs.	Rs
Creditors	75,600	Cash in hand		6,300
Capital	20,4,450	Cash at Bank		82,500
(Balancing figure)		Stock		94,500
		Debtors	72,600	
		less Bad debts	3,600	
				69,000
		less Provision	3,450	65,550
		Prepaid Insurance		600
		Furniture	18,000	
		less Depreciation on 1,5000 for 1year 1500 on 3,000 for 1/2year 150	1650	16,350
		Machinery	15,000	
		less Depreciation for 1/2 year	750	
				14,250
	2,80,050			2,80,050

Note : Date of purchase of new furniture is not given in the question, so depreciation on this furniture has been charged for half year.

Statement of Profit of Varun as on 31st March 2008.

	Amount Rs.	Amount Rs.
Capital as at the 31st March 2008		204450
Add Drawings	6000	
Cash (21000 - 15000) goods less	4500	10500
Additional capital introduced		214950
		30000
less capital as at 1-4-2007 profit		184950
before allowing interest		177600
		7,350

on capital		
less Interest on capital @ 10% p.a on Rs 1,77,600 for 1year.	17760	
on Rs 30000 for 1/2 year.	1500	19260
loss for the year.		11910

Illustration 3

Nalini, Rajani, sujani were in partnership and towards the end of 2007 most of their books and records were destroyed in the fire. The Balance sheet as on 31st December. 2006 was as follows:

		Rs		Rs
Creditors		22,000	Cash	9,600
Capital			Debtors	14,400
Nalini	18,000		Stock	26,000
Rajini	12,000		Machinery	5,760
Sujani	6,000	36,000	Fixtures & Fittings	2,400
Current A/cs:				
Nalini	580		Currant Account	
Rajini	400	980	Sujani	680
		58,980		58,980

The partners drawing during 2007 have been proved at A- Rs 5600, B- Rs 4000 and C-Rs 2,600. on 31st Dec, 2007 the cash was Rs 12,800, Debtors Rs 16,100, stock Rs 2360 Advance payments Rs 100 and creditors Rs 24,160. Machinery is to be depreciated by 10% per annum and Fixtures and fillings at 71/2%. 5% Interest is to be allowed on capitals. The partners share profits in the proportions of 1/2, 1/3 and 1/6.

You are required to prepare a statement showing the net trading profit for the year 2007 and the division of the same between the partners, together with the Balance sheet as on 31st December 2007.

Statement of affairs of M/s Nalini, Rajani, Sujani as at 31st December 2007

Liabilities	Amount Rs	Amount Rs	Assets	Amount Rs	Amount Rs
Creditors			Cash		12,800
Capitals		24,160	Debtors		16,100
			Stock		23,600
Nalini	18,000		Prepaid expenses		100
Rajani	12,000		Machinery	5,760	

Sujani	6,000	36,000	less Depreciation	576	5,184
			Fixtures & Eittings	2,400	
			less Depreciation	180	2,220
			Combined current Account of Nalini, Rajani, sujani		156
		60,160			60,160

Statement of Profit of Profit & Loss
For the year ending 31st Dec 2007.

	Amount Rs.	Amount Rs.
Combine of current Accounts of Nalini, Rajani, Sujani on 31-12-07		-156
Add Drawings during the year:		
Nalini	5600	
Rajani	4000	
Sujani less Combined current Account 1-1-07	2600	12200
		12,044
Nalini	580	
Rajani	400	
Sujani profit before allowing interest	-680	300
		117,44
on capital		
less Interest on capital @ 5% p.a		
Nalini	900	
Rajani	600	
Sujani	300	1,800
Net profit made during the year Divided among Nalini, Rajani Sujani as follows :		9,944
Nalini - 1/2 of 9944		4,972
Rajani - 1/3 of 9944		3,316
Sujani - 1/6 of 9944		1,656

Balance sheet Nalini, Rajani and Sujani as at
31st December 2007.

Liabilities	Amount Rs	Amount Rs	Assets	Amount Rs	Amount Rs
Creditors		24,160	Cash		12,800
Capitals			Debtors		16,100
			Stock		23,600
Nalini	18,000		Prepaid expenses		100
Rajani	12,000		Machinery	5,760	
Sujani	6,000	36,000	less Depreciation		5,184
Nalini Curent A/c			Fixtures & Eittings	576	
				2,400	
Balance on 1-1-07	580		less Depreciation	180	2,220
Add Interest	900				
Profit	4,972				
	6,452				
less Drawings	5,600	852	Sujani Current Account		
Rajani Current A/c	400		Balance on 1-1-07	680	
Balance of 1-1-07			Add Drawings	2,600	
Add Interest	600			3,280	
Profit	3,316		less Interest 300		
	4,316		Profit 1650	1.956	1324
less Drawings	4,000	316			
		61,328			61,328

3.10 SUMMARY :

Small proprietors, traders and professional people usually adopt a system of keeping incomplete book - keeping records, This is known as single entry system. Limited companies cannot adopt this system of accounting. Under this system only personal accounts are kept. Real and nominal accounts are generally not maintained. One cash book is kept in which business and private transactions of the proprietor are mixed up. This system lacks uniformity. It is an adjustment of double entry system to suit the convenience of a person. It is difficult to prepare final accounts in the absence of real and nominal accounts. Single entry system is full of defects. Arithmetical accuracy of the books cannot be checked by preparing a trial balance. Frauds are common under this system.

Profits can be ascertained under two methods. 1. Statement of Affairs or net worth Method 2. Convertion method. Under networth method, to find out the capital on the opening and closing days, the accounting equation “capital = Assets - Labilities to outsiders” is used and statement of affairs prepared accordingly. Adjustments with regard to drawings, capital introduced, depreciation etc. are made to closing capital and then true profit or loss is ascertained.

3.11 SELF ASSESSMENT QUESTIONS :

1. What do you mean by single entry system ?
2. How does profit can be ascertained under single entry system.
3. What are the features of single entry system ?
4. Briefly describe the limitations of single entry system.
5. Distinguish single entry system from double entry system.
6. What is a statement of Affairs.
7. What are the differences between a statement of Affairs and a Balance sheet.
8. What are the methods of ascertaining profit under single entry system.

3.12 EXERCISES :

1. Kusuma a Retail merchant commenced business with a capital of Rs 75,000 on 1-12006. subsequently on 1st May 2006, she invested a further sum of Rs 35,000 as capital in the business, During the year he has with drawn Rs 15,000 for his personal use. On 31-122007 her assets and liabilities were : cash at Bank Rs 30,000, Debtors Rs 40,000, stock of goods Rs 160,000, Furniture's Rs 20,000 and sundry creditors Rs 50,000 Ascertain profit or loss for the year 2006.

2. Subba Rao keeps books by the single entry system. Assets and liabilities on 31st December 2006 and 2007 were as under :

	31 - 12 - 2006	31 - 12 - 2007
Cash in hand	1,200	1,800
Cash at Bank	1,800	12,000
Stock	1,20,000	1,14,000
Sundry debtors	51,000	84,000
Furniture	10,800	9,000
Plant and Machinery	90,000	1,62,000
Sundry creditors	1,32,000	1,74,000

During the year Subba Rao introduced Rs 30,000 as further capital in the business and with drew Rs 4,500 per month.

From the above prepare a statement showing the profit or loss made by him for the year ended 31-12-2007.

3. Chalapati kept their books on single Entry system their position on 31-12-2006 was as follows:

Cash in hand Rs 1400; cash at Bank Rs 21,000 stock Rs 14,0000! Sundry Debtors Rs 59,500; Fixtures and Fittings RS 12,600; plant and Machinery Rs. 1,05,000; Sundry Creditors Rs 1,54,000.

Chalapati put Rs 3,5000 during the year as new capital and his drawings were @ Rs 5,250 per month.

His position on 31st Dec 2007 was as follows:

Cash in hand Rs 2,100 : Cash at Bank Rs 14,000: sundry Debtors Rs 98,000 stock Rs 1,33,000 plant and Machinery Rs 1,89,000: Fixtures and Fittings Rs. 10,500 sundry creditors Rs 2,03,000.

From the above information prepare a statement of Affairs showing profit or loss during the year 31-12-2007.

4. Aravind commenced business on 1-1-2006 with capital of RS 2,00,000. He immediately bought furniture for Rs 48,000 During the year he borrowed Rs 120000 from his wife and introduced a further capital of his own amounting to Rs 76,000. He had withdrawn Rs 7200 at the end of each month for family expenses. On 31st December 2006, his position was as follows.

Cash in hand Rs 4,800; cash at Bank Rs 62,400 sundry Debtors; Rs 1,15,200; stock Rs 1,63,200: Bills Receivable Rs 38,400: sundry creditors Rs12,000; Rent due Rs 3600.

Furniture to be depreciated by 10% Ascertain the profit or loss made by Aravind during 2006.

5. Phalgun commenced business on 1st january 2007 with a capital of Rs 18,0000. Soon after he bought furniture and fixtures for Rs 32,000. On 30th June 2007 he borrow Rs 90,000 from his brother at 12% per annum (interest not yet paid) and introduced a further capital of his own amounting Rs 2700. He withdrew @ Rs 5400 per month at the end of each month for household expenses. On 31st December 2007 his position was as follows.

Cash in hand Rs 3600: Cash at Bank Rs. 46,800 sundry Debtors Rs 86,400: stock Rs 90,000: Bills Receivable Rs 28,800: sundry creditors Rs 9,000 and owing for rent Rs 2,700.

Furniture and fixtures are to be depreciated by 10% Ascertain the profit or loss made by phalgun during 2007.

6. Vijay commended business on 1st January 2007 with a capital of Rs 1,00,000 which he paid into Banking Account opened for that purpose. On the same date he bought stock valved at Rs 65,000 and furniture which cost Rs 20,000. He kept his books on single entry basis. On 31st December 2007, stock was valued at Rs 83,000. There were book debts amounting to Rs 34,000 of which Rs 2000 represented debts which were irrecoverable. Creditors amounted to Rs 36,000 and the cash book showed a balance of Rs 16,500, but according to pass Book, the balance at vijays credit was only Rs 14500 he having given his son Rs 2,000 and omitted to enter in the cash book. Vijay with drew Rs 18,000 from the business for his private expences and in addition he used Rs 5000 worth of goods from his shop He took RS 10,000 as loan from his wife during the year.

Prepare a statement showing vijay's profit or loss in the business for the year ended 31-122007 from the above information.

7. Sobhan and Bharat are equal partners in a business in which the books are kept by single entry. The position of affairs on 1st January was as follows:

Liabilities	Rs	Assets	Rs
Bills payable	12,920	Cash in hand	540
Sundry creditors	40,580	Cash at bank	4,400
Capital Accounts		Bills Receivable	8,140
Sobhan	1,46,800	Sundry Debtors	97,360
Bharat	1,46,800	Stock	65,700
		Plant	1,60,360
		Furniture	10,600
	3,47,100		3,47,100

The following was the state of affairs on 31st December; cash in hand Rs 8000; Cash at Bank Rs 11,680; Debtors Rs 1,12,580; Bills Receivable Rs 13,680 stock Rs 73,460; Creditors Rs 42,940; Bills payable Rs 11,900. The partners had drawn Rs 9,000 each and were further entitled to interest on their capital at 5% per annum. It was agreed to depreciate plant at the rate of 10% and furniture at 5%. Draw up the final accounts.

8. Chinna, Madhu, Vasu are in partnership and keep their books by single entry. The state of Affairs of the firm as on 30th september 2006 was as under.

Liabilities		Rs	Assets	Rs
Bills payable		2,100	Cash in hand	3,750
Expenses outstanding		1,950	Cash at bank	10,350
Creditors		23,100	Bills Receivable	9,000
Capital Accounts			Debtors	30,600
Chinna	15000		Stock	25,200
Bharat	15000		Madhu's Current A/c.	2,790
Vasu	15000	45,000		
Chinna Current A/c		6,450		
Vasu Current A/c		3,090		
		81,690		81,690

The position of the firm on 30th September 2007 was :

Cash in hand Rs 4,200 : Cash at Bank Rs 10,710; Debtors Rs 36,900; stock Rs 28,080; Bills payable Rs 1500; creditors Rs 18,600 and 4% investment of the face value of Rs 6,000 purchased at 97%

Each partner had drawn Rs 750 per month at the beginning of every month during the year. 8% interest on capital and drawings drawn during the year is to be charged. On 1st April 2007 each partner had introduced Rs 4,500 as further capital in the firm.

Ascertain the profit or loss made by the firm during the year ending september 30,2007 and show the Balance sheet as on that date.

3.13 SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal
Financial Accountancy : Jain and Narang
Financial Accountancy : R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda.

LESSON - 4

SINGLE ENTRY SYSTEM - II

OBJECTIVES : In the previous lesson you learned that the profit under single entry system can be ascertained under two methods i.e. statement of Affairs Method and conversion method. As we have already seen how the statement of Affairs is prepared, In the present lesson you can learn the conversation method how the account under single entry can be converted into double entry system.

STRUCTURE OF THE LESSON :

4.1 Introduction.

4.2 Conversion of Books of last year from single entry into Double entry

4.3 Some important points for conversion

4.4 Illustrations

4.5 Summary

4.6 Questions

4.7 Exercises

4.8 Suggested Books

4.1 INTRODUCTION :

The word conversion denote the change of accounts prepared under single entry system into Double entry system. If any business concern desire to change the system of accounting from single entry to double entry on a given date the following procedure should be adopted :

A statement of Affairs should be prepared on the date on which the change is to be made. For bringing into books the various assets and liabilities appearing in the statement of Affairs an opening journal entry should be made as follows :

Various Assets Account Dr
  To various liabilities Account
  To Capital Account
(Being balance brought forward from the statement of Affairs)

The books will thus be opened under the double entry. In future all transactions should be recorded according to the double entry system. i.e: first through proper subsidiary books and then posted to the ledger.

4.2 CONVERSION OF BOOKS OF LAST YEAR :

If a businessman wants to convert the books of the 2000 maintained on single entry system into double entry system in 2001, he should follow the following procedure, which is based on the assumption that proper subsidiary books have been maintained under the single entry system.

1. A statement of Affairs at the beginning of the year 2000 should be prepared and posted from it all those accounts which have not been maintained already.
2. The cash book should be gone through and entries relating to impersonal accounts should be posted to their respective accounts as these items were not posted to impersonal accounts under the single entry system. This would complete the double entry of the cash book
3. The Debtors and creditors accounts which have already been kept under the single entry system Should be scrutinised in order to find out the items which have been made direct there in without passing through the accounts e,g, debts, discounts , allowances etc should be posted to their respective impersonal accounts so that the two-fold effect of such transactions may be completed.
4. If a petty cash book is maintained, the monthly analysis should be posted to the debit of the various accounts for expenses and the total credited to petty cash account.
5. After completing the double entry of all the transactions of the previous year, a trial balance should then be prepared to test the arithmetical accuracy of the books. After taking into consideration the necessary adjustments like outstanding expenses and incomes, depreciation, provision for bad debts and discounts, Trading and profit and loss account and Balance sheet should be prepared in the usual manner.

4.3 IMPORTANT POINTS FOR CONVERSION :

For the convenience of the students for converting the single entry into double entry some important points are given below.

1 Ascertainment of credit sales and credit purchases.

Usually a question on single entry does not give the figures of credit sales and credit purchases so to find them out a Total Debtors Account and a Total creditors account is prepared.

Illustration I

From the following information you are required to calculate total purchases :

	Rs.
Cash purchases	2,55,000
Creditors as on April 1, 2006	1,20,000
Cash paid to creditors	4,65,000
Purchases returns	15,000
Creditors as on March 31st 2007	2,01,000

Solution :

Dr Total Creditors Account Cr

	Amount Rs		Amount Rs
To cash	4,65,000	By Balance b/d	1,20,000
To returns	15,000	By Purchases made	
To Balance c/d	2,01,000	during the year (Balancing figure)	56,100
	6,81,000		68,1000

Total Purchases = Cash purchases 2,55,000
Credit purchases 5,61,000
8,16,000

Illustration 2

From the following information calculate Total sales :

	Rs.
Opening debtors	20,000
Cash received from debtors	40,000
Cash sales	40,000
Closing debtors	32,000
Returns inward	2,000
Bad debts	8,000

Solution :

Dr Total Debtors Account Cr

	Amount Rs		Amount Rs
To Balance b/d	20,000	By Cash	40,000
To credit sales		By Returns	2,000
(Balancing figure)	62,000	By Bad debts	8,000
		By Balance c/d	32,000
	82,000		82,000

Total Sales = Cash Sales = 40,000
Credit Sales = 62,000
1,02,000

2. Ascertainment of opening and closing Debtors and creditors when credit sales and purchases are given :

In such a case the opening or closing balance of debtors and creditors can easily be ascertained by preparing the total Debtors and total creditors account as already explained. The balancing figure in the Total Debtors Account and the Total creditors Account will be opening or closing balance of debtors and creditors.

Illustration 3 :

Calculate debtors balance at the end :

	Rs
Opening debtors	1,00,000
Total sales	4,00,000
Bad debts	10,000
Returns inwards	2,500
cash sales	50,000
cash received from customers	1,50,000
Bills Received from customers	45,000

Solution :

Dr **Total Debtors Account** Cr

	Amount Rs		Amount Rs
To Balance b/d	1,00,000	By Bad debts	10,000
To Sales		By Returns	2,500
(4,00,000 – 50,000)	3,50,000	By Cash	1,50,000
		By B/R	4,500
		By Balance c/d	2,42,500
	4,50,000		4,50,000

Illustration 4

Calculate creditors balance at the end.

			Rs.
Sundry creditors on the Opening day	7,600		
Cash paid to creditors			1,750
Discount Received	250 Credit Purchases	9,300	
Acceptances given to creditors			5,870

Solution :

Dr Sundry Creditors Account Cr

	Amount Rs		Amount Rs
To Cash	1750	By Balance b/d	7,600
To Discount250		By Credit purchases	9,300
To Bills payable	5870		
To Balance c/d (Balancing figure)	9030		
	16,900		16,900

3. Ascertainment of Bills Receivable and Bills payable :

Sometimes the question may not give the opening or closing balances of Bills Receivable and Bills payable. Such figures can be found out by preparing the Bills Receivable Account and Bills payable Account as shown below:

Illustration 5 :

Calculate opening Balance of Bills receivable from the following information.

	Rs.
Bills Receivable accepted during the year	41,800
Bills Receivable an cashed during the year	41,800
Bills Receivable Dishonoured	3,600
Bills Receivable at the end of the year	12,000

Solution :

Dr Bills Receivable Account Cr

	Amount Rs		Amount Rs
To Balance b/d	15,600	By cash	41,800
(Balancing fig)		By Bills dishonoured	3,600
To Bills received	41,800	By Balance c/d	12,000
	57,400		57,400

Illustration 6

From the following data calculate the opening Balance of Bills payable.

	Rs.
Cash paid during the year on Bills	44,500
Closing Balance of Bills payable	35,000
Bills accepted during the year	54,500

Bills Payable Account

Dr Cr

	Amount Rs		Amount Rs
To Cash	44,500	By Balance b/d	25,000
To Balance c/d	35,000	(Balancing figure)	
		By Creditors (acceptances)	54,500
	79,500		79,500

4. Ascertainment of opening and closing stock when Rate of gross profit is given.

These figures will be calculated as follows :

Opening stock = Cost of goods sold + Cl. stock - Purchases.

Closing stock = Opening stock + Purchases - Cost of goods sold

Illustration 6

Calculate the stock at the end

	Rs.
Stock in the beginning	20,000
Cash Sales	60,000
Credit sales	40,000

Purchases 70,000

Rate of gross Profit on cost 1/3 Solution :

Total sales		Rs
Cash sales	=	60,000
Credit sales	=	40,000
		=1,00,000

Cost of goods sold is = 100000 5 3/4 = 75,000

Closing stock = op. stock + purchases – cost of goods sold.

= 20,000 + 70,000 – 75,000

= Rs 15,000

Note : If gross profit Ratio on Cost of goods is given in the problem, first we have to convert it on sales.

On cost of goods	=	on sales
25%	=	20%
33/3%	=	25%
50%	=	33 1/3%
662/3%	=	50%
1/2	=	1/3
1/3	=	1/4
1/3	=	1/5
1/4	=	1/5
1/5	=	1/6
1/6	=	1/7 and so on

In the above problem grass Profit is 1/3 on cost of goods sold. It is equal to 1/4 of sales i.e. 100000 5 1/4 = Rs 25,000.

5. Ascertainment of opening Balance of capital, an Asset or a liability.

Such a missing figure can be ascertained by preparing the opening statement of Affairs. The missing item would be the balancing figure in the statement of Affairs.

This can be seen in the following example.

Illustration 7 calculate the capital in the beginning.

	Rs.
Profit made during the year 48,000 capital at the end	1,60,000
Capital introduced during the year	40,000
Drawings	24,000

Solution :

Dr Capital Account Cr

	Amount Rs		Amount Rs
		By Balance b/d (Balance figures)	96,000

To Drawings	24,000	By Cash	40,000
To Balance c/d	160,000	By Profit	48,000
	184,000		184,000

It can be calculated by the following equation :

Profits = Capital at the end + Drawings – Capital Introduced – Capital in the beginning.

Capital in the beginning = Rs 16,0000 + Rs 24,000 – Rs 40,000 – Rs 48,000 = 96,000

6. Ascertainment of cash and Bank Balances :

Sometimes opening and closing balance of cash in hand or cash at Bank are not given, such figures can be ascertained by preparing the columnar cash Book. When all the known items are written up in the cash Book, the balancing figure would be the missing item.

Illustration 8 :

From the following information find the cash balance on the opening day.

	Rs.
Cash received from the Debtors	25,000
Cash sales	15,000
Interest paid	1,100
Drawings	3,000
Salaries	9,500
Expenses paid	8,900
Amount paid to creditors	16,000
Cl. Balance of cash	4,500

Solution :

Cash Book

Receipts	Amount Rs	Payments	Amount Rs
To Balance b/d	3,000	By interest	1,100
(Balancing figure)		By Drawings	3,000
To Sales	5,000	By Salaries	9,500
To Debtors	25,000	By Expenses	8,900
		By Creditors	16,000
		By Balance c/d	4,500
	43,000		43,000

Illustration 9 :

From the following particulars extracted from the books of a trader kept under the single Entry system, you are required to find out the figures for credit sales and credit purchases by showing the total Debtors Account and total creditors Account. Show also the Bills Receivable Account and Bills payable Account, Balance 1-1-2007 :

	Amount Rs		Amount Rs
Total Debtors	1,14,400	Discount allowed to customers	8,400
Bills Receivable	8,000	Returns from customers	3,250
Total creditors	52,800	Return to suppliers	2,660
Bills Payable	5,000	Bad debts written off`	7,080
H is transaction for the year			
Cash paid to creditors	1,40,500		
Discount allowed by suppliers	5,300	Cash received against bills receivable	28,400
Cash received from customers	270800		
Payment made again s Bills payable	14,000	Closing Balances 31-12-07	
Bills receivable Dishonoured	22,00	Total debtors	1,11,200
Bad debts previously written off now recovered	2000	Total creditors	56,800
		Bills receivable	2,000
cash sales during the year	31,600	Bills payable	6,000
Cash purchases during the year	38,500		

Solution :

Dr Total Debtors Account Cr

Date	Particulars	Amount Rs.	Date	Particulars Rs.	Amount
2007			2007		
Jan 1	To Bal b/d	1,14,400	2007 Jan1 to	By cash	2,70,800
				By Discount	8,400
Jan 1	To Bills Receivable A/c	2,200	Dec31	By Returns in words	3,250
to	To Credit sales	3,08,730		By Bad debts	7080
Dec31	(Balancing figure)			By Bills Receivable A/c	24,600
				By Balance c/d	1,11,200
		4,25,330			4,25,330
2008 Jan 1	To Bal b/d	1,11,200			

Dr Total Creditors Account Cr

Date	Particulars	Amount Rs.	Date	Particulars Rs.	Amount
2007	To Balance b/d	8,000	2007		
Jan 1	To Total Debtors (B/R)	24,600	Jan 1	By cash	28,400
to Dec31	(Balancing figure)			By Total Debtors A/c	2200
			Dec31	(Bills dishonoured)	2,000

Date	Particulars	Amount Rs.	Date	Particulars Rs.	Amount
2007	To cash	1,40,500	2007		
Jan 1	To Discount	5,300	Jan 1	By Balance b/d	52,800
to	To Returns out words	2,660	Jan 1	By credit purchases	1,67,460
Dec31	To Bills payable	15,000	to	(Balancing big)	
Dec31	To Balance c/d	56800	Dec31		
		2,20,260			2,20,260
			2008 Jan	By Balance b/d	56,800

Dr Bills Receivable

Account Cr

Dec31Balance c/d 32,600

32,600

2008 Jan 1To Balance b/d 2,000

Dr Bills Payable Account Cr

Date	Particulars	Amount Rs.	Date	Particulars Rs.	Amount
2007			2007		
Jan 1 to Dec31	To Cash (B/R)	14000	Jan 1	By Balance b/d	5,000
	To Balance c/d	6000	Jan 1 to	By Total creditors (Bills accepted)	15,000
			Dec31	(Balancing fig)	
		20,000	2008		20,000

	Jan 1	By Balance b/d	6,000

Illustration 10 :

Anil carries on a small business, but he does not maintain a complete set of account books. He banks all receipts and makes all payments only by means of cheques. He maintains properly a cash book, a sales ledger and a purchase ledger. He also makes a proper record of the assets and labilities as at the close of every accounting year. From such records you are able to gather the following facts :

Receipts	Amount Rs	Payments	Amount Rs
From sundry Debtors	52,875	New plant purchased	1,875
Cash sales	12,375	Drawings	4,500
Paid in by the proprietor	7,500	Salaries	3,375
		Interest paid	225
		Telephone	375
		Rent	3,600
		Light and power	1,425
		Sundry expenses	6,375
		Sundry creditors (Purchase ledger Accounts)	22,875
	72,750		72,750

Assets and liabilities :

	As at 31-12-2006 Rs	As at 31-12-2007 Rs
Sundry Creditors	7,575	7,200
Sundry Debtors	11,250	18,375
Bank	1,875	------
Stock	18,750	9,375
Plant	22,500	21,975

From the above data, prepare the profit and loss Account for the year ended 31st December, 2007 and the Balance sheet as on that date.

Solution :

Trading and profit and loss Account of Mr. Anil for the year ended 31-December 2007.

Particulars	Amount Rs	Particulars		Amount Rs
To opening stock	18,750	By sales		
To Purchases	22,500	Cash	12,375	
To wages	20,175	Credit	60,000	72,375
To Light and power	1,425			
To gross profit c/d	18,900	By closing stock		9,375

	81,750		81,750
To salaries 3,375 To Interest 225			
To Telephone	375	By gross profit b/d	18,900
To Rent	3,600		
To sundry expenses 6,375 To Depreciation 2,430			
To Net - profit	2,520		
	18,900		18,900

Balance sheet of Mr. Anil
as on 31st December 2007,

Liabilities	Amount Rs	Amount Rs	Assets	Amount Rs	Amount Rs
Sundry creditors		7200	Cash at Bank		98,25
Capital Account			Sundry Debtors		18,375
as on 1-1-07	46,800		Stock		9,375
Add Additional capital	7,500		Plant on 1-1-07	22,500	
Net profit	2,520		Add Purchase	1,875	
	56,820			24,375	
Less Drawings.	4,500	52,320	less Depreciation	2,430	21945
		59,520			59520

Working Notes :

1. Calculation of credit purchases :

Creditors Account.

	Rs		Rs
To cash account	22,875	By Balance b/d	7,575
Balance c/d	7,200	By credit purchases (Balancing fig)	22,500
	30,075		30,075

2. Calculation of credit Sales :

Sundry Debtors Account

	Rs		Rs
To balance b/d	11,250	By Cash	52,875

To credit sales	60,000	By Balance b/d (Balancing fig)	18,375
	71,250		71,250

3. Calculation of Depreciation of Plant :

	Rs.	
Book value of plant on 1-1-07	22,500	
Add Plant purchased	1,875	
	24,375	
less Book value of plant on 31-12-07	21,945	
Depreciation for the year		2,430

4. Calculation of Balance at Bank :

	Rs.
Balance as on 1-1-07	1,875
Add Receipts for the year	72,750
	74,625
less Payment made during the year	64,800
Balance as on 31-12-07	9,825

Computation of capital as on 1-1-07

Statement of Affairs

Liabilities	Rs	Assets	Rs
Sundry creditors	7,575	Cash at Bank	1,875
Capital (Balancing figure)	46,800	Sundry Debtors	11,250
		Stock	18,750
		Plant	22,500
	54,375		54,375

Illustration : 11

Mr. Ajay Kumar keeping his books under single Entry system has placed the following facts before you :

1. His statement of Affairs as on 1st Jan 2007. 2. A summary of cash transactions for the year 2007.
3. A list of remaining transactions for the year.1.

	Rs		Rs
Bank over draft	1,00,000	Debtors 300000	
creditors	2,00,000	less Provision 15000	28,500
Bills payable	12,000	Bills Receivable	72,000

Outstanding exp	8,000	Stock	2,80,000
Capital Account	6,08,000	Plant	2,00,000
		Building	80,000
		Cash in hand	11,000
	9,28,000		9,28,000

2.

	Rs		Rs
To Balance on 1-1-07	11,000	By payment to crs	7,20,000
To Bills Receivable	2,00,000	By cash purchases	1,60,000
To Debtors	8,72,000	By Bills payable	3,20,000
To cash sales	1,64,000	By salaries	60,000
To Mrs. Ajay kumar	1,00,000	By Rent	32,000
		By general exp	18,000
		By Drawings	21,600
		By Balance c/d	11,400
	13,47,000		13,47,000

3.

	Rs		Rs
Total sales	16,10,000	Stock on 31-12-07	3,40,000
Total purchases	14,40,000	Outstanding general expenses	12,000
Discount allowed	4,000		
Discount Received	8,000	Bad debts	8,000
Bills Receivable	1,20,000	Prepaid rent	7,200
31-12-07			
Bills payable accepted during the year.	3,72,000		

Provide 5%. For doubtful debts and 2 1/2 % for discount on debtors. Depreciate building by 2% and plant by 10%.

You are required to prepare trading and profit and loss account and Balance sheet of M.r Ajay Kumar form the above particulars.

Solution :

Trading & Profit and Loss Account of Mr. Ajay Kumar For
the year ending 31 Dec 2007.

	Rs	Rs		Rs	Rs
To opening stock		2,80,000	By sales		9,825

To purchases			Cash	1,64,000	
Cash	1,60,000		Credit	14,46,000	16,10,000
Credit	12,80,000	14,40,000	By closing stock		3,40,000
To G Profit c/d		2,30,000			
		19,50,000			19,50,000
To salaries		60,000			
To rent	36,000		By gross profit b/d		2,30,000
less prepaid	7,200	28,800			
To gen. expenses	18,000		By Discount Received		8,000
less out standing last year	8,000				
	10,000				
Add out standing this year	12,000	22,000			
To Discount allowed		4,000			
To Bad Debts	8,000				
Add provision for Doubtful debts	30,700				
	38,700				
less Existing provision	15,000	23,700			
To provision for Discount on Drs		14,584			
To Depreciation : Buildings	1,600				
Plant	20,000	21,600			
To Net profit		63,316			
		2,38,000			2,38,000

Balance sheet of Mr. Ajay Kumar as on 31st December 2007.

Liabilities	Rs	Rs	Assets	Rs	Rs
Out standing		12,000	Cash in hand		11,400

Bank O.D	1,00,000	less provision	30,700
Mrs. Ajay's loan	1,00,000	for Bad debts	

				6,44,700
6,08,000			less Provision	
21,600			for Discount	14,584
5,86,400			Stock	3,40,000
63,316	6,49,716		Prepaid Rent	
			Plant	
				2,00,000
			less Depreciation	20,000
			Buildings	80,000
			less Depreciation	1,600
	13,0,5716			

expenses					
Bills payable		64,000	Bills Receivable		1,20,000
Creditors		3,80,000	Debtors	6,14,000	

Capital A/c on 1-1-2007

less Drawings5,68,716 Add Net profit7,200

1,80,000 78,400

13,05,716 Workings Notes :

1. Calculation of Debtors as on 31-12-07

Total Debtors Account

	Rs		Rs
To Balance b/d	3,00,000	By Cash	8,72,000
To credit sales	14,46,000	By Bills Receivable A/c	
			2,48,000

		By Discount allowed	4,000
		By Bad debts	8,000
		By Balance c/d	6,14,000
	17,46,000		17,46,000

Bills Receivable Account

	Rs		Rs
To Balance b/d	72,000	By Cash	2,00,000
To Debtors Account (Balancing figure)	2,48,000	By Balance c/d	1,20,000
	3,20,000		3,20,000

Total creditors Account

	Rs		Rs
To cash	7,20,000	By Balance b/d	2,00,000
To Discount8,000	By Total credit	1,20,000	
To Bills payable Account	3,72,000	Purchases	
To Balance c/d	3,80,000		
	14,80,000		14,80,000

Bills payable Account

	Rs		Rs
To cash	3,20,000	By Balance b/d	12,000
To Balance c/d (Balancing figure)	64,000	By Total creditors A/c	3,72,000
	3,84,000		3,84,000

Illustration 12

Sri Gopi krishna a small producer of machine parts has supplied the following details of his business transactions.

	Rs.
Cash and Discount credited to Debtors	3,21,000
Discount Received	1,000
Expenses paid in cash	17,000
Bad debts	2,500
Cash withdrawal from Bank	22,500

Expensed paid by cheque	17,500
Cash collections from Debtors	1,01,500
Cash deposit in Bank	77,500
Cash drawings	7,500
Cheques collected from Debtors	2,16,000
Drawings by cheques	21,000
Cash in hand on 30-9-2007	11,000
Discount allowed	3,500
Cheques paid to creditors	2,67,000
Total sales	3,45,500
Cash purchases	10,500
Cash paid to creditors	31,500

	As on 1-10-2006 Rs	As at 1-10-2007 Rs
Debtors	?	75,000
Cash and Bank Balance	69,500	26,500
Stock	43,500	52,500
Plant	28,000	23,000
Furniture	11.000	11.000
Creditors	30,000	47,000
Labilities for expenses	2,500	4,000

You are required to prepare Trading and profit and loss Account for the year ending 30-9-07 and Balance sheet as at that date for Sri Gopi Krishna..

Solution :

Trading and profit and loss Account of Gopi Krishna for the year ending 30-9-07

Dr	Rs	Rs		Rs	Rs
To opening stock		43.500	By sales		
To purchases			Cash	11.500	
Cash	10.500		Credit	3.34.000	3.45.500
Credit	3.16.500	3.27.000	By closing stock		52.500
To Gross profit c/d		27.500			
		3.98.000			3.98.000
To Expences			By gross profit b/d		27.500
by cash	17.000		By Discount Received		1.000
by cheque	17.500		Net loss		18.500
	34.500				
less out standing last year	2.500				
Add out standing this year	32,000 4.000	36,000			
To Discount allowed		3.500			
To Bad Debts		2.500			
To Depreciation		5.000			
On palant		5.000			
(28000 - 23000)		47.000			47.000

Cr

Balance sheet of Shri Gopi Krishna as on 30th september, 2007.

Liabilities	Rs	Assets	Rs
Creditors	47,000	Cash in hand	11,000
Outstanding Expenses	4,000	Cash at Bank	15,500
Capital		Stock	52,500
As on 1-10-06		Debtors	75,000
184000		Furniture	11,000
less:Drawings28,500		Plant 28,000	
Net loss 18,500		less Depreciation 5,000	23,000
47,000	1,37,000		
Working Notes :			
	1,88,000		188,000

Dr Cr

Particulars	Cash Rs.	Bank Rs	Particulars	Cash	Bank Rs.
To Balance b/d		50,000	By Expenses	17,000	17,000
(Balance fig for bank)			By Cash		22,500
(69500 - 50,000)	19,500		By Bank	77,500	
To Bank, cash	22,500	77,500	By Drawings	7,500	21,000
Debtors	1,01,500	2,16,000	By Creditors	31,500	2,67,000
Cash sales	11,500		By Purchases	10,500	
(Bala fig)			By Balance c/d	11,000	155,00
	15,50,000	3,43,500		1,55,000	3,43,500

Dr Sundry Debtors Account Cr

	Rs		Rs
To Balance b/d	64,500	By Cash	1,01,500
(Balancing figure)		By Bank	2,16,000
To credit sales		By Discout	3,500

Total sales 3,45,500			By Bad debts	2,500
less cash sales 11,500	3,34,000		By Balance c/d	75,000
	3,98,500			3,98,500

Dr Balance sheet as at 1-10-2006 Cr

	Rs		Rs
Creditors	30,000	Cash	19,500
Out standing Expenses	25,000	Bank	50,000
Capital (Balancing figure)	1,84,000	Debtors	64,500
		Stock	43,500
		Furniture	11,000
		Plant	28,000
	2,16,500		1,16,500

Dr Creditors Account Cr

	Rs		Rs
To Bank	2,67,000	By Balance b/d	30,000
To Cash	31,500	By credit purchases	
To Discout	1,000	(Bal - fig)	3,16,500
To Balance c/d	47,000		
	3,46,500		3,46,500

4.5 SUMMARY :

Under single Entry system profits can be ascertained by either statement of affairs method or by conversion method. Conversion method involves a number of steps necessary to convert single entry or incomplete records into double entry records. For this purchase, cash/Bank account, Total debtors account, Total creditors accounts, Bills receivable and Bills payable accounts are prepared to find out the missing figure of credit purchases or credit sales. Opening capital is found out by preparing the opening statement of affairs. After finding out the missing figures final account can easily be prepared.

4.6 SELF ASSESSMENT QUESTIONS :

1. State the necessary steps that are required to be taken to convert single entry into double entry.
2. State briefly how you would convert a set of books, which had been kept on the single Entry into the Double Entry.

4.7 EXCERCISES :

1. Mr. Krishna commenced business as a cloth merchant on 1st January , 2007 with a capital of Rs 20,000. On the same date he purchased furniture for cash Rs 6,000. The books are maintained by single Entry method. From the following particulars calculate cash in hand on 31st December, 2007. Prepare trading and profit and loss account for the year ending 31st December, 2007 and the Balance sheet as on that date.

	Rs
sales (including cash sales Rs 14,000)	34,000
Purchases (including cash purchases Rs 8,000)	30,000
Drawings	2,400
Salaries	4,000
Bad debts written off	1,000
Business Expenses	1,400
Stock of goods on 31-12-2007	13,000
Sundry Debtors on 31-12-2007	10,400
Sundry creditors on 31-12-2007	7,200

Provide depreciation on furniture at 10% p.a.

2. Mani a trader does not keep proper books of account he is able to give you the following information regarding his assets and liabilities.

	As on Dec 31 2006		As on Dec 31 2006
Creditors for goods	21,000		19,000
Creditors for expenses	1,500		1,800
Bills payable	8,700		11,500
Sundry debtors	35,000		34,000
Stock (at cost)	28,000		25,000
Furniture	10,000		12,000
Cash	5,100		?

The following additional information is also available in respect of his business for 2007.

	Rs
Bills payable issued	20,800
Payments to creditors	31,000
Cash sales	15,000
Expenses paid	6,600
Drawings	8,000

Bad debts during the year amounted to Rs 900 As regards sales, he informs you it is his practice to sell goods at cost + 25% . Prepare the annual accounts for 2007 provide for depreciation on furniture at 10%.

3. From the following details, prepare Trading profit and loss Account and Balance sheet.

	As on 1-1-2007		As on 1-1-2007
Stock	25,000		12,500
Debtors	62,500		87,500
Cash	6,250		10,000
Furniture	2,500		2,500
Creditors	37,500		43,750

Bad debts Rs 1250, Discount received Rs 3,750 Discount allowed Rs 2,500. Sundry expenses Rs 7,500 payable to creditors Rs 1,12,500 Received from debtors Rs 1,33,750. Drawings Rs 10,000, sales returns Rs 3,750 Purchase returns Rs 1,250 charge depreciation on furniture at 5%.

4. Sri Ram commenced business on 1st Jan 2007 with a capital of Rs 25,000 out of this he purchased furniture Rs 4,000. During the year he borrowed from his wife Rs 5,000. and introduced a further capital of Rs 3,000.

From the following particulars extracted from his books prepare the Trading and profit and loss account and Balance sheet as on 31-12-2007.

	Rs.
Receipts from debtors	46,700
Cash sales	30,000
Cash purchases	10,000
waged paid	1,000
Salaries to staff	6,200
Trade Expenses	3,400
Cash Drawings	7,700
Paid to creditors	50,000
Discounts Allowed to debtors	800
Bad debts	1,500

Sri Ram used goods worth Rs 1,300 for private purpases which was not recorded in the book. On 31-12-2007 his debtors were worth Rs 21,000 and creditors Rs 15,000 stock in trade is Rs 10,000 Furniture is to be depreciated at 20% per annum.

5. The following information is supplied from which you are required to prepare the p & L Account for the year ended 31st Dec 2007.

	1-1-2007 Rs	31-1-2007 Rs
Sundry Assets	18,000	20,000
Stock	1,400	19,000
Cash in hand	8,200	4,800
cash at a Bank	2,200	8,000
Debtors	?	26,000
Creditors	12,000	9,800

Outstanding expenses	1,000	600
Details of transactions for 2007		Rs.

Receipts from and discount credited to Debtors
2,45,000

Returns from debtors	6,000
Bad debts	1,000
Sales cash and credit	3,00,000
Returns to creditors	3,000
Payments to creditors by cheque	2,36,200
Receipts from debtors deposited into Bank	2,43,000
Cash purchases	10,000
Salary paid out of bank	18,000
Expenses paid by cash	5,000
Drawings cash	9,400
Purchase of sundry assets by cheque	2,000
Cash with drawn from bank	21,000
Cash sales deposited in Bank	?
Discount allowed by creditors	4,000

Debtors at the beginning Rs 50,000 and at the end Rs 60,000 cash received from debtors Rs 40,000. Allowances Rs 4,000, Bad debts Rs 6,000 Discount allowed Rs 2,000. Draw the relevant ledger account and calculate credit sales.

7. Suneel maintained his books under single entry system. He maintained a cash book and a debtors ledger and creditors ledger. He desires you to prepare final accounts for the year ended 31st December 2007. The analysis of his cash book showed the following.

Receipts	Rs	Payments	Rs
Received from debtors	17,625	New plant	625
Cash sales	4,125	Drawings	1,500
Additional capital	2,500	wages	7,200
		Salaries	1,125
		Interest	75
		Telephone	125
		Rent	1,200
		Printing	2,125
		Creditors	7,625
	24,250		21,600

Additional Information :

	1-1-2007		31-12-2007
Creditors	2525		2400
Debtors	3750		6125
Bank	625		?
Stock	6250		3125
Plant	7500		7315

8. Balaji maintains his records under single - entry method. His financial position as on 1-1-2007 was as follows.

Capital Rs 70,000; Creditors Rs 17,000; Freehold property Rs 50,000; Stock Rs 25,000; Debtors Rs 20,000; Furniture Rs 20,000.

Cash Account

Receipts	Rs	Payments	Rs
To debtors	15,000	By Bank O.D.	10000
To Cash sales	80,000	By Drawings	3,000
		By Expenses	50,000
		By Payments to Creditors	20,000
		By Balance c/d	12,000
	95,000		95,000

Additional information :

Balance on 31-12-2007, stock Rs 30,000; Debtors Rs 25,000; Creditors Rs 20,000; Depreciate Free hold property and furniture at 10% and 15% respectively. Create 2 1/2% Reserve for doubtful debts on debtors.

Show the trading account, profit and loss Account and Balance sheet as on that date.

4.8 SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal

Financial Accountancy : Jain and Narang

Financial Accountancy : R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda

LESSON – 5

HIRE PURCHASE SYSTEM - I

OBJECTIVES : By going through this lesson the student is able to understood what is Hire purchase system ? What are its features and How these transactions are recorded in the books of Accounts

STRUCTURE OF THE LESSON :

5.1 INTRODUCTION :

Most of the trade now - a - days carried on the basis of not only on credit but also under instalment payment that means the buyer need not pay the cost of goods. Immediately, certain percentage is paid on the date of agreement and the remaining in instalment. This system of purchase is known as Hire purchase system or Instalment Purchase system.

5.2 FEATURES :

Under hire purchase system, the buyer acquires the possession of the goods immediately and agrees to pay the total hire purchase price in instalments. Each instalment being treated as hire charges till the payment of last instalment. After payment of last instalment the ownership of goods is passes from the seller to the buyer If the buyer makes default in payment of any instalment the seller has a right to take back the goods from the buyer, and the amount already received is treated as a hire charge. But if the buyer is paying all the instalments on the due dates the sellers has no right to repossess these goods from the buyer. The purchaser can also return the goods at anytime without having to pay further instalments that means he has an option to buy the goods. Thus this system is advantageous both to the buyer and the seller. The buyer gets the facility of paying the total amount in instalments under this system and the seller is able to sell more goods under this system. Under the Hire purchase Act, the purchaser has certain rights the chief of which is that. if a certain proportion of the total amount due is paid, the goods cannot be repossessed without sanction of the court. There is also a ceiling on the interest that can be charged.

5.3 INSTALMENT SYSTEM :

In case of instalment system, both the possession and ownership of goods are transferred to the buyer immediately on signing the contract, In case the buyer defaults, the seller cannot take back the goods sold, he can only sue for non payment of the instalments.

5.4 DISTINCTION BETWEEN HIRE PURCHASE SYSTEM AND INSTALMENT PURCHASE SYSTEM :

The following are the main Points of distinction between the two systems.

Hire Purchase	Instalment Purchase
1. It is an agreement of Hiring.	1. It is an agreement of Sale.
2. The ownership remains with the Seller until the payment of last Instalment.	2. The ownership passes from seller to the buyer immediately on entering the agreement.
3. Goods can be returned if the buyer Does not want to pay rest of the Instalment.	3. The goods cannot be returned by the buyer to the seller unless there Is some default on the part of the Seller.
4. Under the system the buyer cannot Sell destroy transfer damage or Pledge the goods.	4. The buyer can do all these things.
5. Under this system the seller can Repossess the goods if the buyer Was in default of payment of any Instalment.	5. Under instalment purchase the seller can sure in the court of law if the buyer was in default in Payment of any instalment.

In case of both Hire purchase and instalment system, the buyer has to pay more than the cash price. This is because of the fact that hire purchase price includes interest. It is called as hire charges or finance charges, The buyer cannot debit the whole amount paid to the cost of asset acquired. Only the cash price should be debited to asset account and interest is to be charged to profit and loss account treating it as a revenue expense.

5.5 SYSTEMS OF ACCOUNTING RECORDS :

The systems of maintaining records for hire purchase transactions is different in each of the following circumstances.

1. When goods of substantial sales value are the subject matter of sale. e.g. trucks, heavy machinery.
2. When goods of small sales value are the subject matter of sale.

As we have already seen that there are two parties in the hire purchase agreement. i.e. buyer and seller.

5.5.1 Goods of considerable value :

In case the hire purchase transactions relating to goods of substantial sales value, in the Books of buyer's there are three methods of recording hire purchase transactions in the books of the buyer.

1. Treating the goods not becoming the property of the buyer

Under this method goods purchased under hire purchase system will not become the property of the buyer until at the instalment are paid.

5.6 JOURNAL ENTRIES IN THE BOOKS OF BUYER :

1. When an asset is purchased on hire Purchase No Entry
2. For down Payment on the date of agreement

   Asset Account Dr.

   To cash account.
3. When first instalment due

   Asset Account Dr

   Interest Account Dr

   To Hire vender Account.
4. When Instalment Paid.

   Hire vender A/c Dr

   To cash Account.
5. When depreciation charged.

   Depreciation Account Dr

   To Asset A/c.
6. When depreciation and Interest transferred to P & L Account

   Profit & Loss Account Dr To

   interest Account Dr

   To Depreciation Account

Note : Entries 3 to 6 will be repeated in the subsequent years until last instalment paid.

2. Treating the goods as outright property

When the goods purchased on hire purchase system is treated as property of the business, the following entries appears in the books of the buyer.

1. When an asset is purchased on hire purchase system.

   Asset Account Dr

   To Hire Vendor Account
2. For down payment on the date of agreement

   Hire vendor Account Dr

   To Cash / Bank Account.
3. Before 1st instalment date for Interest due

   Interest Account Dr

   To vendor Account
4. For the payment of 1st instalment

   Hire vendor Account Dr

   To Bank Account
5. For depreciation.

   Depreciation Account Dr

   To Asset Account
6. For transfer of interest and depreciation to profit and loss account.

Profit and loss Account Dr

To Interest Account

To Depreciation Account.

Note : Entries 3 to 6 appears in all the years,

3. Interest suspense Method :

Under this method, the total interest payable due to purchase of asset under Hire purchase is debited to interest suspense account, Interest included in each instalment is credited to interest suspense account by giving debit to interest account. The following entries appears in the books of the buyer.

1. When an asset is purchased on hire purchase system.

   Asset Account Dr

   Interest suspense A/c Dr

   To Hire vender A/c.

2. For down payment on the date of agreement. Hire vender Account Dr

   To Bank A/c.

3. For interest due at the end of the year

   Interest Account Dr

   To Interest suspense Account.

4. For the payment of the first instalment

   Hire vendor Account Dr.

   To Bank Account.

5. For depreciation at the year end Depreciation Account Dr

   To Asset Account

6. For transfer of interest and depreciation to profit and loss account

   Profit and Loss account Dr

   To Interest account

   To Depreciation account.

Note : Entries from 3 to 6 will appear every year.

Generally the second method is adopted in the absence of any specific method in the examination Questions.

5.7 JOURNAL ENTRIES IN THE BOOKS OF HIRE VENDOR :

Under the first Method :

1. When goods are sold on hire purchase Hire purchaser's Account Dr

   To sales Account.

2. For cash received on the date of agreement.

   Bank Account Dr

   To Hire purchaser's Account.

3. For interest due on instalment at the end of the year.

   Hire purchasers Account Dr

   To Interest Account.

4. For receipt of the instalment.

   Bank Account Dr

To Hire purchasers Account.

5. For transferring the balance of interest to profit and loss account.

Interest Account Dr

To Profit and loss Account.

Note : Entries of 3 to 5 will appear in every year.

Interest suspense Method :

Under this method, the differences between the hire purchase price and the cash price is credited to the interest suspense account. As and when the interest becomes due on each instalment, it is credited to interest account and corresponding debit given to interest suspense account. The following entries passed under this method.

1. When goods are sold on hire purchase

Hire purchaser's Account Dr

To sales Account

To Interest suspense Account

2. For cash received on delivery

Bank Account Dr

To Hire purchaser's Account

3. For interest due on instalment at the end of the year.

Interest suspense Account Dr

To Interest Account

4. For receipt of the amount of instalment

Bank Account Dr

To Hire purchaser's Account

5. For transfer of Interest to P & L A/c

Interest Account Dr

To P & L A/c

Note : Entries from 3 to 5 appears every year. Interest in the last instalment will be difference between the instalment payable and amount remaining unpaid by way of principal.

5.8 ILLUSTRATION – I :

'Y' acquires from 'X' machine on hire purchase system on 1-1-2004. The cash price is Rs. 60,000. Payment is to be made as follows Down payment Rs 1,00,00 and 21,000 annually for three years. Interest is to be charged @ 12%. p.a pass the necessary journal entries and ledger accounts in the books of both the parties under three Methods.

Solution :

calculation of Interest :

1 - 1 - 2004	Cash price	Instalment	Interest included Purchase In instalment
Down payment on	60,000		----

1-1-2004	10,000	10,000	
due on 31-12-2004 Interest included in 2nd	35,000		
instalment @ 12% on 35,000	16,800	21,000	4,200
due on 1-1-2004.	50,000		
Interest @ 12% on In first instalment	15,000	21,000	6,000
due on 31-12-2005 Interest included in 3rd instalment	18,200		
(Difference between 21,000 - 18,200) Due on 31-12-2005	18,200	21,000	2,800
			13,000
Total	Nil	73,000	

Calculation of Depreciation :

		Rs.
	Cash price on 1-1-2004	60,000
Less	Depreciation @ 20% for 2004	12,000
	Balance on 1-1-05	48,000
Less	Depreciation @ 20% for 2005	9,600
	Balance on 1-1-06	38,400
Less	Depreciation @ 20% for 2006	7,680
	Balance on 1-1-07	30,720

Solution :

First Method : In the books of y & co.

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2004 Jan1	Machinery A/c	Dr		10,000	
	To Bank A/c.				10,000
	(Being down payment paid)				
Dec 31	Machinery Account	Dr		15,000	
	Interest A/c	Dr		6,000	
	To x's A/c				21,000
	(Being Instalment due)				
Dec 31	X's A/c	Dr		21,000	
	To Bank A/c				21,000
	(Being Instalment paid)				
Dec 31	Depreciation A/c	Dr		12,000	
	To Machinery A/c				12,000
	(Being Depreciation charged)				
Dec31	Profit & loss Account	Dr		18,000	
	To Interest A/c				6,000
	To Depreciation A/c				12,000
	(Being interests & Depreciation transferred to P & L A/c)				
2005 Dec31	Machinery A/c	Dr		16,800	
	Interest A/c	Dr		4,200	
	To X's A/c				21,000
	(Being 2nd instalment due)				
Dec 31	x's A/c	Dr		21,000	
	To Bank A/c				21,000
	(Being 2nd Instalment paid)				
Dec 31	Depreciation A/c	Dr		9,600	
	To Matchinery A/c				9,600
	(Being Depreciation charged on Asset)				
Dec 31				13,800	

Date	Particulars		Debit	Credit
	Profit & loss Account	Dr		
	To Interest A/c			4,200
	To Depreciation A/c			9,600
	(Being interests & Depreciation transfered to P&L A/c)			
2006	Machinery A/c	Dr	18,200	
Dec31	Interest A/c	Dr	2,800	
	To x's A/c			21,000
	(Being 3rd instalment due)			

Dec31 x's A/c Dr 21,000

To Bank A/c21,000

(Being 3rd instalment paid)

Dec31 Depreciation A/c Dr 7,680

To Machinery A/c

(Being Depreciation charged on Asset)7,680 Dec31 Profit & loss Account Dr

10,480

To Interest Account2,800

To Depreciation Account7,680

(Being Interest and Depreciation transferred to P & L Account)

LEDGER

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Dec31	To x Account	6,000	2004 Dec 31	By P & L A/c	6,000
2005			2005		
Dec31	To x Account	4,200	Dec31	By P & L A/c	4,200
2006			2006		
Dec31	To x Account	2,800	Dec31	By P & L A/c	2,800

Dr Machinery Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004			2004		

Ja1	To Bank	10,000		By Depreciation A/c	12,000
Dec31	To Bank	15,000	Dec 31	By Bal c/d	13,000
		25,000			25,000
2005 Jan1	To Bal b/d	13,000	2005	By Depreciation	9,600
Dec 31	To Bank A/c	16,000	Dec 31	By Bal c/d	20,200
		29,800			29,800
2006 Jan1	To Bal b/d	20,200	2006	By Depreciation	7,680
Dec 31	To Bank A/c	18,200	Dec31	By Bal c/d	30,720
2007 Jan1		38,400			38,400
	To Bal b/d				

Dr Interest Account Cr

Dr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Dec31	To Machinery A/c	12,000	2004	By P & L A/c Dec 31	12,000
2005 Dec31	To Machinery A/c	9,600	Dec31	2005 By P & L A/c	9,600
2006 Dec31	To Machinery A/c	7,680	Dec31	2006 By P & L A/c	7,680

Second Method :

Depreciation Account Cr

Dr **Journal Entries** Cr

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2004 Jan1	Machinery A/c	Dr		60,000	
	To x's A/c				60,000
	(Being Machinery purchased on Hire purchase)				
Jan1	x's A/c	Dr		10,000	

	To Bank A/c			10,000
	(Being down payment paid)			
Dec 31	Interest A/c	Dr	6,000	
	To x's Account			6,000
	(Being interest due)			
Dec 31	To x's Account	Dr	21,000	
	To Bank A/c			21,0001
	(Being1st instalment paid)			
	Depreciation A/c	Dr	12,000	
Dec31	To Machinery A/c			12,000
	(Being Depreciation charged on asset)			
Dec31	Profit & loss Account	Dr	18,000	
	To Interest Account			6,000
	To Depreciation Account			
	(Being Interest & Depreciation			12,000
	transferred to P & L A/c)			
2005		Dr	4,200	
	Interest Account			
Dec31	To x's A/c (Being interest due)			4,200
Dec 31	x's A/c	Dr	21,000	
	To Bank A/c21,000			
	(Being 2nd instalment paid)			
Dec 31	Depreciation Account	Dr	9,600	
	To Machinery Account9,600			
	(Being Depreciation charged on Asset)			
Dec31	Profit & loss Account	Dr	13,800	
	To Depreciation Account9,600			
	To Interest Account4,200			

	(Being Interest & Depreciation transferred to P & L A/c)		
2006	Interest Account	Dr	2,800
Dec31		To x's Account2,800	
	(Being interest due)		
Dec31	x's Account	Dr	21,000
	To Bank Account21,000		
	(Being 3rd instalment Paid)		
Dec31	Depreciation Account	Dr	7,680
	To Machinery Account7,680		
	(Being Depreciation charged on Asset)		
Dec31	Profit & loss Account	Dr	10.480
	To Depreciation A/c7680		
	To Interest Account2,800		
	(Being Interest & Depreciation transferred to P & L A/c		

Dr **Machinery Account** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Jan1	To x's A/c	60,000	2004	By Depreciation A/c	12,000
Dec 31			Dec 31	By Bal c/d	48,000
2005 Jan1			2005	By Depreciation	
		60,000			60,000
	To Bal b/d	48,000			9,600
			Dec31	By Bal c/d	38,400
		48,000			48,000
2006					

2007	Jan1To Bal b/d2006By	38,400		Depreciation	7,680
				Dec31By Bal c/d	30,720
		38,400			38,400
	Jan1To Bal b/d	30,720			

Dr **'X' Account** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004			2004		
Dec31	To Bank	10,000	Jan 1	By Machinery A/c	60,000
	To Bank	21,000	Dec 31	By Interest A/c	6,000
Dec 31	To Bal c/d	35,000			
2005					
		66,000			66,000
			2005		
Dec 31	To Bank	21,000	Jan 1	By Bal b/d	35,000
Dec 31	To Bal c/d	18,200	Dec 31	By Interest A/c	42,000
		39,200			39,200
2006			2006		
Dec 31	To Bank	21,000	Jan 1	By Bal b/d	18,200
			Dec 31	By Interest A/c	2,800
		21,000			21,000

Dr **Interest Account** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004			2004		
Dec31	To x's A/c	6,000	Dec31	By P & L A/c	6,000
2005			2005		
Dec 31		4,200			4,200

2006 Dec 31	To x's A/c	2,800	Dec31	By P & L A/c	2,800
	To x's A/c		2006 Dec31	By P & L A/c	

Depreciation Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004				2004	
Dec31	To Machinery A/c	12,000	Dec31	By P & L A/c	12,000
2005				2005	
Dec 31	To Machinery A/c	9,600	Dec31	By P & L A/c	9,600
2006					
Dec 31	To Machinery A/c	7,680	2006 Dec31	By P & L A/c	7,680

Dr **Journal Entries** Cr

Date	Particulars	L.F.	Debit Rs.	Credit Rs.
2004	Machinery A/c Dr		60,000	
Jan1	Interest Suspense A/c Dr		13,000	
	To x's A/c			73,000
	(Being Machinery purchased on Hire purchase)			
	x's Account Dr			
Jan1			10,000	
	To Bank A/c			10,000
	(Being down payment paid)			
Dec 31			6,000	

Date	Particulars		L.F.	Dr	Cr
	Interest Account	Dr			
	Interest suspense Account				6,000
	(Being interest due)				
	To x's Account	Dr			
Dec 31				21,000	
	To Bank A/c				21,000
	(Being 1st instalment paid)				
	Depreciation Account	Dr			
Dec31				12,000	
	To Machinery Account				12,000
	(Being Depreciation charged on asset)				
	Profit & loss Account	Dr			
Dec31				18,000	
	To Depreciation Account				12,000
	To Interest Account				6,000
	(Being Interest & Depreciation transferred to P & L A/c)				
	Interest Account	Dr			
2005				4,200	
Dec31	To Interest suspense A/c				4,200
	(Being Interest due)				

Dec31	x's Account	21,000	
	To Bank Account		21,000

Depreciation Account	Dr		9,600
To Machinery Account (Being Depreciation charged on Machinery)			
Profit & loss Account	Dr		13,800
To Depreciation A/c To Interest A/c (Being Depreciation and Interest transferred to P & L A/c)			
Interest Account	Dr		2,800
To Interest suspense A/c (Being interest due)			
x's Account	Dr		21,000
To Bank A/c (Being 3rd instalment paid)			
Depreciation Account	Dr		7,680
To Machinery Account (Being Depreciation charged)			10,480
Profit & loss Account	Dr		
To Interest Account To Depreciation Account (Being Interest & Depreciation transferred to P & L A/c)			

(Being 2nd instalment paid)

2005

Dec31 9,600

Dec31 9,600

4,200

2006

Dec31 2,800

Dec 31

21,000

Dec31

7,680

Dec31

2,800

7,680

Dr **Machinery Account** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To x Account	60,000	2004	By Depreciation	6,000
Jan1			Dec31	By Bal c/d	48,000
2005					
Jan1		60,000	2005	By Depreciation	60,000
	To Bal b/d	48,000			9,600
			Dec31	Bal c/d	38,400
		48,000	2006	By Depreciation	48,000
		38,400			7,680
2006	To Bal b/d				
Jan 1			Dec31	By Bal c/d	30,720
2007					
		38,400			38,400
		30,720			
	To Bal b/d				

Interest suspense A/c

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Jan1	To x' Account	13,000	2004 Dec31	By Interest A/c	6,000
				By Bal c/d	7,000
		13,000			13,000
2005 Jan1	To Bal b/d	7,000	2005 Dec31	By Interest A/c	4,200
				By Bal c/d	2,800
		7,000			7,000
2006 Jan1	To Bal b/d	2,800	2006 Dec31	By Interest A/c	2,800

Dr **X's Account** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004Jan1	To Bank A/c	10,000	2004 Jan1	By Machinery A/c	60,000
Dec 31	To Bank A/c	21,000	Jan1	By Interest suspence A/c	13,000
Dec31	Bal c/d	42,000			
		73,000			73,000
2005 Dec31	To Bank A/c	21,000	2005 Jan1	By Bal b/d	42,000
Dec31	To Bal c/d	21,000			
		42,000			42,000
2006 Dec31	To Bank A/c	21,000	2006 Dec31	By Bal c/d	21,000
		21,000			21,000

First Method : In the books of 'x'

(Being Interest in 1st instalment)

Dec 31 Bank Account21,000

To y’s Account12,000

(Being 1st instalment received)

Dec31 Interest Account Dr 6,000

To Profit & loss Account6,000

(Being interest transferred to P & L Account)

2005 y’s Account Dr4,200

Dec 31 To Interest Account 4,200

(Being interest received)

Dec31 Bank Account Dr 21,000

To y’s Account21,000

(Being 2nd instalment received)

Dec31 Interest Account Dr 4,200

To Profit & Loss Account4,200

(Being interest transferred to P & L Account)

2006 y’s Account Dr2,800

Dec 31 To Interest Account 2,800

(Being Interest due)

Dec31 Bank Account Dr 21,000

To y’s Account21,000

(Being 3rd instalment received)

Dec31 Interest Account Dr 2,800

To Profit & Loss Account28,00

(Being interest transferred to P & L A/c)

LEDGER

Dr y’s Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To H. Sales A/c	60,000	2004 Jan1	By Bank A/c	10,000
Jan1	To Interest A/c	6,000	Dec 31	By Bank A/c	21,000
			Dec 31	By Bank c/d	35,000
		66,000	2005	By Bank A/c	66,000
Dec31		35,000			21,000
2005Jan	To Bal b/d				
Dec31		4200	Dec31	By Balance c/d	18,200
			Dec 31		
2006		39,200			39,200

Jan1	To Interest A/c		2006		
	To Bal b/d	18,200			
Dec31	To Interest A/c	2,800	Dec31	By Bank A/c	21,000
		21,000			12,000

Interest Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Dec1	To P & L Account	6,000	2004	By y's Account Dec31	6,000
2005				2005	
Jan1	To P & L Account	4,200	Dec31	By y's Account	4,200
2006				2006	
Dec31	To P & L Account	2,800	Dec31	By y's Account	2,800

2nd Method :

Journal Entries

Date	Particulars		L.F.	Debit Rs.	Credit Rs.
2004	y's Account	Dr		73,000	
Jan1	To Interest suspense A/c				13,000
	To Hire sales Account				60,000
	(Being Machine sold on Hire) and total interest payable for it)				
Jan1	Bank Account Dr	Dr		10,000	
	To y's Account				10,000
	(Being down payment received)				
Dec 31	Interest suspense Account	Dr		6,000	
	To Interest A/c				6,000
	(Being Interest due in 1st instalment)				
Dec 31	Bank Account	Dr		21,000	
	To y's Account				12,000
	(Being 1st instalment received)				
Dec31	Interest Account	Dr		6,000	

	To Profit & loss Account			6,000
	(Being interest transferred to P & L Account)			
2005 Dec31	Interest Suspense Account	Dr	4,200	
	To Interest Account			4,200
	(Being interest due)			
Dec31	Bank Account	Dr	21,000	
	To y's Account			21,000
	(Being 2nd instalment received)			
Dec31	Interest Account	Dr	4,200	
	To Profit & Loss Account			4,200
	(Being interest transferred to P & L Account)			
2006	Interest Account		2,800	
	To Interest Account			2,800
	(Being Interest due)			
Dec31	Bank Account	Dr	21,000	
	To y's Account			21,000
	(Being 3rd instalment received)			
Dec31	Interest Account	Dr	2,800	
	To Profit & Loss Account			2,800
	(Being interest transferred to P & L A/c)			

LEDGER

Dr y's Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To H. Sale	60,000	2004Jan1	By Bank	10,000
Jan1	To Interest sus A/c	13,000	Dec 31	To Bank	21,000
			Dec 31	Bal c/d	42,000
		73,000			73,000
			2005	By Bank	
2005Jan	Bal b/d	42,000			21,000
2006			Dec31	By Bal c/d	21,000
Jan1					
	To Bal b/d				
			2006		42,000
		42,000			

			Dec31	By Bank	
		21,000			21,000
		21,000			21,000

Dr Interest suspense A/c Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004	To Interest A/c	6,000	2004	By y's Account	13,000
Dec 31	To Bal c/d	7,000	Jan1		
		13,000			13,000
		2005 To Interest A/c 4,200 2005			
2005	To Interest A/c		2005		
Dec 31		2,800	Jan1	By Bal b/d	7,000
2006			2006		
		7,000			7,000
Dec 31	To Interest A/c	2,800	Jan1	By Bal b/d	2,800
		2,800			2,800

Interest Account

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004 Dec31	To P & L A/c	6,000	2004 Dec31	By Interest suspense	6,000
2005 Dec31	To P & L A/c	4,200	2005 Dec31	By Interest suspense	42,000
2006 Dec31	To P & L A/c	2,800	2006	By Interest suspense	28,000

Illustration – II :

When there are different amount of instalments.

Surya purchased a machine on hire purchase system. The total cash price of the machine is 67,000, payable Rs 16,000 down and there instalments of Rs 24,000 Rs. 20,000 and Rs. 18,700 payable at the end of the first, second and third year respectively. Interest is charged at 5% P.a. Charge depreciation at 10% on straight line method. Prepare ledger Accounts in the books of surya.

Solution :

calculation of Interest and Depreciation

year of Payment	Total	Instalment Price	Interest	Cash Price	Deprecation
Machine Purchased	67,000				
Down Payment	8,000	8,000	----	8,000	-----
	59,000				
At the end of 1st year	21,050	24,000	2,950 1900	21050	6,700
At the end of 2nd year	37,950			20100	6,700
	20,100	22000			
	17,850				
At the end of 3rd year					6700
	17,850	18,700	850	17850	
	Nil	72700	5700	67000	

Dr **Machinery Account** Cr

Date	Particulars	Amount	Date	Particulars	Amount
		Rs.			Rs.
	To Hire vendor A/c	67,000	Year end	By Depreciation	6,700
			end	By Bal c/d	60,300
		67,000			67,000

2ndTo Bal b/d2nd yearBy Yearend By Bal c/d	60,300		Depeciation	6,700 53,600
	60,300			60,300
3rdTo Bal b/d3rd yearBy	53,600	Bal c/d	Depreciation endBy	6,700 46,900
	53,600			53,600
4thTo Bal b/d	46,900			

Dr Hire vendor Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1st year	To Bank A/c	8,000	1st Year	By Machinery	67,000
	To Bank A/c	24,000		By Interest	2,950
	To Bal c/d	37,950			
		69,950			69,950
2nd year	To Bank A/c	22,000	2nd year end	By Bal b/d	37,950
	To Bal c/d	17,850		Interest A/c	19,000
		39,850			39,850
3rd	To Bank	18,700	3rd year end	By Bal b/d	17,850
				By Interest A/c By (bal fig)	850
		18,700			18,700

Dr Interest Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1st	To Hire vendor	2,950	1st	By Profit & loss	2950
2nd	To Hire vendor	1900	2nd	By P & L A/c	1900
3rd	To Hire vendor	850	3rd	By P & L A/c	850

Dr Depreciation Account Cr

Date	Particulars	Amount	Date	Particulars	Amount

		Rs.			Rs.
1st	To Machinery	6,700	1st	By P & L A/c	6,700
2nd	To Machinery	6,700	2nd	By P & L A/c	6,700
3rd	To Machinery	6,700	3rd	By P & L A/c	6,700

When the instalments are exclusive of interest :

Illustration – 3 :

On 1st January 2,000 vindhya purchased a machine from Nivedita on Hire - purchase basis. The particulars are as follows;

Cash price is Rs 50,000 payable as follows on signing the agreement Rs 20,000 and balance in three instalments of rs 10,000 each plus interest. Interest is charged at 5% on outstanding balance Depreciation at 10% p.a on written down value method. Prepare Nivedita Account in the books of vindhya.

Dr **Nivedita Account** Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2000 Jan 1	To Bank A/c	20,000	2000	By Machinery A/c	50,000
Dec 31	To Bank A/c	11,500	Jan1	By Interest A/c	1,500
Dec31	To Balance c/d	20,000	Dec31		
2001		51,500	2001		51,500
Dec31	To Bank A/c	11,000	Jan1	By Bal b/d	20,000
Dec 31	To Bal c/d	10,000	Dec31	By interest A/c	1,000
2002		21,000	2002		21,000
Dec31	To Bank A/c	10,500	Jan1	By Bal b/d	10,000
			Dec31	By interest A/c	500
		10,500			10,500

Calculation of interest when rate is not given

If the rate of interest is not given in the problem, first total interest will be calculated by deducting cash price from the total hire purchase price. Then the total interest is distributed in the ratio of outstanding balance of each year.

Illustration 4 :

On 1st January 2000 Akhil took delivery from Nikhil co Ltd of a machine on hire purchase system. Rs 6000 being paid on delivery and the balance in five instalments of Rs 12,000 each payable annually on 31st December. The cash price of the machine was Rs 60000. Calculate the amount of interest of each year.

Solution :

			Rs
2000	Amount Outstanding	After down payment	60,000
2001	Amount Outstanding	After 1st instalment	48,000
2002	Amount Outstanding	After 2nd instalment	36,000
2003	Amount Outstanding	After 3rd instalment	24,000
2004	Amount Outstanding	After 4th instalment	12,000

Total interest for all the five years is Rs 6,000. (66000 - 60000) Which should be divided in the ratio of 5 : 4 : 3 : 2 : 1 for five years.

Hence the interest comes to

2000	Rs 6,000 5 $\frac{5}{15}$	=	Rs 2000
2001	Rs 6,000 5 $\frac{4}{15}$	=	Rs 1600
2002	Rs 6,000 5 $\frac{3}{15}$	=	Rs 1200
2003	Rs 6,000 5 $\frac{2}{15}$	=	Rs 800
2004	Rs 6,000 5 $\frac{1}{15}$	=	Rs 400

Calculation of cash price when it is not given

Sometimes in the question the cash price is not given. For solving the problem first we have to find out the cash price with which the asset account is debited For calculating the cash price first take the final instalment an deduct interest from it. Interest can be calculated by using the formula = Rate of interest /100 + rate of interest. The remaining amount after deducting the interest represents the amount due at the beginning of the year. The opening balance of the current year also represent the closing balance of the previous year after payment of instalment. The total of these two will give the amount due at the end of the last but one year. This procedure followed until the first instalment To that amount add down payment then we can find the cash price of the asset this can be better understood with the following illustration.

Illustration 5 :

On January 1st sai purchased a machine on Hire Purchase under a Hire purchase agreement which provided for an initial payment of Rs 30,000 and the balance in four equal annual instalments of Rs 40,000 each, rate of interest is 6% per annum find out the cash price of the machine.

Solution:

No of instalments	Balance Rs	Amount of instalments	Total Rs	Interest at 6/106	Opening balance Rs
4	Nil	40,000	40,000	2264	37,736
3	37,736	40,000	77,736	4400	73,336
2	73,336	40,000	1,13,336	6415	1,06,920
1	1,06,920	40,000	1,46,920	8320	1,38,600

Cash = 1,38,600 + 30,000(Down payment) = Rs 1,68,600

Illustration 6 :

Little Masters purchase a machinery on instalment basis from Machine Manufacturing co Ltd on the following terms :

a. Cash down payment at the time of signing agreement Rs 24,000

b. Five annual instalments of Rs 15,400

c. Interest at 10% p.a, is charged by the seller.

d. Depreciation at 20% p.a. on W,D.V basis is written off on machinery.

g. Machinery is sold for Rs 30,000 on completion of payments of instalments show the machinery account for the entire period.

Solution :

Dr **Machinery Account** Cr

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
I	To Machine Manufacturers A/c	82,378	I	By Depreciation	16,476
				By Balance c/d	65,902
		82,378			82,378
I	To Balance b/d	65,902	I	By Depreciation	13,180
				By Balance c/d	52,722
		65,902			65,902
III	To Balance b/d	52,722	III	By Depreciation	10,544
				By Balance c/d	42,178
		52,722			52,722
IV	To Balance b/d	42,178	IV	By Depreciation	8,436
				By Balance c/d	33,742
		42,178			47,178
V	To Balance b/d	33,742	V	By Depreciation	6,748
				By Balance c/d	26,994
		33,742			33,742
VI	To Balance b/d	26,994	VI	By Bank A/c	30,000
	To P & L	3,006			
		30,000			30,000

Working :

Calculation of Cash Price.

No of instalments	Balance Rs	Amount of instalments	Total Rs	Interest at 6/106	Opening balance Rs
V	NiLL	15,400	15,400	1,400	14,000
IV	14,000	15,400	29,400	2,672	26,728
III	26,728	15,400	42,128	3,830	38,298
II	38,298	15,400	53,698	4,882	48,816

I	48,816	15,400	64,216	5,838	58,378

Cash Price = 58,378 + 24,000 (Down payment) = Rs 82,378

5.9 SUMMARY :

Most of the trade now - a - days carried on the basis of not only on credit but also under instalment payment, under hire purchase system the buyer acquires the possession of the goods immediately and agrees to pay the remaining balance in instalments. After payment of last instalment the ownership of goods is passed from the seller to buyer. If the buyer makes default in payment of instalment the seller has right to take back the goods from the buyer. The amount already paid is treated as hire charges for using the asset.

5.10 SELF ASSESSMENT QUESTIONS :

1. What do you mean by hire - purchase system ?
2. What is instalment purchase ?
3. Write down the differences between hire purchase and instalment purchase.
4. Write down the features of hire - purchase system.
5. Explain the methods of recording hire purchase transactions in purchaser's book.
6. Explain cash price hire purchase price and down payment.
7. In the absence of Interest rate how can it be calculated ?
8. In the absence of cash price, how can it be calculated ?

5.11 EXCERCISES :

1. Nani purchased a Machine under hire purchase system at a cash price of Rs 56,000. He has to make down payment of Rs 24,000 Further he has to make payment of Rs 10,000 each in four annual instalments. Calculate the interest included in each instalment.
2. PQR company purchased an asset from EFG Co Ltd. On 1-1-2000 on hire purchase system and paid Rs 30,000 at the time of signing the agreement and agreed to pay the balance in four equal instalments of Rs 40,000 each on 31st December every year. Vendor company charges 5% rate of interest per year depreciate the asset at 10% p.a. On straight line mouthed. Write up the ledger accounts in the books of both the parties.
3. Mr. Venkat purchased a machine from Hari on 1st January 2000 on Hire purchase system. The cash price of machine Rs 50,000. Down payment is Rs 26,000. Balance in three equal instalments of Rs 10,000 each. Find out how much interest is included in each instalment.
4. Mr. Kartik purchased a truck on Hire purchase system for Rs 56,000. Payment to be made Rs. 15,000 down and three instalments of Rs 15,000 each at the end of each year. The rate of interest is charged at 5% p.a. on the balance due. The purchaser is depreciating the truck at 10% p.a. on reducing balance method. Write down the necessary journal entries and ledger accounts to record the above transaction in the books of both the parties.

5. On 1st April 2002. Somu purchased a machine on hire purchase by paying Rs 1,500 as initial payment and the balance in four equal instalments of Rs 2,000 each at the end of every year. The rate of interest charged is at 6% p.a. Determine the cash price of the machine.

6. 1-4-2000. Surat Transport company purchased from Metro Motors Ltd., three trucks costing Rs 5,00,000/- each on Hire purchase system. Payment was to be made, Rs 3,00,000 down and the remainder in three equal instalments together with interest at 9% p.a. at the end of each year. Surat transport company writes off depreciation at 20% on reducing balance. Write up the necessary ledger accounts in the books of both the parties.

7. Mr. white purchased a Machinery on hire purchase system and agreed to pay in five instalments at the end of each year, It also agreed to pay interest at 10% p.a. on the balance due of cash price every year. Calculate the interest included in each instalment.

Instalment	Amount paid Rs
1	2,250
2	2,100
3	1,950
4	1,800
5	1,650

8. A Ltd purchased three Buses from B Ltd costing Rs 75,000 each on Hire purchase system. Payment was to be made Rs 45,000 cash down and the remainder in three equal yearly instalments together with interest at 12% p.a B Ltd writes off depreciation at 20% p.a on diminishing balance method. Prepare necessary Accounts in the books of A Ltd.

9. Mr. Mani purchased a machine under Hire - purchases agreement from siddhartha Motars a machine costing Rs 31,000, The payment was to be made as follows.

	Rs
on siging the agreement	6,000
1st, 2nd & 3rd instalments	10000 each

Calculate interest for each year.

10. The Rajastan Transport company purchased three lorries from leyland Motars on Hire purchase system on 1st January 2000. Paying cash Rs 20,000 and agreeing to pay further three instalments of Rs 20,000 each on 31st December each year the cash price of the lorry is Rs 74,500. And the leyland Ltd charge interest at 5% p.a The Madras Transport company writes off 10% o.a. as depreciation on the reducing instalment system. Pass Journal entries and prepare necessary ledger accounts in the books of Rajastan Transport company.

11. A company hires a machine on the hire purchase system. The hire purchase price was Rs. 32,000 payable Rs. 8,000 down and rest in three instalments of Rs 8,000 company is writing off depreciation at 10% on written down value, open necessary ledger accounts in the books of the company.

12. Nikhil delivers a machine on hire purchase system for Rs 150,000 including interest at 10% p.a. on cash value to be paid as follows, Down payment Rs 24,000 1st instalment Rs 36,000, 2nd instalment Rs 66,000 and third instalment Rs 24,000 at end of each year. Show ledger accounts in the books of vendor.

13. Anirudh purchases a L.C.D TV set on Hire purchase basis for Rs 1,00,000 and makes the payment in the following order.

Down payment	Rs 20,000
1st instalment	Rs 40,000
2nd instalment	Rs 20,000
3rd instalment	Rs 20,000
The cash Price is	Rs 86,000

Prepare necessary ledger account in the books of vender.

14. Gowtami purchased a truck on Hire purchase system. The cash price of the truck was Rs 1,49,000. He paid Rs 40,000 on signing of the agreement and rest in three annul instalments of rs 40,000 each calculate interest for each year.

15. Sahiti purchased an asset on hire purchase system on agreement to pay as follows. On down payment Rs 40,000 at the end of first year Rs 56,000, at the end of second year 52,000, at the end of third year Rs 48,000 and at the end of fourth year Rs 44,000. Annul interest rate is 10% prepare necessary ledger accounts in the books of both the parties.

5.12 SUGGESTED READINGS :

Financial Accountancy	:	Shukla Grewal
Financial Accountancy	:	Jain and Narang
Financial Accountancy	:	R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda

LESSON - 6

HIRE PURCHASE SYSTEM- II

OBJECTIVES : In the previous lesson you learned what is Hire purchase ? How these transactions are recorded in the books of both hire purchaser and hire vendor. Already we learned that if a hire purchaser failed to pay any instalment the hire vendor had a right of repossession. After going through the current lesson the student can know how the transactions of repossession recorded in the books ? What is instalment system ? What is the difference between these two ?

STRUCTURE OF THE LESSON :

6.1 Introduction
6.2 Types of repossession
6.3 Accounting treatment in case of partial repossession
6.4 Accounting treatment in case of small value items
6.5 Hire purchase trading Account
6.6 Stock and Debtors system
6.7 Summary
6.8 Self Assessment Questions
6.9 Exercises
6.10 Suggested Readings

6.1 INTRODUCTION :

When the hire purchaser failed to pay any instalment the vendor has a right to repossess the goods sold on hire purchase. The amount already paid is forfeited by treating it as hire charges for using the asset.

6.2 TYPES OF REPOSSESSION :

There are two methods of repossession. They are :

1. The vendor takes the complete repossession of asset and
2. The vendor takes repossession of only a part of the total asset sold on hire purchase system. This is known as partial repossession.

The accounting treatment for these two methods is different. Hence, we discuss them separately.

Accounting treatment in case of complete repossession

In the books of Hire purchaser :

The following steps should be followed by the student to record the transactions relating to complete repossession :

1. In the year of default, entries for interest and Depreciation should be passed as usual that means except the entry for payment, all the entries are passed.
2. Close the account of vendor by transferring the balance to asset account by debiting the vendor's account and crediting the asset account.

3. Balance left in the asset account will represent loss on default and will be closed by transferring to the profit and loss account.

In the books of vendor :

The following steps are necessary in the books of vendor in case of complete repossession.

1. Entry for interest due is passed as usual in the year of default.
2. Close the account of hire purchaser by transferring its balance to repossessed stock account i.e. hire purchaser account is credited and repossessed stock account is Debited.
3. The repossessed stock account is further debited with expenses incurred in repairing or overhauling.
4. When these stock is sold again, with the sale price, the repossessed stock account is credited.
5. The balance in this account represent either profit or loss, this account is closed by transferring this balance to profit and loss account.

This can be better understood with the following illustration.

Illustration – I :

M/s Sri Rama Motar transport Co purchased a truck on hire-purchase system for Rs.2,50,000 on Ist January 2004. Payment to be made Rs.1,00,000 down and three annual instalments of Rs.75,000 each payable on 31st December every year. Rate of interest is 25% per annum. The buyer depreciates the truck at 20 percent per annum on written down value method.

Because of Financial difficulties M/s. Sri Rama Motor Transport Co, after having paid down payment and first instalment at the end of Ist year, could not pay second instalment and the vendor took possession of the truck. Vendor, after spending Rs.75,000 on repairs of the asset sold it away for Rs.1,62,500/-

Open necessary ledger accounts in the books of both the parties to record the transactions of repossession.

Solution :

Calculation of Interest and Depreciation

Date of Payment	Total Cash Price	Instal-ments	Interest	Cash Price	Depreci-ations
Ist Jan 2004	2,50,000				
Down Payment	1,00,000	1,00,000	---	1,00,000	---
31st Dec 2004	1,50,000	75,000		7,5000	
	37,500		37,500		50,000
	1,12,500				
31st Dec 2005	46,875	75,000	28,125	46,875	40,000
31st Dec 2006	65,625	75,000	9,375	65,625	32,000
	65,625	75,000	9,375	65,625	32,000
	Nil	3,25,000	75,000	2,50,000	

In the books of Sri Rama Motor transport company

Dr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2004			2004		
Jan1	To Hire Vendor A/c	2,50,000	Dec 31	By Depreciation	50,000
			Dec 31	By Bal c/d	2,00,000
		2,50,000			2,50,000
2005			2005		
Jan 1	Bal b/d	2,00,000	Dec 31	By Depreciation	40,000
			Dec 31	By Hire Vendor	1,40,625
				By P & L A/c	19,375
		2,00,000			2,00,000

Hire Vendor Account

Truck Account Cr

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2004			2004		
Jan 1	To Bank A/c	1,00,000	Jan 1	By Truck A/c.	2,50,000
Dec31	To Bank A/c	75,000	Dec 3	By Interest A/c	37,5000
Dec 3	Balance C/d	1,12,500			
		2,87,500			2,87,500
2005			2005		
Dec 3	To Truck A/c	1,40,625	Jan 1	By Balance b/d	1,12,500
			Dec 3	By Interest a/c	28,125
		1,40,625			1,40,625

In the Book of Hire Vendor

Sri Rama Motar Transport Company

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2004		2004			
Jan 1	To Sales a/c	2,50,000	Jan 1	By Bank A/c	1,00,000
Dec31	To Interest a/c	37,500	Dec 3	By Bank a/c	75,000
				By Balance c/d	1,12,500
		2,87,500			2,87,500
2005			2005		
Jan 1	To Balance b/d	1,12,500		By Respossed stock	1,40,625

Dec31	To Interest a/c	28,125			
		1,40,625			1,40,625

Repossessed Stock Account

Dr Cr

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2005			2005		
Dec31	To Sri Rama Motor Transport Company A/c	1,40,625	Dec 31	By Bank	16,2,500
Dec31	To Bank a/c	7,500			
Dec31	To P & L A/c	14,425			
		1,62,500			1,62,500

6.3 ACCOUNTING TREATMENT IN CASE OF PARTIAL REPOSSESSION :

The following method is followed in case the seller takes possession of only part of the total assets sold to buyer.

1. In the year of default also pass the entries for interest due and for depreciation as done in the case of complete repossession.
2. In this case both buyer and seller do not close seller's and buyer's account in their respective books. The entry is passed with the agreed value of the asset which is taken away by the seller. The seller always calculate the asset value taken over at a higher rate of depreciation.
3. The buyer finds out the value of asset still left with him using the normal rate of depreciation with this balance the asset account is continued, i.e. this account shows the balance of that asset which is left to him by the seller.
4. After crediting the asset account with the value of asset taken away by the seller and after keeping the balance of the asset left as calculated above the difference shown by the asset account represents either profit or loss on default. This difference is transferred to profit and loss account.

This can be better understood by the following illustration.

Illustration II :

A Transport company purchased 2 trucks costing Rs.1,60,000 each from Seshagiri Auto Ltd., on Ist January 2004, on the basis of hire purchase system. The terms were; payment on delivery Rs.40,000 for each truck. Remainder in 3 equal instalments together with interest at 10% per annum to be paid at the end of each year.

Transport company writes of off 25% depreciation each year on the diminishing balance method. Transport Ltd paid the instalments due on 31st December 2004 and on 31st December 2005 but could not pay the final instalment.

Seshagiri Auto Ltd., repossessed one truck adjusting its value against the amount due. The repossession was done on the basis of 30% depreciation on the diminshing balance method. The vendor spend Rs.16,000 for the repairs and over hauling of the truck and sold it for Rs.80,000.

Write up the ledger accounts in the books of both parties.

Solution :

In the books of Transport company

Dr

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2004			2004		
Jan 1	To Seshagiri Auto Ltd A/c	3,20,000	Dec 31	By Depreciation A/c	80,000
				By Balance c/d	2,40,000
		3,20,000			3,20,000
2004					
Jan1	To Balance b/d	2,40,000	Dec 31	By Depreciation A/c	60,000
			Dec 31	By Balance c/d	1,80,000
		2,40,000			2,40,000
2006			2006		
Jan 1	To Balance b/d	1,80,000	Dec 31	By Depreciation A/c	45,000
			Dec 31	By Seshagiri Auto Ltd.A/c	54,880
			Dec 31	By P & L A/c	12.620
			Dec 31	By Balance c/d	67,500
		1,80,000			1,80,000

Trucks Account Cr

Dr. Seshagiri Auto Ltd. Cr

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2004			2004		
Jan 1	To Bank	80,000	Jan 1	By Trucks A/c	3,20,000
	To Bank	1,04,000	Jan 1	By Interest A/c	24,000
Dec31	To Balance c/d	1,60,000			
		3,44,000			3,44,000
2005					
			2005		
Dec31	To Bank A/c	96,000	Jan 1	By Balance b/d	1,60,000

Dec31	To Balance c/d	80,000	Dec 31	By Interest A/c	16,000
		1,76,000			1,76,000
2006			2006		
Dec31	To Truck A/c	54,880	Jan 1	By Balance b/d	80,000
Dec 3	To Balance c/d	33,120	Dec 31	By Interest A/c	8,000
		88,000			88,000
2007					
Jan 1	By Balance b/d	33,120			

In the books of Seshagiri Auto ltd.

Dr. Transport Company Account Cr

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2004			2004		
Jan 1	To Sales A/c	3,20,000	Jan 1	By Bank A/c	80,000
Dec31	To Interest A/c	24,000	Jan 1	By Bank	1,04,000
			Dec 31	By Balance c/d	1,60,000
		3,44,000			3,44,000
2005			2005		
Jan 1	To Balance b/d	1,60,000	Dec 31	By Bank A/c	96,000
Dec31	To Interest A/c	16,000	Dec 31	By balance c/d	80,000
		1,76,000			1,76,000
2006			2006		
Jan 1	To Balance b/d	80,000	Dec 31	By Repossessed Stock A/c	54,880
Dec31	To Interst A/c	8,000		By Balance c/d	33,120
		88,000			88,000
2007					
Jan 1	To Balance b/d	33,120			

Dr Re possessed Stock Account Cr

Cost 2004	1,60,000
Less: Dep. at 30% P.A.	48,000

Year		Particulars	Amount Rs.	Year		Particulars	Amount Rs.
2006				2006			
Dec31	To	Seshagiri transport Co.A/c	54,800	Dec 31	By	Bank A/c	80,000
Dec31	To	Bank A/c (expenses)	16,000				
Dec31	To	Profit & Loss A/c	9,120				
			80,000				80,000

Working Notes :

1. Value of truck repossessed :

Balance on 1-1-2005	1,12,000
Less : Dep. for 2005 @ 30%	33,600

Balance on 1-1-2006 78,400 Less : Dep. for 2006@ 30% 54,880 23,520

2. Value of truck retained :

Cost 2004	1,60,000
Less : Dep. for 2004 @25%	40,000
Balance on 1-1-2005	1,20,000
Less : Dep. for 2005 @ 25%	30,000
Balance on 1-1-2006	90,000
Less : Dep. for 2006@ 25%	23,500
	67,500

6.4 ACCOUNTING TREATMENT FOR SALES OF SMALL VALUE ITEMS :

When seller sells goods of small value on hire purchase system, it may become inconvenient for him to maintain separate accounts for each customer, as in the case of considerable high value items. Hence under such circumstances he maintains a subsidiary book and records there the date of contract, name of customer, description of the article, number of instalments and dates of payment of instalments.

Profit for this type of business is calculated in two ways 1. by preparing hire- purchase trading account and 2. by preparing hire purchase adjustment account. In detail we will see how these accounts are prepared.

6.5 HIRE PURCHASE TRADING ACCOUNT :

To prepare a hire purchase trading account the following information is needed.

1. **Opening Stock :** This information is not needed if the business is run as a department of the main shop. Like simple trade account, this figure is shown on the debit side of hire-purchase trading account.

2. **Instalment unpaid and not due :** This information is needed whether the business is run as a department or as an independent business. This information is available at hire purchase price so it must be reduced to cost price and then shown on the debit side of hire-purchase trading account.

3. **Purchases :** If the business is run independently then purchases term is used. But when business is run as a department, then the information relating to purchases made by the department is given under the term, 'goods sold during the year'. Since goods sold during the year are given at hire purchase price, they are reduced to cost price. This is shown on the debit side of hire purchase trading account.

4. **Sales :** Hire purchase trading account is credited with sales. But in hire purchase trading account, instead of showing single figure of sales three figures are shown. Opening balance of instalments due but not received is shown on the debit side of the trading account and cash received from customers during the year and closing balance of instalments due but not received are shown on the credit side.

5. **Stock at the end :** This is shown on the credit side of hire purchase trading account except in case of department of the main shop.

6. **Stock with customers :** This is shown on the credit side of hire-purchase trading account as cost price irrespective of the type of business. It is also termed as instalments unpaid and not due.

This can be better understood with the following illustration.

Illustration 3 :

Vinod sells goods on hire-purchase system at cost plus 60 percent. From the following prepare Hire-purchase Trading Account.

2006

April 1	Goods out on hire purchase at hire purchase price	Rs. 1,60,000
2007 March 31	Instalments not due and unpaid	3,60,000
	Instalments due and unpaid	20,000

The following transactions took place during the year :

1. Goods sold on hire purchase system at hire purchase price 8,00,000
2. Cash received from customers on hire purchase price 5,60,000
3. Goods received back on default (Instalments due Rs.20,000) valued at 4,000

Solution :

Dr.

Date	Particulars	Amount Rs	Date	Particulars	Amount Rs
	To Goods out on hire purchase at cost $(1,60,000 \times \frac{100}{160})$	1,00,000		By Cash received	5,60,000
				By Instalment due	20,000
				By Returns	4,000
	To Goods sold at Cost $(8,00,000 \times \frac{100}{160})$	5,00,000		By Instalments not due at cost $(3,60,000 \times \frac{100}{160})$	2,25,000
	To Net profit	2,09,000			
		8,09,000			8,09,000

Hire Purchase Trading Account Cr.

Note : When goods are received back they are included into stock at cost price or market price whichever is lower and are shown in the trading account on the credit side.

Illustration 4 :

Vyshnavi & Co has a hire-purchase department and goods are sold on hire-purchase at cost plus 60%. From the following information prepare Hire purchase Trading Account to ascertain the profit or loss made in the hire-purchase department.

2006

April 1 Goods with Hire purchase customers at (H.P. Price) 3,20,000

March 31 Goods sold on hire-purchase during the year at H.P. price 16,00,000 Cash received during the year from customers 11,20,000 Repossed goods valued at (Instalments due Rs.40,000) 6,000

Goods with the H.P. customers at H.P. price 7,20,000

Solution :

Vyshnavi & Co

Dr.

Year	Particulars	Amount Rs.	Year	Particulars	Amount Rs.
2006			2006		
April	To Stock	3,20,000	April.1	By Bank	11,20,000
	To Goods sold	16,00,000		By Repossessed stock	6,000
	To Stock Reserve (72,000x 60/160)	2,70,000		By Instalments due	40,000
				By Hire purchase Stock	7,20,000
	To P & L	4,16,000		By Stock Reserve A/c (3,20,000 x)	1,20,000
				By Goods sold on H.p. (16,00,000 x 60/100)	6,00,000
		26,06,000			26,06,000

Goods sold on Hire Purchase Account

Dr. Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2007			2006		
Marh31	To Hire purchase (Loading)	6,00,000	April 1	By H.P. Trading A/c	16,00,000
	To Purchases A/c	10,00,000			
		16,00,000			16,00,000

Hire purchase Trading Account Cr.

Dr. **Instalments due Account** Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2007			2007		
Mar31	To H.P. Trading A/c.	40,000	Mar 31	By Balance c/d	40,000
		40,000			40,000
Aprl1	To Balance b/d	40,000			

Dr. Hire Purchase Stock Account Cr

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
2007			2006		
APrl1	To Balance b/d	3,20,000	April 1	By H.P,. Trading A/c. (transfer)	3,20,000
Mar31	To H.P. Trading A/c	7,20,000	Mar 31	By Balance c/d	7,20,000
	To Balance b/d	7,20,000			

Dr. **Stock Reserve Account** Cr.

Date	Particulars	Amount Rs.	Date Rs.	Particulars	Amount
2007			2006		
Mar31	To H.P. Trading A/c (Transfer)	1,20,000	Aprl.1	By Balance b/d	1,20,000
2007			2007		
Mar31	To Balance c/d	2,70,000	Mar.31	By H.P. Trading A/c	2,70,000
			Aprl	By Balance b/d	2,70,000

Working

Calculation of instalments due :	Rs.
Op.Stock (H.P. Price)	3,20,000
Good sold	16,00,000
	19,20,000

	Rs.	
Less : Cash received	11,20,000	
Repossessed goods (H.P. Price)	40,000	
Stock with customers	7,20,000	18,80,000
Instalments due		40,000

6.6 STOCK AND DEBTORS SYSTEM :

Under this method the following ledger accounts are prepared

1. Hire purchase stock account
2. Shop stock account
3. Hire purchase debtors account
4. Goods on hire -purchase account.
5. Hire purchase adjustment account.

The following journal entries are passed to record the transactions under this system.

1. When goods are made available for sale on hire purchase:

   Shops stock A/c Dr
   To Purchase A/c (at Cost price) (Being goods available for Sale)

2. When goods sold on HP.

   Hire purchase stock A/c Dr
   To goods sold on H.P. A/c
   (at sale price)
   Goods sold on H.P. A/c (Sale price) Dr
   To Shop stock A/c (Cost price)
   To H.P. Adjustment A/c

3. When instalments become due

   Hire purchase debtors A/c Dr
   To Hire purchase Stock A/c

4. When cash is received

   Cash A/c Dr
   To Hire purchase Stock A/c

5. For loading included in instalment not due

   H.P. Adjustment A/c Dr
   To Stock Reserve A/c

6. For instalments not paid of repossessed goods

   Repossessed goods A/c Dr
   To Hire purchase debtors A/c

7. For Profit

   H.P. Adjustment A/c

   To P & L A/c

8. For Loss

   P & L A/c Dr

   To H.P. Adjustment A/c

Illustration 5 :

A trader sold out goods on hire purchase at a profit of 25% on cost price. Prepare a. Hire purchase stock Account b. Shop stock account and cl. Hire purchase Debtor's account in the books of the Trader from the following details.

Stock in godown :	Rs.
On 1-4-2006	1,20,000
On 31-3-2007 Over	1,00,000
due instalments :	
On 1-4-2006	8,000
On 31-3-2007	12,000
Goods with customers on hire purchases	
On 1-4-2006	1,44,000
Purchases	2,58,400
Instalments received	2,40,000

Solution :

H.P. Stock A/c

Date	Particulars	Invoice	Amount Rs.	Date	Particulars	Invoice	Amount Rs.
1-1-06	To Bal b/d	1,44,000	1,15,200	31-3-07	By H.P. Debtors A/c	2,44,000	2,44,000
31-3-07	To Goods sold	3,48,000	2,78,400	31-3-07	By Bal c/d	2,48,000	1,98,400
31-3-07	To Gross profit	---	48,899				
		4,92,000	4,42,400			4,92,000	4,42,400

Dr. Shop Stock A/c Cr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1-4-06	To Bal b/d	1,20,000	31-307	By Cost of goods	
31-3-07	To purchase A/c	2,58,400	31-3-07	Sold on H.p.	2,78,400
			31-3-07	(Bal fig)	

			31-3-07	By Bal c/d	1,00,000
		3,78,400			3,78,400

Dr.

Date	Particulars	Amount Rs.	Date	Particulars	Amount Rs.
1-4-06	To Bal b/d	8,000	31-307	By Bank A/c	2,40,000
31-3-07	To H.P. Stock A/c	2,44,000	31-3-07	By Balance c/d	12,000
		2,52,000			2,52,000

H.P. Debtors A/c

6.7 SUMMARY :

The hire - vender can repossess the goods sold on hire purchase if the purchaser commits default in payment of any instalment Repossession can be complete or partial. Partial repossession occurs when the vender sells different goods on hire purchase to the same party and allows him to continue his business with goods not repossessed. When hire purchase transactions are of small value, the hire vender may prepare Hire purchase trading account on stock method. Under stock and debtors method, hire purchase stock account, goods on hire purchase account and Hire purchase adjustment account are prepared.

6.8 SELF ASSESSMENT QUESTIONS :

1. What is Hire purchase trading account ? Why is it prepared ? Give a proforma.
2. What is the difference between hire purchase trading account and Hire purchase adjustment account.
3. Explain the methods of repossession.

6.9 EXERCISES 1 :

1. X Purchased a machine on 1st Jan 2000 on Hire - purchase system. The cash price of the machine is Rs 149000. The terms of the agreement provided for payment of Rs 40,000 at the end of every six months over two years. The first payment was to be made on 30th June 2000. Rate of interest is 6% p.a. Wrote off 10% Depreciation on the reducing balance system and closed his books on 30th June every year. Could not pay the instalment due on 30th June 2001 and as a result, the hire vender took back the machine give the machine a/c and vender account in the books of X.

2. Y Ltd purchased a machine from Z Ltd on 1st January 2001 on the Hire purchase system. The cash price of the machine was Rs.1,20,000, payment was to be made Rs 40,000 half yearly over two years. The first payment was to be made on 30th June 2001. Rate of interest 5% p.a. Depreciation to be written off @ 10% p.a on the diminishing balance method. The books of

accounts were closed on 30th June every year. The instalment due on 30th June 2002 could not be paid and as a result of which the vender took repossession of the machine. Prepare machine account and hire vender account in the books of Ltd.

3 Pavan purchased six trucks on hire - purchase on 1st July 2002. The cash price of each truck was Rs 2,50,000. He was to pay 20% of the cash purchase price at the time of delivery and the balance in five yearly instalments starting from June 2003 with interest at 20% per annum.

On pavan's failure to pay the instalment due on June 2004 it was agreed that pavan would return 3 trucks to the vendor and remaining would be retained by him. The returned trucks were valued at 30% per annum where as pavan depreciates trucks at 20% p.a. Vender after spending Rs 5000 on repairs sold away all the three trucks for Rs 2,00,000 Show necessary accounts in the books of both the parties.

4. On January 2000 Yogesh acquires 3 machines on hire purchase from Somesh at 10% p.a interest Yogesh immediately pays Rs 1,20,000 and also agrees to pay in three annual instalments of Rs. 2,00,000 each. The first instalment becoming due at Dec 31, 2000. Yogesh duly pays the first instalment but fails to pay thereafter, on yogesh's default somesh repossessed all machines yogesh is charging depreciation at 20% p.a on straight line basis at 31st December each year, show the relevant ledger accounts in the books of both the parties.

5. Naveen purchased four machines of Rs 70,000 each from Praveen under hire purchase system. The down payment is Rs 75,000 and three instalments of Rs 75,000 each at the end of each year. Naveen depreciates the machines at 10% per annum on the straight line method. Down payment and first instalment were paid. Naveen could not pay the second instalment and therefore praveen took back three machines leaving one machine with Naveen. The machines were taken at 20% depreciation on written down method. Praveen repaired the machines at a cost of Rs 15,600 and sold them for Rs 1,75,000.

Prepare necessary ledger accounts in the books of both the parties.

6. Nitin sells goods on hire purchase price which is made of profit at 50% on hire purchase Price. Calculate profits from the information given below by preparing Hire Purchase trading and Hire - purchase adjustment accounts.

2006		Rs.
April	Instalments due	4,50,000
2007		
March 31	Instalments due during the year	12,00,000
	Cash received during the year	15,00,000
	goods sold during the year Instalments unpaid (not due)	12,60,000
	On 31 March 2007	3,00,000
	Goods repossessed during the year	
	(amount due 15,000) valued at	1,500

7. Rajesh sells goods at hire - purchase price. Hire purchase price is made of profit at 50% on hire purchase price. Calculate profit from the information given below by preparing hire purchase trading account.

2007		Rs.
Jan 1	Instalments due in the beginning	75,000
Dec 31	Instalments due during the year	2,00,000
	Cash received during the year	2,50,000
	goods sold during the year Instalments un paid (not due)	2,10,000
	on 31st December goods repossessed during	50,000
	the year (amount due Rs 2,500)	500

8. Comfort furnishers supply the furnishing on hire purchase. Terms at a profit of 50% over the cost. The following are the transactions for the year ended 31st Dec 2007.

2007		Rs.
Jan 1	stock out on hire at cost	1,20,000
Jan 1	Instalments due (customers still paying) goods repossessed during the year	10,800
	(for instalments unpaid) evaluated at	900
	instalments realised during year.	234000
Dec31	stock out on hire at cost	114000
Dec 31	Instalments due (customers still paying)	18,000

Prepare hire purchase stock account Hire purchase debtors account and Hire- purchase adjustment account.

6.10 SUGGESTED READINGS :

Financial Accountancy : Shukla Grewal

Financial Accountancy : Jain and Narang

Financial Accountancy : R.L. Gupta & V.K. Gupta

Dr. Ch. Suravinda

LESSON - 7
PARTNERSHIP ACCOUNTS I – ADMISSION OF A PARTNER

OBJECTIVES :

After going through the lesson you will be able to understand the following:

1. Definition and meaning of partnership.
2. Accounting procedure while a new partner joins the partnership.
3. Method of calculating goodwill in view of admission.

STRUCTURE OF THE LESSON :

7.1 DEFINITION AND MEANING OF PARTNERSHIP :

According to Section 4 of Indian Partnership Act, Partnership is "the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

The above definition gives the following features to a partnership:

1. It is an association of two or more persons.
2. It has an agreement entered by all the partners concerned.
3. It deals with a business.
4. It can be carried on by all partners or any of them can act for them.
5. The partners share profits and losses as per the agreement.

7.2 ACCOUNTS IN PARTNERSHIP :

Partnership accounts do not present much difficulty unless there is an admission, retirement, death or dissolution. Profit and Loss Account is prepared in the usual way and the Balance Sheet is also made out in the usual manner. In this lesson we learn how to prepare accounts when a new partner enters the organization i.e. admission. The following four lessons deals with other areas of partnership accounts.

7.3 ADMISSION IN PARTNERSHIP :

It is a usual thing that some new partners join the partnership often which is already in existence and the firm continues its operations as usual with the old and new partners together. When a new person is admitted as partner, the two main problems to be tackled are regarding

a) treatment of goodwill and
b) revaluation of assets and liabilities.

7.4 TREATMENT OF GOODWILL :

It is generally observed that a firm, which has been in existence for a number of years, is in a position to earn a higher amount of profits year after year in comparison to a new firm in spite of all other things remaining the same. This is because over a period of time a firm establishes its reputation on account of which not only the old customers continue to patronize the firm but they also bring new customers. This results in enabling an old established firm to earn excess profits as compared to a new firm. Goodwill has, therefore, been defined as, "the present value of a firm's anticipated excess earnings".

In the ongoing firm when a new partner is admitted, he automatically enjoys the benefits of the firm i.e. the goodwill. Therefore, generally the new partner needs to bring some extra amount towards this goodwill and the existing partners share this in their agreed ratio.

Depending upon the share of profits to be given to the new partner, either a sum of money will be paid by him to the old partners (through the firm or privately) or the old partners will be credited with their share of the goodwill. As said earlier, the new partner will take a share of profits which comes out of the shares of other partners. The old partners must be compensated for such a loss. The amount to be brought in by the new partner for goodwill is in addition to the amount to be brought in as capital.

The following are the various possibilities as regards goodwill;

1. Premium Method: Under this method, the new partner brings goodwill in cash which is left in the business or that cash is withdrawn by the old partners. Sometimes, new partner may pay the goodwill to the old partners privately.

Journal entries:

a) When the new partner brings goodwill in cash which is left in the business —

i) Cash/Bank A/C Dr

To Goodwill

ii) Goodwill A/C Dr

To Old partners Capitals

b) When goodwill brought in by new partner withdrawn by old partners ——

i) Cash/Bank A/C Dr

To Goodwill

ii) Goodwill A/C Dr

To Old partners Capitals iii)

Old partners Capitals A/C Dr

To Cash/Bank

c) When the goodwill is paid by the new partner to the old partners privately, No entry is required.

2. Revaluation Method: The new partners do not bring cash as goodwill but is raised in the books of the firm. The entry required is as follows:

Goodwill A/C Dr

To Old partners Capitals

The old partners Capital accounts are to be credited in their old profit sharing ratio. Goodwill thus created appears in the balance sheet.

3. Memorandum Revaluation Method: Under this method, goodwill is raised in the books and then is immediately written off. In the above case, goodwill is credited to the old partners in the old profit-sharing ratio. But when it is to be written off, the goodwill should be credited to all partners in the new profit sharing ratio.

When a new partner comes into the organization, the existing ratio of the old partners should be changed to accommodate him. And the partners who are losing their part of the share should get benefit in the form of goodwill. This is called as sacrificing ratio. For example, A and B, sharing in the ratio of 3:2 and admit C as partner and it is agreed that the new profit-sharing ratio is 2:2:1. It is obvious that B does not suffer at all on C's admission. He previously received 2/5ths of profits; he still receives 2/5ths of profits. It is A alone who has suffered and, therefore, any amount brought in as goodwill by C should be credited to A only. Thus, it is proper to credit goodwill brought in by a new partner to the old partners in the ratio in which they suffer on the admission of the new partner.

Goodwill to be inferred: Sometimes, the value of goodwill is not specifically given and has to be inferred from the arrangement of capital and profit-sharing ratio. Suppose, A's capital is Rs.5, 000 and B's capital is also Rs.5, 000 and they share profits equally. They admit C, as equal partner, on his bringing in Rs.8, 000 as capital. In this case, the point is that C's capital should only be one-half of the combined capitals of A and B. If C's capital is Rs.8, 000 the combined capitals of A and B should be Rs.16, 000. Since their present capital is Rs.10, 000, there must be goodwill of Rs.6000 to be shared equally by A and B.

7.5 REVALUATION OF ASSETS AND LIABILITIES :

When a new partner is admitted, it is natural that he should not benefit any appreciation in the value of assets which has occurred or vice versa in the value of assets. Similar is the case with liabilities. Therefore, assets and liabilities are revalued and the old partners are debited or credited with the net loss or profit, as the case may be, in the ratio in which they have been sharing profits and losses. Partners may agree that the change in the value of assets and liabilities is to be adopted and figures changed accordingly or that the assets and liabilities should continue to appear in the books of the firm at the old figures.

1. When valued are altered in the books: In this case, a profit and loss adjustment account (or revaluation account0 is opened and the result is to be transferred to the capitals of the old partners in their profit sharing ratio.

a) For an increase in asset the following entry is required ——

Asset A/c Dr

To P & L Adj. A/C

b) For a reduction in asset——

P & L Adj. A/C Dr

To Asset A/C

c) For increase in liabilities——

P & L Adj. A/C Dr

To Liability

d) For a decrease in liabilities——

Liability A/C Dr

To P & L Adj. A/C

2. When values are not altered in the books: In this case, the increase in the amounts of assets and liabilities is entered in a Memorandum Adjustment or Revaluation Account but the corresponding entry is not made in the asset or liability accounts and the balance is transferred to old partners' capital accounts in the old ratio. Then, to complete double entry, the entries made in the Memorandum Adjustment Account are put down on the reverse side and the balance transferred to all partners, including the new one, in the new profit-sharing ratio.

7.6 ILLUSTRATIONS :

Illustration 1:

R and S are equal partners in a firm. They decided to admit T as a new partner and to readjust the Balance Sheet values for this purpose. The balance sheet of the firm as at 31st December, 2007 was as under.

Creditors			5,000	Machinery		5,000
Bills payable			2,000	Furniture		3,500
Capital:				Stock		3,000
R	7,500			Debtors	5,800	
S	5,000	12,500		Less: Reserve	300	5,500
				Cash		2,500
			19,500			19,500

The following adjustments were to be made before T's admission:

a) Rs.500 more to be provided for bad debts.

b) Furniture is to be valued at Rs.3, 000.

c) Value of machinery is to be appreciated by Rs.1, 000.

d) Investments worth Rs.600 (not included in Balance Sheet) are to be taken into account.

e) T brings Rs.5, 000 for capital and Rs.2, 000 for Goodwill. The amount of Goodwill isshared by R and S in their due proportions. Give journal entries and prepare the Balance Sheet of the firm after admission of T as a partner.

Solution:

Profit and Loss (Adj) A/C	Dr	1,000	
To Reserve for bad debts			500
To Furniture			500
(Being Assets value reduced)			
Machinery A/C	Dr	1,000	
Investments A/C	Dr	600	
To Profit and Loss (Adj) A/C			1,600
(Being Assets value raised)			
Profit and Loss (Adj) A/C	Dr	600	
To R's Capital A/C			300
To S's Capital A/C			300
(Being profit distributed to partners)			
Cash A/C	Dr	7,000	
To T's Capital A/C			5,000
To Goodwill			2,000
(Being Capital and Goodwill brought in by T)			
Goodwill A/C	Dr	2,000	
To R's Capital A/C			1,000
To S's Capital A/C			1,000
(Being Goodwill distributed between R and S)			

Balance Sheet of the New Firm

Liabilities		Assets	
Creditors	5,000	Furniture	3,000
Bills payable	2,000	Machinery	6,000
Capital:		Stock	3,000

R	8,800		Investments		600
S	6,300		Debtors	5,800	
T	5,000	20,100	Less: Reserve	800	5,000
			Cash		9,500
		27,100			27,100

Working Notes:

Profit and Loss Adj. Account

To Reserve for bad debts		500	By Machinery	1,000
To Furniture		500	By Investments	600
To R's Capital	300			
To S's Capital	300	600		
		1,600		1,600

Illustration 2 :

Mukund and Makarand were partners in a firm sharing profits equally. Their business position as on 30th June 2007 was as follows:

Balance Sheet

Liabilities			Assets
Sundry Creditors	6,000	Cash in hand	150
Bank overdraft	1,500	Stock	3,600
Mukund capital	2,100	Sundry debtors	6,200
Makarand capital	1,600	Furniture	600
		Investments	650
	11,200		11,200

It is agreed to take Manohar into partnership and to make the following adjustments:

a) Bad debts to be written off for Rs.1, 600.

b) Value of the furniture to be reduced to Rs.400

c) Depreciate stock at 10%.

d) Write off 20% on investments.

e) Create goodwill for Rs.1, 000.

Manohar introduced Rs.1, 000 as capital for his 1/3 share. Other partners' capitals should be adjusted according to the new partner's capital.

Pass necessary journal entries and prepare the balance sheet of the new firm.

Solution:

Profit and Loss (Adj) A/C	Dr	2,290	
To Reserve for bad debts			1,600
To Furniture			200
To Stock			360
To Investments (Being assets value reduced)			130
Mukund Capital A/C	Dr	1,145	
Makaran Capital A/C	Dr	1,145	
To Profit and Loss (Adj) A/C (Being profit transferred to capital accounts)			2,290
Goodwill A/C	Dr	1,000	
To Mukund Capital			500
To Makarand Capital			500
(Being goodwill created)			
Cash A/C	Dr	1,000	
To Manohar Capital A/C			1,000
(Being capital brought in by Manohar)			
Cash A/C	Dr	45	
To Makarand Capital			45
(Being the cash brought in)			

Mukund Capital A/C	Dr	455	
To Cash			455
(Being cash paid)			

Mukund Capital Account

To Profit & Loss A/C	1,145	By Balance B/D	2,100
To Cash	455	By Goodwill	500
To Balance C/D	1,000		
	2,600		2,600

Makarand Capital Account

To Balance B/D	150	By Mukund's Capital	455
To Manohar's Capital	1,000	By Balance C/D	740
To Makarand's Capital	45		
	1,195		1,195
To Balance B/D	740		

Balance Sheet of the New firm

Liabilities			Assets		
Creditors		6,000	Cash		740
Overdraft		1,500	Stock		3,240
Capitals:					
Mukund	1,000		Debtors	6,200	
Makarand	1,000		Less: R.B.D	1,600	4,600
Manohar	1,000	3,000	Furniture		400
			Investments		520
			Goodwill		1,000
		10,500			10,500

Working notes:

Profit sharing ratio of old partners: 1:1

New partners share 1/3

Remaining 1-1/3 = 2/3

Mukund’s share 2/3X1/2=1/3

Makaran’s share 2/3X1/2=1/3

To Profit & Loss A/C	145	By Balance B/D	1,600
To Balance C/D	1,000	By Goodwill	500
		By Cash	45
	2,145		2,145

Manohar Capital Account

		By Cash	1,000

Goodwill Account

To Mukund’s Capital	500	By balance C/D	1.000
To Makarand’s Capital	500		
	1,000		1,000

Cash Account

Manohar’s Capital for his 1/3 share = 1,000

Mukund’s Capital for his 1/3 share = 1,000

Makarand’s Capital for his 1/3share = 1,000

Illustration 3:

Anup and Bhupal share profits in the proportion of three-fourths and one-fourths. The Balance Sheet on December 31, 2006 was as follows:

Sundry creditors	41,500	Cash at Bank	22,500
Anup’s Capital	30,000	Bills receivable	3,000
Bhupal’s Capital	16,000	Debtors	16,000
		Stock	20,000
		Fixtures	1,000
		Buildings	25,000

	87,000	87,500

On January 1, 2007 Chandrajit was admitted into partnership on the following terms:

a) That Chandrajit pays Rs.10, 000 as his capital for a fifth share.

b) That Chandrajit pays Rs.5, 000 for goodwill half of this sum is to be withdrawn by Anupand Bhupal.

c) That the capitals of Anup and Bhupal be adjusted on the basis of Chandrajit's capital by opening the necessary current accounts.

d) That Stock and Fixtures be reduced by 10% and a 5 % provision be created for doubtfuldebts on Debtors and Bills receivable.

e) That value of Buildings is appreciated by 20%.

f) That an item of Rs.650 included in creditors is not likely to be claimed and hence should be written back.

Solution:

Profit and Loss (Adj) Account

To Stock		2,000	By Buildings	5,000
To Fixtures		100	By Creditors	650
To Reserve for bad debts		800		
To Reserve on Bills		150		
To Anup's Capital	1,950			
To Bhupal's Capital	650	2,600		
		5,650		5,650

Anup Capital Account

To Cash	1,875	By Balance B/D	30,000
To Current A/C	3,825	By Profit & Loss A/C	1,950
To Balance C/D	30,000	By Goodwill	3,750
	35,700		35,700

Bhupal Capital Account

To Cash	625	By Balance B/D	16,000
To Current A/C	7,275	By Profit & Loss A/C	650
To Balance C/D	10,000	By Goodwill	1,250

17,900

17,900

Chandrajit Capital Account

10,000

By Cash

Anup Current Account

3,825

By Capital

Bhupal Current Account

7,275

By Capital

Cash Account

To Balance C/D	22,500	By Anup Capital	1,875
To Chandrajit capital	10,000	By Bhupal Capital	625
To Goodwill	5,000	By Balance C/D	35,000
	37,500		37,500

Balance Sheet of the firm as on 1-1-2007

Liabilities			Assets		
Creditors		40,850	Cash at Bank		35,000
Capitals:			Bills receivable		2,850
Anup	30,000		Debtors	16,000	
Bhupal	10,000		Less: RBD	800	15,200
Chandrajit	10,000	50,000	Stock		18,000
Current Accounts:			Fixtures		900
Anup	3,825		Buildings		30,000
Bhupal	7,275	11,100			
		1,01,950			1,01,950

Working notes:

Old partners' profit sharing ratio = ¾: ¼ : 1 share 10,000 Capital

New partner ratio = 1/5 (420) : 3 share 30,000 Capital

Remaining = 1-1/5 = 4/5

Anup new Ratio = 4/5 x ¾ = 12/20

Bhupal new Ratio = 4/5 x ¼ = 4/20

New profit sharing ratio = 3 (Anup) : 1 (Bhupal) : 1 (Chandrajit)

Illustration 4:

The balance sheet of Sridhar and Muralidhar as on 31st December 2007 is set out below. They share profits and losses in the ratio of 2:1.

Liabilities		Assets	
Sridhar's Capital	40,000	Freehold property	20,000
Muralidhar's Capital	30,000	Furniture	6,000
General Reserve	24,000	Stock	12,000
Creditors	16,000	Debtors	60,000
		Cash	12,000
	1, 10,000		1, 10,000

They agree to admit Purnachandra into the firm subject to the following terms and conditions:

a) Purnachandra will bring in Rs.21, 000 of which Rs.9, 000 will be treated as his share of goodwill to be retained in the business.

b) He will be entitles 1/4th share of the profits of the firm.

c) Fifty per cent of the general reserve is to remain as a reserve for bad and doubtful debts.

d) Depreciation is to be provided on furniture at 5%.

e) Stock is to be revalued at Rs.10, 500.

Show the journal entries giving effect to the above said arrangements (including cash transaction) and prepare the opening balance sheet of the new partnership.

Solution:

Profit & Loss (Adj) A/C	Dr	1,800
To Furniture		300
To Stock		1,500

(Being assets value reduced)

Sridhar capital A/C	Dr	1,200	
Muralidhar capital A/C	Dr	600	
To Profit & Loss (Adj) A/C (Being loss distributed among partners)			1,800
General Reserve A/C	Dr	12,000	
To Reserve for bad debts (Being provision created from reserve)			12,000
General Reserve A/C	Dr	12,000	
To Sridhar Capital			8,000
To Muralidhar Capital			4,000
(Being reserve distributed)			
Cash A/C	Dr	21,000	
To Purnachandra Capital			12,000
To Goodwill			9,000
(Being capital and goodwill brought in by Purnachandra)			
Goodwill A/C	Dr	9,000	
To Sridhar Capital			6,000
To Muralidhar Capital			3,000
(Being goodwill distributed)			

Balance sheet of the new firm

Liabilities			Assets		
Capitals:			Freehold premises		20,000
Sridhar	52,800		Furniture		5,700
Muralidhar	36,400		Stock		10,500
Purnachandra	12,000	1, 01,200	Debtors	60,000	
Creditors		16,000	Less: RBD	12,000	48,000
			Cash		33,000

1, 17,200

Working Notes; 1, 17,200 Capital Accounts

	Sridhar	Muralidhar	Purna		Sridhar	Muralidhar	Purna
To P & L A/C	1,200	600	——	By Balance	40,000	30,000	—
To Balance C/D	52,800	36,400	12,000	By Cash			12,000
				By Gl. Reserve	8,000	4,000	
				By Goodwill	6,000	3,000	
	54,000	37,000	12,000		54,000	37,000	12,000

Illustration 5:

On 1st January 2007, A and B who were in partnership sharing 7/12 and 5/12 respectively, take in C giving him 1/6 share. A and B were to share future profits in the ratio of 13/24 and 7/24.

Over and above his capital, C brings in Rs. 96, 000 as his goodwill for the 1/6 share. The cash brought in by C as his capital and his goodwill is credited to one separate account in his personal name. On 31st December 2007, the Trial Balance of the firm stood as follows:

Machinery	6,00,000	A's Capital	3,36,000
Furniture	40,000	B's Capital	2,40,000
Stock	1,20,000	C's Capital	2,24,000
Debtors	2, 00,000	Creditors	48,000
A's drawings	32,000	Current year's profit	2,32,000
	10, 80,000		10,80,000

Interest on drawings is to be ignored but interest on capital accounts is to be allowed at 5% per annum after the necessary adjustments therein consequent one's admission. Prepare the Balance Sheet of the firm as on December 31, 2007.

Solution:

Working Notes:

Profit sharing ratio of A & B before C's admission = 7/12 : 5/12

Profit sharing ratio of A & B after C's admission = 13/24 : 7/24

Sacrificing ratio : A = 7/12- 13/24= 14-13/24 = 1/24

B = 5/12 – 7/24 = 10-7/24 = 3/24

= 1:3

The goodwill brought in by C (which is kept in an account opened in his personal name) is to be shared by A and B in their sacrificing ratio i.e. 1:3 respectively. This sharing is to be done immediately after C's admission. But it was not done at that time. Therefore, this is to be adjusted now, with retrospective effect.

1. C's Personal A/C		Dr	2,24,000
To C's Capital			1,28,000
To A's Capital			24,000
To B's Capital			72,000

(Being Rs.96,000 goodwill shared by A and B and the balance transferred to C's capital)

Profit & Loss A/C for the year 2007

To Interest on Capital				
A: 3,60,000 x 5/100		18,000	By Balance	2,32,000
B: 3,12,000 x 5/100		15,600		
C: 1,28,000 x 5/100		6,400		
To Net Profit transferred to				
A's Capital	1,04,000			
B's Capital	56,000			
C's Capital	32,000	1,92,000		
		2,32,000		2,32,000

A's Capital Account

To Drawings	32,000	By Balance B/D	3,36,000
To Balance C/D	4,50,000	By C's personal A/C(goodwill)	24,000
		By Interest on capital	18,000
		By P & L A/C (profit)	1,04,000
	4,82,000		4,82,000

B's Account

To Drawings	52,000	By Balance B/D	2,40,000

To Balance C/D	3,31,600	By C's personal A/C(goodwill)	72,000
		By Interest on capital	15,600
		By P & L A/C (profit)	56,000
	3,83,000		3,83,000

C's Capital Account

To Drawings	8,000	By C's personal A/C (goodwill)	1,28,000
To Balance C/D	1,58,000	By Interest on capital	6,400
		By P & L A/C (profit)	32,000
	1,66,400		1,66,400

Balance Sheet of A, B and C as on 31-12-2007

Capital	A	4,50,000	Machinery	6,00,000
Capital	B	3,31,000	Furniture	40,000
Capital	C	1,58,400	Stock	1,20,000
Creditors		48,000	Cash	28,000
		9,88,000		9,88,000

Note:

1. Interest on capital in to be allowed on the amount which is remained after adjusting the goodwill into the capital accounts.
2. The sacrificing ratio is to be taken into account, when the goodwill is brought in by new partner in cash and also when the old ratio and new ratio is given.

Illustration 6:

A and B were partners in AB Coal Stores sharing profits equally. On 31st December, 2007, their balance sheet was as follows:

Liabilities				Assets	
Creditors			7,480	Furniture and fittings	1,200
Bills payable			8,520	Lorries	9,300
Capitals:				Horses and Carts	4,760
	A	30,000		Debtors	35,000
	B	26,000	56,000	Stock of Coal	7,700
				Cash at Bank	13,660
				Cash in hand	180
			72,000		72,000

On the above date they admitted C as new partner with the following adjustments:

1. A, B and C share future profits in 3:2:1 ratio.
2. As Capital C is bringing Rs.5, 600 debtors (provide 5% reserve), Rs.3, 000 goodwill and the remaining in cash. C's capital being Rs.10, 000.
3. The following adjustments were made in A and B balance sheet:
   a) Lorries value to be raised to Rs.10, 000.
   b) Provide reserve on debtors at 71/2%.
   c) Create goodwill for Rs.4, 450.
4. A's Capital should be equal to that of B.

Pass the necessary journal entries for the above adjustments and prepare cash account, capital accounts and the new balance sheet.

Solution:

Lorries A/C	Dr	700	
To P & L A/C			700
(Being the asset value appreciated)			
P & L Adj A/C	Dr	2,640	
To Reserve for bad debts A/C			2,640
(Being the reserve provided on debtors)			
A's Capital A/C	Dr	970	
B's Capital A/C	Dr	970	
To P & L Adj. A/C			1,940
(Being the loss shared to partners)			
Goodwill A/C	Dr	4,450	
To A's Capital			2,225
To B's Capital (Being goodwill created)			2,225
Debtors A/C	Dr	5,600	

Goodwill A/C	Dr	3,000	
Cash A/C (Balancing figure)	Dr	1,680	
To C's Capital A/C			10,000
To Reserve for doubtful debts			280

(Being the new partner brings various assets towards capital)

A's Capital A/C	Dr	4,000	
To Cash A/C			4,000

(Being the excess capital paid to partner)

P & L Adj. Account

To Reserve for bad debts	2,640	By Lorries	700
		By A's Capital	970
		By B's Capital	970
	2,640		2,640

A's Capital Account

To P & L Adj. A/C	970	By Balance	30,000
To Cash A/C	4,000	By Goodwill	2,225
To Balance C/D	27,225		
	32,225		32,225

B's Capital Account

To P & L Adj. A/C	970	By Balance	26,000
To Balance C/D	27,255	By Goodwill	2,225
	28,225		28,225

C's Capital Account

		By Sundries	10,000

Cash Account

To Balance: Bank	13,660	By A's Capital	4,000
Cash	180	By Balance C/D	11,520

To C's Capital	1,680			
	15,520			15,520

Balance Sheet of A, B and C on 31-12-2007

Liabilities			Assets		
Capital A		27,255	Furniture		1,200
Capital B		27,255	Lorries (9,300+700)		10,000
Capital C		10,000	Horses and Carts		4,760
Creditors		7,480	Debtors	35,200	
Bills payable		8,520		5,600	
				40,800	
			Less: RBD (2,640+280)	2,920	37,880
			Coal Stock		7,700
			Goodwill		7,450
			Cash		11,520
		80,510			80,510

Illustration 7:

The following was the balance sheet of A, B and C who were equal partners, on 1st June 2007.

Liabilities			Assets	
Bills payable		3,300	Cash	600
Creditors		6,000	Debtors	10,800
Capital Accounts:			Stock	11,400
A	16,800		Furniture	2,400
B	12,600		Building	19,500
C	6,000	35,400		
		44,700		44,700

They decided to take D into partnership and give him a fourth share in the profits on the following terms:

1. That D should bring in Rs.9, 000 for goodwill and Rs.15,000 as capital.
2. That one-half of the goodwill shall be withdrawn by the old partners.
3. That stock and furniture be depreciated by 10 per cent.
4. That a provision of 5 per cent on debtors be created for doubtful debts.
5. That a liability for Rs.1, 050 be created against hills discounted.
6. That the value of the building having appreciated, the building should be valued of Rs.27,000.
7. That the values of liabilities and assets other than cash are not being altered.

Prepare the necessary ledger accounts and the opening balance sheet of the firm as newly constituted.

Solution:

Working Notes;

Here in this problem, first the Assets and Liabilities were revalued and again after D's admission, it was asked no to alter the values of Assets and Liabilities. For this purpose, a separate account called "Memorandum P & L A/C" is to be prepared.

Memorandum P & L Adj. Account

To Stock 1,140 By Buildings 7,500

To Furniture 240

To Reserve for bad debts 540 To

Liability on bills discounted 1,080 To

Capital A/Cs (profit):

A 1,500 B

1,500

C 1,500 4,500

7,500 7,500

By Sundry Assets (debited to this

Account previously) 3,000 To Buildings

7,500 By Capital Accounts (Less)

A 1,125

B 1,125

C 1,125 4,500

7,500 7,500

Goodwill Account

To A's Capital	3,000	By Cash	9,000
To B's Capital	3,000		
To C's Capital	3,000		
	9,000		9,000

A's Capital Account

To Cash	1,500	By Balance	16,800
To P & L Adj. A/C	1,125	By P & L Adj. A/C	1,500
To Balance C/D	18,675	By Goodwill	3,000
	21,300		21,300
		By Balance B/D	18,675

B's Capital Account

To Cash	1,500	By Balance	12,600
To P & L Adj. A/C	1,125	By P & L Adj. A/C	1,500
To Balance C/D	14,475	By Goodwill	3,000

	17,100		17,100
		By balance B/D	14,475

C's Capital Account

To Cash	1,500	By Balance	6,000
To P & L Adj. A/C	1,125	By P & L Adj. A/C	1,500
To Balance C/D	7,875	By Goodwill	3,000
	10,500		10,500
		By Balance B/D	7,875

D's Capital Account

To P & L Adj. A/C	1,125	By Cash	15,000
To Balance C/D	13,875		
	15,000		15,000
		By Balance B/D	13,875

Cash Account

To Balance	600	By Capital A/C:	
To D's Capital	15,000	A	1,500
To Goodwill	9,000	B	1,500
		C	1,500
		By Balance C/D	20,100
	24,600		24,600
To Balance B/D	20,100		

Balance Sheet of A, B, C and D as on 1st June, 2007

Liabilities		Assets	
Bills payable	3,300	Cash	20,100
Creditors	6,000	Debtors	10,800
Capitals:		Stock	11,400
A	18,675	Furniture	2,400
B	14,475	Buildings	19,500
C	7,875		
D	13,875		
	64,200		64,200

Illustration 8:

Sudha and Aruna are partners in a firm sharing profits in the ratio of 2:1. The Balance Sheet of the firm on 31st December, 2007 was as follows:

Liabilities		Assets	
Creditors	4,200	Bank	3,012
Investments provision	1,200	Bills receivable	7,500

Workmen compensation fund		3,600	Debtors	12,000	
General reserve		6,300	Less: Provision	1,500	10,500
Capitals:			Stock		9,000
Sudha	18,000		Investments		15,000
Aruna	14,700	32,700	Goodwill		2,988
		48,000			48,000

On this date Prathima is admitted for 2/5th share in the profits of the firm. Following revaluations were made at the time of admission:

1. Accrued incomes not appearing in the books Rs.300
2. Market value of investments is Rs.13, 500.
3. Claim on account of compensation is estimated at Rs.450.
4. Provision for doubtful debts is required at Rs.1800.
5. X, an old customer, whose account was written off as bad, has promised to pay Rs.1, 050 in settlement of his full claim.
6. Sudha and Aruna have purchased machinery on hire-purchase system for Rs.9, 000 of which only Rs.300 are to be paid. Both machinery and unpaid liability did not appear in the Balance Sheet.
7. There was a Joint Life Policy on the lives of Sudha and Aruna for Rs.45, 000. Surrender value of the policy on the date of admission amounted Rs.7, 200. It was decided to record this as an asset of the new firm.
8. Prathima is required to bring in Rs.30, 000 as capital. Her share of Goodwill was calculated at Rs.7, 200.

You are required to make journal entries and prepare new Balance Sheet after the admission of Prathima.

Solution:

Accrued income A/C	Dr	300	
Workmen compensation fund A/C	Dr	3,150	
X's A/C(old customer)	Dr	1,050	
Machinery A/C	Dr	9,000	
Joint Life Policy A/C	Dr	7,200	
To P & L Adj. A/C			20,700
(Being assets and liabilities revalued)			
P & L Adj. A/C	Dr	900	

To Investment Provision A/C			300	
To Reserve for doubtful debts				300
To Hire vendor (Machinery) A/C			300	
(Being assets and liabilities revalued)				
P & L Adj. A/C	Dr	19,800		
To Sudha Capital A/C			13,200	
To Aruna Capital A/C			6,600	
(Being the profit on revaluation shared between partners)				
General Reserve A/C	Dr	6,300		
To Sudha Capital A/C			4,200	
To Aruna Capital A/C			2,100	
(Being the accumulated profit shared to partners)				
Goodwill A/C	Dr	15,012		
To Sudha Capital			10,008	
To Aruna Capital			5,004	
(Being the goodwill created)				

Full value of goodwill 5/2 x 7,200 =18,000

Less: Already appearing 2,988

15,012

Cash A/C	Dr	30,000	
To Prathima's Capital A/C			30,000
(Being the new partner brings capital)			

Balance Sheet of Sudha, Aruna and Prathima

Liabilities			Assets		
Creditors (including hire vendor)		4,500	Cash (3,012 + 30,000)		33,012
Investment provision		1,500	Bills receivable	7,500	
Workmen's compensation fund		450	Debtors 12,000		
Capitals:			X 1,050		
Sudha	45,408		13,050		
Aruna		28,404	Less: Provision 1,800		11,250
Prathima		30,000	Stock	9,000	
			Investments	15,000	
			Joint life policy	7,200	
			Machinery	9,000	
			Goodwill	18,000	

		Accrued incomes	300
	1, 10,262	Capital	1, 10,262

Accounts

	Sudha	Aruna		Sudha	Aruna
			By Balance	18,000	14,700
			By P & L Adj. A/C	13,200	6,600
			By General reserve	4,200	2,100
To Balance C/D	45,408	28,404	By Goodwill	10,008	5,004
	45,408	28,404		45,408	28,404

Profit & Loss Adj. Account

To Sundry Assets & Liabilities	900	By Sundry Assets & Liabilities	20,700
To Capital Accounts:			
Sudha	13,200		
Aruna	6,600		
	20,700		20,700

Note: Liability as compensation fund is only Rs.450; the balance will be accumulated profit, to be shared by the partners.

7.7 TRY YOURSELF:

1. Sunil, Kapil and Rakesh trading in partnership and sharing profits and losses in the proportion of ½, 1/3 and 1/6 respectively agree to take Ajay into the partnership on the following terms;

a) Ajay should be given ¼ share and he should bring Rs.10, 000 as goodwill and Rs.1, 28,000 as capital.

b) A reserve for bad and doubtful debts should be created at 5%.

c) The value of Land and Building should be brought up to Rs.6, 20,000.

d) Stock should be taken at Rs.2, 61,000.

e) Machinery should be revalued at Rs.61, 600.

The following is the Balance Sheet of the firm of Sunil, Kapil and Rakesh on the eve of Ajay's admission.

Balance Sheet as on 31-12-2007

Sundry Creditors		38,000	Cash on hand	8,000
Partners' Capitals:			Debtors	2, 52,000
Sunil	5, 70,000		Stock	2, 90,000
Kapil	3, 20,000		Machinery	70,000
Rakesh	1, 60,000	10, 50,000	Land and Buildings	4 80,000
Reserve fund		12,000		
		11, 00,000		11, 00,000

The capitals of the old partners who continue to share in the same proportion in the new firm as before should be adjusted on the basis of the proportion of Ajay's capital to his share in the business, involving cash movements in or out, as the case may be.

Pass journal entries in the books of the new firm, keeping these arrangements in view and show the balance sheet of the newly constituted firm.

(Capital Accounts: Sunil- 1,92,000; Kapil – Rs.1,28,000; Rakesh – Rs.64,000; Ajay – Rs.1,28,000; Balance Sheet total – Rs.13,28,000)

2. A and B are partners in a firm sharing profits and losses as 5:3. The position of the firm as on31st March 2007 is as follows:

Capital and Liabilities			Property and Assets	
Capital Accounts:			Plant and Machinery	40,000
A	30,000		Stock	30,000
B	20,000	50,000	Sundry Debtors	20,000
Sundry Creditors		15,000	Bills receivable	10,000
Bank overdraft		42,500	Cash at bank	7,500
		1, 07,500		1,07,500

C now joins them on condition that he will share 3/4th of the future profits, the balance of profits being shared by A and B as 5:3. He introduces Rs.40, 000 by way of capital in cash and pays off the overdraft. He also pays Rs.4, 000 by way of premium for goodwill of the business and this amount is to remain in business. The partners agree to depreciate plant by 10% and raise a reserve against Sundry Debtors by 5%.

You are asked to journalise the entries in the books of the firm and the resultant Balance Sheet. How will the partners share future profits?

(Capitals: A – Rs.29,375; B – Rs.19,625; C – Rs.82,500; Balance Sheet total Rs.1,46,500)

3. Shriram and Krishna are partners in a firm sharing profits and losses as Shriram 75% and Krishna 25% on 1st January, 2007; their position was as given below:

Liabilities			Assets	
Capital Accounts;			Plant	40,000
Shriram	50,000		Stock	10,000
Krishna	30,000	80,000	Debtors	30,000
Sundry Creditors		20,000	Cash at bank	20,000
		1,00,000		1,00,000

Nair is now to join the partnership. He agrees to pay the partners Rs.20,000 by way of goodwill and introduce one half of the combined capital of the two existing partners after depreciating plant and stock at 20% and 10% respectively and raising a reserve of 10% against Sundry Debtors. The new partner is to be allowed 1/4th share of the profits of the firm.

You are asked to record the above transactions in the books of the firm and give the resultant Balance Sheet of the new firm.

(New Capitals: Shriram – Rs.56, 000; Krishan – Rs.32,000; Nair – Rs.44,000; Total of Balance Sheet – Rs. 1,52,000)

4. The following is the Balance Sheet of Srinivas and Chandrasekhar as on 31st March 2007. Narayana is admitted as partner on that date when the position of Srinivas and Chandrasekhar was as under:

Liabilities		Assets	
Srinivas's Capital	3,000	Debtors	3,300
Chandrasekhar's Capital	2,400	Land and Buildings	2,400
Creditors	3,600	Plant and Machinery	3,000
General Reserve	4,800	Stock	3,600
Workmen's compensation fund	1,200	Cash and Bank Balances	2,700
	15,000		15,000

Srinivas and Chandrasekhar shared profits in the proportion of 3:2. The following terms of admission are agreed upon:

1. Revaluation of assets: Land and Buildings Rs.5, 400, Stock Rs.4, 800.
2. The liability on workmen's compensation fund is determined at Rs.600.
3. The new partner has to bring in as his share of goodwill Rs.3,000 in cash.
4. The new partner was to bring further cash as would make his capital equal to 20% of the combined capitals of partners Srinivas and Chandrasekhar after above revaluation and adjustments are carried out.
5. The future profit sharing proportions were as under: Srinivas – 2/5th; Chandrasekhar -2/ 5th; Narayana – 1/5th. Prepare the new Balance Sheet of the firm and the capital accounts of the partners.

(New Capitals: Srinivas- Rs.11, 760; Chandrasekhar –Rs.6, 240; Narayana – Rs.3, 600;

Total Balance Sheet – Rs.25, 800)

5. X, Y and Z were partners sharing Profits and Losses in the ratio of 3:2:1. On January 1st, 2007, they admitted A into partnership on the following terms:

Goodwill of the firm was valued at Rs.2, 70,000; A paid Rs.45, 000 to X, through the books, on account of goodwill. A paid in proportionate of capital. It was further agreed that investments are to be revalued at Rs.54, 000; plant should be reduced to Rs.87, 000. A sum of Rs.9, 000 included in creditors was to be written back as there was no viability to pay the amount. The Balance Sheet before A's admission was as follows:

Liabilities		Assets	
Creditors	2, 70,000	Cash at bank	1, 20,000
Capitals;		Debtors	1, 80,000
X	1, 80,000	Stock	1, 50,000
Y	1, 20,000	Investments at cost	90,000
Z	60,000	Furniture and Fittings	30,000

Reserve	45,000	Plant	1, 05,000
	6, 75,000		6, 75,000

The Profits for 2007 were Rs.1, 80,000 and drawings were Rs.45, 000 for X, Rs.36, 000 for Y, Rs.22, 500 for Z and Rs.18, 000 for A.

Journalise the entries to be made on A's admission, give the capital accounts and the resulting Balance Sheet.

(Current Accounts: X – Rs.15, 000; Y – Rs.24, 000; Z – Rs.7, 500; A – Rs.12, 000; balance sheet – Rs.6, 79,500)

7.8 SUMMARY :

Partnership is a business carried on by one partner for all and all working together to share profits and bear losses. New partners may join the ongoing partnership which is called as admission of partnership. When a new partner admits into the firm, normally, he brings with him the capital and an agreed amount of goodwill. There are various ways of preparing accounts depending on different circumstances. Normally, in admission, a profit and loss adjustment account and a new balance sheet is to be prepared after adjusting the old partners capital accounts.

7.9 GLOSSARY :

Partnership : It is the relation between persons who have agreed to share the profits of the business carried on by all or any of them acting for all.

Goodwill : It is the present value of a firm's anticipated excess earnings.

7.10 SELF ASSESSMENT QUESTIONS :

1. Define partnership. What are the things to be remembered when a new partner comes in?

2. What is goodwill? How it is valued in case of admission of a new partner?

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LESSON - 8
PARTNERSHIP ACCOUNTS II – RETIREMENT OR EATH OF A PARTNER

OBJECTIVES :

After going through this lesson you will be able to understand the following:

1. Treatment of goodwill and revaluation of assets and liabilities in case of retirement or death of a partner.
2. Purchase of retiring partner's share by the remaining partners.
3. Treatment of Joint Life policy.

STRUCTURE OF THE LESSON :

8.1 Retirement of a partner

8.1.1 Goodwill

8.1.2 Revaluation of Assets and Liabilities

8.1.3 Payment to Retiring Partner

8.1.4 Purchase of Retiring partner's share

8.2 Death of a Partner

8.3 Joint Life policy

8.4 Illustrations

8.5 Try yourself

8.6 Summary

8.7 Glossary

8.8 Self- Assessment Questions

8.1 RETIREMENT OF A PARTNER :

In the partnership, any of the partners may retire in accordance with agreement, or with the consent of the remaining partners or where the partnership is at will, by giving notice in writingto all other partners of his intention to retire. A retiring partner will not be liable for liabilities incurred by the firm after his retirement. However, he must give a public notice to that effect. Such a public notice is not necessary in case of a sleeping or dormant partner.

The problems to be dealt with on retirement of a partner are mainly similar to those arising on the admission of a partner. The main difference between admission of a partner and retirementof a partner is on the question of payment of the dues to the retiring partner. Treatment of goodwill and revaluation of assets and liabilities in retirement are as follows:

8.1.1 Goodwill :

Goodwill will be valued in the manner prescribed in the deed or by mutual understanding. One of the following cases may be adopted:

1. Goodwill may be raised in the books of the firm. Then the following entry is required.

Goodwill A/C Dr

To Partners' A/Cs (to all partners in the old profit sharing ratio)

2. Goodwill may be raised in the books of the firm and is written off. The following entries arerequired:

a) Goodwill A/C Dr

To Partners' A/Cs (to all partners in the old profit sharing ratio)

b) Partners' Capital A/Cs (Remaining partners and in the new profit sharing ratio) Dr

To Goodwill

3. Only the share of the retiring partner is brought into books. The entry is

Goodwill A/C Dr

To Retiring partner Capital A/c (his share level)

In this case, it is advisable to write off the goodwill to the remaining partners in the ratio in which they gain on the retirement. If goodwill appears in the books already, entries for raising goodwill should be made only for the difference.

8.1.2 Revaluation of Assets and Liabilities :

The method of dealing with revaluation of assets is exactly similar to that followed at the time of admission of a partner. The Profit and Loss Adjustment Account or Revaluation Account will be prepared and the balance transferred to all the partners, including the retiring one, in the old profit-sharing ratio. Assets and liabilities will then appear in the books at changed values. Butif it is desired that assets and liabilities should continue to appear in the books at the old values, a Memorandum Revaluation Account will be prepared. Its balance will be transferred to all the partners in the old profit-sharing ratio and then the same amount will be put on the reverse side and transferred to the remaining partners in the new profit-sharing ratio.

8.1.3 Payment to Retiring Partner:

The amount due to the retiring partner will be paid as per terms of the partnership agreementor as otherwise mutually agreed. When the amount payable to the retiring partner is determined,it will be transferred to his loan account.

Then the journal entry will be:

Retiring Partner's Capital A/C DrTo Retiring Partner's Loan A/C

In case the continuing partners agree to bring cash to pay off the retiring partner, the entries will be:

Bank A/C Dr

To Continuing Partners' Capitals A/Cs

(Being cash brought in by the partners in the agreed ratio to pay off the retiring partner)

Retiring Partner's Capital A/C Dr

To Bank

(Being cash paid to the retiring partner)

In case the continuing partners decide to pay the retiring partner in their individual capacity in their profit - sharing ratio, the entry will be:

Retiring Partner's Capital Loan A/C Dr

To Continuing Partners' Capital A/Cs

The amount due to the retiring partner may be agreed to be paid *in installments* withinterest.

In such case Loan account will be closed after the last installment is paid.

8.1.4 Purchase of retiring partner's share :

There may, sometimes, be an agreement that the retiring partner's share in the firm will be purchased by the remaining partners. If the agreement does not state the proportion in which the remaining partners will buy the share of the retiring partner, it will be in the profit-sharing ratio. In the case of purchase, the amount due to the retiring partner is ascertained in the usual manner and then the retiring partner's capital account is debited and the other partners' capital accountscredited in the profit-sharing ratio or the ratio agreed upon. The retiring partner's loan will not figure in the books of the firm and he will look to the partners in their individual capacities for the satisfaction of his claim.

8.2 DEATH OF A PARTNER :

In the event of death of a partner, usually, the surviving partners carry on the business, purchasing the share of the deceased partner after determining the amount due to him and then treating it as a loan to the firm. The legal representatives or the executor of the deceased partnerwill be entitled to get from the firm the amounts due. It is ascertained adding deceased persons capital, share of goodwill, profit on revaluation and share out of the proceeds of a joint life insurancepolicy. Except this, the treatment in accounts is not different from that in case of retirement. After ascertaining the amount due to the deceased partner, the balance in his capital account should be transferred to an account opened in the name of his executor.

It should be noted that according to the Partnership Act, the executors would be entitled, at their choice, to interest at 6% p.a. on the amount due from the date of death to the date of payment or to that portion of profit which is earned by the firm with the help of the amount due tothe deceased partner. This also applies to a retiring partner.

8.3 JOINT LIFE POLICY :

For funds to pay to the executor of a deceased partner, without upsetting the working capital of the firm, it is usual to take out a joint policy on the lives of the partners. The insurance company undertakes to pay a fixed sum of money when any of the partners dies. There are threeways to deal with this in the accounts:

1. All the premiums paid are treated as expenses and debited to Profit and Loss Account and, when a partner dies, the amount received from the insurance company is treated as a profit and credited to all partners in the profit-sharing ratio.

2. The premiums paid are debited to the Joint Life Policy account.

   a) Every year, an amount equal to the premium is debited to the Profit and Loss Account and credited to Joint Life Policy Reserve account.

   b) The Joint Life Policy account and Joint Life Policy Reserve account are mutually adjusted so as to leave a balance in each account equal to the surrendervalue of the policy.

   c) When death occurs of a partner, the amount received is credited to the Joint Life Policy account. The amount standing to the credit of the Joint Life Policy Reserve account is also transferred to it and then it is closed by transfer to the capital accounts of all partners.

3. The surrender value of the policy is considered as an asset and the excess of the amount paid over the surrender value as an expense. In this case, the premiums paid aredebited

to a Joint Life Policy account which is reduced to its surrender value by appropriate debit to the Profit and Loss account. The Joint Life Policy Account is an asset and will be shown in the Balance Sheet. When a partner dies, the amount received from the insurance company will be credited to the joint life Policy Account,the balance on this account being then transferred to the capital accounts of partners(including the deceased partner) in the profit-sharing ratio.

8.4 ILLUSTRATIONS :

Illustration 1 :

A, B and C are partners, sharing profits equally. Their Balance Sheet at 31st December 2007 is as follows;

Liabilities		Assets		
Sundry Creditors	4,000	Cash at Bank		4,000
Capitals:		Bills receivable		3,000
A	12,000	Sundry debtors	20,000	
B	8,000	Less: RBD	1,000	19,000
C	7,500	Stock		18,000
Reserve	6,000	Fixtures		3,500
	47,500			**47,500**

B retires on the date and the following adjustments are to be made for the purpose:

a) Goodwill of the firm is valued at Rs.12, 000.

b) Fixtures to be depreciated by 5%.

c) Stock to be appreciated by 10%.

d) Reserve for bad debts to be increased by Rs.500.

Draw up the Profit and Loss Adjustment Account, Capital Accounts of the partners and the Opening Balance Sheet of the continuing partners.

Solution :

Profit and Loss Adj. Account

To Fixtures		175	By Stock account	1,800
To Reserve for bad debts		500		
To A's Capital	375			
To B's Capital	375			
To C's Capital	375	1,125		
		1,800		**1,800**

Goodwill Account

To A's Capital	4,000	By Balance C/D	12,000
To B's Capital	4,000		
To C's Capital	4,000		
	12,000		**12,000**

To Balance B/D	12,000		

Reserve Account

To A's Capital	2,000	By Balance B/D	6,000
To B's Capital	2,000		
To C's Capital	2,000		
	6,000		**6,000**

A's Capital Account

To Balance C/D	18,375	By Balance B/D	12,000
		By P & L Adj. A/C	375
		By Goodwill	4,000
		By Reserve	2,000
	18,375		**18,375**
	By Balance B/D	18,375	

B's Capital Account

To Loan A/C	24,375	By Balance B/D	18,000
		By P & L Adj. A/C	375
		By Goodwill	4,000
		By Reserve	2,000
	24,375		**24,375**

C's Capital Account

To Balance C/D	13,875	By Balance B/D	7,500
		By P & L Adj. A/C	375
		By Goodwill	4,000
		By Reserve	2,000
	13,875		**13,875**
		By Balance B/D	13,875

B's Loan Account

By Capital A/C23,475

Balance Sheet of A and C as on 31-12-2007

Liabilities		Assets		
Creditors	4,000	Cash		4,000
Capitals:		Bills receivable		3,000
A	18,375	Debtors	20,000	
C	13,875	Less: RBD	1,500	18,500

B's Loan Account	24,375	Stock (18,000+1,800)	19,800
		Fixtures	3,325
		Goodwill	12,000
	60,625		**60,625**

Illustration 2 :

Viswanath, Gavaskar and Sobers are in partnership sharing profits equally. Sobers retiredon 31st March 2007. The Balance Sheet of the firm on 31st December 2006 stood as follows:

Balance Sheet

Liabilities			Assets	
Creditors		7,740	Cash in hand and bank	3,000
General Reserve		2,400	Debtors	6,000
Investment fluctuation		720	Stock	6,000
Reserve for doubtful debts		480	Investments (at cost)	3,000
Capitals:			Freehold property	24,000
Viswanath	18,000		Goodwill	11,340
Gavaskar	12,000			
Sobers	12,000	42,000		
		53,340		**53,340**

On the date of retirement it was found that: a) Freehold property e valued at Rs.34, 800.b) Investments be valued at Rs.2, 820. c) Debtors were all good. d) Stock is valued at Rs.5, 640. e) Goodwill is valued at on year's purchase of the average profit of the past five years. f) Sobers share of profit to the date of retirement be calculated on the basis of average profit of the precedingthree years.

The books showed the profits of the last five years as follows: 2002 – Rs.6, 900; 2003 – Rs.8, 400; 2004 – Rs.5, 400; 2005 – Rs.4, 800; 2006 – Rs.6000.

You are required to pass journal entries, give capital account of Sobers, and prepare Balance Sheet of the remaining partners.

Solution :

Calculation of Goodwill :

Total profit of 5 years: 6,900+8,400+5,400+4,800+6,000=31,500

One year's average goodwill = 31,500/5 = 6,300

Goodwill already appearing in Balance Sheet =

11,340Less: Revalued amount 6,300

Decrease in the value of Goodwill **5,040**

Sobers's share of profit to the date of

retirement:Date of Balance Sheet 31

December 2006

Date of retirement 31 March 2007 i.e. after 3 months.

Total of the preceding 3 years profit = 5,400+4,800+6,000 =

16,200Average = 16,800/3 = 5,400

Profit for 3 months = 5,400/12x3 =

1,350Sobers's share = 1,350x 1/3 =

450 Journal entries;

1. P & L Adj. A/C	Dr	5,400		
To Stock			360	
To Goodwill			5,040	
(Being the assets revalued)				
2. Freehold Property A/C	Dr	10,800		
RBD A/C	Dr	480		
Investment fluctuation fund A/C	Dr	540		
To P & L Adj. A/C			11,820	
(Being two assets revalued)				
3. P & L Adj. A/C	Dr	6,420		
To Viswanath's Capital			2,140	
To Gavaskar's Capital				2,140
To Sobers's Capital			2,140	
(Being the profit on revaluation distributed among the partners)				
4. General Reserve A/C	Dr	2,400		
To Viswanath's Capital			800	
To Gavaskar's Capital				800
To Sobers's Capital			800	
(Being the accumulated profit distributed to the partners)				
5. P & L Suspense A/C	Dr	450		
To Sobers's Capital			450	
(Being the share of profit to the date of retirement (3 months) Credited to partner)				
6. Sobers's Capital A/C	Dr	15,390		
To Sobers's Loan A/C		15,390		
(Being the retiring partner's claim transferred to the loan account)				

Sobers's Capital Account

To Loan A/C	15,390	By Balance	12,000
		By P & L Adj. A/C	2,140
		By General Reserve	800
		By P & L Suspense A/C (3 months profit)	450

	15,390		**15,390**

Balance Sheet of Viswanath and Gavaskar as on 31-3-2007

Liabilities		Assets	
Capitals:		Cash	3,000
Viswanath	20,940	Debtors	6,000
Gavaskar	14,940	Stock	5,640
Sobers Loan A/C	15,390	Investments	3,000
Creditors	7,740	Freehold Property	34,800
Investment fluctuation fund	180	Goodwill	6,300
		P & L Suspense A/C	450
	59,190		**59,190**

Working notes:

Profit and Loss Adjustment Account

To Sundry Assets	5,400	By Sundry Assets	11,820
To Capital Accounts:			

Note :

Viswanath	2,140	
Gavaskar	2,140	
Sobers	2,140	6,420
	11,820	**11,820**

Capital Account

Viswanath	Gavaskar		Viswanath	Gavaskar
		By balance	18,000	12,000
		P & L Adj. A/C	2,140	2,140
		General Reserve	800	800
			20,740	**20,740**

As the Goodwill is already appearing in the Balance Sheet, no special treatment for Goodwill is necessary. It is enough to adjust in the P & L Adj. A/C, along with other assets.

Investments:	Actual value as per Balance Sheet	= 5,000
	Less: Existing fund	1,200
	Value as per Balance Sheet	3,800

i.e. there is an appreciation in the value by Rs.900. This appreciation is shown in another way by reducing the investment fluctuation fund.

Illustration 3 :

P, Q and R are partners, sharing profits equally. Balance Sheet at 31st December 2007 isas follows:

Liabilities		Assets		
Sundry Creditors	5,000	Cash at Bank		3,000
Current Accounts;		R's Current A/C		2,500
P	2,000	Bills receivable		5,000
Q	3,000	Sundry debtors		20,000
Reserve Capitals:		Less: RBD	1,000	19,000
P	10,000	Stock		18,000
Q	15,000	Fixture		3,500
R	10,000			
	51,000			**51,000**

R retires on that date and the following adjustments are to be made for the purpose:

1. Goodwill is valued at Rs.12,000.
2. Fixtures to be depreciated by 5%.
3. Stock to be appreciated by 10%.
4. Bad debts provision to be increased by Rs.500.

Find out the amount due to R and transfer it to his loan account. Pass journal entries, open partners account and Profit and Loss Adjustment Account, and prepare the opening BalanceSheet of the continuing partners.

Solution :
Journal entries :

1. P & L Adj. A/C	Dr	675	
To Fixtures			175
To Reserve for bad debts			600
(Being Assets value reduced)			
2. Stock A/C	Dr	1,800	
To P & L Adj.A/C			1,800
(Being Asset value rose)			
3. P & L Adj. A/C	Dr	1,125	
To P's Current A/C			375
To Q's Current A/C			375
To R's Current A/C			375
(Being profit transferred to current accounts)			
4. Goodwill A/C	Dr	12,000	
To P's Current A/C			4,000
To Q's Current A/C			4,000
To R's Current A/C			4,000
(Being Goodwill created)			
5. Reserve A/C	Dr	6,000	
To P's Current A/C			2,000
To Q's Current A/C			2,000
To R's Current A/C			2,000
(Being Reserve distributed)			
6. R's Current A/C	Dr	3,875	
To R's Capital A/C			3,875
(Being current account balance transferred to Capital Account)			
7. R's Capital A/C	Dr	13,875	
To R's Loan A/C			13,875
(Being Capital account balance transferred to Loan account)			

Profit and Loss Adjustment Account

To Fixtures	175	By Stock	1,800
To Reserve for bad debts	500		
To P's Current A/C	375		
To Q's Current A/C	375		
To R's Current A/C	375		
	1,800		**1,800**

Goodwill Account

To P's Current A/C	4,000		
To Q's Current A/C	4,000		
To R's Current A/C	4,000		
	12,000		

P's Current Account

To Balance C/D	8,375	By Balance B/D	2,000
		By P & L Adj. A/C	375
		By Goodwill	4,000
		By Reserve	2,000
	8,375		**8,375**

Q's Current Account

To Balance C/D	9,375	By Balance B/D	3,000
		By P & L Adj. A/C	375
		By Goodwill	4,000
		By Reserve	2,000
	9,375		**9,375**

R's Current Account

To Balance C/D	2,500	By P & L Adj. A/C	375
To Capital A/C	3,875	By Goodwill	4,000
		By Reserve	2,000
	6,375		**6,375**

R's Capital Account

To Loan A/C	13,875	By Balance B/D	10,000
		By Current A/C	3,875
	13,875		**13,875**

R's Loan Account

To Balance C/D	13,875	By Capital A/C	13,875
	13,875		**13,875**
		By Balance B/D	13,875

Balance Sheet of P and Q

Liabilities		Assets	
Creditors	5,000	Bank Balance	3,000

R's Loan A/C		13,875	Bills receivable		5,000
Current Accounts:			Debtors	20,000	
P	8,375		Less: RBD	1,500	18,500
Q	9,375	17,750	Stock		19,800
Capital Accounts:			Fixtures		3,325
P	10,000		Goodwill		12,000
Q	15,000	25,000			
		61,625			**61,625**

Illustration 4 :

The Balance Sheet of A, B and C who were sharing profits is proportion to their capitals stood as follows on December 31, 2007.

Liabilities			Assets		
Sundry Creditors		6,90,000	Cash at Bank		5,50,000
Capital Accounts:			Sundry Debtors	5,00,000	
A	20,00,000		Less : Provision	10,000	4,90,000
B	15,00,000		Stock		8,00,000
C	10,00,000	45,00,000	Plant and Machinery		8,50,000
			Land and Buildings		25,00,000
		51,90,000			**51,90,000**

B retired on the above date and the following was agreed upon:

1) That stock is depreciated by 6%.
2) That the provision for Doubtful debts be brought up to 5% on Debtors.
3) That the Land and Buildings be appreciated by 20%.
4) That a provision of Rs.7, 700 be made I respect of outstanding legal charges.
5) That the Goodwill of the entire firm be fixed at Rs.10,00,000 and B's share of it be adjusted intothe amounts of A and C who are going to share future profits in the ratio 5:3.
6) That the assets and liabilities (except cash) were to appear in the balance sheet at their old figures.
7) That the entire capital of the firm as newly constituted be fixed at Rs.28,00,000 between A and C in the proportion of 5:3 (actual cash to be brought in or paid off, as the case may be).

Pass journal entries to give effect to above arrangements. Show the Balance Sheet after B's retirement. Also give a statement showing how much cash is brought in by or pay to the partners.

Solution :

Profit sharing ratio of A, B & C 4:3:2 i.e. 4/9;

3/9; 2/9New profit sharing A & C = 5:3 = 5/8; 3/8

Gaining Ratio of A = 5/8 – 4/9 =

13/72 Gaining Ratio of C = 3/8-2/9

= 11/72

= 13:11

Goodwill share given to B, shall be charged to A & C in this ratio.

Total Capital of the firm after B's retirement = 28,00,000

A's Capital = 28,00,000 x 5/18 = 17,50,000
C's Capital = 28,00,000 x 3/8 = 10,50,000
Journal entries:

1. P & L Adj. A/C Dr 1,40,000
 To Stock 48,000
 To Reserve for bad debts 15,000
 To Outstanding legal bills

77,000(Being the assets revalued)

2. Land and Buildings A/C Dr 5,00,000
 To P & L A/C 5,00,000

(Being the assets appreciated)

3. P & L A/C Dr 3,60,000
 To A's Capital 1,60,000
 To B's Capital 1,20,000
 To C's Capital 80,000

(Being the profit on revaluation distributed to partners)

4. A's Capital A/C Dr 1,95,000
 C's Capital A/C Dr 1,65,000
 To B's Capital A/C 3,60,000

(Being the retiring partner's share of goodwill changed to continuing partners capitals in their gaining ratio i.e. 13:11)

5. B's Capital A/C Dr 19,80,000
 To B's Loan A/C 19,80,000
 (Being the retiring partner's claim transferred to his Loan A/C)

6. A's Capital A/C Dr 2,25,000
 C's Capital A/C Dr 1,35,000
 To P & L Adj. A/C 3,60,000

(Being Loss on revaluation distributed to A & c in their new ratio i.e.5:3; assuming that the valueof assets and liabilities were reinstated)

7. Cash A/C Dr 2,80,000
 To A's Capital 10,000
 To C's Capital 2,70,000

(Being the shortage in Capital Accounts brought in by partners)

Memorandum P & L Adj. Account

To Stock	48,000	By Land & Buildings	5,00,000
To RBD	15,000		
To Outstanding legal bills	77,000		

To C's Capital 80,000	3,60,000			
	5,00,000			5,00,000
To Land & Buildings	5,00,000	By Sundry Assets&Liabilities		1,40,000
		By A's Capital	2,25,000	
		By B's Capital	1,35,000	3,60,000
	5,00,000			**5,00,000**

A's Capital Account

To B's Capital (goodwill)	1,95,000	By Balance	20,00,000
To P & L Adj. A/C	2,25,000	By P & L Adj.A/C	1,60,000
To Balance C/D	17,50,000	By Cash (brought in)	10,000
	21,70,000		**21,70,000**
		By Balance B/D	17,50,000

B's Capital Account

To Loan A/C	19,80,000	By Balance	15,00,000
		By P & L Adj. A/C	1,20,000
		By A's Capital A/C- Goodwill	1,95,000
		By C's Capital A/C – Goodwill	1,65,000
	19,80,000		**19,80,000**

C's Capital Account

To B's Capital – goodwil	1,65,000	By Balance	10,00,000
To P & L Adj. A/C	1,35,000	By P & L Adj. A/C	80,000
To Balance C/D	10,50,000	By Cash (brought in)	2,70,000
	13,50,000		**13,50,000**
		By Balance B/D	10,50,000

To A's Capital 1,60,000
To B's Capital 1,20,000

B's Loan Account

		By Capital	19,80,000

Balance Sheet A & c as on 1-1-2007

Liabilities		Assets		
Creditors	6,90,000	Cash	5,50,000+2,80,000	8,30,000
Capitals:		Debtors	5,00,000	
A	17,50,000	Less: Provision	10,000	4,90,000
C	10,50,000	Stock		8,00,000
B's Loan A/C	19,80,000	Plant		8,50,000
		Land and Buildings		25,00,000

54,70,000	**54,70,000**

	A	C
Capitals of partners before the cash brought in	17,40,000	7,80,000
Cash to be brought in	10,000	2,70,000

Illustration 5 :

Bedi and Prasanna were carrying on business, as equal partners. It was agreed that Bedi should retire from the firm on March 31, 2007, and that his son Chandra should join Prasanna from 1st April, 2007, and should be entitled to one third of the profits. The Balance Sheet on March 31, 2007 was as follows:

Bedi's Capital	23,800	Cash at bank	7,700
Prasanna's Capital	19,740	Sundry debtors	11,270
Sundry Liabilities	6,860	Furniture	9,940
		Buildings	14,490
		Goodwill	7,000
	50,400		**50,400**

On 31st March, 2007, goodwill was valued of Rs.15, 400 and Buildings at Rs.16, 800. It was agreed that enough money should be introduced to enable Bedi to be paid out and leave Rs.7, 000 cash by way of working capital. Prasanna and A Chandra were to provide such sums aswould make their capital proportionate to their share of profits. Bedi agreed to make a friendly loan to Chandra by transfer from his capital account of half the amount which Chandra had to provide.

Prasanna and Chandra paid in cash due from them on 1st April, 2007 and the amount dueto Bedi was paid out on the same day.

Pass the necessary journal entries and prepare the Balance Sheet as on 1st April, 207.

Solution :

Balance Sheet (after paying off Bedi and after the admission of Chandra)

Liabilities			Assets
Sundry Liabilities	6,860	Cash (as per revaluation)	7,000
(no change in revaluation)		Debtors(no change)	11,270
Combined Capital of Prasanna		Furniture (no change)	9,940
And Chandra (Bal. Fig)	53,550	Buidings (as per revaluation)	16,800
		Goodwill (as per revaluation)	15,400
	60,410		**60,410**

Total Capital of Prasanna Chandra after paying off Bedi 55,550 Prasanna's share2/3 = 53,550 x 2/3 35,700 Chandra's share 1/3 = 53,550 x1/3 17,850Less: Transfers from his father's A/C(Bedi's A/C)1/2 8,925Cash to be brought in by Chandra **8,925**

Journal Entries:

1. Goodwill A/C Dr 2,310

Buildings A/C	Dr	8,400	
To P & L Adj. A/C			10,710

(Being the assets appreciated)

2. P & L Adj. A/C	Dr	10,710	
To Bedi's Capital			5,355
To Prasanna's Capital			5,355

(Being the profit on revaluation distributed to partners)

3. Cash A/C	Dr	19,530	
To Prasanna's Capital			10,605
To Chandra's Capital			8,925

(Being shortage of capital brought in by Prasanna and the new partner brings half of his share of capital)

4. Bedi's Capital A/C	Dr	29,155	
To Cash			20,230
To Chandra's Capital A/C			8,925

(Being retiring partner's claim settled and some account transferred to his son's capital (New partner) A/C)

Balance Sheet of Prasanna and Chandra as on 1-4-2007

Liabilities		Assets	
Capitals:		Cash	7,000
Prasanna	35,700	Debtors	11,270
Chandra	17,850	Furniture	9,940
Sundry Liabilities	6,860	Buildings	16,800
		Goodwill	15,400
	60,410		**60,410**

Working Notes:

Bedi's Capital Account

To Cash	20,230	By Balance	23,800
To Chandra's Capital A/c	8,925	By P & L Adj. A/C	5,355
	29,155		**29,155**

Prasanna's Capital Account

		By Balance	19,740
		By P & L Adj. A/C	5,355
		By Cash	10,605
			35,700

Chandra's Capital Account

		By Cash	8,925
		By Bedi's Capital	8,925
			17,850

Prasanna's Capital in the new firm:	35,700
Less: Existing Capital after revaluation	25,095
Cash to be brought in	**10,605**

Cash Account

To Balance	7,700	By Bedi's Capital	20,230
To Prasanna's Capital	10,650	By Balance C/D	7,000
To Chandra Capital	8,925	(working capital)	
	27,230		**27,230**
To Balance B/D	7,000		

Illustration 6 :

A, B and C are partners sharing profits and losses in the proportion of 3:2:1 and their Balance Sheet of 31st December, 2007 was as follows:

Bills payable		7,560	Cash in hand	250
Creditors		12,300	Cash at bank	960
General Reserve		3,000	Bills receivable	3,300
Capitals:			Debtors	7,450
A	10,000		Stock	12,470
B	6,000		Investments	10,430
C	4,000	20,000	Building	8,000
		44,860		**42,860**

B died on February 28 2007 and according to partnership agreement his executor is entitledto be paid out as follows:

a) The capital to his credit at the time of his death and interest up to the time of his death at 6% per annum.

b) His appropriate share of general reserve.

c) His share of profit to the date of his death which is to be taken on the basis of preceding year's profit.

d)His share of goodwill which is calculated at two year's purchase of the average profit of the preceding three years.

The investments were sold for Rs.16,020 and B's executor was paid off. The profits in the three preceding years was 2004 – Rs.7,800; 2005 – Rs.9,000; 2006 – Rs.9,600.

Pass the journal entries and write the accounts of B.

Solution :

Journal entries :

1. Interest on capital A/C	Dr	60.00	
To B's Capital Account			60.00

(Being the interest for 2 months @ 6% due to B)

2. General Reserve A/C	Dr	3,000	
To A's Capital			1,500
To B's Capital			1,000
To C's Capital			500

(Being the accumulated profits shared)

3. P & L A/C	Dr	533.33	
To B's Capital			533.33

(Being the share of profit on the basis of preceding year's profit)

4. Goodwill A/C	Dr	17,600	
To A's Capital			8,800.00
To B's Capital			5,866.67
To C's Capital			2,933.33

(Being the goodwill raised)

(7,800+9,000+9,600=26,400/3x2=17,600)

5. Cash A/C	Dr	16,020	
To Investment A/C			16,020

(Being the assets sold)

6. B's Capital A/C	Dr	13,460	
To B's executor's A/C			

13,460(Being the claim transferred to executor's account)

7. Executor's Account	Dr	13,460	
To Cash			13,460

(Being cash paid to the executor)

B's Capital Account

To Executor's A/C	13,460.00	By Balance	6,000.00
		By Interest on capital (6,000x2/12x6/100)	
		By General Reserve (3,000 x 1/3)	1,000.00
		By P & L A/C (9,600x2/12x1/3)	533.33
		By Goodwill	5,866.67
	13,460.00		**13,460.00**

Illustration 7 :

A, B and C carried on business in partnership, profits being divisible in 3:2:1. The balance sheet on 31st December 2006 showed their capitals as Rs.10, 400; Rs. 5,000 and Rs.3, 000 respectively. On 28th February 2007 A died. From the following particulars prepare an account for presentation to A's executor.

a) The firm issued the partners' lives severally A for Rs.9, 000, B for Rs.4, 800 and C for Rs.2,400. The premiums have been charged to the profit and loss account. The surrender value on 28th February 2007 was one fourth of the sum assured.

b) Capital carries interest at 5% per annum.

c) A's drawings from 1st January 2007 to the date of his death were Rs.1, 200.

d) A's share of profits for the portion of the current year in which he was alive was to be taken at the sum calculated on the average of the previous three completed years and goodwill was to be raised on the basis of two years' purchase of average profits of those three years.

The profits of the three previous completed years were Rs.9, 200; Rs.7, 400 and Rs.8, 600 respectively.

Show A's account. Take calculations to the nearest rupee.

Solution :

A's Capital Account

To Drawings	1,200	By Balance	10,400
To A's Executor's A/C	23,787	By Joint life policy	5,400
		By Interest on Capital(for 2 months)	87
		By P & L A/C(share of profit)	700
		By Goodwill	8,400
	24,987		**24,987**

A's Executor's Account

		By A's Capital A/C	24,987

Working Notes:

Joint Life Policy:

A	9,000 (full value as he leaves the firm)
B (4,800 x ¼)	1,200
C (2,400 x ¼)	600
	10,800

A's share = 10,800 x ½ = 5,400.

Interest on Capital = 10,400 x 5/100 x 2/12 = 87 (approx)
Share of profit = profit for the 3 preceding years =9,200+7,400+8,600=25,200

Average of one year = 25,200/3 = 8,400.

Profit for 2 months = 8,400 x 2/12 =

1,400A's share = 1,400 x ½ =700

Goodwill: Two years' purchase of average profits of 3 years

Average profit = 8,400

2 years' purchase = 8,400x 2 = 16,800

Goodwill = 16,800
A's share = 16,800 x ½= 8,400.

Illustration 7:

S, J and N were partners sharing profits and losses in the ratio of 3:2:1 on 31st December 2007. Their balance sheet was as follows:

Creditors		8,000	Goodwill		6,000
General Reserve		9,000	Buildings		20,000
Capitals:			Patents		5,000
S	35,000		Machinery		15,000
J	20,000		Stock		8,000
N	15,000	70,000	Debtors		8,000
			Cash at Bank		25,000
		87,000			**87,000**

J died on 1st July 2007. The following terms and conditions were agreed upon betweenher executor and the remaining partners.

a) Goodwill was valued at 1 ½ years purchase price of past three years' profits which were as follows:

2004	16,000
2005	8,000
2006	12,000

b) Patents were valued at Rs.8, 000; buildings at Rs.25, 000; and machinery at Rs.24,000.

c) Profit up to the date of death of J was to be taken on the basis of the average profits of the past three years.

d) Interest on capital at 5% per annum was to be charged.

e) Cash amounting to Rs.7, 500 was paid immediately and the balance due to the executorof the deceased was payable together with interest at 6% per annum in two equal yearly installments.

f) Reserve for bad and doubtful debts was to be provided for an amount of Rs. 1,000.

g) J's drawings up to the date of his death were Rs.4, 000.

Draft the necessary journal entries to record the above transactions and prepare J's capitalaccount as on the date of her death.

Solution :

Journal entries:

1. General Reserve A/C	Dr	3,000	
To J's Capital A/C			3,000
(Being J's share in the reserve transferred to his capital account)			
2. Goodwill A/C	Dr	12,000	
Patents A/C	Dr	3,000	
Buildings A/c	Dr	5,000	

Machinery A/C	Dr	9,000	
To P & L Adj. A/C			29,000
(Being Assets revalued)			
3. P & L Adj. A/C	Dr	1,000	
To Reserve for bad debts			1,000
(Being provision credited on debtors)			
4. P & L Adj. A/C	Dr	28,000	
To S's Capital			14,000
To J's Capital			9,333
To N's Capital		4,667	
(Being profit on revaluation distributed)			
5. Profit and Loss Suspense A/C	Dr	2,000	
To J's Capital A/C			2,000
(Being the share of profit of J for six months transferred to his account)			
6. Interest on Capital A/C	Dr	500	
To J's Capital A/C			500
(Being interest on Capital for six months transferred to his account)			
7. J's Capital A/C	Dr	30,833	
To Executor's A/C			30,833
(Being J's capital balance transferred to his Executor's account)			
8. Executor's A/C	Dr	7,500	
To Cash			7,500
(Being part payment made)			

J's Capital Account

To Drawings	4,000	By Balance B/D	20,000
To Executor's A/C	30,833	By Reserve	3,000
		By P & L Adj. A/C	9,333
		By P & L Suspense A/C	2,000
		By Interest on Capital	500
	34,833		**34,833**

Executor's Account

To Cash	7,500	By J's Capital A/C	30,833
To Balance C/D	23,333		
	30,333		**30,333**
		By Balance B/D	23,333

Working Notes :

Goodwill 1 ½ years purchase of the average profit of preceding 3 years

3 years profit = 16,000+8,000+12,000=36,000

1 year average =

36,000/3=12,000 11/2 years average =

12,000 x 1 ½ = 18,000

Less: Goodwill already in the balance sheet = 6,000
Increase in goodwill =12,000

Illustration 8 :

A and B who share profit in the ratio of 3:2, took out a joint life policy on 1st May, 2000 for Rs.30, 000. The annual premium was Rs.1, 300. The surrender value of the policy was:

2000 – Nil; 2001 – Rs.400; 2002 – Rs.900; 2003 – Rs.1, 450.

B died on 15th September, 2003 and the amount of the policy was received on 31st December, 2003. The books are closed on December 31 each year.

Give journal entries if premium paid is written off to profit and loss account each year.

Solution :

Journal Entries:

May 1, 2000 Joint life policy A/C Dr 1,300
To Cash 1,300
(Being the 1st premium paid on Joint

Policy)Dec 31,2000 P & L A/C Dr

1,300

To Joint Policy Reserve A/C 1,300(Being the reserve

created for Joint Policy)

Joint Life Policy Reserve A/C Dr 1,300

To Joint Life Policy 1,300

(Being the surrender value taken into

account)May 1, 2001 Joint Life Policy A/c Dr

1,300

To Cash 1,300
(Being the 2nd premium paid)
Dec 31, 2001 P & L A/C Dr 1,300
To Joint Life Policy Reserve 1,300(Being the reserve

created for Joint Life Policy)

Joint Life Policy Reserve A/C Dr 900
To Joint Life Policy 900
(Being the surrender value of Rs.400 taken into

account)May 1, 2002 Joint Life Policy A/C Dr 1,300

To Cash 1,300

(Being 3rd premium paid)
Dec 31, 2002 P & L A/C Dr 1,300
To Joint Life Policy Reserve1,300(Being the reserve created)

Joint Life Policy Reserve A/C Dr 800

To Joint Life Policy 800
(Being the surrender value Rs.900 taken into account)May 1.2003

Joint Life Policy A/C Dr 1,300

To Cash 1,300

(Being the 4th premium paid)

Dec 31, 2003 Cash A/C Dr 30,000

To Joint Policy 30,000

(Being the policy surrendered due to the death of a partner and cash received)Joint Life Policy Reserve A/C Dr 900

To Joint Life Policy 900

(Being the reserve cancelled)

Joint Life Policy A/C	Dr	28,700	
To A's Capital			17,220
To B's Capital			17,220

(Being the policy amount distributed among the partners)Working Notes:

Joint Life Policy Account

1-5-00 To Cash	1,300	31-12-00By Joint Life Policy Reserve	1,300
1-5-01 To Cash	1,300	31-12-01 By Joint Life Policy Reserve	900
		By Balance C/D	400
	1,300		**1,300**
1-1-02 To Balance B/D	400	31-12-02 By Joint Life Policy Reserve	800
1-5-02 To Cash	1,300	By Balance C/D	900
	1,700		**1,700**
1-1-03 To Balance B/D	900	31-12-03 By Cash	30,000
1-5-03 To Cash	1,300	By Joint Life Policy reserve	900
To A's Capital 17,220			
To B's Capital 11,480	28,700		
	30,900		**30,900**

Joint Life Policy Reserve Account

31-12-00 To Joint Life Policy	**1,300**	31-12-00 By P & L A/C	**1,300**
31-12-01 To Joint Life Policy	900	31-12-01 By P & L A/C	1,300
To Balance C/D	400		
	1,300		**1,300**
31-12-02 To Joint Life Policy	800	1-1-02 By Balance B/D	400
To Balance C/D	900	31-12-02 By P & L A/C	1,300
	1,700		**1,700**
31-12-03 To Joint Life Policy	**900**	1—1-03 By Balance B/D	**900**

Illustration 9 :

Shiv, Shankar and Shambu took a joint life policy on 10th January, 2000, to provide the necessary amount at the time a partner's death. The policy amount is

Rs.40, 000. On 10th January 2003 they paid Rs.1, 000 as last annual premium. Shiv died on 20th February 2003. The surrender value of the policy was as follows:

2000 - Nil: 2001 - 250; 2002 - 450;

After the death of Shiv, on 1st March the policy amount received. Pass the necessary journal entries regarding the policy for three years. Show the final adjustment after Shiv's death.

Partners share profits in 2:1 ratio and close the books every year on 31st December.

Solution :

Journal Entries:

10-1-00	Joint Life Policy A/C	Dr	1,000	
	To Cash			1,000
	(Being the first premium paid)			
31-12-00	P & L A/C	Dr	1,000	
	To Joint Life Policy Reserve			1,000
	(Being the premium transferred to P & L A/C and created reserve)Joint Life Policy Reserve A/CDr		1,000	
	To Joint Life Policy A/C			1,000
	(Being the surrender value taken into account)			
10-1-01	Joint Life Policy A/C	Dr	1,000	
	To Cash			1,000
	(Being the second premium paid)			
31-12-01	P & L A/C	Dr	1,000	
	To Joint Life Policy Reserve A/C			1,000
	(Being the premium transferred to P & L A/C)			
	Joint Life Policy Reserve A/C Dr		750	
	To Joint Life Policy			750
	(Being the surrender value taken into account)			
10-1-02	Joint Life Policy A/C	Dr	1,000	
	To Cash			1,000
	(Being the third premium paid)			
31-12-02	P & L A/C	Dr	1,000	
	To Joint Life Policy Reserve			1,000
	(Being the premium transferred to P & L A/C)Joint Life Policy Reserve A/C Dr			
	800			
	To Joint Life Policy			800
	(Being the surrender value taken into account)			
10-1-03	Joint Life Policy A/C	Dr	1,000	
	To Cash			1,000
	(Being fourth premium paid)			

1-3-2003	Cash A/C	Dr	40,000	
	To Joint Life Policy			40,000
	(Being the policy amount received)			
	Joint Life Policy A/C	Dr	3,000	
	To Shiv's Capital			9,750
	To Shankar's Capital			9,750
	To Shambu's Capital			9,750
	(Being the policy amount distributed to partners)			
	Joint Life Policy Reserve A/C	Dr	450	
	To Joint Life Policy			450
	(Being the reserve account written off)			

Joint Life Policy Account

10-1-00	To Cash	**1,000**	31-12-00	By Joint Life Policy Reserve	**1,000**
10-1-01	To Cash	1,000	31-12-01	By Joint Life Policy Reserve	750
				By Balance C/D	250
		1,000			**1,000**
1-1-02	To Balance B/D	250	31-12-02	By Joint Life Policy Reserve	800
	To Cash	1,000		By Balance C/D	450
		1,250			**1,250**
1-1-03	To Balance B/D	450	1-3-03	By Cash	40,000
10-1-03	To Cash	1,000		By Joint Life Policy Reserve	450
	To Shiv's Capital	19,500			

To Shankar's Capital

9,750To Sambu's

Capital 9,750

40,450 **40,450**

Joint Life Policy Reserve Account

31-12-00	To Joint Life Policy A/C	**1,000**	31-12-00	By P & L A/C	**1,000**
31-12-01	To Joint Life Policy A/C	750	31-12-01	By P & L A/C	1,000
	To Balance C/D	250			
		1,000			**1,000**
31-12-02	To Joint Life Policy A/C	800	1-1-02	By Balance B/D	250
	To Balance C/D	450	31-12-02	By P & L A/C	1,000
		1,250			**1,250**
1-3-03	To Joint Life Policy A/C	**450**	1-1-03	By Balance B/D	**450**

8.5 TRY YOURSELF :

1. A, B and c were carrying on business in partnership sharing profits and losses in the ratio of 3:2:1. On 31st December 2003, Balance Sheet of the firm stood as follows:

Liabilities			Assets	
Sundry Creditors		13,590	Cash	5,900
Capital Accounts:			Debtors	8,000
A	15,000		Stock	11,690
B	10,000		Buildings	23,000
C	10,000	35,000		
		48,590		**48,590**

B retired on the above mentioned date on the following terms:

i) Buildings are to be appreciated by Rs.7, 000.

ii) Provision for bad debts is to be made @ 5% on debtors.

iii) Goodwill of the firm is to be valued at Rs.9, 000 and adjustment is this respect to be made without raising goodwill account.

iv) Rs.5, 000 is to be paid to B immediately and the balance due to him be treated as a loan carrying interest @ 6% per annum. Pass journal entries to record the above transactions and show the Balance Sheet of the firm as it would appear immediately after B's retirement.

(A's Capital: Rs.16, 050; C's Capital: Rs.10, 350; B's Loan A/C: Rs.10, 200)

2. The Balance Sheet of X,Y and Z who were sharing profits in the ratio of 4:3:2 respectively stoodas follows on 31st December, 2007:

Liabilities		Assets		
Sundry Creditors	4,140	Cash at Bank		3,300
Capital Accounts:		Sundry Debtors	3,045	

X	12,000		Less: Provision	105 2,940
Y	9,000		Stock	4,800
Z	6,000	27,000	Plant and Machinery	5,100
			Land and Buildings	15,000
		31,140		**31,140**

Y having given notice to retire from the firm, the following adjustments in the books of thefirm were agreed upon:

1. That land and buildings are appreciated by 10%.
2. The provision for bad debts is no longer necessary.
3. That the stock is to be appreciated by 20%.
4. That adjustment is to be made in the accounts to rectify a mistake previously made whereby Y was credited in excess by Rs.810 while X and Y were debited in excess by Rs.420 and Rs.390 respectively.
5. That the goodwill of the firm is to fixed at Rs.5, 400 and Y's share of the same is to be adjusted to that of X and Z who are going to share in future profits in the ratio of 2:1.
6. That the entire capital of the firm, as newly constituted, will be readjusted by fringing in or paying of cash so that the future capital of X and Z is in the ratio of 2:1.

Pass journal entries and prepare the Balance Sheet of the new firm showing Y's balanceas loan.

(New capitals of X Rs.12, 480; Z Rs.6, 240; Y's loan A/C Rs.10, 845; B/S total Rs.33, 705)

3. Gupta, Badal and sinha are in partnership sharing profits and losses in the ratio of 2:2:1. Sinha retires on 31st December, 2007. The Balance Sheet of the firm on the date of retirement of Sinhais as follows:

Liabilities		Assets	
Creditors	2,300	Cash in hand	500
General Reserve	2,500	Cash at Bank	3,000

Capitals:			Debtors	6,000
Gupta	10,000		Stock	10,000
Badal	8,000		Buildings	8,000
Sinha	7,200	25,200	Furniture	2,000
Profit & Loss Account		500	Goodwill	1,000
		30,500		**30,500**

The following adjustments are to be made:

1. Buildings are to be revalued at Rs.10, 000.
2. Bad debts to be written off Rs.400.
3. Stock is to be revalued at Rs.9 000.
4. Furniture is to be revalued at Rs.1, 800.
5. The Goodwill of the firm is to be completely written off.
6. It was agreed to pay Rs.2, 000 only to the sundry creditors in full settlement of their dues.
7. The amount available at Bank is agreed to be paid to Sinha and the balance of the amount due to Sinha to be transferred to his loan account.

You are required to prepare capital accounts of the partners, profit and loss adjustmentaccount and balance sheet of the firm.

(New Capitals: Gupta: Rs.11,080; Badal: Rs.9, 80; Sinha Loan A/C: Rs.4,740; Total ofBalance Sheet: Rs.26,900)

4. Amit, Dharam and Rajesh were partners sharing profits and losses in the ratio of 5:3:2. They had taken out a joint life policy of the face value of Rs.24,000. On 31st December 2007 its surrender value was Rs.4,800 on this date the balance sheet of the firm stood as under:

Liabilities		Assets	
Sundry creditors	6,360	Fixed assets	30,000

Expenses outstanding		840	Stock	13,200
Reserve		3,600	Book debts	10,800
Capitals:			Cash at bank	2,400
Amit	24,000			
Dharam	12,000			
Rajesh	9,000	45,600		
		56,400		**56,400**

On this date Dharam decided to retire and for this purpose: i) goodwill was valued at Rs.18, 000; ii) fixed assets were valued at Rs.36, 000 and iii) stock was considered as worth Rs.12, 000.

Dharam to be paid through cash brought in by Amit and Rajesh in such a way as to make their capitals proportionate to their new profit sharing ratio which was Amit 3/5 and Rsjesh 2/5. Goodwill was to be passed through books without raising a goodwill account. The joint life policy was also not to appear in the balance sheet.

Record these matters in the journal of the firm and prepare the resultant balance sheet. (New Capitals: Amit: Rs.32,400; Rajesh: Rs.21,600;Cash to Dharam: Rs.21,360; Total of Balance Sheet: Rs.61,200)

5. X, Y and Z were partners sharing profits in 6:4:3. The amount payable to the expired partner will be paid 40% in the first year, 40% in the second year and 20% in the third year. To ascertainthe amount of an expired partner, the following items should be taken into account:

1. Share of profit should be calculated basing on the profits of the year in which the partner died.
2. Goodwill should be calculated basing on the two years' purchase of the average profits of the preceding three years profits plus the profits of the year in which the partner died up to the date ofhis death.
3. Interest should be calculated at 6% on capital.

X died on 1st January 2004. Business closes every year on 31st March. Profits of the preceding years were:

2000-01	42,000
2001-02	46,500
2002-03	48,000
2003-04	52,000

X Capital on 31st March 2003 was Rs.20, 000; X drawings from 31st March 2003 to 1 st January 2004 were Rs.6, 200. Show X executor's account up to full payment.

(X executor's account (beginning balance): Rs.75, 750; Last installment Rs.16, 059 (including interest))

8.6 SUMMARY :

This lesson dealt with the accounting procedure when a partner retires or dies in the firm. The retirement or death basically makes no difference as the existing partners have to pay his part. However, in certain aspects there are some differences. The retired partner's due is transferred to his loan account and will be paid later. The deceased partner's due is transferred to his executor's account and will be paid immediately or with interest. Treatment of goodwill andrevaluation of assets and liabilities are almost same as in admission of partnership. Joint Life Policy helps the partnership firm when a person dies and it has three methods of accounting treatment.

8.7 GLOSSARY :

Joint Life Policy: It is a policy taken on the lives of partners to meet the commitment when a partner dies.

8.8 SELF ASSESSMENT QUESTIONS :

1. How goodwill is treated when a partner dies?
2. What are the accounting differences in retirement and death of a partner?
3. Explain the methods of Joint Life Policy treatment when a partner dies?

Dr. R. Jayaprakash Reddy.

LESSON - 9
PARTNERSHIP ACCOUNTS III: ALGAMATION

OBJECTIVES :

After going through the lesson you will be able to understand the following:

1. Meaning and purpose of amalgamation in partnership firms.
2. Method of accounting.

STRUCTURE OF THE LESSON :

9.1 Meaning of amalgamation

9.2 Journal entries

9.3 Illustrations

9.4 Try yourself

9.5 Summary

9.6 Glossary

9.7 Self Assessment Questions

9.1 MEANING OF AMALGAMATION :

When two or more firms of similar nature merge, there come many economies. Because of this, often firms merge or amalgamate themselves. The partners in the old firm continue in the new firm. They reach an agreement regarding the revaluation of assets, future sharing of profits and other modalities. These require separate entries in the books of old partnership firms and new firm. After amalgamation, the firm will continue the operations and the old partnership firms ceased to exist. For example, A &B firm and C & D firms may amalgamate and become A, B, C & D firm. The partners in the old firms become partners of the new firm. Their old firms will be closed down after amalgamation.

9.2 JOURNAL ENTRIES :

The following journal entries are required in the books of old firms and new firm when amalgamation takes place:

Books of Old Firms

1. For Goodwill: The value of goodwill will be ascertained in case of each firm and the amount will be credited to their respective partners' capital accounts in their respective books.

Goodwill A/C Dr

To Partners' Capital A/C

3. Reserve and other undistributed profits: They will be credited to the partners of each of the firms in their respective books.

Reserves Dr

P & L A/C Dr

To Partners' Capital A/C

In case of losses the entry will be reversed.

3. Revaluation of assets and liabilities: A profit and loss adjustment account will be opened in each firm's books. The profit or loss will be credited or debited to their partners' capital accounts in the old profit sharing ratio.

i) For increase in the value of assets or decrease in the value of liabilities:

Assets/Liabilities Dr

To P & L Adj. A/C ii) For decrease in the value of assets or increase in the value of liabilities:

P & L Adj. A/C Dr

To Assets/Liabilities

iii) For distribution of profits:

P & L Adj. A/C Dr

To partners' Capital A/Cs In case of loss the entry will be reversed

4. For an asset taken over by a partner:

Partner's Capital A/C Dr

To Asset A/C

5. For a liability taken over by a partner:

Liability A/C Dr

To Partner's Capital A/C

6. For assets and liabilities taken over by the new firm:

New Firm Dr

Liabilities A/C Dr

To Assets A/C

7. Assets or Liabilities not taken over by the new firm will be either sold away or paid off andany profit or loss on such selling or payment will be transferred to partners' capital accounts in their profit and loss sharing ratio. In case they are not disposed off, the will be transferred to partners' capital accounts in the ratio of their capitals.

8. Partners' capital accounts will be closed by transferring them to the new firm's account.

Partners' Capital A/Cs Dr

To New Firm A/C

Books of New Firm

1. For assets and liabilities taken over:

Assets taken over Dr

To Liabilities taken over

To Partners' Capital A/Cs

2. For any further contribution towards capital by the partners:

Bank A/C Dr

To Partners' Capital A/Cs

3. For any capital withdrawn by the partners:

Partners' Capital A/Cs Dr

To Bank

9.3 ILLUSTRATIONS :

Illustration 1:

X and Y are two sole traders, their Balance Sheets as on 1st January 2007 are given below:

Balance Sheet of X

Sundry creditors	8,000	Plant and Machinery	10,000
Capital Account	20,000	Stock in trade	5,000
		Sundry debtors	11,000
		Cash at bank	2,000
	28,000		28,000

Balance Sheet of Y

Sundry creditors	8,000	Plant and Machinery	10,000
Capital Account	20,000	Stock in trade	5,000
		Sundry debtors	11,000
		Cash at bank	2,000
	28,000		28000

They agree to amalgamate their business as on 1-1-2007. The following revaluations were to be made:

a) Plant and Machinery were to be reduced by 10%.

b) Stock in trade was to be reduced in case of X by 20% and in the case of Y 10%.

c) A reserve of 2 ½ % is to be made against Sundry debtors.

d) Each partner is to be credited with goodwill of Rs.5, 000.

You are required to give journal entries for recording the above transactions in the books of X and Y. Give also the amalgamated Balance Sheet of the partners as on 1-1-2007.

Solution:

Books of X

Journal Entries:

1. P & L Adj. A/C Dr 2,275

1,000

To Plant and Machinery			
To Stock in trade			1,000
To Reserve for bad debts			275
(Being the assets value reduced)			
2. Capital A/C	Dr	2,275	
To P & L Adj. A/C			2,275
(Being loss transferred to capital)			
3. Goodwill A/C	Dr	5,000	
To Capital			5,000
(Being goodwill transferred to capital)			
4. Creditors A/C	Dr	8,000	
Reserve for bad debts A/C	Dr	275	
New firm A/C	Dr	22,725	
To Goodwill			5,000
To Plant and Machinery			9,000
To Stock in trade			4,000
To Debtors			11,000
To Bank			2,000
(Being various assets and liabilities transferred to the new firm)			
5. Capital A/C	Dr	22,725	
To New firm			22,725
(Being the capital account closed)			

Books of Y

Journal Entries:

1. P & L Adj. A/C	Dr	1,175	
To Plant and Machinery			1,000
To Stock in trade			500
To Reserve for bad debts			275
(Being assets value reduced)			
2. Capital A/C	Dr	1,775	
To P & L Adj. A/C			1,775
(Being loss transferred to capital)			
3. Goodwill A/C	Dr	5,000	

To Capital			5,000
(Being goodwill transferred to capital)			
4. Creditors A/C	Dr	8,000	
Reserve for bad debts A/C	Dr	275	
New firm A/C	Dr	23,225	
To Goodwill			5,000
To Plant and Machinery			9,000
To Stock in trade			4,500
To Debtors			11,000
To Bank			2,000
(Being various assets and liabilities transferred to the new firm)			
5. Capital A/C	Dr	23,225	
To New firm			23,225
(Being the capital account closed)			

Balance Sheet of the New Firm

Liabilities			Assets		
Sundry Creditors		16,000	Goodwill		10,000
Capitals: Plant and Machinery 18,000 X		22,725	Stock in trade	8,500	
Y	23,,225	45,950	Debtors	22,000	
			Less: RBD	550	21,450
			Bank		4,000
		61,950			61,950

Illustration 2:

The following were the Balance Sheet of M/S A & B M/S C and D on December31, 2007.

Liabilities	A&B	C&D	Assets	A&B	C&D
Sundry Creditors	40,000	50,000	Cash at Back	11,200	13,400
Mrs.A's Loan	10,000		Stock	40,800	36,600
Capitals:			Sundry Debtors	30,000	40,000
A		80,000	Furniture	8,000	10,000
B		40,000	Premises	80,000	—

C		48,000	Investments	———	30,000
D		32,000			
	1, 70,000	1, 30,000		1, 70,000	1,30,000

The two firms decided to amalgamate their businesses as from 1st January, 2007. For this purpose it was agreed that Mrs.A's loan should be repaid and that the investments of M/ C C and D be not taken over by the new firm. Goodwill of M/S A and B was fixed at Rs.16, 000 and that of M/S C and D at Rs.20, 000. Premises were revalued at Rs.1, 00,000 but the stock of M/S A and B was found over-valued by Rs.8, 000. The stock of M/S C and D was under valued by Rs.4, 000. A provision of 5% was created for bad debts of both the firms. The total capital of the new firm was to be Rs.80, 000 and the capital of each partner was to be in his profit-sharing ratio which was to be 3:2:3:2. Goodwill account in the new firm was to be written off.

Close the books of the two firms and pass opening entries of M/S A, B, C and D. Also give the Balance Sheet of the newly constituted firm.

Solution:

Books of M/S A and B

1. Mrs A's Loan A/C	Dr	10,000	
To Cash			10,000
(Being the loan paid off before amalgamation)			
2. P & L Adj. A/C	Dr	9,500	
To Stock			8,000
To Reserve for bad debts			1,500
(Being the assets revalued)			
3. Premises A/C	Dr	20,000	
To P & L Adj. A/C			20,000
(Being the asset appreciated)			
4. P & L Adj. A/C	Dr	10,500	
To A's Capital			5,250
To B's Capital			5,250
(Being the profit on realization shared to partners)			
5. Goodwill A/C	Dr	16,000	
To A's Capital			8,000
To B's Capital			8,000
(Being the goodwill raised)			
6. M/S A, B, C and D A/C (New firm)	Dr	1,46,500	
Creditors A/C	Dr	40,000	
RBD A/C	Dr	1,500	
To Cash			1,200

To Stock			32,800
To Debtors			30,000
To Furniture			8,000
To Premises			10,000
To Goodwill			16,000

(Being the assets and liabilities transferred to new firm)

7. A's Capital A/C Dr 93,250 B's Capital A/C Dr 53,250

To A,B,C and D (New firm)			1,46,500

(Being the capitals transferred to new firm)

Books of C and D

1. P & L Adj. A/C	Dr	2,000	
To RBD			2,000
(Being the asset revalued)			
2. Stock A/C	Dr	4,000	
To P & L Adj.			4,000
(Being the asset revalued)			
3. P & L Adj. A/C	Dr	2,000	
To C's Capital			1,000
To D's Capital			1,000
(Being the profit on revaluation shared to partners)			
4. Goodwill A/C	Dr	20,000	
To C's Capital			10,000
To D's Capital			10,000
(Being the goodwill raised)			
5. C's Capital A/C	Dr	18,000	
D's Capital A/C	Dr	12,000	
To Investments			30,000
(Being the asset not taken over by the new firm shared to partners in their capital ratio)			
6. M/S A, B, C and D A/C	Dr	72,000	
Creditors A/C	Dr	50,000	
RBD A/C	Dr	2,000	

To Cash			13,400
To Stock			40,600
To Debtors			40,000
To Furniture			10,000
To Goodwill			20,000

(Being the assets and liabilities transferred to new firm)

7. C's Capital A/C	Dr	41,000	
D's Capital A/C	Dr	31,000	
To A, B, C and D A/C			72,000

(Being the capitals transferred)

Books of A, B, C and D

1. Cash A/C	Dr	14,600	
Stock A/C	Dr	73,400	
Debtors A/C	Dr	70,000	
Furniture A/C	Dr	18,000	
Premises A/C	Dr	1,00,000	
Goodwill A/C	Dr	36,000	
To Creditors			90,000
To RBD			3,500
To A'sCapital			93,250
To B's Capital			53,250
To C's Capital			41,000
To D's Capital			31,000

(Being the assets and liabilities of old firms acquired)

2. A's Capital A/C Dr 10,800 B's Capital A/C Dr 7,200

C's Capital A/C Dr 10,800

D's Capital A/C	Dr	7,200	
To Goodwill			36,000

(Being the goodwill written off)

3. Cash A/C	Dr	26,000	
To C's Capital			17,800
To D's Capital			8,200

(Being the cash brought in partners to make their capitals proportionate to the profit sharing ratio)

4. A's Capital A/C	Dr	34,450	
B's Capital A/C	Dr	14,050	
To A's Current A/C			34,450
To B's Current A/C			14,050

(Being the surplus amount in capitals transferred to current accounts, as there is no sufficient cash)

Balance Sheet of M/S A, B, C, and D as on 1-1-2007

Liabilities		Assets		
Capitals:		Cash		40,600
A	48,000	Stock		73,400
B	32,000	Debtors	70,000	
C	48,000	Less: RBD	3,500	66,500
D	32,000	Furniture		18,000
Current Accounts:		Premises		1,00,000
A	34,450			
B	14,050			
Creditors	90,000			
	2,98,500			2,98,500

Note: The assets and liabilities not taken over the new firm are to be transferred to capital accounts of respective partners in their capital ratio.

Capitals of Partners of the New Firm

	A	B	C	D
Capitals transferred Less goodwill	82,450	46,050	30,200	23,800
Less: Capitals to be in the new firm	48,000	32,000	48,000	32,000
Cash to be payable or to be brought in (-)	34,450	14,050	-17,800	– 8,200

Illustration 3:

Richard and Lloyd have been carrying on businesses as general merchants. They decided to amalgamate, and, henceforth, trade under the name of R&L on the following terms:

1. Each partner shall have a fixed capital of Rs.40, 000.
2. Richard's stock is to be brought in at Rs.12, 800 and Lloyd's at Rs.10, 800.
3. Provisions for Bad debts are to be increased to 6% on debtors.
4. Lloyd's furniture is not to be taken over while Richard's furniture is to be taken at Rs.1,800.
5. Richard is to pay the loan from his son before amalgamation.

6. Any deficiency on the net assets brought in is to be paid into the firm's bankers while any excess is to be withdrawn.

Richard's Balance Sheet on 31-12-2007

Liabilities		Assets		
Creditors	4,800	Furniture and Fixtures		1,400
Loan from his son	2,400	Machinery		20,000
Capital	42,540	Stock in trade		13,600
		Debtors	11,000	
		Less: RBD	480	10,520
		Cash at Bank		4,220
	49,740			49,740

Lloyd's Balance Sheet on 31-12-2007

Liabilities		Assets		
Creditors	8,400	Furniture and fixtures		800
Capital	40,400	Machinery		22,000
		Stock in trade		11,200
		Debtors	12,100	
		Less: RBD	500	11,600
		Cash at Bank		3,200
	48,800			48,800

Give journal entries necessary to adjust each trader's books prior to amalgamation and the opening journal entries and the Balance Sheet of M/S R & L.

Solution:

Books of Richard

1. Loan from his son A/C	Dr	2,400	
To Cash			2,400
(Being the loan paid off)			
2. Furniture A/C	Dr	400	
Capital A/C	Dr	580	
To Stock			800
To RBD (660-480)			180
(Being the assets revalued and loss debited to capital account)			

Note: As there is one partner (Sole trader) the profit or loss arising out of revaluation can be credited or debited to his capital account directly. No need of Preparation of P & L Adj. Account.

3. M/S R & L A/C (New firm)	Dr	41,960	

Creditors A/C Dr 4,800 RBD A/C Dr 600

To Furniture 1,800

To Machinery 20,000

To Stock 12,820

To Debtors 11,000

To Cash 1,820

(Being the assets and liabilities transferred to new firm)

4. Capital A/C Dr 41,960

To M/S R & L (New firm) 41,960

(Being the capital transferred to new firm)

Books of Lloyd

1. Capital A/C Dr 1,426

To Furniture 800

To Stock 400

To RBD (726 – 500) 226

(Being the asset not taken over by the new firm, i.e. Furniture and loss on revaluation debited to capital Account)

2. M/S R & L A/C (New firm) Dr 38,974

Creditors A/C Dr 8,400

RBD A/C Dr 726

To Machinery 22,000 To Stock 10,800 To Debtors 12,100

To Cash 3,200

(Being the assets and liabilities transferred to new firm)

3. Capital A/C Dr 38,974

To M/S R & L (New firm) 38,974

(Being the capital transferred to new firm)

Books of M/S R & L (New Firm)

1. Furniture A/C Dr 1,800 Machinery A/C Dr 42,000 Stock A/C Dr 23,600 Debtors A/C Dr 23,100 Cash A/C Dr 5,020

To Creditors 13,200

To RBD 1,386

To Richard's Capital 41,960

To Lloyd's Capital 38,974

(Being the assets and liabilities of both firms acquired)

2. Cash A/C Dr 1,026

To Lloyd's Capital 1,026

(Being the cash brought in partner to make his capital Rs.40, 000)

3. Richard's Capital A/C Dr 1,960

To Cash 1,960

(Being the surplus capital paid to partner, to make his capital Rs.40, 000)

Balance Sheet of M/S R & L as on 31-12-2007

Liabilities		Assets		
Capitals:		Furniture		1,800
Richard	40,000	Machinery		42,000
Lloyd	40,000	Stock		23,600
Creditors	13,200	Debtors	23,100	
		Less: RBD	1,386	21,714
		Cash (See note)		4,086
	93,200			93,200

Note:

Cash: Balance transferred	5,020
Add: Brought in by Lloyd	1,026
	6,046
Less: Paid to Richard	1,960
	4,086

Illustration 4 :

R and S are partners sharing profits and losses equally in a business similar to that carried on by T. In order to avoid competition they decided to amalgamate the two businesses by taking over the assets and liabilities of T and admitting him into partnership with them as from 1st January, 2007. Their Balance Sheets as at 31st December, 2006 were as follows:

Liabilities		R&S	T	Assets		R&S	T
Sundry creditors		15,000	37,500	Cash		300	700
Bank overdraft		5,000	32,000	Debtors	35,000		
Bills payable		—	3,000	Less: Provision	1,500	33,500	25,000
Loan		—	10,500	Stock		21,200	26,300
Capital Accounts:				Investment		—	27,000
R	20,000			T's Capital (over drawn)		—	4,000
S	15,000	35,000	——				
		55,000	83,000			55,000	83,000

The new partnership is to be carried on as R, S and T and it was agreed among all the partners that the book debts of both the businesses should be provided with bad debts provisions at 10% and the stock to be reduced by 5% for the purpose of amalgamation and that the investments of T should be valued at Rs.35, 000 and that T was credited with a sum of Rs.5, 000 for goodwill. It was further agreed that in order to raise the total capital of the firm to Rs.60, 000, each partner shall introduce such sum as would make his capital in the new business equal to one third of the capital.

Give journal entries in the books of the new firm and show amalgamated Balance Sheet as at 1st January 2007.

Solution:

Books of the New Firm

1. Cash A/C	Dr	300	
Debtors A/C	Dr	35,000	
Stock A/C (21,200-1,060)	Dr	20,140	
To Sundry Creditors			15,000
To Bank Overdraft			5,000
To RBD			3,500
To R's Capital			18,470
To S's Capital			13,470

(Being the assets and liabilities of old firm acquired)

R's Capital 20,000 – 1,530 (loss on revaluation) : 18,470

S's Capital 15,000 – 1,530 (loss on revaluation): 13,470

Loss on Revaluation: RBD = 3,500 – 1,500		2,000
Stock		1.060
		3.060
R's share	3,060/2 =1,530	
S's share	3,060/2 =1,530	

2. Cash A/C	Dr	700	
Debtors A/C	Dr	25,000	
Stock A/C (26,300 – 1,315)	Dr	24,985	
Investments A/C	Dr	35,000	
Goodwill A/C	Dr	5,000	
To RBD			2,500

To Sundry Creditors 37,500

To Bank overdraft 32,000

To Bills payable 3,000

To Loan 10,500

To T's Capital 5,185

(Being the assets and liabilities of old firm acquired)

T's Capital 4,000

Profit revaluation:

Goodwill 5,000

Investment 8,000

13,000

less: RBD 2,500

Stock 1,315 3,815 9,185

Capital 5,185

3. Cash A/C Dr 22,875

To R's Capital (20,000 – 18,470) 1,530

To S's Capital (20,000 – 13,470) 6,530

To T's Capital (20,000 – 5,135) 14,815

(Being the partners brings cash to make their capital Rs.20, 000 each)

Balance Sheet of R, S and T as on 1-1-2007

Liabilities		Assets		
Capitals:		Cash (300+700+22,875)		23,875
R	20,000	Debtors	60,000	
S	20,000	Less: RBD10%	6,000	54,000
T	20,000	Stock (20,140 + 24,985)		45,125
Sundry Creditors	52,500	Investments		35,000
Bank overdraft	37,000	Goodwill		5,000
Loan	10,500			
Bills payable	3,000			
	1, 63,000			1,63,000

Illustration 5:

X &Co. having X and Y as equal partners decided to amalgamate with P& Co. having P and Q as equal partners on the following terms and conditions:

1. The new firm to take investments at 10% depreciation, land at Rs.80,000, premises atRs.45,000, Machinery at Rs.9,000 and to take over only the trade liabilities of both the firms. The debtors are taken over at book values including reserve.
2. The new firm to pay Rs.12, 000 to each firm for goodwill.
3. Typewriters at the written off value of Rs.800, belonging to P & Co. and not appearing in the Balance Sheet was also not taken over by the new firm.
4. It was also agreed that the furniture belonging to both the firms be not taken over by the new firm.
5. All the four partners in the new firm to bring in Rs.1, 60,000 as capital in equal shares.

The following were the Balance Sheets of both the firms on the date of amalgamation. Balance Sheets

Liabilities	X& Co.	Y& Co.	Assets	X& Co.	Y& Co.
Sundry Creditors	20,000	10,000	Cash at Bank	15,000	8,000
Bills payable	5,000	———	Investments	10,000	8,000
Bank Overdraft	2,000	10,000	Debtors 10,000		
X's Loan	6,000		Less: Provision 1,000	9,000	8,000
Capitals:			Furniture	12,000	6,000
X	35,000	—	Premises	30,000	———
Y	22,000	—	Land	————	50,000
P	——	36,000	Machinery	15,000	———
Q	——	20,000	Goodwill	9,000	——
General Reserve	8,000	3,000			
Investment fluctuation Fund	2,000	1,000			
	1, 00,000	80,000		1, 00,000	80,000

Pass journal entries in the books of both the firms and prepare a Balance Sheet of the new firm.

Solution:

Books of X& Co.

		Dr	Cr
1. P& L Adj. A/C Dr		6,000	
Investment fluctuation fund A/C		1,000	
To Machinery			6,000
To Investment			1,000

(Being the assets depreciated and decrease in investment value adjusted in investment reserve)

2. Premises A/C Dr 15,000

To P&L Adj. A/C 15,000

(Being the asset appreciated)

3. P&L Adj. A/C Dr 9,000

To X's Capital 4,500

To Y's Capital 4,500

(Being the profit on revaluation shared)

4. General Reserve AC Dr 8,000

Investment fluctuation fund A/C Dr 1,000

To X's Capital 4,500

To Y's Capital 4,500

(Being the reserve and balance in investment fund shared to partners)

5. Goodwill A/C Dr 3,000

To X's Capital 1,500

(Being the goodwill adjusted)

6. Bank overdraft A/C Dr 2,000

X's Loan A/C Dr 6,000

To X's Capital 4,912

To Y's Capital 3,088

(Being the liabilities not taken over by the new firm transferred to capital accounts in their capital ratio i.e. 35:22)

7. X's Capital A/C Dr 7,368

Y's Capital A/C Dr 4,632

To Furniture 12,000

(Being the asset not taken over debited to capital accounts)

8. New Firm A/C Dr 74,000

Bills payable A/C Dr 5,000

Creditors A/C Dr 20,000

Reserve for bad debts A/C Dr 1,000

To Bank 15,000

To Investments 9,000

To Debtors 10,000

To Premises 45,000

To Machinery 9,000

To Goodwill 12,000
(Being the assets and liabilities transferred to new firm)

9. X's Capital A/C Dr 43,044
Y's Capital A/C Dr 30,956
To New Firm 74,000
(Being the capitals transferred to new firm)

Working Notes:

Goodwill value to be raised is Rs.12, 000 but already Rs.9, 000 is appearing in the Balance Sheet. The difference only can be adjusted.

Capital Accounts

	X	Y		X	Y
To Furniture	7,368	4,632	By Balance	35,000	22,000
To New Firm	43,044	30,956	By P&L Adj. A/C	4,500	4,500
			By Gel. Reserve & Investment fund	4,500	4,500
			By Goodwill	1,500	1,500
			By Liabilities	4,912	4,912
	50,412	35,588		50,412	35,558

Books of P& Co.

1. Typewriter A/C Dr 800
Land A/C Dr 30,000
To P&L Adj. A/C 30,800
(Being asset revalued and unrecorded asset taken into the books)

2. Investment fluctuation fund A/C Dr 800
To Investments 800
(Being the asset revalued and difference adjusted out of reserve)

3. P&L Adj. A/C Dr 30,800 To P's Capital 15,400
To Q's Capital 15,400
(Being the profit on revaluation shared to partners)

4. General Reserve A/C Dr 3,000
Investment fluctuation fund A/C Dr 200
To P's Capital 1,600
To Q's Capital 1,600

(Being the reserve and balance in investment fund shared)

5. Goodwill A/C Dr 12,000 To P’s Capital 6,000

To Q’s Capital 6,000

(Being the goodwill created)

6. P’s Capital A/C Dr 4,371

Q’s Capital A/C Dr 2,429

To Furniture 6,000

To Typewriter 6,000

(Being the assets not taken over by the new firm debited to capital of partners in their capital sharing ratio of 9:5)

7. Bank overdraft A/C Dr 10,000

To P’s Capital 6,429

To Q’s Capital 3,571

(Being the liability not taken over credited to capitals)

8. Creditors A/C Dr 10,000

New Firm A/C Dr 1,05,200

To Bank 8,000

To Investments 7,200

To Debtors 8,000

To Land 80,000

To Goodwill 12,000

(Being the assets and liabilities transferred to new firm)

9. P’s Capital A/C Dr 61,058

Q’s Capital A/C Dr 44,142

To New Firm 1,05,200

(Being the capitals transferred to new

firm) Working Notes:

Capital Accounts

	P	Q		P	Q
To Furniture& Type			By Balance		
36,000				20,000	
Writer	4,371	2,429	By P&L Adj. A/C		
15,400				15,400	

To New Firm	61,058	44,142	By Gen. Reserve	1,600	1,600
			By Goodwill	6,000	6,000
			By Overdraft	6,429	3,571
	65,429	46,571		65,429	46,571

Books of New Firm

Balance Sheet of the New Firm

Liabilities		Assets			
Capitals:		Cash at Bank(see working notes)			3,800
X	40,000	Investments	16,200		
Y					
Z	40,000	Debtors	18,000		
P	40,000	Less:Provision		1,000	17,000
Q					
R	40,000	Machinery		9,000	
Creditors	30,000	Premises			45,000
Bills payable	5,000	Land			80,000
24,000					
	1, 95,000				1, 95,000

The Balance Sheets of Sun and Moon and A and B as on 31st December 2007 were as follows:

Goodwill

Working Notes: X

Capitals transferred	43,044	30,956	61,058	44,142
Capitals in the new firm	40,000	40,000	40,000	40,000
Cash payable or to brought in	3,044	- 9,044	21,058	4,142

Cash at Bank: Balance transferred 23,000

Cash brought in by Y 9,044

32,044

Less: Cash paid to X 3,044

P 21,054

Q 4,142 28,244

3,800

Illustration 6 :

	S&M	A&B		S&M	A&B
Capitals :			Land & Workshops	50,000	60,000
Sun	50,000		Machinery& Tools	35,000	40,000
Moon	50,000		Furniture& Fixtures	15,000	17,500
A		50,000	Sundry Debtors	30,000	42,500
B		50,000	Stock	40,000	50,000
Creditors	75,000	50,000	Cash at Bank	1,500	5,000
Loan		50,000			
Outstanding expenses	10,000	15,000			
	1, 85,000	2, 15,000		1, 85,000	2,15,000

The two firms decided to amalgamate and form in S, M, A & B Co. with effect from 1st January 2007. Partners would share equally between themselves as they were doing prior to amalgamation and they agreed to the following revaluation of assets and liabilities:

	Sun & Moon	A & B
Land and Workshops	50,000	50,000
Machinery and Tools	35,000	40,000

Furniture and Fixtures 12,500 12,500 Sundry debtors 27,500 35,000

Stock	40,000		40,000	
Outstanding expenses		10,000		10,000

In addition to the above it was decided —

i) That the new firm would not take over the loan of A&B which is taken over by the two partners equally.

ii) That the goodwill of Sun & Moon and A&B was valued at Rs.50, 000 and Rs.25, 000 respectively in the first instance but for the purpose o the Balance Sheet of the new firm the combined goodwill could be valued at Rs.60,000.

iii) That the reconstructed capitals of partners should be Rs.70, 000 each, introducing cash if necessary.

You are required to show the profit and loss adj. accounts of amalgamating firms and partners capital accounts before and after amalgamation and the balance sheet of the new firm.

Solution:

Books of Sun and Moon

P & L Adjustment Account

To Furniture A/c	2,500	By Sun Capital A/C	2,500
To RBD	2,500	By Moon Capital A/C	2,500
	5,000		5,000

Sun Capital Account

To P&L Adj. A/C	2,500	By Balance	50,000
To New Firm	72,500	By Goodwill (1/2 of 50,000)	25,000
	75,000		75,000

Moon Capital Account

To P&L Adj. A/C	2,500	By Balance	50,000
To New Firm	72,500	By Goodwill (1/2 of 50,000)	25,000
	75,000		75,000

Books of A and B

P & L Adj. Account

To Land	14,000	By A's Capital	17,500
To Furniture	5,000	By B's Capital	17,500
To RBD	7,500		
To Stock	10,000		
To Outstanding expenses	2,500		
	35,000		35,000

A's Capital Account

To P & L	17,500	By Balance	50,000
To New Firm	70,000	By Goodwill	12,500
		By Loan (not taken over)	25,000
	87,500		87,500

B's Capital Account

To P & L Adj. A/C	17,500	By Balance	50,000
To New Firm	70,000	By Goodwill	12,500
		By Loan (not taken over)	25,000
	87,500		87,500

Books of New Firm

Balance Sheet of New Firm as on 1-1-2007

Liabilities		Assets		
Capitals:		Land and Workshops		1,00,000
Sun	70,000	Machinery		75,000
Moon	70,000	Furniture		25,000
A	70,000	Debtors	72,500	
B	70,000	Less: Provision	10, 000	62,500
Creditors	1,25,000	Stock		80,000
Outstanding expenses	27,500	Goodwill		60,000
		Cash (see working notes)		30,000
	4, 32,500			4, 32,500

Working Notes:

Goodwill transferred from old firm 50,000+25,000	75000
Less: Goodwill to be shown in the Balance Sheet	60,000
Goodwill to be written off from Capital Accounts	15,000

	Sun	Moon	A	B
Capital transferred to New Firm	72,500	72,500	70,000	70,000
Less: Goodwill share (15,000 x ¼)	3,750	3,750	3,750	3,750
	68,750	68,750	66,250	66,250
Cash to be brought in	1,250	1,250	3,750	3,750
Capital of the partners in the New Firm	70,000	70,000	70,000	70,000

Debtors:

Transferred from old firm 30,000 + 42,500 72,500

Less RBD transferred	2,500 + 7,500	10,000	
		62,500	

Cash Balance:

Balance transferred from old firms	15,000 + 5,000	20,000	
Add: Cash brought in by the partners			10,000
		30,000	

9.4 TRY YOURSELF :

1. A and B who are in partnership sharing profits and losses in the proportion of three-fifths andtwo-fifths respectively, decided to admit into partnership C who is trading alone in the same line. Their Balance Sheets on the 31st December, 2006 are as follows:

Liabilities	A & B	C	Assets	A & B	C
A's Capital Account	1, 05,000		Cash	20,000	10,000
B's Capital Account	70,000		Book debts	65,000	2,500
C's Capital Account		20,000	Machinery	35,000	—
Creditors	15,000	7,500	Stock	70,000	15,000
Reserve	10,000				
	2, 00,000	7,500		2, 00,000	27,500

It is decided that C should be given a quarter share in the new firm, A and B sharing the balance in the old proportion. It is also agreed that C's assets and liabilities were to be taken over as per his balance sheet, but the following adjustments were to be made in A and B's balance sheet:

a) Debtors to be written off by Rs.15, 000.

b) Stocks to be written off by Rs.15, 000.

c) Machinery to be written off by Rs.5, 000.

C also agrees to pay privately to A and B by way of goodwill quarter share of A and B's profits for the last two years which were 2005 – Rs.27, 000; 2006 –Rs.33, 000. It was also decided that the partners' capitals in the new business shall be in the same proportion as they share profits.

Draw up the new firm's Balance Sheet as at 1st January 2007 and state a) the total cost to C for his share in the business, b) how much A and B will each receive for goodwill.

(A's Capital: Rs.76, 500; B's Capital: Rs.51, 000; C's Capital: Rs.42, 500; Total of Balance Sheet Rs.1, 92,500; C pays Rs.9, 000 to A and Rs.6, 000 to B as goodwill)

2. Singh and Khan have each been carrying on business as general merchants. They decideto amalgamate, and, henceforth, trade under the name of Singh & Khan, on the following terms:

    1) Each partner shall have fixed capital of Rs.10, 000.
    2) Singh's stock is to be brought in at Rs.3, 200 and Khan's at Rs.2, 700.
    3) Provisions for bad debts are to be increased to 6 per cent on the debtors.
    4) Khan's furniture is not to be taken over while Singh's furniture is to be taken atRs.450.
    5) Singh is to pay the loan from his son before amalgamation.

6) Any deficiency on the net assets brought in it's to be paid into the firm's bankerswhile any excess is to be withdrawn.

The Balance Sheets of Singh and Khan as on 31st December, 2007.

Liabilities	Singh	Khan	Assets		Singh		Khan
Creditors	1,200	2,100	Furniture and Fixtures		350		200
Loan from his son	600	—	Machinery		5,000		5,500
Capital	10,635	10,100	Stock in trade		3,400		2,800
			Debtors	2,750		3,025	
			Less: Provision	120	2,630	125	2,900
			Cash at Bank		1,055		800
	12,435	12,200			12,435		12,200

Give journal entries necessary to adjust each trader's books prior to amalgamation and the opening balance sheet of Singh and Khan.

(Khan pays: Rs.257; Singh receives: Rs.1, 090; Total of Balance Sheet: Rs.23, 300)

3. Two partnership firms, carrying on business under the styles of Black & Co. and White & Co. respectively, decide to amalgamate into Grey & Co. with effect from 1st April, 2007. The Balance Sheets are as follows:

Liabilities	Black & Co.	White & Co.	Assets	Black & Co.	White & Co
B's Capital	19,000		Plant and Machinery	10,000	
X's Capital		10,000	Stock in trade	20,000	5,000
Y's Capital		2,000	Sundry debtors	10,000	10,000
Sundry Creditors	10, 000	28,000	A's Capital	4,000	
Bank overdraft	15,000		Cash in hand		6,000
			Cash at bank		9,000
			Goodwill		10,000
	44,000	40,000		44,000	40,000

The following further information is given:

i) Goodwill of Black & Co. is to be valued on the basis of 3 years' purchase of the average profits for 3 years in excess of 10% of the total assets of the firm, the total assets being taken as on 31st March 2007 and the profits for the three preceding years were:

2004-05 Rs.11, 000 (after a credit of Rs.3, 000 in respect of claims raised in 2002-03)

2005-06 Rs.6, 000

2006-07 Rs.12, 000 (after a debit of Rs.1, 000 for loss by theft)

ii) X brings in Rs.8, 750 and Y Rs.16, 750 as fresh capital into the new firm but otherwise they will be deemed to have contributed capitals in proportion to their share in profits, taking the capitals and A and B in total as the base.

iii) A and B will bring or take cash to make their capitals in the profit sharing ratio .iv) Goodwill will not remain in the books of Grey & Co.

v) Black & Co owes Rs.5, 000 to White & Co.

vi)Stock of Black & Co. includes Rs.10, 000 worth goods purchased from White & Co. whose practice is to sell goods at a margin of 25%.

vii) The two pairs of partners as between themselves will share profits in the ratio of 3:5 but the old profit-sharing ratios amongst the partners will remain undisturbed. viii) B will make a gift of Rs.5, 000 to A towards his capital.

Prepare journal entries for White & Co. and the Balance Sheet of Grey & Co.

(Total of the balance sheet: Rs.71, 500)

4. A and B carry on independent business in provisions and their positions as at 30th September, 2007 are reflected in the Balance Sheets given below:

Liabilities	A	B	Assets	A	B
Creditors	1, 10,000	47,000	Stock in trade	1, 70,000	98,000
Payable expense	750	2,000	Sundry debtors	89,000	37,000
Bills payable	12,500	——	Cash at Bank	13,000	7,500
Capital Account	1, 53,000	95,500	Cash in hand	987	234
			Furniture	2,750	1,766
			Investments	513	—
	2, 76,250	1, 44,500		2, 76,250	1, 44,500

Both of them want to form a partnership firm form 1 October, 2007 on the following understanding:

a) The capital of the partnership would be Rs. 3 lakhs which would be contributed by them in the ratio 2:1.

b) The assets of the individual businesses would be evaluated by C at which the contribution due by A and B.

c) C gave his valuation report as follows: Business of A: Stock in trade to be written down by 15% and a portion of Sundry debtors amounting to Rs.9, 000 estimated unrealizable not to be assumed by a firm; furniture to be valued at Rs.2, 000 and investments to be taken at market value of Rs.1, 000.

Assets of B: Stocks to written up by 10% and sundry debtors to be admitted at 85% of their value; rest of the assets to be assumed at their book value.

d) The firm is not to assume any creditors other than the dues on account of purchases made.

Prepare the opening Balance Sheet of the firm.

(A introduces Rs.8, 513 and B withdraws Rs.1, 750; Balance Sheet: Rs.4, 58, 750)

9.5 SUMMARY :

Two partnership firms amalgamate themselves to reap economies and to avoid unnecessary competition between them. The assets and liabilities of the firms are revalued and capital accounts of the partners are adjusted accordingly after preparing profit and loss adjustment account. Closing the old firms, new balance sheet of the new firm is prepared and new capital accounts are opened.

9.6 GLOSSARY :

Amalgamation: Merging of two partnership firms into one single new firm is called amalgamation.

9.7 SELF ASSESSMENT QUESTIONS :

1. How amalgamation takes place in partnership?

2. And what is the procedure adopted while it is taking place?

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LESSON - 10

PARTNERSHIP ACCOUNTS IV – DISSOLUTION OF A PARTNERSHIP FIRM

OBJECTIVES :

After going through the lesson you will be able to understand the following:

1. Dissolution of partnership firm and partnership.
2. Modes of dissolution.
3. Accounting procedure for dissolution.
4. Selling a partnership firm to a company.

STRUCTURE OF THE LESSON :

10.1 DISSOLUTION OF PARTNERSHIP FIRM – INTRODUCTION :

In the foregoing lessons we have studied about partnership accounts relating to admission and retirement or death. In this lesson let us know about dissolution. Dissolution is nothing but closing down the business which is running at present. The existing partner ceased to do business and apart after taking their shares and thus the existing business with its present shape comes to an end. When there is a change in the partnership deed i.e. admission of a new partner or retirement or death of a partner, it is also a kind of dissolution. Closing the firm totally is no doubt dissolution. Selling a partnership firm to a company is also dissolution. Let us discuss all these aspects in this lesson.

10.2 DISSOLUTION OF PARTNERSHIP AND PARTNERSHIP FIRM :

Any change in the relations of the partners is called dissolution of partnership. Thus, in all those cases where a partnership is reconstituted, there is dissolution of the partnership. For example, in case there is a partnership between X and Y, and a new partner Z is admitted, the partnership between X and Y comes to an end and a new partnership between X, Y and Z comes into existence. Hence, in dissolution of the partnership, the firm continues in a reconstituted form. Similarly, a retirement or death of a partner also leads to reconstitution of the partnership.

The dissolution of partnership among all the partners of a firm is called the dissolution of the firm. In this case, the business of the firm is closed down and its affairs are wound up. The assets are realized and the liabilities are paid off. The dissolution of a partnership may or may not result in the dissolution of a firm but the dissolution of a firm will necessarily result in the dissolution of the partnership.

10.3 MODES OF DISSOLUTION OF A PARTNERSHIP FIRM :

Partnership firm may be dissolved voluntarily or with the intervention of the court. Here in this lesson, we consider only voluntary dissolution. This dissolution may take place in any of the following ways:

1. Dissolution by agreement: A partnership firm comes into existence by mutual agreement and, therefore, it can be dissolved by the mutual consent of all the partners.
2. Compulsory dissolution: In the following cases a partnership firm will have to be compulsorily dissolved:
    a) by the adjudication of all the partners or of all the partners but one as insolvent, or
    b) by the business of firm becoming unlawful due to the happening of any such event.
3. Dissolution on the happening of certain contingencies: In the absence of any contract to the contrary, a firm will be dissolved on the happening of the following contingencies:
    a) on the expiry of the fixed period for which the firm was constituted,
    b) on the completion of the adventure or undertaking for the carrying out of which the firm was constituted.
    c) on the death of a partner; and
    d) on the adjudication of a partner as insolvent.
4. Dissolution by notice: When a partnership is at will, the firm may be dissolved by any partner giving a notice in writing to all the other partners of his intention to dissolve the firm. The firm will be taken to be dissolved from the date as specified in the notice, or if no date is mentioned from the date of the communication of the notice to the last of the partners.

In this lesson, only voluntary and mutual agreed dissolution related problems are discussed. At the time of dissolution, a realization account is prepared and all assets and liabilities are sold and paid off and the result of realization will be transferred to the capital accounts of the partners and finally, the partners’ accounts are also be closed down. When partners take assets or responsibility of liabilities their capital accounts are adjusted accordingly.

10.4 ACCOUNTING ENTRIES :

In the event of dissolution of a partnership firm, all its assets are sold away and liabilities paid off. A Realisation Account is opened in order to find out any profit or loss on realization of assets and making payment of liabilities.

Journal Entries :

1. For transfer of assets to Realisation Account:

Realisation A/C Dr

To Sundry Assets A/C

It is to be noted that when an asset is transferred to the Realisation Account, its corresponding provision or reserve appearing on the liabilities side of the balance sheet, will also be transferred to the Realisation Account. For example, Investments and Joint Life Insurance Policy appear on the assets side of the balance sheet while Investments Fluctuation Fund and Joint Life Insurance Policy Reserve appear on the liabilities side of the balance sheet. The accounting entries in the event of dissolution of the firm would be as follows:

a) Realisation A/C Dr

To Investments A/C

To Joint Life Insurance Policy A/C

b) Investments Fluctuation Fund A/C Dr

Joint Life Insurance Policy Reserve A/C Dr

To Realisation A/C

2. For transfer of liabilities to Realisation Account:

Liabilities A/C Dr

To Realisation A/C

All liabilities excluding partners' loans will be transferred at book values. Each liability should debit individually. This will close accounts of all liabilities transferred.

3. For Realisation of assets:

Cash/Bank A/C Dr

To Realisation A/C

4. For payment of liabilities:

Realisation A/C Dr

To Cash/Bank A/C

5. In case a partner takes an asset:

Partner's Capital A/C Dr

To Realisation A/C

6. In case a partner agrees to meet a liability:

Realisation A/C Dr

To Partner's Capital A/C

7. For expenses on Realisation:

Realisation A/C Dr

To Cash/Bank

8. For profit on Realisation:

Realisation A/C Dr

To Partners' Capital A/Cs

9. For paying off partner's loan:

Partner's Loan A/C Dr

To Bank A/C

10. For distribution of reserves, undistributed profits etc.

P & L A/C Dr

Reserve A/C Dr

To Partners' Capital A/Cs

11. For cash brought in by a partner on account of his account showing a debit balance:

Cash/Bank A/C Dr

To Partner's Capital A/C

12. The credit balance in a partner's capital account will be paid off:

Partner's Capital A/C Dr

To Cash/Bank A/C

10.5 SALE TO A COMPANY :

Often, a partnership firm converts itself into a joint stock limited company or sells its business to an existing one. Broadly, the procedure already discussed above will be followed for closing the books of the firm. Realization Account will be opened and assets transferred to it, so also liabilities as per the agreement reached with the company. Whatever the company pays as purchase consideration will be credited to the Realisation Account. If expenses are incurred by the firm, the amount will be debited to Realisation Account. If the creditors are taken over by the company, no further treatment is necessary except transferring them to Realisation Account. But if the creditors are to be paid by the firm, the actual amount paid to them will be debited to liability account concerned; the difference between the book figure and the amount actually paid should be transferred to the Realisation Account. The profit or loss on realization will be transferred to the capital accounts in the profit-sharing ratio.

Usually, the company takes over all the assets including cash. Therefore, cash should also be transferred to Realisation Account. Otherwise, it will not be transferred. Normally, the company will discharge the amount due from it in the form of cash, debentures and shares. Separate accounts will be opened for debentures and shares received. Partners will divide the debentures and shares among themselves, in absence of an express agreement, in the ratio of their final claims, that is to say, in the ratio of capitals standing after the loss or profit on realization has been transferred. Further, since no fraction of a share or debenture can be issued, the nearest whole number being made in cash. If there is an agreement to divide the shares or debentures in a particular manner, the agreement should be followed.

It is to be noted that if there is some valueless assets in the books of the firm and if this has to be divided among the partners, it should be divided in the profit-sharing ratio so that any ultimate profit or loss may correspond to the ratio in which profits are shared.

10.6 ILLUSTRATIONS :

Illustration 1 :

The Balance Sheet of a firm showed the following position as on 31st December, 2007.

Liabilities				Assets
Partners Capitals:			Buildings	40,000
	D	25,000	Investments	10,000

E	20,000		Debtors	5,000
F	15,000	60,000	Bank Balance	15,000
Sundry Creditors		10,000		
		70,000		70,000

The partnership was dissolved on 31-12-2007. Creditors were paid at 5% discount. D agreed to take over buildings at Rs.45, 000, E took over investments at Rs, 26,000 and F took debtors at Rs.3, 000.

Show necessary accounts in the firm's books.

Solution:

Realisation Account

To Buildings		40,000	By Creditors	10,000
To Investments		10,000	By D's Capital – Buildings	45,000
To Debtors		5,000	E's Capital – Investments	26,000
To Cash – Creditors		9,500	F's Capital – Debtors	3,000
To D's Capital – profit	6,500			
To E's Capital – profit	6,500			
To F's Capital – profit	6,500	19,500		
		84,000		84,000

D's Capital Account

To RealisationA/C	45,000	By Balance B/D	25,000
		By Realisation A/C	6,500
		By Cash	13,500
	45,000		45,000

E's Capital Account

To Realisation A/C	26,000	By Balance B/D	20,000
		By Realisation A/C	6,500
	26,500		26,500

F's Capital Accounts

To Realisation A/C	3,000	By Balance B/D	15,000
To Cash	18,500	By Realisation A/C	6,500
	21,500		21,500

Cash Account

To Balance B/D	15,000	By Realisation A/C	9,500

To D's Capital	13,500	By E's Capital A/C	500
		By F's Capital A/C	18,500
	28,500		28,500

Illustration 2:

The following was the Balance Sheet of Raja and Sudhir as on 31st December, 2007.

Liabilities		Assets		
Sundry Creditors	38,000	Cash at Bank		11,500
Mrs. Raja's Loan	10,000	Stock in trade		6,000
Sudhir's Loan	15,000	Sundry Debtors	20,000	
Reserve Fund	5,000	Less: Provisions	1,000	19,000
Raja's Capital	10,000	Furniture & Fittings		4,000
Sudhir's Capital	8,000	Machinery and Plant		28,000
		Investments		10,000
		Profit and Loss Account		7,500
	86,000			86,000

The firm was dissolved on 31st December, 2007 and the following was the result:

a) Raja took over investments, at an agreed value of Rs.8, 000 and agreed to pay of the loan of Mrs. Raja.

b) The assets realized the following:

Stock	5,000	Machinery and Plant	25,500
Expenses	1,100	Furniture & Fittings	4,500
Debtors	18,000		

c) The Sundry Creditors were paid off less 2 ½ % discount. Raja and Sudhir shared profits and losses in the ratio of 3:2. Journalise the entries to be made on the dissolution and show Realisation Account, Cash Account, and Partners' Capital Accounts.

Solution:

Journal Entries:

1. Realisation A/C	Dr	68,000	
To Stock			6,000
To Debtors			20,000
To Furniture & Fixtures			4,000
To Machinery			28,000
To Investments			10,000

(Being assets transferred to Realisation account)

2. Bad debts Reserve A/C	Dr	10,000	
Creditors A/C	Dr	38,000	
Mrs. Raja's loan A/C	Dr	10,000	
To Realisation A/C			49,000
(Being liabilities transferred to Realisation account)			
3. Raja's Capital A/C	Dr	8,000	
To Realisation A/C			8,000
(Being investments taken over by Raja)			
4. Realisation A/C	Dr	10,000	
To Raja's Capital A/C			10,000
(Being the risk of payment for liability of Mrs. Raja taken over by Raja)			
5. Cash A/C	Dr	53,000	
To Realisation A/C			53,000
(Being the assets realized)			
6. Realisation A/C	Dr	1,100	
To Cash			1,100
(Being realization expenses paid)			
7. Realisation A/C	Dr	37,050	
To Cash			37,050
(Being liabilities paid)			
8. Reserve Fund A/C	Dr	5,000	
To Raja Capital			3,000
To Sudhir Capital			2,000
(Being reserve fund distributed)			
9. Raja Capital A/C	Dr	4,500	
Sudhir Capital A/C	Dr	3,000	
To Profit and Loss A/C			7,500
(Being loss distributed)			
10. Sudhir Loan A/C	Dr	15,000	
To Cash			15,000
(Being Sudhir's loan paid)			

Realisation Account

To Sundry Assets	68,000	By Sundry Liabilities	49,000
To Raja Capital	10,000	By Raja Capital	8,000
To Cash – expenses	1,100	By Cash – Assets	53,000
To Cash – liabilities	37,050	By Raja Capital – loss	3,690
		By Sudhir Capital – loss	2,460
	1,16,150		1,16,150

Raja Capital Account

To Profit and Loss A/C	4,500	By Balance B/D	10,000
To Realisation A/C	8,000	By Reserve fund	3,000
To Realisation A/C – loss	3,690	By Realisation	10,000
To Cash A/C	6,810		
	23,000		23,000

Sudhir Capital Account

To Profit and Loss A/C	3,000	By Balance B/D	8,000
To Realisation A/C – loss	2,460	By Reserve fund	2,000
To Cash	4,540		
	10,000		10,000

Cash Account

To Balance B/D	11,500	By Realisation A/C	1,100
To Realisation A/C	53,000	By Realisation A/C	37,050
		By Sudhir's Loan	15,000
		By Raja Capital	6,810
		By Sudhir Capital	4,540
	64,500		64,500

Illustration 3 :

A, B and C commenced business on 1st January 2006, with capitals of Rs.50,000, Rs.40,000 and Rs.30,000. Profits and losses were shared in the ratio of 4:3:3 capitals carried interest at 5% per annum. During 2006, and 2007, they made profits of Rs.20, 000, and Rs.25, 000 (before allowing interest). Drawings of each partner were Rs.5, 000 per year.

On 31st December 2007, the firm was dissolved. Creditors on that date were Rs.12, 000. The assets realized Rs.1, 30,000 net. Give necessary accounts to close the books of the firm.

Solution :

Balance Sheet of the firm as on 31-12-2007

Liabilities		Assets	
Creditors	12,000	Sundry Assets	1, 47,000

Joint Capital (A, B & C) (Bal. Fig)
On 1-1-2006 1, 20,000

Add: 2 years' profits 45,000

1, 65,000

Less: 2 years' drawings 30,000 1, 35,000

1, 47,000 1,47,000

Which means Rs.1, 47,000 worth of assets was realized Rs.1, 30,000.

To ascertain the capital of each partner, capital accounts should be prepared for 2006 and 2007.

A's Capital Account

To Drawings 5,000 1-1-2006 By Cash 50,000 31-12-2006 To Balance

C/D 53,100 31-12-2006By Interest 2,500

By P & L A/C 5,600

58,100 58,100

To Drawings 5,000 1-1-2007 By Balance B/D 53,100 31-12-2007 To Realisation

A/C 6,800 31-12-2007 By Interest 2,655

By P & L A/C 7,500

63,255 63,255

B's Capital Account

To Drawings 5,0001-1-2006 By Cash 40,000 31-12-2006 To

Balance C/D 41,200 31-12-2006 By Interest 2,000

By P & L A/C 4,200

46,200 46,200

To Drawings 5,0001-1-2007 By Balance B/D 41,200

31-12-2007 To Realisation A/C 5,100 31-12-2007 By Interest 2,060

To Cash 38,785 By P & L A/C 5,625

48,885 48,885

C's Capital Account

To Drawings 5,000 1-1-2006 By Cash 30,000

31-12-2006 To Balance C/D 30,700 31-12-2006By Interest 1,500

By P & L A/C 4,200

35,700 35,700

To Drawings 5,000 1-1-2006 By Balance B/D 30,700

31-12-2007	To Realisation A/C	5,100	31-12-2007	By Interest	1,535
	To Cash	27,760		By P & L A/C	5,625
		37,860			37,860

Realisation Account

To Sundry Assets	1,47,000	By Creditors	12,000
		By Cash – Assets	1,30,000
To Cash – Creditors	12,000	By A's Capital	6,800
		By B's Capital	5,100
		By C's Capital	17,000
	1,59,000		1,59,000

Cash Account

To Realisation A/C - (Assets realized)	1,30,000	By Realisation A/C - (Creditors paid)	12,000
		By A's Capital	51,455
		By B's Capital	38,785
		By C's Capital	27,760
	1,30,000		1,30,000

Illustration 4 :

A, B and C decided to dissolve their partnership on 30th June, 2007. Their Balance Sheet is as follows:

Liabilities		Assets	
Creditors	3,400	Cash at Bank	2,500
Capitals:		Debtors	6,200
A	12,000	Stock	3,700
B	9,000	Loose Tools	800
C	6,000	Plant and Machinery	6,000
		Freehold premises	10,000
	30,400		30,400

B and C agreed to form a new partnership to carry on the business and it is agreed that they shall acquire from the old firm the following assets at figures shown below:

Stock	4,000
Loose Tools	500
Motor Vehicles	2,500

Plant and Machinery	7,800
Freehold premises	8,400
Goodwill	6,000

The partnership agreement of A, B and C provide that trading profit and loss shall be divided in the ratio of 3:2:1 and that capital profits or losses shall be divided in proportion of their respective capitals.

Debtors realize Rs.5, 900 and discounts amounting to Rs.72 are secured on payments due to creditors.

Prepare the necessary accounts of A, B and C giving effect to these transaction and draw up the opening Balance Sheet of B and C bring the necessary cash to pay A in the ratio of 3:2.

Solution:

Realisation Account

To Debtors		6,200	By Creditors		3,400
To Stock		3,700	By B & C Joint Account:		
To Loose Tools		800	Stock	4,000	
To Motor Vehicles		1,200	Loose Tools	500	
To Plant and Machinery		6,000	Vehicles	2,500	
To Freehold Premises		10,000	Plant	7,800	
To Cash – Creditors (3,400-72)		3,328	Freehold	8,400	
To A's Capital	3,236		Goodwill	6,000	29,200
To B's Capital	2,424		By Cash – debtors		5,900
To C's Capital	1,612	7,272			
		38,500			38,500

The profit realized on Stock, Bills receivable, Bills payable and Creditors is revenue profit or trading profit.

The profit realized on other fixed assets is capital profit.

Profit on Stock	300
Profit on Creditors	72
	372
Loss on debtors	300
Trading profit or Revenue profit	72

A's Share 72 x ½ = 36

B's Share 72 x 1/3 = 24

C's Share 72 x 1/6 = 12

Total Profit on realization 7,272 Less:

Trading Profit 72

Capital Profit 7,200

A's Share 7,200 x 4/9 = 3,200

B's Share 7,200 x 3/9 = 2,400

C's Share 7,200 x 2/9 = 1,600

Total Profit to A 3,200 + 36 = 3,236

Total Profit to B 2,400 + 24 = 2,424

Total Profit to C 1,600 + 12 = 1,612

B & C Joint Account

To Realisation A/C	29,200	By B's Capital A/C	17,523
		By C's Capital A/C	11,677
	29,200		29,200

Cash Account

To Balance	2,500	By Realisation – Creditors	3,328
To Realisation – Debtors	5,900	By A's Capital	15,236
To B's Capital	6,099		
To C's Capital	4,065		
	18,564		18,564

A's Capital Account

To Cash – payment	15,236	By Balance	12,000
		By Realisation	3,236
	15,236		15,236

B's Capital Account

To B & C Joint A/C	17,523	By Balance	9,000
		By Realisation	2,424
		By Cash	6,099
	17,523		17,523

C's Capital Account

To B & C Joint A/C	11,677	By Balance	6,000
		By Realisation	1,612
		By Cash	4,065
	11,677		11,677

Books of New Firm

Balance Sheet of B & C

Liabilities			Assets
Capitals:		Stock	4,000
B	17,523	Loose Tools	500
C	11,677	Motor Vehicles	2,500
		Plant and Machinery	7,800
		Freehold Premises	8,400
		Goodwill	6,000
	29,200		29,200

Working Notes:

Cash available as per Balance Sheet 2,500 Add: Realisation on

Debtors5,900

8,400

Less: Payment to creditors 3,328 Cash available to pay to A 5,072

Cash required to pay to A 15,236

Cash brought by B & C in the ratio of 3:2 10,164

B = 10,164 x 3/5 = 6,099

C= 10,164 x 2/5 = 4,065

Illustration 5 :

Rao, Gopi and Krishna are partners of a firm of Chartered Accountants having office at Nagpur, Pune and Goa, sharing profits and losses in the ratio of 5:3:2 respectively. The statement of affairs of the firm as at 31st March, 2007 is shown below:

Capital Accounts:

Rao 1,50,000

Gopi 1,20,000

Krishna 60,000

Current Accounts:

Rao 75,500

Gopi 25,750

Krishna 11,150 Accounts payable

49,150

Accounts receivable:

Nagpur 1,20,000

Pune	86,250
Goa	98,750
Goodwill	50,000
Cash in hand	5,750
Cash with bank	57,000

On that date, Rao desires to retire from the firm and other two partners agree and it is decided that Gopi would take over the Nagpur and Pune offices and Krishna would take over the Goa office with respective assets and liabilities. You are given the following additional information:

a) Rao's share of goodwill is valued at Rs.1,50,000 and this would be brought by Gopi and Krishna in their profit sharing ratios.

b) Accounts payable include rent of the Goa office for the months of February and March2007 at the monthly rate of Rs.2,500 and the balance represents outstanding expenses of Nagpur and Pune offices.

c) Cash in hand is to be utilized to pay Rao and other settlements to take place before 1st May, 2007.

d) Accounts receivable to be discounted by 2%.

Draw up the necessary accounts to give effect to the above and also the books of the firm.

Solution:

Realisation Account

To Accounts receivable A/C:		By Accounts payable	49,150
Nagpur	1,20,000	By Gopi's Capital A/C	2,02,125
Pune	86,250	(Assets taken)	
Goa	98,750	By Krishna's Capital A/C	96,775
To Gopi's Capital A/C	44,150	By Gopi's Capital A/C – loss	16,830
To Krishna 's Capital A/C	5,000	By Krishna's Capital A/C – loss	11,200
Goodwill	50,000	By Rao's Capital A/C – loss	28,050
	4, 04,150		4, 04,150

Rao's Capital Account

To Realisation A/c	28,050	By Balance	1,50,000
To Cash – payment	3,47,450	By Current A/C – transfer	75,500
		By Gopi's Capital – goodwill	90,000
		By Krishna's Capital – goodwill	60,000
	3,75,500		3,75,500

Gopi's Capital Account

To Current A/C – transfer	25,750	By Balance	1,20,000

To Realisation – loss	16,830	By Realisation – liability	44,150
To Realisation – assets taken	2,02,125	By Cash – introduced	1,70,555
	3,34,705		**3,34,705**

Krishna's Capital Account

To Current A/C – transfer	11,150	By Balance	60,000
To Realisation – loss	11,220	By Realisation – liability	5,000
To Realisation – assets taken	96,775	By Cash – introduced	1,14,195
	1,79,145		1,79,145

Cash Account

To Balance : Bank	57,000	By Rao's Capital	3,47,450
Cash	5,750		
To Gopi's Capital	1,70,555		
To Krishna's Capital	1,14,145		
	3,47,450		**3,47,450**

Working Notes:

Assets taken over by partners:

	Gopi (Nagpur and Pune offices)	Krishna (Goa office)
Accounts receivable (1,20,000 + 86,250)	2,06,250	98,750
Less: 2% discount	4,125	1,975
Net value of Assets taken over (to be debited to Capitals and creditors to Realisation A/C)	2, 02,125	96,775

Liabilities:

Accounts payable	49,150
Less; 2 months rent of Goa office @ 2,500 per month	5,000
Liabilities of Nagpur and Pune offices	44,150

That is liabilities taken over by Gopi: Rs.44, 150 (to be credited capital and debited to Realisation Account0

Liabilities taken over by Krishna Rs.5, 000.

Goodwill : The balance appearing in the Trial Balance is to be transferred to Realisation account to write off it, and Rao's share of Goodwill is credited him and debited to Gopi and Krishna in their profit sharing ratio.

Cash : Gopi and Krishna brought cash as their capital accounts shown debit balance. The existing cash balance and the amount brought in by Gopi and Krishan is utilized to pay off Rao's claim.

Current Accounts: The balance in Current Accounts is transferred to respective sides of Capital Accounts and all the adjustments wee carried out through Capital Accounts.

Sale to a company :

Illustration 6 :

The Balance Sheet of Young and Active sharing 5/8 and 3/8 respectively stood as follows, when they determined to sell of their business to a newly started Joint Stock Company:

Liabilities		Assets	
Young Capital	60,000	Machinery	32,000
Active Capital	36,000	Debtors	20,000
Reserve	8,000	Stock	64,000
Creditors	16,000	Cash	4,000
	1, 20,000		1, 20,000

The company takes over all the assets except cash for Rs.1, 20,000 of which Rs.80, 000 payable in shares of the company and Rs.40, 000 in cash. The expenses of realization amounted to Rs.720 and the creditors were paid off at 5% discount.

Pass journal entries and open realization, cash and capital accounts in the books of the firm.

Solution :

Journal Entries :

		Dr	Cr
1. Realisation A/C	Dr	1,16,000	
To Machinery			32,000
To Debtors			20,000
To Stock			64,000
(Being assets transferred to realization account)			
2. Creditors A/C	Dr	16,000	
To Realisation			16,000
(Being creditors transferred to realization accounts)			
3. Company A/C	Dr	1,20,000	
To Realisation			1,20,000
(Being the assets sold)			
4. Cash A/C	Dr	40,000	
Shares A/C	Dr	80,000	
To Company			1,20,000
(Being the purchase consideration received)			
5. Realisation A/C	Dr	720	
To Cash			720
(Being expenses paid)			

6. Realisation A/C	Dr	15,200	
To Cash			15,200
(Being creditors paid with 5% discount)			
7. Reserve A/C	Dr	8,000	
To Young's Capital			5,000
To Active's Capital			3,000
(Being Reserve distributed)			
8. Realisation A/C	Dr	4,080	
To Young's Capital			2,550
To Active's Capital			1,530
(Being profit on realization distributed)			
9. Young's Capital A/C	Dr	50,000	
Active's Capital A/C	Dr	30,000	
To Shares			80,000
(Being shares distributed in the final capital ratio)			
10. Young's Capital A/C	Dr	17,550	
Active's Capital A/C	Dr	10,530	
To Cash			28,080
(Being final settlement made)			

Realisation Account

To Machinery		32,000	By Creditors		16,000
To Debtors		20,000	By Company		1,20,000
To Stock		64,000			
To Cash – expenses	720				
To Cash – creditors	15,200				
To Young's Capital	2,550				
To Active's Capital	1,530	4,080			
		1,36,000			1,36,000

Cash Account

To Balance B/D	4,000	By Realisation A/C		720
To Company A/C	40,000	By Realisation A/C		15,200
		By Young's Capital	7,500	

		By Active's Capital	10,530	28,080
	44,000			44,000

Shares Account

To Company A/C	80,000	By Young's Capital	50,000
		By Active Capital	30,000
	80,000		80,000

Young's Capital Account

To Shares	50,000	By Balance B/D	60,000
To Cash	17,550	By Realisation A/C	2,550
		By Reserve	5,000
	67,550		67,550

Active's Capital Account

To Shares	30,000	By Balance B/D	36,000
To Cash	10,530	By Realisation A/C	1,530
		By Reserve	3,000
	40,530		40,530

Working Notes:

Final Capital Ratio: 67,550: 40,530

5: 3

Note: shares should be distributed first in the final capital ratio.

Illustration 7 :

Ram and Shyam are in partnership sharing profits and losses in the ratio of two-thirds and one-thirds respectively. Their Balance Sheet as on 31st December 2007, on which date they agreed to convert their business into a limited company was as follows:

Balance Sheet

Liabilities			Assets	
Sundry Creditors		30,000	Cash	7,000
Mortgage on Freehold premises		10,000	Sundry Debtors	26,000
Capitals:			Stock	16,000
Ram	20,000		Plant	5,000
Shyam	10,000	30,000	Freehold premises	16,000
		70,000		70,000

The company takes over all the assets and liabilities with the exception of the mortgage loan purchase price being Rs.60, 000, payable as to Rs.12, 000 in cash, Rs.24, 000 in debentures and the balance in equity shares of the company.

Close the books of the firm after the above transactions have been carried out including the payment of mortgage. The partners agree to share the debentures and shares in proportion to their capitals.

Solution :

Purchase Consideration:

In the form of cash 12,000 In the form

of debentures 24,000

In the form of equity shares 24,000

60,000

Realisation Account

To Cash		7,000	By Creditors	30,000
				60,000
To Debtors		26,000	By Company A/C	
To Stock	16,000 To Plant	5,000		
To Freehold premises		16,000		
To Ram's Capital	13,333			
To Shyam's Capital	6,667	20,000		
		90,000		90,000

Company Accounts

To realization A/C	60,000	By Cash	12,000
		By Debentures	24,000
		By Shares	24,000
	60,000		60,000

Mortgage Loan Account

To Cash	10,000	By Balance B/D	10,000
	10,000		10,000

Cash Account

To Company A/C	12,000	By Mortgage Loan	10,000
		By Ram's Capital	1,333
		By Shyam's Capital	667

	12,000		12,000

Debentures Account

To Company A/C	24,000	By Ram's Capital	16,000
		By Shyam's Capital	8,000
	24,000		24,000

Shares Account

To Company A/C	24,000	By Ram's Capital	16,000
		By Shyam's Capital	8,000
	24,000		**24,000**

Ram's Capital Account

To Debentures	16,000	By Balance B/D	20,000
To Shares	16,000	By Realisation A/C	13,333
To Cash	1,333		
	33,333		**33,333**

Shyam's Capital Account

To Debentures	8,000	By Balance B/D	10,000
To Shares	8,000	By Realisation A/C	6,667
To Cash	667		
	16,667		**16,667**

Illustration 8 :

Rao and Reddy carry on business in partnership wished to dissolve the firm and sell off the business to a limited company on 31st December, 2006, when the firm's position was as under:

Sundry Creditors	21,250	Furniture	3,320
Rao's Capital	34,000	Stock	15,380
Reddy's Capital	17,000	Debtors	48,450
		Cash	5,100
	72,250		72,250

The arrangement with the limited company was as follows:

a) Furniture and stock were purchased at Balance Sheet values less 10%.

b) Goodwill of the firm was valued at Rs.10, 120.

c) The firm's debtors, cash and creditors were not to be taken over by the company, but the company agreed to collect the book debts and discharge the liabilities of the vendors as agent, for which services the company was to he paid 3% on all collections from the vendors' debtors and 2% on cash paid to Vendors' creditors.

d) The purchase price was to be discharged by the company in fully paid ordinary shares ofRs.100 each at a premium of Rs.10 per share.

The company received during the first two months after the purchase of business Rs.48, 000 from vendors' debtors in full satisfaction. The creditors were paid off less Rs.250 allowed by them as discount. The company paid the balance due to the vendors on March 1, 2007.

Ignore the question of interim distribution of cash write up the realization account, cash account and the capital accounts of the partners.

Solution:

Purchase Consideration:

Assets taken over:

Furniture	3,320		
Less: 10%	332	2,988	
Stock	15,380		
Less: 10%	1,538	13,842	
Goodwill		10,120	
Purchase price			26,950

In the form of shares of Rs.110 each

Number of shares: 26,950/110 = 245

Cash collected by the company from debtor on behalf of the firm:		48,000
Less: Cash paid to creditors on behalf of the firm		21,000
		27,000
Cash due from the company		
Less: Commission 48,000 x 3/100	1,440	
21,000 x 2/100	420	1,860
Cash received from the company		25,140

Realisation Account

To Furniture		3,320	By Creditors	21,250
To Stock		15,380	By Company A/C	26,950
To Debtors		48,450	By Company A/C- cash due	25,140
To Rao's Capital	3,095			
To Reddy's Capital	3,095	6,190		

	73,340		**73,340**

Company Account

To Realisation A/C	26,950	By Shares – Company	26,950
To Realisation A/C	25,140	By Cash	25,140
	52,090		52,090

Shares Account

To Company A/C	26,950	By Rao's Capital	17,490
		By Reddy's Capital	9,460
	26,950		26,950

Cash Account

To Balance	5,100	By Rao's Capital	19,605
To Company A/C	25,140	By Reddy's Capital	10,635
	30,240		30,240

Rao's Capital Account

To Shares	17,490	By Balance B/D	34,000
To Cash	19,605	By Realisation A/C	3,095
	37,095		37,095

Reddy's Capital Account

To Shares	9,460	By Balance B/D	17,000
To Cash	10,635	By Realisation	3,095
	20,095		20,095

Note: Shares to be distributed first in the ratio of final claims of the partners =

37,095:20095 = 370: 201 (adjusted)

Shares to Rao = 245 x 371/572 = 17,490

Shares to Reddy = 245 x 201/572 = 9,460

The remaining claim to the partners should be paid in cash.

10.7 TRY YOURSELF :

1. Rahul and Kiran are partners sharing profits as 2:1. The position of the firm as on 31st December 2007 when they decided to dissolve the business was as follows:

Liabilities			Assets
Sundry Creditors	15,000	Plant and Machinery	25,000

General Reserve		10,000	Furniture	4,000
Capital Accounts:			Stock	10,000
Rahul	22,000		Sundry Debtors	20,000
Kiran	22,000	44,000	Cash at Bank	10,000
		69,000		69,000

The realization shows the following result:

a) Rahul took over plant and machinery and furniture at book values less 10%.

b) Kiran took over the stock and goodwill at Rs.17, 500

c) Sundry debtors realized Rs.18, 500.

d) Sundry creditors wee settled at a discount of 5%.

Close the books of the firm.

(Rahul gets Rs.5, 134 and Kiran gets Rs.9, 116)

2. Lakshman, Mukund and Mohan sharing profits in the proportion of 3:2:1 agreed upon dissolution of their partnership on 31st December, 2007 on which date their Balance Sheet was as under:

Liabilities					Assets
Capital Accounts:			Machinery		60,750
Lakshman	60,000		Stock in trade		11,325
Mukund	30,000	90,000	Investments		31,245
Mrs.Lakshman Loan		15,000	Joint Life Policy		21,000
Creditors		27,750	Debtors	13,950	
Life Policy Fund		21,000	Less: Provision	900	13,050
Investments fluctuation fund		9,000	Current Account – Mohan		17,250
			Cash at bank		8,130
		1, 62,750			1,62,750

The Life Policy is surrendered for Rs.18, 000. The investments are taken over by Lakshman for Rs.26, 250. Lakshman agrees to discharge his wife's loan. Mukund takes over all the stock at Rs.10, 500 and debtors amounting to Rs.7, 500 at Rs.6, 000. Machinery is sold for Rs.82, 500. The remaining debtors realize 50% of book value. The expenses of realization amount to Rs.900.

It is found that an investment not recorded in the books is worth Rs.3, 000. The same is taken over by one of the creditors at this value.

Show the necessary ledger accounts including the final accounts of the partners on completion of the disillusion of the firm.

(Realisation: Lakshma – Rs.21,353; Mukund – Rs.14,235; Mohan – Rs.7,117; Final settlement: Lakshman gets Rs.70,103; Mukund gets Rs.27,735; Mohan pays Rs.10,133)

3. P, Q and R carried on business in partnership. On 31st December, 2007, their balance sheet was as under:

Liabilities			Assets	
Sundry Creditors		40,500	Land and Buildings	36,000
P's Loan		54,000	Plant and Machinery	72,000
Capital Accounts:			Loose Plant and Tools	13,500
P	1, 08,000		Stock in trade	90,000
Q	90,000		Sundry debtors	1, 26,000
R	67,500	2, 65,500	Cash at Bank	22,500
		3, 60,000		3, 60,000

They decided to dissolve the firm as on 31st December, 2007. Q and R continued the business, agreeing to purchase P's share in the capital of the firm in the proportions in which they shared profits and losses. P agreed to allow his loan to remain in the business. Profits and losses are shared: P two-fifths, Q two- fifths, and R one-fifths. Q and R utilize the cash at bank to pay P and contribute the balance.

For the purpose of the dissolution, the following valuations were made:

Goodwill 45,000; Land and Buildings Rs.50,500; Plant and Machinery as in the Balance Sheet, subject to 10% depreciation; Loose plant and tools as in the Balance Sheet; Stock in trade Rs.81, 000; Sundry Debtors as in the Balance Sheet, subject to Rs.9, 900; Provision for bad debts and an allowance of 5% for discounts. The liability to sundry creditors is taken over by Q and R subject to a allowance of Rs.1, 800 for discounts.

Q and R continue to share profits and losses in the same proportion as before. Draw up the Realisation Account and other necessary accounts in the books of P, Q and R to close the books and opening Balance Sheet of M/S Q and R together with their opening entries.

(Realisation: P- Rs.7, 758; Q – Rs.7, 758; R – Rs.3, 879; P receives cash Rs.1, 15,758; New firm total of Balance Sheet Rs.3, 55,095)

4. X, Y and Z carry on business in partnership sharing profits and losses ½, 3/8 and 1/8 respectively. On 31st March, 2007, they agreed to sell their business to a limited company. Their position on that date was as follows:

Liabilities		Assets	
X Capital	40,000	Freehold property	36,000
Y Capital	30,000	Machinery	24,000
Z Capital	26,000	Book debts	30,000
Loan on Mortgage	8,000	Stock	26,000
Sundry Creditors	16,000	Cash	4,000
	1, 20,000		1, 20,000

The company took the following assets at the valuation shown below:

Freehold property 44,000 Machinery 22,000

Book debts	28,000	Stock	24,000
Goodwill	8,000		

The company also agreed to pay the creditors which were agreed at Rs.15, 400. The company paid Rs.67, 000 in fully paid shares of Rs.10 each and the balance in cash. The expenses amounted to Rs.1, 000.

You are required to prepare Realisation and other related accounts in the books of the firm with the calculation of purchase consideration)

(Realisation A/C: X – Rs.4, 800; Y – Rs.3, 600; Z – Rs.1, 200; Cash to X – Rs.16, 380; Y – Rs.12, 280; Z – Rs.9, 940; Purchase consideration: Rs.1,10,600;)

5. Rao, Raheman and Robert were partners in a partnership firm sharing profits in ½, 3/8, 1/8 ratio. On 31st December, 2007 they want to sell the firm to a newly established Joint Stock Company. Their position on the above date was as follows:

Liabilities			Assets	
Capitals:			Freehold Assets	18,000
Rao	20,000		Machinery	12,000
Raheman	15,000		Book debts	15,000
Robert	13,000	48,000	Stock	13,000
Sundry Creditors		12,000		
		60,000		60,000

Company took the following assets as under:

Freehold Assets Rs.26, 000; Machinery Rs. 10, 000; Book debts Rs.14, 000; Stock Rs.12, 000; Goodwill Rs.5, 000.

The purchase price of Freehold assets and machinery for Rs.36, 000 are to be paid in the form of equity shares, the purchase price of book debts, stock and goodwill are to be paid in cash. The partnership firm paid creditors with 3% discount. Expenses of Realisation amounted to Rs.1, 000.

Pass the necessary journal entries to close the books of the firm and prepare the necessary ledger accounts to show the result of dissolution and final settlement among the partners.

(Realisation A/C: Rao – Rs.4, 180; Raheman – Rs. 3, 135; Robert – Rs.1, 045; Rao receives – Rs.8, 750 and shares Rs.15, 430; Reheman receives Rs.6, 565 and shares Rs.11, 570; Robert receives Rs.5, 045 and shares Rs.9, 000; Purchase consideration: Rs.67, 000)

10.8 SUMMARY :

Partnership dissolves when the term of the partnership expires, or when the adventure completes, or when any of the partners die or retire or insolvent. In all these cases, the partnership firm may continue with the remaining partners. There is also a possibility of dissolution of partnership firm. When all the partners agree, or any of the partners become insolvent, or when business becomes illegal or when partnership has a will or when court orders; the partnership firm dissolves. In this lesson the accounting procedure when a firm dissolves voluntarily are discussed. Further, the method of accounts when a firm is sold to a joint stock company is also discussed.

10.9 GLOSSARY :

Dissolution of partnership: Closure of the existing partnership relation among the partners is called dissolution of partnership. The expiry of the term of duration, the completion of the adventure, the death of a partner, the insolvency of a partner and the retirement of a partner lead to dissolution of partnership.

Dissolution of partnership firm: It is the closure of the existing partnership firm after clearing the assets and liabilities and closing down and settling the capital accounts of partners once for all.

Purchase Consideration: It is the value or compensation offered by the buying company to the partnership firm for taking the firm into its fold. The consideration consists of cash or cash with shares and debentures.

10.10 SELF ASSESSMENT QUESTIONS :

1. Distinguish between dissolution of partnership and dissolution of partnership firm.
2. Mention the accounting procedure when a joint stock company purchases a partnership firm.

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LESSON - 11

PARTNERSHIP ACCOUNTS: V – INSOLVENCY

OBJECTIVES :

After going through the lesson, you will be able to understand the following:

1. Accounting method when a partner becomes insolvent.
2. Garner vs. Murray case.
3. Accounting procedure when all partners become insolvent.
4. Piece meal method of distribution after realization of assets.

STRUCTURE OF THE LESSON :

11.1 INSOLVENCY – INTRODUCTION :

Whenever any partner in the partnership firm becomes insolvent, the firm dissolves and the burden of the insolvent partner should be borne by the solvent partners in their profit sharing ratio. As usual, a realization account needs to be prepared and the loss or profit that comes out of it should be transferred to the partners. The debit balance of the insolvent partner should be transferred to the debit side of the solvent partners in their respective profit sharing ratio and thus the accounts of all partners will be closed. This is a usual practice to be adopted. But after the case of Garner vs. Murray, the method of bearing the burden of insolvent partner had changed. In this lesson, we discuss the accounting procedure before and after this case and also the case when all partners become insolvent. Finally, the piece meal distribution method of the sale proceeds when a partnership firm dissolves is also discussed.

11.2 GARNER VS. MURRAY CASE :

When a partner becomes insolvent, he may not be in a position to pay the amount owed by him to the firm in full. The amount not so paid is a loss to the firm. This loss has to be borne by the solvent partners. Generally, they share in their profit sharing ratio. This was the procedure used to be adopted before Garner vs. Murray case. The Garner vs. Murray case gave a new look regarding sharing the loss of the insolvent partner. The case says the following points:

1. The solvent partners should bring in cash their share of loss on realization.
2. The loss on account of insolvency of a partner should then be borne by the solvent partners in the ratio of their capitals after bringing in cash such loss on realization.

According to this case, the loss on account of insolvency of partner should be borne by the solvent partners in the ratio of their capitals standing in the balance sheet, just before the dissolution of the partnership firm.

In this connection, the following points should be noted :

1. The term capitals here mean the real capitals of the partners and not the capitals as maybe standing in the books of the partnership firm in the names of different partners. This distinction is particularly important when the partners are maintaining their capital accounts on fluctuating capital system. The true capitals in case of this system will be ascertained after making all adjustments regarding reserves, drawings, unrecorded assets on the date of the balance sheet, just before dissolution of the partnership firm.
2. In case a partner, though solvent has a debit balance in his capital account, just before the dissolution of the partnership firm, such a partner will not be required to bear the loss on account of insolvency of a partner.

11.3 WHEN ALL PARTNERS ARE INSOLVENT :

If all the partners are insolvent then the creditors cannot expect to be paid in full. All the cash available, together with whatever can be received from the private estates of all partners, will be paid to the creditors after the expenses of realization are met. The Realisation Account should be prepared in the usual course but creditors should not be transferred to this account nor will payment to creditors be debited to this amount. The loss on realization should be transferred to the capital accounts of partners in the profit-sharing ratio. The available cash should then be paid to the creditors. The amount remaining unpaid should be transferred to Deficiency Account to which account the balances of partners' capital accounts should be transferred. Thus, the books will be closed.

11.4 GRADUAL REALIZATION OF ASSETS AND PIECEMEAL DISTRIBUTION :

In the previous lessons, it is assumed that all assets have been realised on the date of dissolution and all liabilities have also been paid on that date. This assumption makes possible the ascertainment of profit or loss on realization immediately. However, in actual practice, this does not happen. The assets are sold gradually to realize the best price for them. Similarly, the liabilities are paid gradually depending upon amount realised from the sale of the assets. Thus, the final profit or loss on realization can be known only after the expiry of certain time when all assets are completely realised and all liabilities completely paid off.

After payment of all outside liabilities and partners loans, the capitals of the partners are returned. However, the amount payable to a partner on account of his capital cannot be ascertained, unless the total profit or loss on realization is known. This means that the partners should not be paid any amount till realization is complete. This may create financial problems for the partners, since on the one hand the partnership business is being dissolved and on the other the partners do not get any money from the firm to start a new business or to meet their expenses. Thus, the partners should not be required to wait till realization is complete. They should be paid as and when the firm has funds left with it after payment of all outside liabilities. This is called as piecemeal distribution of assets.

In dissolution, first of all the outside creditors have to be paid, then if surplus remains, any loans given by the partners over and above their capitals are paid and last of all the partners' capitals will be paid off. It is clear, therefore, that any cash in hand or cash collected should be distributed among creditors until all of them are paid off. It is to be remembered that sufficient funds for liabilities are to be kept in hand for future contingencies like for bills discounted expected to be dishonoured.

Basis of distribution: As we know well, the profit or loss cannot be adjusted in the capital accounts immediately. However, cash must be distributed in such a way that the amounts finally left unpaid (i.e. the loss to be borne by the partners) are in the ratio in which profits and losses are shared. The available cash cannot be distributed according to the profit sharing ratio (unless the capitals are themselves in the profit sharing ratio) because that will leave the balances unpaid out of proportion. The cash available cannot also be distributed in the ratio of capitals because, and then the partners will be forced to bear the final loss in the ratio of capitals which may be different from the profit sharing ratio.

11.5 ILLUSTRATIONS :

Illustration 1 :

Partners A, B and C share profits in the ratio of 2:1:2 respectively on 31st March 2007. They decided to dissolve the partnership. The Balance Sheet as on that date is given below:

Liabilities		Assets	
Sundry Creditors	40,000	Balance in Bank	4,000
Capitals:		Other assets	3, 96,000
A	1, 60,000		
B	1, 60,000		
C	40,000		
	4, 00,000		4, 00,000

The assets realized Rs.2, 40, 000 only, and realization expenses were Rs.10, 000. C has been declared insolvent. C has no assets other than the capital stated above.

Show the capital accounts of the partners, before and after the decision of Garner vs. Murray.

Solution:

Realisation Account

To Other assets	3, 96,000	By Creditors		40,000
To Cash – expenses	10,000	By Cash		2, 40,000
To cash – creditors	40,000	By Realisation – loss:		
		A	66,400	
		B	33,200	
		C	66,400	1, 66,000
	4, 46,000			4, 46,000

Before Garner vs. Murray case:

A's Capital Account

To Realisation – loss	66,400	By Balance	1, 60,000
To C's Capital	17,600		
To Cash	76,000		

	1, 60,000			1, 60,000

B's Capital Account

To Realisation – loss	33,200	By Balance		1, 60,000
To C's Capital	8,800			
To Cash	1, 18,000			
	1, 60,000			1, 60,000

C's Capital Account

To Realisation – loss	66,400	By Balance		40,000
		By A's Capital	17,600	
		By B's Capital	8,800	26,400
		(Profit sharing ratio: 2:1)		
	66,400			66,400

Cash Account

To Balance	4,000	By Realisation- exps. & liabilities		50,000
To Realisation	2, 40,000	By A's Capital		76,000
		By B's Capital		1, 18,000
	2, 44,000			2, 44,000

After Garner vs. Murray case:

A's Capital Account

To Realisation A/C	66,400	By Balance	1, 60,000
To C's Capital	13,200	By Cash (nominal entry)	66,400
To Cash	1, 46,800		
	2, 26,400		2, 26,400

B's Capital Account

To Realisation A/C	33,200	By Balance	1, 60,000
To C's Capital	13,200	By Cash (nominal entry)	33,200
To Cash	1, 46,800		
	1, 93,200		1, 93,200

C's Capital Account

To Realisation A/C	66,400	By Balance		40,000
		By A's Capital	13,200	
		By B's Capital	13,200	26,400
	66,400			66,400

Cash Account

To Balance	4,000	By Realisation – Exps. & liabilities	50,000

To Realisation A/C	2, 40,000	By A's Capital	1, 46,800
To A's Capital (nominal)	66,400	By B's Capital	1, 46,800
To B's Capital (nominal)	33,200		
	3, 43,600		3, 43,600

Real Payment:

A: 1, 46,800 – 66,400 = 80,400 B:

1, 46,800 – 33,200 = 1, 13,600

Note:

Before Garner vs. Murray case – the debit balance of insolvent partner is shared by solvent partners in their profit sharing ratio (2:1).

After the case – the debit balance of insolvent partner is to be shared by solvent partners in their final capital ratio (after writing the entry for bringing their share of realization less cash) (1:1).

Illustration 2 :

The position of Rakesh, Rajeev and Ramesh on June 30, 2007 was as follows:

Sundry Creditors	25,000	Cash	10,000
Rakesh Loan Account	16,000	Sundry Assets	68,000
Rakesh Capital	25,600	Ramesh Capital	31,200
Rajeev Capital	14,400		
Profit and Loss A/C	28,000		
	1, 09,200		1, 09,200

Profits and losses are shared Rakesh 18/35; Rajeev 7/35. The firm is dissolved on the above date. Sundry assets realize Rs.56, 000. Sundry creditors are paid Rs.24, 000 in full settlement. Expenses amount to Rs.3, 200. Ramesh is insolvent.

Assume the capitals are not fixed. Close the books of the firm.

Solution:

Realisation Account

To Sundry Assets	68,000	By Creditors A/C		25,200
To Cash – expenses	3,200	By Cash – expenses		56,000
To Cash – creditors	24,000	By Rakesh Capital	7,200	
		By Rajeev Capital	2,800	
		By Ramesh Capital	4,000	14,000
	95,000			95,000

Rakesh Capital Account

To Realisation – loss	7,200	By Balance	25,600
To Ramesh Capital	18,133	By P & L A/C	14,400

To Cash	21,867	By Cash	7,200
	47,200		47,200

Rajeev Capital Account

To Realisation – loss	2,800	By Balance	14,400
To Ramesh Capital	9,067	By P & L A/C	5,600
To Cash	10,933	By Cash	2,800
	22,800		22,800

Ramesh Capital Account

To Balance	31,200	By P & L A/C	8,000
To Realisation – loss	4,000	By Rakesh Capital 18,133	
		By Rajeev Capital 9,067	27,200
		(Final Capital ratio)	
	35,200		35,200

Cash Account

To Balance	10,000	By Realisation – expenses	3,200
To Realisation – assets	56,000	By Realisation – creditors	24,000
To Rakesh Capital	7,200	By Rakesh Loan	16,000
To Rajeev Capital	2,800	By Rakesh Capital	21,867
		By Rajeev Capital	10,933
	76,000		76,000

Note: When a partner becomes insolvent, the formula in Garner vs. Murray case is to be applied. As per that formula – a) the realization loss is to be shared to all partners; b) the solvent partners should bring their share of realization less in cash; c) the debit balance in insolvent partner's capital account should be charged to solvent partners' capital account in their final capital ratio.

Illustration 3 :

X, Y and Z were in partnership sharing profits and losses in the ratio of 1/5, 3/10 and ½. The following is their Balance Sheet as on 30th June 2007 when they decided to dissolve:

Liabilities		Assets	
X Capital	3,000	Cash	1,000
Y Capital	4,000	Plant and Machinery	5,000
Z Capital	3,000	Sundry Debtors	20,000
Trade Creditors	12,000	Advance to X	2,000
Loan from Bank on book debts, plant etc.	14,000	Loss to date	8,000
	36,000		36,000

The assets realized Rs.20, 000. X has private estate which is valued at Rs.4, 000. Y is insolvent. From Z's estate a dividend of 50 paise in a rupee is received.

Show the Realisation Account and the accounts of the partners assuming that all entries relating to dissolution are passed through the Realisation Account.

Solution:

Realisation Account

To Plant		5,000	By Loan from Bank		14,000
To Sundry Debtors		20,000	By Creditors		12,000
To advance to X		2,000	By Cash – assets	20,000	
			Advance to X	2,000	22,000
			By X Capital	1,000	
To Cash – loan	14,000		By Y Capital	1,500	
- Creditors	12,000	26,000	By Z Capital	2,500	5,000
		53,000			53,000

Cash Account

To Balance	1,000	By Realisation – liabilities	26,000
To Realisation – assets	22,000		
To X Capital	1,250		
To Z Capital	1,750		
	26,000		26,000

X Capital Account

To Realisation – loss	1,000	By Balance	3,000
To P & L A/C	1,600	By Cash (Bal. Fig)	1,250
To Z Capital	750		
To Y Capital	900		
	4,250		4,250

Y Capital Account

To Realisation – loss	1,500	By Balance	4,000
To P & L A/C	2,400	By X Capital	900
To Z Capital	1,000		
	4,900		4,900

Z Capital Account

To Realisation – loss	2,500	By Balance		3,000
To P & L A/C	4,000	By Cash		1,750
		By X Capital	750	
		By Y Capital	1,000	1,750
	6,500			6,500

Note: First Z capital account was settled as his capital is showing a debit balance. It was transferred to capitals of X and Y in their capitals ratio 3:4. Then Y capital account debit balance was transferred to X capital Account. The necessary cash was then brought in by X.

Illustration 4 :

The Balance Sheet of O, P, Q, and R showed the following position on dissolution.

Balance Sheet

Liabilities		Assets	
Creditors	10,000	Cash at Bank	34,000
O's Capital	15,000	Q's Capital	10,000
P's Capital	10,000	R's Capital	3,000
Profit on Realisation	12,000		
	47,000		47,000

Show the final adjustments among the partners assuming that R is insolvent.

Solution:

Realisation Account

To O's Capital	3,000	By Balance B/D	12,000
To P's Capital	3,000		
To Q's Capital	3,000		
To R's Capital	3,000		
	12,000		12,000

Creditors' Account

To Cash	10,000	By Balance B/D	10,000
	10,000		10,000

O's Capital Account

To Cash	18,000	By Balance B/D	15,000
		By Realisation A/C	3,000
	18,000		18,000

P's Capital Account

To Cash	13,000	By Balance B/D	10,000
		By Realisation A/C	3,000
	13,000		13,000

Q's Capital Account

To Balance B/D	10,000	By Realisation A/C	3,000
		By Cash	7,000
	10,000		10,000

R's Capital Account

To Balance B/D	3,000	By Realisation A/C	3,000
	3,000	Cash Account	3,000
To Balance B/D	34,000	By Creditors A/C	10,000
To Q's Capital A/C	7,000	By O's Capital A/C	18,000
		By P's Capital A/C	13,000
	41,000		41,000

Illustration 5 :

P, Q, R and S were partners sharing profits and losses in the ratio of 3:3:2:2.

Following was their Balance Sheet as on 30th June 2007.

Liabilities			Assets		
Sundry Creditors		15,500	Cash at bank		2,000
P's Loan		10,000	Sundry debtors	16,000	
Capital Accounts:			Less: Provision	500	15,500
P	20,000		Stock		10,000
Q	15,000	35,000	Furniture and fittings		4,000
			Trade marks		7,000
			Capital Accounts:		
			R	16,000	
			S	6,000	22,000
		60,500			60,500

On 30th June, 2007 the firm was dissolved and Q was appointed to realize the assets and pay off the liabilities. He was appointed to receive 5% commission on the amounts finally paid to other partners as capital. He was to bear the expenses of realization. The assets realized as followed.

Study debtors	11,000	Stock	8,000
Furniture and fittings	1,000	Trade marks	4,000

Creditors were paid off in full, in addition a contingent liability for bills receivable discounted materialized to the extent of Rs.2, 500. Also there was a joint life policy for Rs.30, 000. This was surrendered for Rs.3, 000. Expenses of realization amounted to Rs.500. R was insolvent but Rs.3, 700 were recovered from his estate.

Write up the necessary accounts to close the books of the firm.

Solution:

Realisation Account

To Debtors	16,000	By Reserve for bad debts	500
To Stock	10,000	By Creditors	15,500

To Furniture		4,000	By Cash – Debtors	11,000	
To Trade marks		7,000	Stock	8,000	
To Cash – Creditors	15,500		Furniture	1,000	
Discounted bill	2,500	18,000	Trademarks	4,000	
			Policy	3,000	27,000
			By Realisation – loss:		
			By P’s Capital A/C	3,600	
			By Q’s Capital A/C	3,600	
			By R’s Capital A/C	2,400	
			By S’s Capital A/C	2,400	12,000
		55,000			55,000

P’s Loan Account

To Cash	10,000	By Balance B/D		10,000
	10,000			10,000

P’s Capital Account

To Realisation A/C – loss	3,600	By Balance B/D		20,000
To R’s Capital A/C	8,400	By Cash (nominal entry)		3,600
To Q’s Capital – commission	381			
To Cash	11,219			
	23,000			23,000

Q’s Capital Account

To Realisation A/C –loss	3,600	By Balance B/D		15,000
To R’s Capital A/C	6,300	By Cash (nominal entry)		3,600
To Cash – expenses	500	By P’s Capital – commission		381
To Cash	8,581	(8,000 x 5/105)		
	18,981			18,981

R’s Capital Account

To Balance B/D	16,000	By Cash		3,700
To Realisation A/C –loss	2,400	By P’s Capital	8,400	
		By R’s Capital	6,300	14,700
	18,400			18,400

S’s Capital Account

To Balance B/D	6,000	By Cash		8,400

To Realisation – loss	2,400		
	8,400	Cash Account	8,400
To Balance B/D	2,000	By Realisation – liabilities	18,000
To Realisation A/C	27,000	By P's Loan	10,000
To R's Capital A/C	3,700	By Q's Capital – expenses	500
To S's Capital A/C	8,400	By P's Capital (11,210 – 3,600)	11,219
To P's Capital (nominal entry)	3,600	By Q's Capital (8,581 – 3,600)	8,581
	48,300		48,300

Note: S's Capital account shows debit balance, but he is not insolvent. He brings in the necessary cash. R is insolvent. His debit balance charged to P and Q in their final capital ratio i.e. after writing the entry for bringing their loss of realization in cash. But really any partner, who is solvent, does not bring cash for the realization loss. A notional entry will be written for bringing cash. Therefore the actual amount payable to P comes to Rs.8, 000 (20,000-3,600+8,400). On this amount, the commission to Q is to be calculated. If calculation is made as 5/100 on 8, 000, P does not get Rs.8, 000. So calculation shall be 5/105 on 8, 000. The commission is to be chargeable to P as the realization account and other partners' capital accounts were already closed.

It is assumed that expenses of realization were paid first by the firm, and then they were charged to Q, who has to bear them.

Illustration 6 :

A, B and C are partners in a business sharing profits equally. Their Balance Sheet at 31st March 2007 is as follows:

Liabilities			Assets		
Sundry Creditors		10,000	Furniture		2,100
Bills payable		2,000	Stock		15,400
Capital Accounts:			Sundry debtors	18,000	
A	12,000		Less: Provision	900	17,100
B	9,000		C's Current Account		5,000
C	1,000	22,000	Cash in hand		1,400
Current Accounts:					
A	2,000				
B	2,000	3,000			
		41,000			41,000

C is insolvent and his estate pays Rs.1, 800 to the firm. The partnership is consequently dissolved and sundry debtors, stock and furniture realize Rs.23, 600. Sundry creditors are settled at Rs.8, 000. You are required to prepare the necessary ledger accounts to close the books of the firm in accordance with the decision in Garner vs. Murray.

Solution :

Realisation Account

To Furniture		2,100	By Reserve for bad debts		900
To Stock		15,400	By Creditors		10,000
To Debtors		18,000	By Bills payable		2,000
To Cash – creditors	8,000		By Cash – assets realized		23,600
- bills payable	2,000	10,000	By A's Current A/C	3,000	
			By B's Current A/C	3,000	
			By C's Current A/C	3,000	9,000
		45,500			45,500

A's Current Account

To Realisation A/C	3,000	By Balance	2,000
To C's Capital A/c (4/7th share of C's deficiency)	2,400	By Reserve fund	1,000
		By Cash	3,000
To A's Capital A/C – transfer	600		
	6,000		6,000

B's Current Account

To Realisation A/C	3,000	By Balance	2,000
To C's Capital A/C(3/7th share)	1,800	By Reserve fund	1,000
To B's Capital – transfer	1,200		
	6,000		6,000

C's Current Account

To Balance	5,000	By Reserve fund		1,000
To Realisation A/C	3,000	By C's Capital A/C – transfer	7,000	
	8,000			8,000

A's Capital Account

To Cash	12,600	By Balance	12,000
		By Current A/C	600
	12,600		12,600

B's Capital Account

To Cash	10,200	By Balance	9,000
		By Current A/C	1,200
	10,200		10,200

C's Capital Account

To Current A/C	7,000	By Balance	1,000

		By Cash – brought in	1,800
		By A's Current A/C (4/7th share)	2,400
		By B's Current A/C (3/7th share)	1,800
	7,000		7,000

Cash Account

To Balance	1,400	By Realisation – liabilities	10,000
To Realisation – assets	23,600	By A's Capital A/C	12,600
To A's Current A/C – loss brought in	3,000	By B's Capital A/C	10,200
To B's Current A/C – loss brought in	3,000		
To C's Capital A/C – loss brought in	1,800		
	32,800		32,800

Note: In the case of Garner vs. Murray, the solvent partners have to bring their share of realization loss in cash before sharing the deficiency caused by the insolvency of one of the partners. But when the partners have current accounts in addition to their capital accounts, they need not bring the loss in cash, as it makes no difference even if it is not brought in.

When there are current accounts the following procedure is to be followed:

1) Insolvent partner's current account balance is to be transferred to his capital account.
2) Debit balance of his capital account is to be charged to the current account of other solvent partners in their capital ratio.
3) Current account balances of solvent partners to be transferred to respective capital accounts and the final payment are to be made.

Insolvency of all Partners:

Illustration 7:

Kalyan and Krishna are equal partners. Their Balance Sheet stood as under:

Liabilities		Assets	
Kalyan's Capital	6,000	Plant and Machinery	13,750
Creditors	39,000	Furniture	5,000
		Debtors	5,000
		Stock	6,250
		Cash at bank	3,000
		Krishna's drawings	12,000
	45,000		45,000

The partnership was dissolved and the assets were realised as follows:

Stock Rs.3, 500; Furniture Rs.3, 000; Debtors Rs.5, 000; Machinery Rs.6, 000;

The cost of collecting and distributing the estate amounted to Rs.1, 500. Kalyan's private estate is not sufficient even to pay his private debts, whereas in Krishna's private estate there is a surplus of Rs.500.

Prepare Realisation account, cash account and profit and loss account and creditors' account showing dividend payable to creditors.

Solution:

Realisation Account

To Plant and Machinery	13,750	By Cash – Stock	3,500	
To Furniture	5,000	- Furniture	3,000	
To Debtors	5,000	- Machinery	6,000	
To Stock	6,250	- Debtors	5,000	17,500
To Cash – expenses	1,500	By Kalyan Capital A/C	7, 000	
		By Krishna Capital A/C	7, 000	14,000
	31,500			31,500

Creditors Account

To Cash A/C	19,500	By Balance	39,000
To Deficiency (or P & L A/C)	19,500		
	39,000		39,000

Cash Account

To Balance	3,000	By Realisation A/C	1,500
To Realisation A/C	17,500	By Creditors	19,500
To Krishna's Capital	500		
	21,000		21,000

Kalyan's Capital Account

To Realisation A/C	7,000	By Balance	6,000
		By Deficiency (or P & L A/C)	1,000
	7,000		7,000

Krishna's Capital Account

To Balance	12,000	By Cash	500
To Realisation A/C	7,000	By Deficiency (or P & L A/C)	18,500
	19,000		19,000

Deficiency Account (P & L A/C)

To Kalyan's Capital A/C	1,000	By Creditors A/C	19,500
To Krishna's Capital A/C	18,500		
	19,500		19,500

Note: When all partners became insolvent, the creditors need not be transferred to realization account. In such case the realization account shall be utilized only for the assets and expenses.

Illustration 8 :

Below is the Balance Sheet of A, B and C as on December 31, 2007.

Liabilities			Assets	
Sundry creditors		40,000	Cash	1,000
A's Loan		10,000	Stock	24,000
Capital Accounts:			Debtors	20,000
A	5,000		Furniture	3,000
B	3,000	8,000	C's Capital overdrawn	10,000
		58,000		58,000

Due to the inability to pay the creditors, the firm is dissolved. B and C cannot pay anything. A can contribute only Rs.1, 500 from his private estate. Stock realises Rs.15, 000. Debtors realize Rs.16, 000 and furniture is sold for Rs.1, 000. Expenses amounted to Rs.3, 000. Prepare accounts to close the books of the firm.

Solution :

Realisation Account

To Stock	24,000	By Cash – assets	32,000
To Debtors	20,000	By A's Capital – loss	6,000
To Furniture	3,000	By B's Capital – loss	6,000
To Cash – expenses	3,000	By C's Capital – loss	6,000
	50,000		50,000

Creditors Accounts

To Cash	31,500	By Balance B/D	40,000
To Deficiency A/C	8,500		
	40,000		40,000

A's Loan Account

To Deficiency A/C	10,000	By Balance B/D	10,000
	10,000		10,000

A's Capital Account

To Realisation A/C – loss	6,000	By Balance B/D	5,000
To Deficiency A/C	500	By Cash	1,500
	6,500		6,500

B's Capital Account

To Realisation A/C - loss	6,000	By Balance B/D	3,000
		By Deficiency A/C	3,000

	6,000		6,000

C's Capital Account

To Balance B/D	10,000	By Deficiency A/C	16,000
To Realisation A/C – loss	6,000		
	16,000		16,000

Cash Account

To Balance B/D	1,000	By Realisation A/C	3,000
To Realisation A/C	32,000	By Creditors A/C	31,500
To A's Capital A/C	1,500		
	34,500		34,500

Deficiency Account

To B's Capital A/C	3,000	By Creditors A/C	8,500
To C's Capital A/C	16,000	By A's Loan A/C	10,000
		By A's Capital A/C	500
	19,000		19,000

Note: When all partners become insolvent, the firm becomes unable to pay the creditors in full. In such cases the creditors should not be transferred to Realisation account. As the creditors are not satisfied fully the question of payment of A's loan does not arise and that loan shall be transferable to Deficiency account.

Gradual or Piecemeal Distribution :

Illustration 9 :

Moon, Light and Shade were partners sharing profits in the ratio 4:3:1. They want to dissolve the firm from the following Balance Sheet as on 31st March 2007.

Balance Sheet 31-12-2007

Liabilities				Assets
Creditors		2,625	Sundry Assets	18,500
Bank Overdraft		875		
Capital Accounts:				
Moon	7,000			
Light	3,000			
Shade	5,000	15,000		
		18,500		18,500

Capital should be repaid whenever the assets realised. Firm's assets realised as follows:

May 2,000

July	1,500
September	2,500
October	4,000
December	6,500

No additional amount was realised.

From the above Balance Sheet and other information prepare the statement showing the interim distribution of cash.

Solution:

Statement showing the distribution of cash

Particulars	Creditors	O D	Moon	Light	Shade
Balances	2,625	875	7,000	3,000	5,000
Less: Receipts in May (3:1)	1,500	500	—	—	—
	1,125	375	7,000	3,000	5,000
Less: Receipts in July (3:1)	1,125	375	—	—	—
	—	—	7,000	3,000	5,000
Less: Receipts in September	—	—	—	—	2,500
	—	—	7,000	3,000	2,500
Less: Receipts in October	—	—	—	—	750
	—	—	7,000	3,000	1,750
Remaining (4,000-750) to Moon & Shade in 4:1 ratio	—	—	2,600	—	650
	—	—	4,400	3,000	1,100
Less: Receipts in December (500 in 6,500 to Moon and Shade in 4:1ratio)	—	—	400	—	100
	—	—	4,000	3,000	1,000
Remaining 6,000 in 4:3:1 ratio	—	—	3,000	2,250	750
Partners' share in loss (4:3:1)	—	—	1,000	750	250

Note: The liabilities are to be payable first. Creditors and overdraft were in the ratio of 3:1. Until they are discharged completely the cash available is to be distributed between creditors and overdraft in the ratio of 3:1. The amount available in the first two instalments is sufficient to discharge the liabilities.

The cash realised in the subsequent instalments is to be distributed to the partners so as to bring their capitals in to their profit sharing ratio. It will enable the partners to suffer the loss on realization (which can be known only at the end of last instalment) in their profit sharing ratio.

Working Notes:

Total book value of assets	18,500
Less: Assets realised in instalments	16,500

Loss on Realisation		2,000
Moon's share	2,000 x 4/8	1,000
Light's share	2,000 x 3/8	750
Shade's share	2,000 x 1/8	250

Cash Account

May	To Realisation A/C	2,000	May	By Creditors	1,500
July	To Realisation A/C	1,500		By Overdraft	500
Sept.	To Realisation A/C	2,500	July	By Creditors	1,125
Oct	To Realisation A/C	4,000		By Overdraft	375
Dec	To Realisation A/C	6,500	Sept.	By Shade Capital	2,500
			October	By Moon Capital	2,600
				By Shade Capital	1,400
			Dec.	By Moon Capital	3,400
				By Light Capital	2,250
				By Shade Capital	850
		16,500			16,500

Moon's Capital Account

Oct.	To Cash	2,600	By Balance B/D	7,000
Dec.	To Cash	3,400		
	To Realisation A/C	1,000		
		7,000		7,000

Light's Capital Account

Dec.	To Cash	2,250	By Balance B/D	3,000
	To Realisation A/C	750		
		3,000		3,000

Shade's Capital Account

Sep.	To Cash	2,500	By Balance B/D	5,000
Oct.	To Cash	1,400		
Dec.	To Cash	850		
	To Realisation A/C	250		
		5,000		5,000

Creditor's Account

May	To Cash	1,500	By Balance B/D	2,625
July	To Cash	1,125		
		2,625		2,625

Overdraft Account

May	To Cash	500	By Balance B/D	875
July	To Cash	375		
		875		875

11.6 TRY YOURSELF :

1. A, B and C were equal partners. On 31st December, 2007, their position was as follows:

A's Capital	2,000	Cash	1,500
B's Capital	600	C's Capital	200
		Loss on Realisation	900
	2,600		2,600

C is insolvent and can pay nothing. Close the books of the firm ignoring the decision in Garner vs. Murray.

(A gets Rs.1, 450 and B gets Rs.50)

2. The following is the balance sheet of a firm as on 31st December 2007, when D has become insolvent:

Balance Sheet as on 31st December, 2007

Liabilities			Assets
Sundry Creditors	10,000	Sundry Assets	50,000
General Reserve	10,000	C's Capital A/C	10,000
A's Capital A/C	30,000	D's Capital A/C	10,000
B's Capital A/C	20,000		
	70,000		70,000

The assets realised Rs.40, 000. Creditors are paid in full. Partners share profits and losses equally. You are required to close the books of the firm applying Garner vs. Murray rule.

(D's deficiency Rs.7,500; A's share Rs.4, 432 and B's share Rs.3,068; Finally A gets Rs.26, 590 and B gets Rs.18, 410)

3. A, B and C were partners in a firm. They shared profits and losses in 40%, 30%, and 30%respectively. The firm was dissolved and B was appointed to realize assets and distribute the proceeds. B is to receive 5% commission on the amounts realized from sale of assets and to bear all expenses of realization. The Balance Sheet on the date of dissolution was as under:

Liabilities		Assets		
Creditors	17,700	Cash		450
A's Capital	9,000	Debtors	13,650	
B's Capital	6,000	Less: Provision	750	12,900
		Stock		18,000
		C's Capital overdrawn		1,350
	32,700			32,700

Debtors realized Rs.10, 500; stock Rs.13, 500; goodwill Rs.600. Creditors were paid Rs.17, 250 in full settlement. In addition, outstanding creditors Rs.150 and expenses Rs.180 paid by B. A and B agreed to receive Rs.900 in full settlement from C.

Show the Realisation Account, Cash Account and Capital Accounts of the partners.

(Loss on Realisation: A- Rs.2,892; B- Rs.2,169; C- Rs.2,169; A gets Rs.7,428 and B gets Rs. Rs.6,003)

4. Ram and Shyam were in equal partnership. Their Balance Sheet stood as under on 31st December, 2007 when the firm was dissolved.

Creditors	3,200	Machinery and Plant	1,200
Ram's Capital	400	Furniture	300
		Debtors	500
		Stock	400
		Cash	180
		Shyam's drawings	1,020
	3,600		3,600

The assets realised as under:

Machinery	600	Furniture	100
Debtors	400	Stock	300

The expenses of realization amounted to Rs.140. Ram's private estate is not sufficient even to pay his private debts, whereas in Shyam's private estate there is a surplus of Rs.140 only.

Give accounts to close the books of the firm.

(Profit on Realisation: Ram – Rs.240; Shyam – Rs.240; Deficiency Rs.1, 450)

5. A, B and C carried on business as partners, sharing profits and losses in the ratio of 3:4:5. They decided to dissolve the partnership as on 1st July, 2007 and agreed that the sale of the assets should not be forced but should be made gradually. As the realization was not likely to be completed for over a year and as the partners wished the receipts from sales to be dealt with as and when received, you are asked to prepare a scheme for the equitable distribution of such receipts.

The following was the Balance Sheet of the firm at the date of dissolution:

Liabilities Assets

Creditors		10,000	Sundry Assets	36,000
B's Loan Account Capital Accounts:		2,000		
A	12,000			
B	8,000			
C	4,000	24,000		
		36,000		36,000

The net amounts realised from the gradual sale of assets were as follows:

1st Instalment 5,000

2nd Instalment 10,000

3rd Instalment 5,100 4th Instalment

6,300

5th Instalment 5,700

Draw up a detailed statement showing the distribution of each instalment received and the final settlement.

(In II instalment A gets Rs.3,000; In III installent A gets Rs.3,900 and B Rs.1,200; In IV instalment A gets Rs.2,700; B Rs.3,600; In V instalment A gets Rs.1,425; B Rs.1,900 and C Rs.2,375)

11.7 SUMMARY :

Insolvency of a partner, Insolvency of all partners and distribution of the proceeds among the partners are discussed in this lesson at length along with their accounting procedures. Garner vs. Murray case and method of distribution of loss among the solvent partners and final settlement are also discussed with suitable accounting problems. Finally, in this lesson, the piecemeal method of distribution of proceeds of assets among partners is discussed.

11.8 GLOSSARY :

Garner vs. Murray case: Under this case - first, the solvent partners should bring in cash equal to their share of the loss on realisation and second – the loss due to the insolvency of a partner should be divided among the other partners in the ratio of capitals then standing.

11.9 SELF ASSESSMENT QUESTIONS :

1. Explain the peculiarities of Garner vs. Murray case with an illustration.
2. Explain the procedure of accounting and distribution of proceeds of assets among the partners and creditors under piecemeal distribution.

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